

Q2 2020 Earnings Call

Company Participants

- Andre Luis Rodrigues, Vice Chief Executive Officer
- Andre Salgueiro, Investor Relations Manager
- Paulo Geraldo Polezi, Chief Finance & Investors Relations Officer

Other Participants

- Alex Falcao, Analyst
- Catherine Kiselar, Analyst
- Gabriel Rezende, Analyst
- Lucas T. Barbosa, analyst
- Marcelo Motta, Analyst
- Regis Cardoso, Analyst
- Unidentified Participant
- Victor Mizusaki, Analyst

Presentation

Operator

Good morning and welcome to WEG's Conference Call on the results for the Second Quarter 2020. We would like to inform you that we are broadcasting this conference call, accompanied by the slides on our Investor Relations website at ri.weg.net. And at its completion, the audio will be available on our IR website.

(Operator Instructions)

Any estimates contained in this document or any forward-looking statements that we made during this conference call about future events, the business perspective, the operational and financial projections and goals and the potential future growth effects constitute mere beliefs and expectations from the management, based on the information currently available.

These involve risks, uncertainties as they refer to future events 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 WEG's future performance and could lead to results that differ materially from those expressed in such forward-looking statements.

We would like to remind you that this conference call is being conducted in Portuguese with simultaneous translation into English. With us today in Jaragua do Sul, are Mr. Andre Luis Rodrigues, Chief Financial Administrative Officer; Paulo Polezi, Chief Financial and Investor Relations Office;,, Wilson Watzko, Controlling Officer and Andre Salgueiro; Investor Relations Manager of WEG.

Mr. Andre Rodrigues, you may proceed, sir.

Andre Luis Rodrigues {BIO 17964192 <GO>}

FINAL

Bloomberg Transcript

Good morning, everyone. Once again, it's a pleasure to be with you in this earnings call to discuss WEG's results. We start with the highlights of the quarter, the first being the net operating income, which grew 23.7% compared to the second quarter 2019. The demand for long cycle equipment both in Brazil and abroad, together with the positive impact of the exchange rate variation were relevant factors for this positive performance, despite the difficulties imposed by the COVID-19 pandemic, which caused important negative impacts in part of our short-circle businesses.

Another highlight in the second quarter was the EBITDA, which grew by 36.3% and reached BRL732 million. The EBITDA margin increased 1.7 percentage points, reaching 18%. Throughout the presentation, Paulo will give more details about this variation.

Finally, we had another quarter of ROIC evolution, as we will see in the next slide. With a growth of 3.2 percentage points over the second quarter 2019, reaching 21.6%. 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 EBITDA margin, surpassing the increase in the need of working capital and investments made in the past 12 months.

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

Paulo Geraldo Polezi {BIO 19468811 <GO>}

Good morning, everyone. Moving on to Slide five, I present the evolution of the business areas in different markets. I start with industrial electronic equipment in Brazil, where we have seen significant growth in long-cycle equipment. As a result of the product supplied mainly for paper and pulp and mining projects.

However, we observed [ph] an important reduction in the placement of short-cycle equipment orders, in the first half of the quarter, especially in the low voltage electrical motors, limiting the revenue from this product in this period. The GTD area was once again the highlight of the quarter, where most of the revenues are associated with the long-cycle equipment. In Brazil, we have deliveries for important projects.

Projects mainly linked to transmission actions held in recent years. The distributed solar generation business, as well as other short-cycle businesses of the company, suffered [ph] a drop in demand, in relation to the first quarter 2020. Due to the restrictions adopted to combat the pandemic, even so it performed well when compared to the second quarter 2019, given the relevant growth of this business presented in the last 12 months.

In Commercial, and Appliance Motors, as we had already informed in the first quarter 2020. The demand reduction started in March [ph], extending throughout the beginning of the second quarter 2020, a period in which important customers have their operations affected due to the consequences of the pandemic.

In Paints and Varnishes, there was also a drop in the orders, placed in March adversely affecting sales during the beginning of the second quarter 2020, a period in which important segments were affected due to the pandemic. At the end of the quarter, we saw a partial return of demand levels, with emphasis on the activities related to agri business and road implements. In the foreign market, it's important to highlight that the exchange rate variation, played an important role in the 23.2% growth in revenue, measured in reals. In local currencies considered, according to the weight of each market, net revenue from foreign market dropped 4.8%, when compared to the second quarter 2019.

Short cycle industrial, electrical and electronic equipment showed a drop in revenue, a movement partially offset by the good performance of the operations in China, which presented activity similar to the pre-pandemic period in the local market. As for long-cycle equipment, we continue to

perform well, with important deliveries made in the oil and gas, mining and water and sanitation segments, contributing positively to the quarter's results.

In the GTD area. The major contribution was from the transformers business in the USA and Mexico with deliveries of important projects. Another highlight was the operation of generators in the USA, which continues to have positive performance, due to the solid order portfolio previously made. In commercial and appliance motors, the drop in demand was also observed in a generalized way, in the foreign market in the first half of the second quarter this year.

On the other hand, we highlight the positive performance in commercial motors in Mexico, which performed well in the period, reflecting gains in market share in the USA and Mexico, due to the new customers that were gained. In Paints and Varnishes, the stoppages in operations due to the restrictions adopted to defy the pandemic, especially in Argentina, impacted our performance this quarter.

Slide six shows the evolution of EBITDA in the second quarter 2020, where we presented a growth of 36.3% in relation to the second quarter 2019. The EBITDA margin ended the quarter at 18%, showing an increase of 1.7 percentage points in relation to the second quarter 2019. We highlight the margin gain in long-announced the acquisition of cycle operations, mainly in GTD, and high voltage industrial motor businesses, the agility in making operational adjustments due to the pandemic and the impact of the strong exchange devaluation.

Finally on Slide seven, we show the evolution of investments in CapEx. In the second quarter 2020, investments reached BRL107.4 million, 44% of which were allocated in Brazil and 56% to units abroad. Already under the effect of the revisions of the investments plan announced last quarter, as part of the measures adopted to mitigate the impact of the business in -- as the pandemics. We remind you that our production system is based on what we call modular expansion, which allows us to adjust CapEx, according to the demand, maximizing the return on invested capital.

With that I finish my part and give the floor back to Andre.

Andre Luis Rodrigues {BIO 17964192 <GO>}

Thank you, Paulo. Before moving on to the question-and-answer session. I would like to reinforce some recent achievements and comment on our prospects for the remainder of 2020. We recently announced the acquisition of two new businesses, in-line with the Company's strategy in the development of the digital business area. Increasing our offer of solutions aimed at industry 4.0.

In June, we announced the acquisition of control of Mvisia, a Company specialized in artificial intelligence solutions, applied to the computer vision for the industry.

And earlier this month, we announced the acquisition of BirminD, a technology company active in the artificial intelligence market applied to Industrial Analytics. Despite the gradual improvement in the short-cycle business, dynamics seen at the end of the quarter, we cannot yet say, that the crisis has been through. Uncertainties regarding the economic recovery of the countries where we operate, and a possible second-wave of global contagion, may impact our businesses in the coming months.

On the other hand, our portfolio of long-cycle products, is likely to bring stability and resilience to our businesses for the rest of the year. Despite of the improvements in the Company's margins, we remind you that they may present some volatilities, due to the uncertainties present in the market and the very dynamics of WEG's business.

It's important to highlight that we also had some impact -- occasional impact in this quarter, such as reduced working hours and anticipated vacations, which will not be recurring in the coming quarters. Finally, I would like to emphasize that we will continue to take all necessary measures for protection, prevention and mitigation, aiming to preserve the integrity of our employees and minimize as much as possible impact on our operations, as we have done, since the beginning of the pandemic.

I will end my presentation here. Please, operator. We can move on to the Q&A session.

Questions And Answers

Operator

Thank you, ladies and gentlemen, we can now begin the question-and-answer session.

(Operator Instructions) Our first question comes from Mr. Alex Falcao, HSBC.

Q - Alex Falcao

Good morning, everyone. I First would like to talk about solar and distributed generation. I would like to understand, what can be the impact of zeroing the imports to your business. And what's the evolution of the distribution center that you have seen? And how are the sales doing, and if you could make some comments, on your intention to open as a business division, this Industry 4.0 automation. What is it like today and what do you expect in the future. Thank you.

A - Andre Salgueiro

Okay. Good morning. Thank you very much for your question. This is Andre Salgueiro speaking. I'm going to answer the first question, the first part of your question related to solar energy and then the others will continue. Recently, we announced the solar panels and other equipment and in fact, this is process that is valid not only for solar products but also can be applied to other pieces of equipment. And -- but it's usually used for products which are not manufactured in Brazil.

So there is no interference related to the products we produced in Brazil. In general, it tends to be very positive for the market, because the imported products will have their price pressed down, just as solar panels, which are very important for the system. The initiative is very positive for the business and it tends to encourage this business along this period, since this tax have been dropped for solar energy.

And you asked about the dynamics of this business, as to distributed generation. And then I will talk about centralized generation as well. As for distributed generation, I can say that it's a business that has been evolving well. And this is something we have been operating in for some time. And as for short-cycles, we see that the pandemic affected this area. In the month of April, we had some problems for integrators to go into places. So this was affected negatively. And in June, if there was a resumption in the operation, but the operations are lower than expected. Anyhow the segment has good perspectives in the medium and long-term and we believe that by using our business model of -- and using integrators and also considering that WEG is a well-recognized brands in the market. We will continue addressing this market and we are going to take all the advantages that the resumption of business will offer. And we still don't know who, the speed it's going to happen as to solar farms and centralized generation. In the past auctions that were held, we had a number of projects dedicated to solar generation.

And many of those projects still do not have their suppliers defined and we showed this information on the last WEG Day when we mentioned that many of the projects that were in the actions have not been contracted yet. But for many reasons, currency, exchange rate or other factors, so we have seen that some projects do not have any incentive to be brought forward. So

people are way [ph] holding back. So that they will then decide what they will do about those project. So those projects are likely to be materialized in the years to come.

So the perspectives in the medium and long-terms are very positive and we still suffer some of the impacts due to the pandemic in the short-term.

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

This is Andre Luis Rodrigues. And in relation to the Industry 4.0, and the latest information announced, we announced the acquisition of two new businesses, which are part of our strategy to expand our resources WEG digital solution, and our platform and with the acquisition of Mvisia, which is specializes in computer used for the industry and also the provider of artificial intelligence and machine learning, which are applied for solutions with industrial analytics.

So we understand that today we complete our digital ecosystem. In a simplified manner, we can say that our proposal of digital solutions Connect, Integrate, Sensors, Equipment by means of WEG Motor Scan solution and transmitter with solutions provided by V2COM. It also monitors, automate operations by means of management, software. And now considering all the acquisitions we have made, we are going to use machine learning and artificial intelligence applied to the industry; such as the solutions provided by the -- our acquisitions. And we will use those technologies to promote, continuous development of Industry 4.0. We inform that this business are -- businesses which are adjacent to what we already produced. We still haven't reached the moment and -- but we announced all the figures. But we haven't reached the moment to have the openness of these businesses in a separate way.

We expect to grow in a very positive manner and this is something we have been mentioning lately. And at this time around, it's very important to close this ecosystem and this is what we have done, so part one of our strategy, so as the sale is already completed. And we have already offered some product in the market; such as WEG Motor Free Management, which is a system that control a motor fleet, using all the knowledge that can -- are offered by those companies. And this is an initiative that is likely to grow together with the solutions, which are associated.

Q - Alex Falcao

I would like to understand the order of magnitude of those businesses. More than BRL100 million, more or less, just for me to understand the magnitude of the investment.

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

Falcao I can say that it's still very small. And now we have work to be done, so as to create synergies and evolve all those businesses so that they can become more relevant a long-time.

Q - Alex Falcao

Okay, great. Thank you.

Operator

Excuse me, our next question comes from Gabriel Rezende with Bradesco BBI.

Q - Gabriel Rezende {BIO 20589376 <GO>}

Good morning, everyone. I have two questions, one is related to long-cycle. Andre, mentioned that, some companies are postponing their projects. Solar energy project, so that they will wait for the regulatory deadlines. How do you understand the long-cycle recomposition risk, considering other segments in addition to GTD and industrial equipment. If we think about the impact of the pandemic on the global economy, how do you think the customers will behave to recompose the portfolio.

And my second question is to understand how the regulations will play-out in the third quarter? Have you adopted the regulation or not.

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

Gabriel, this is Paulo speaking. As to your question related to long-cycle, it's important to clarify and provide you with some additional information. First of all, it's important to mention that our long-cycle portfolio has been made in the past quarters. And it's very solid, it's very positive, it has reached one of the best level of the past few years. When we talk about long-cycle, we also include the businesses abroad.

Another point is that, those projects are not usually affected by short-term volatility such as the crisis, we are going through now. And the planning process is very long and involves a lot of resources. So when we make a decision, it takes a long-time, so it makes us comfortable to have -- to be sure that we have a sustainable portfolio for many years.

As for the other projects, it's too -- it's difficult to make an estimate. We have been working with -- under a reduction, which is normal and considering the time we are going through. But in the middle and long-term, we will see something different, as the pandemic ends.

It's very difficult to provide you with a figure in this sense. And lastly, I'd like to remind you that for next year, we have a wind generation project which is very important to our portfolio and the revenue starts to come in as early as 2021. So generally speaking, we have a sustainable portfolio for 2021. And Gabriel, in relation to the reduction of working hours, when we announced the results of the first quarter, we mentioned that in the second part of March, we saw that there was a drop in the placement of orders for commercial, appliance motors.

So together with the Paints and Varnishes, we saw that we needed to reduce the working hours and this varied according to the site by 25% to 50% reduction. So -- and sometimes we had to reduce their working hours until June and in May WEG motors, low voltage reduced the working hours of their employees that extended up to June. And we made a decision, considering the placement of orders. And so we decided to reduce the reduction in working hours for industrial motors. So in other words, as of August, all the operations of industrial motors in WEG will resume their working hours, normal working hours. As I said, that the visibility for the portfolio is short, it will last two months or three months at the most.

So we see a justification to stop this reduction of working hours. But we are going to analyze in three months, whether this is going to be sustainable or not.

Q - Gabriel Rezende {BIO 20589376 <GO>}

Thank you very much. As for long cycle, the order placement reached the levels of pre-crisis then. Is that right?

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

Gabriel. I wouldn't say that, it reached the level of pre-crisis. I would say, that this was a portfolio that was built periods before. Some of the orders continue to be placed, and as I said, these are projects which were [ph] -- had already -- had their orders placed and they continue to be addressed at the Company.

So as I said, we do not have enough visibility they're at the pre-pandemic levels. But the new orders from now on will continue to be monitored. I believe it's too early to provide you with any information at this time.

Q - Gabriel Rezende {BIO 20589376 <GO>}

Okay, thank you.

Operator

Our next question comes from Mr. Motta with JPMorgan.

Q - Marcelo Motta {BIO 16438725 <GO>}

Hello, good morning. I have two questions as well. When we look at the margin, you say that some measures were temporary, collective vacations and everything. Is there any processes that were improved during the pandemic, and then you would like to be -- you would like to implement forever. Is there anything that you learned from the crisis that will be implemented on a permanent basis that can provide some results.

In other words, can the Company operates in a more efficient manner? And as for the long-cycle backlog, as far as I can understand, is it correct to say that up to 2021, your pipeline, or your level of revenue is stable. So I could understand the backlog would last up to when. So I would like to understand, whether this backlog would extend throughout 2021.

How big is the backlog you have in your portfolio?

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

Hello, Marcelo. This is Andre Rodrigues speaking. So let's talk a little bit about the main impacts of the margin in this quarter. And then move on to answer the main point of your question of what could be from temporary become permanent. The improvement in the margin happened, as a result of the long-cycle improvements.

We said in the previous quarter that usually, long-cycle would account for 35% of the revenue. And the drop of the short-cycle production reached 40% and we can talk about the B&D and the transformers that were delivered to projects related to the auctions that were held in Brazil.

And the growing demand of those products for renewable generations in the North American and also in Brazil. And in the United States, we are leaders in the market. As for automation, there is a growing demand for our panels and automation. I'm talking about the long-cycles and low voltage equipment, focused on mining and pulp and paper. And also the foreign markets as to oil and gas and water and sanitation.

And we, have to mention the speeds that the Company have always imposed to address any fixed cost aspects in moments of crisis. And this has not been different for this pandemic and we started with a plan of reducing the working hours of anticipated vacations and we foresaw the companies that would lower their orders and this had a very important impact. We also reduced the number of business travels and the positive -- the impact were positive in the margin of the quarter.

And also the exchange variation. This is also something important to consider. We always say that the correlation between the foreign exchange rate, can be minor. But those products, which are more exposed in the foreign market are favored, especially long-cycle product. So this explains a little the impact on the margin for the quarter. Yes, the company, regardless of the pandemic, we always work with a cost reduction program, for example, reducing the number of travels.

Of course, the drop has been enormous, it will go back, but of course it will never go back to the levels we used to record in the past, as the world is doing as a whole. We are resorting to digital technology to improve our communication, processes, communication. So that we will won't need to move around so much.

And together with that, the Company has been announcing that we have been investing in the modernization of our sites, if anyone visited like, five years ago, when you visited our company now, we can see that we have many more automated processes that we used to have in the past. And this is a trend that continues. Of course, at the moment, like this, where we -- especially in the beginning, when we suffered from the absenteeism of where people get sick and the public transportation was not operational and we see the benefit of all this.

So the Company will continue on the lookout for all the opportunities. If you visited our company five years ago, you will have a totally different view on today. So, now we can say that many of the processes were automated. And in your next visits, you will be able to see that we have other units, whose benefit has been implemented and we are always looking for new synergies the purchase of raw materials.

So these are all actions that we have been taken and they are going to continue.

Q - Marcelo Motta {BIO 16438725 <GO>}

Perfect. As to the backlog.

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

Oh, yes. This is Polezi speaking. The WEG has led different business units. So it's a very complex to talk about a single indicator, when we refer to backlog. We talk about wind generation, whose backlog is long three or four years and also B&D, that can reach even six years. And we also have generation energy that has backlog of one year in solar farms which have different period. So these are all portfolios that are being composed a long-time. And before the pandemic, we were at a very positive moment when we are building up our portfolios.

Every year, a portfolio that has been made and another portfolio, which is about to be formed. So in the beginning of each year, so we start building a new portfolio. And this is where we were. And so we have a space to have room to fill. So this is the environment, we live in. It's difficult to give you a single answer but, we are totally able to build a very positive portfolio for the future.

Q - Marcelo Motta {BIO 16438725 <GO>}

Thank you. Polezi.

Operator

Excuse me, our next question is from Victor Mizusaki with Bradesco BBI.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Good morning, congratulations on your results. I have two questions. The first one is thinking about investment cycle, when we consider the last months in terms of results. First we had, wind energy and then solar energy as an additional income. Does it makes sense to expect for the next years, considering the investments that can be made in the sanitation. Do you believe that this can help sustain the growth of WEG.

And the second question is related to return. You mentioned in the call margin, but when we look at ROIC of WEG, we see there is a ROIC consistently being improved. So I would like to ask you, if we could say, that -- this ROIC above 20% would be the new level that can be expected for the future.

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

Victor, this is Andre Rodrigues speaking. So let's talk about the hallmark of sanitation. So what's the information, that is available to us. First, WEG has presented in WEG Day, water and sanitation is an

important segment to the Company. The Company has been structured at the global level to handle this topic. Because many of those opportunities are placed abroad. So this is one of the main segments for the Company. We already supply equipment to the sector, not only motors but the inverters and other pieces of equipment.

It's also important to mention that the solutions of Industry 4.0 can also be used to help in those projects. It's difficult to quantify all those pieces of information, because some of the governments are provided by the government. For example, 2017, only 50% of our households had sewage systems. So the investment may reach BRL700 billion, up to 2030. And this will be extended up to 2040 and based on the information that we have collected.

Yes, we believe this is a very positive because when we talk about water, we have to consider the equipment. But let's think like this, we need pumps, and pumps need electrical motors and motors require electricity, electricity requires substations, transformers, automation panels inverters -- frequency inverters and WEG has all this. We -- as to equipment, we also have industrial paints and we are one of the leaders in the market, so how this level of investment will behave along the time, that is something for us to observe.

And all those -- we would need all the pipelines to have there invested, but considering the macro viewpoint, we can understand that what is addressable to WEG, is using the CapEx according to this visibility. And this is something that we can see by now and we are going to provide you with information as we learn about it.

As for ROIC expectations for the quarters to come, we announced a very positive ROIC. So this year, we expect to deliver another healthy ROIC and even not talking so much about the expectations. It's important to understand that the ROIC can oscillate in the next quarter. In the past quarters, we have managed to offer expansion in margin and growth in revenue and this has helped the ROIC. And the margin, which also impacted the results and we also had the reduction in working hours. As we said, the reduction in the business travel. And all -- those are benefits that are going to be seen along the time, along the year. And as a result, we cannot say that this expansion trending is going to continue. We cannot say for sure. But -- and additionally, we have to remind you that we'll come to a time when we have to increase our investments.

So that, we can provide support to the pace of growth at WEG. So, this can cause an impact and lead to a drop in ROIC. Yes, because the company needs to invest in order to grow. But even so our growth focus in a sustainable manner and also in maintaining good results and an attractive ROIC are all things that are going to continue to be considered.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Thank you. And just a follow-up on my question please. When we compare to solar solutions, when you deliver turnkey, as to sanitation, I know, it's too early to discuss this. But do you believe that there would be a way to sell a solution or do you -- do believe they would work differently.

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

Victor. In that case the models are different. We understand that if we do this, we are going to invade the space occupied by our clients.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Okay, thank you.

Operator

Our next question is from Catherine with Banco do Brasil.

Q - Catherine Kiselar {BIO 20979709 <GO>}

Good morning. Congratulations on the results. I have two questions. And one is related to the previous question, when you mentioned that there is a need to increase the investments to support the growth of the Company. After the pandemic, what do you expect in terms of level of investment and what would be the focus?

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

Catherine. Good morning. This is Paulo Polezi speaking. WEG has discipline, which is quite stringent in the investment of CapEx. If you observe our history, I can also provide you with the volume of historical CapEx invested. And you will see that the Company always keeps a high, a good level of investment, after depreciation and when we have a clear moment for the expansion in the market, we can see that the level increases. From 2014 and 2016, the level of CapEx investment was nearly twice as much as that of depreciation in Mexico, in China we saw that.

And the Company can do this in a very disciplinary way, and this is a place where the CapEx has a very robust position, and this allows us to grow and maintain the ROIC at a sustainable level, as Andre has just mentioned. And 2020, in particular would be a year, when we would reach a level of BRL700 million of investment, at the level higher than that of the depreciation and this is something that the Company is reviewing and coming to the conclusion that we are going to be using levels lower than this.

As the market provides more visibility, the Company will resume its investment. But at this time, we are not canceling any projects, we are rather postponing some of them. But the company has not canceled any projects as the conditions proved to be more favorable, they will go back to the proper levels of investment in order to support the growth as mentioned before.

Q - Catherine Kiselar {BIO 20979709 <GO>}

Okay, perfect. Would you allow me to ask a second question related to digital solutions, last year -- last week, WEG talked about the potential gains of Industry 4.0, related to the cost reduction, reduction in the use of energy, higher production and higher demand. We understand that all those gains due to digital solutions are potentials to be considered. But if we remove this kind from the context, what can we expect as a benefit to WEG from those digital solutions, as gains for the operations of the Company.

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

Hi Catherine. This is Andre Rodrigues speaking. Yes without a doubt that this is not applied only to our clients, this can be applied in Company, part of the investments are focused on the modernization of our plants. As for information, we have already completed another capacity increase project in one of our plants, all the storage plants of our plant is done by robots, which are totally automated and we are going to -- continue improving the improvement of our processes using all those solutions. Another one is the Motor WEG Management, which -- and we apply this in one of the sites of WEG and we used this solution.

So the advantage that we have is that we can make a test first inside our company, and then we offer the product to the client. So the product reaches the market at a very advanced phase, when it's offered in the market. So without any doubt, digital businesses were not developed, only to be sold outside and but rather we are using all those benefits.

Q - Catherine Kiselar {BIO 20979709 <GO>}

Okay, perfect. Thank you.

Operator

Our next question comes from Regis Cardoso with Credit Suisse.

Q - Regis Cardoso {BIO 20098524 <GO>}

Good morning. Thank you very much for taking my question. I have two quick questions on my part. First one is to ask you. Yes, -- sorry if you have already answered, because I missed the beginning of the call. But my question is, if you made an evaluation of the potential impact of the tax reforms that are being discussed today in the conference. From the -- what does it mean to the exports activities, and if there is any other impact that should be considered -- considering WEG's operation.

And my second question is related to the effects that were predominantly seen in the first quarter, which was the devaluation of real -- BRL. And I understand that this is the currency use for most balances, if not all of the companies and all the analysis. Do you understand that the margin of the first quarter was helped by stock-level considering that the COGS were based on BRL currency, which was more valued at that time.

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

Hi, this is Andre Rodrigues. The tax reform, which was presented to the Senate [ph] this month. We have a preliminary analysis of this reform, it's very recent yet. And according to our -- and preliminary analysis we can see that there has been -- there will be some benefits. First, not only quantitative, because those who live and operate in Brazil, will understand the complexity of handling all the tax system. We have consistent rules, avoiding future disputes, we have the information, we understand that the average of dispute, tax dispute will take about eight years and we understand that this will lead to a lot of uncertainties to this.

It also has -- ample discussion of debt and charges and the growth aspects have -- those aspects. But we are going deeper into this knowledge. We understand that when we evaluate the proposal. In a preliminary way, we understand that there will be no impact in terms of a higher tax burden to our Company.

And another point is that. Additionally, any reform that can provide simplification and lessen the burden, so companies spend about 1,500 hours to declare all this taxes aspect. So simplification is very welcome. So we also understand that we pay much more, many more taxes than businesses usually do.

A - Andre Salgueiro

This is Andre Salgueiro speaking, in terms of the currency exchange rates, we made some regression calculations to show if -- or to understand whether there was a correlation between the margin of the Company and the foreign exchange rate.

And we understand that this correlation is very low. We do not like to include the tax -- the currency or tax rate in this calculation. But we understand that part of our cost structure is based in -- on a strong currency. And this is corrected and we have businesses with different dynamics. Some mature products, such as generators and electrical motors, where the export component is very important in the market. And we can see some benefits, but if we consider other aspects, such as components. And many components is very limited to the external market. This impact in the currency exchange is not so positive, it can even be negative, depending on the magnitude. So when we analyze all the business as a whole, the correlation is relatively low because of all those aspects. However, we cannot deny that when there is a currency variation, which is very strong, the devaluation with that has -- which is very strong in a very short-time, as we saw in the second quarter.

So incomes tend to be directly corrected and the impact happens directly. And you understand, we already had some stocks, we had some sales, which we had already been planned. So the impact

tends to be more gradual. Yes, the answer is yes. There is the currency rate, exchange has an impact on the margin, but it tends to dilute along the time as for costs and the impacts on margin.

Q - Regis Cardoso {BIO 20098524 <GO>}

Okay. Very complete answer. Thank you very much.

Operator

Our next question is from Fernando (inaudible) with JB Investments.

Q - Unidentified Participant

Good morning, sirs. Once again, congratulations on the results. I would like to talk about the digital area of WEG. WEG has been transforming into a transformation conversion company to a company that offers solutions. So we have storage batteries. We have the Phase I of the ecosystem that were completed with the latest acquisition. So, considering all those businesses conducted by WEG, how do you see as the biggest possibility to generate results to WEG?

And my second question would be so -- as you said the Phase I has been completed, what would be the next phases for 4.0 project? Thank you.

A - Andre Luis Rodrigues

 {BIO 17964192 <GO>}

Hi, Fernando. It's hard for us to say for sure which will be our share in the future. Where we are going to place our bets, as the first development. As you said, the better story keeping, which complements the renewables, so when we say that the sun doesn't shine at all times, the wind doesn't blow at all times. So that we can use this generation by means of the renewable. What I can say is that, WEG has a long-term strategy and the strategy that we conduct at a very loyal level and this has been built and it continues to be built. So that in the future we can benefit from all this and we can also continue growing. And this is something that the company searches for along the time.

As I answered with Falcao's answer. We have this small business, these are all complementary to our business operations. So the future shows to be very positive in this regard. And the second question is related. I'm sorry, could you repeat that?

Q - Unidentified Participant

Yes. You said that Phase I has been completed.

A - Andre Luis Rodrigues

 {BIO 17964192 <GO>}

Oh, yeah. Phase I. In this ecosystem. So the question is, will there be a second phase or other phases. Yes, why have we adopted this approach? The Industry 4.0 is all connected in terms of technology and it's a very broad, if you start investing in too many things, you may lose your focus. And if you lose your focus oftentimes, it's difficult to have a correct approach with the clients, in how you can help them. As I said, everything starts with the sensor and then you need telemetry and then you have -- to have artificial intelligence and management software.

So these are all items that we identified as a good start for us. We are developing the new phases yet. But I'm going to give you an example; Artificial Intelligence in a very simplified way. We are addressing this computation view, and analytics. But you can also have solutions related to sound and use artificial intelligence, focused on this.

So these are aspects that can be developed by the Company and we can continue making progress. I give you an example using Motor Scan, using all the technologies, which is a technology

that you insert into the motor. So there are other items that are in-line with the company that can continue developing.

For example, everything that is related to transmission and distribution, anything related to the information that you can give to the grid, by means of Telemetry, which is connected to our transformers and sensors and so on and so forth.

So there is still a lot to be developed. However, we prefer to focus on what has been described so far, more specifically to the short-term strategy of the company.

Q - Unidentified Participant

Okay, thank you. And once again congratulations on your results. Thank you.

Operator

Our next question comes from Lucas Barbosa, Morgan Stanley.

Q - Lucas T. Barbosa {BIO 20835372 <GO>}

Andre, Paulo. Thank you very much for taking my question and congratulations on the result. And my question is related to the distributor's network. Considering the numbers that you have and maybe some of the distributors you work with closed because of financial difficulties. And I believe that -- do you see that there are risks in this area.

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

Lucas. Good morning. Thank you very much for your question. Yes we work with a network of distributors, which is very broad both in Brazil and abroad. And most of the element of this network are WEG, they work with the WEG Brand, on an exclusive basis. And the history is very favorable, in terms of financial solidity, and very rarely would they've run into difficulties, as I said. These are companies that have been operating for decades, and they have whole solid process already built. And the risk is very low.

We saw no critical situations from them. But we have a close follow-up on them. In this -- along those lines, as for distributed solar generation, we have been working closely with some distributors and installing companies. And these are companies which are new companies, young companies and they have been developing quite quickly and we have been monitoring them quite closely and we have not had any records of difficulties faced by them.

Q - Lucas T. Barbosa {BIO 20835372 <GO>}

Okay, thank you, Paulo. Another question. I'm not sure if you can answer this, this is related to short-cycle product. Can you tell us how -- what is the profitability of short-time -- short-cycle products as compared to history.

A - Andre Salgueiro

This is Andre Salgueiro here. We do not disclose the profitability per line. But what we provide in terms of information in our institutional information, when we talk about short and long-cycle products. What we say is that short cycle equipment, does not have a big variation in terms of price and margin regardless the scenario. So they have this more stable price dynamics. And another factor to be considered as we mentioned in the release, is related to the cost of raw materials.

So we have not been under any cost pressure, due to the FX variation, so it's likely to continue as it was -- it has been before.

Q - Lucas T. Barbosa {BIO 20835372 <GO>}

Okay, thank you.

Operator

Our next question comes from Alex Falcao with HSBC.

Q - Alex Falcao

Thank you very much for the follow-up. I would like to have some further information related to the solar Energy. Andre mentioned, that many of the projects are still not a 100% hired by the suppliers. In 2021, theoretically you have a relevant number of those projects, and you will need supplier since CapEx. We will need to be invested, can you give us some more details about the market share and who are the main competitors.

And does it give you any opportunity to gain more market share, considering the new business.

A - Andre Salgueiro

Hi Falcao. This is Andre Salgueiro speaking. In terms of solar farms, we can address the topic in two different ways. First, as we did in the previous projects, we could sell the turnkey solution, which is the complete solution, when we do all the project -- already running for the client. And we also have the option to sell the equipment. The inverters, central inverters or transformers, for the substations.

So this is one of the aspects. The first one. So, considering this market, you have players who work using WEG's model. They address the market with a complete solution. The EPC and you have other players which are integrators, engineering company or a generation company, with its own engineering team. And they purchase the equipment on a separate basis. And they themselves execute the integration and they provide their own solutions. So we have the option to sell the complete solution. And the second option is to address the market by means of the equipment. So competitors are in both types of businesses. In terms of market share, we do not have precise numbers because of the very dynamics of the project.

But I believe, that most important is that when we talk about the auctions, let's consider 2018 and 2019 and their auctions, we had 4% and minus 6%. So, these projects have to be ready by 2023 and 2025. So we have all those projects -- and whose suppliers have not been defined yet. May be the supplier who will provide the complete solution or the supplier who will provide separate pieces of equipment. Maybe it's an opportunity that will happen in the future. As I said 2023 or 2025, and the solar farm will take about one year or two years to build it completely, so we can wait.

So the macro-dynamics and scenario, the high cost of panel, the cost of the energy -- it's -- the energy is cheaper now. And this is not an encouragement for them to sell that. So the energy in the free market. So these dynamics is closer to the date when the products need to be installed. So we believe that those projects are going to be implemented as the deadlines, the regulatory deadlines come near.

Q - Alex Falcao

Okay, perfect. Thank you.

Operator

Excuse me. We closed the Q&A session and I would like to give the floor back to Mr. Andre Rodrigues for his final considerations.

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

Thank you very much for taking part in our conference call and see you next time.

Operator

WEG's conference call is now closed, we would like to thank you for your participation and have a nice day.

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