

WEG S.A.

2nd Quarter 2020 Earnings Results Conference Call

July 23, 2020 – 11:00 a.m. (Brasilia time)

Transcript of the simultaneous translation from Portuguese into English



## CORPORATE PARTICIPANTS

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

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

**Mr. Wilson Watzko** – Controller Officer

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

## PRESENTATION

**Operator:** Good morning and welcome to WEG's conference call on the results for 2Q20.



We would like to inform you that we are broadcasting this conference call accompanied by the slides on our investor relations website at [ir.weg.net](http://ir.weg.net) and after its completion the audio will be available on our IR website. If you need support during the conference call please request the assistance from an operator by typing star zero.



Any estimates contained in this document or any forward-looking statements that may be made during this conference call about future events, the business perspectives, the operational and financial projections and goals and the potential future growth of WEG

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 dependent 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.

Today with us in Jaraguá do Sul we have Mr. Andre Luis Rodrigues, Managing Director Financial Superintendent; Paulo Polezi, Finance and Investor Relations officer; Wilson Watzko, Controller and Andre Salgueiro, Investor Relations Manager of WEG.

Please Mr. Andre Rodrigues may carry on.

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

Good morning everyone. Once again it is a pleasure to be with you in this earnings call to discuss WEG's results.

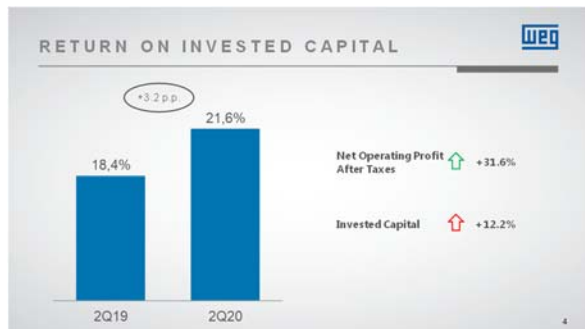


We start with the highlights of the quarter, the first being the net operating income which grew 23.7 compared to 2Q19. The demand for long-cycle equipment both in Brazil and abroad, together with the positive impact of the exchange rate variation, were relevant factors for this positive performance, despite the difficulties imposed by the COVID-19 pandemic,



which caused important negative impacts in part of our short-cycle businesses.

Another highlight in 2Q was EBITDA, which grew by 36.3% and reached 732 million BRL. The EBITDA margin increased 1.7 p.p. 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 p.p. over 2Q19 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.

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

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 products supplied mainly for paper and pulp and mining projects. However, we observed 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 long-cycle equipment. In Brazil we had deliveries for important projects mainly linked to transmission auctions held in recent years.

The distributed solar generation business, as well as other short-cycle businesses of the company, suffered a drop in demand in relation to 1Q20 due to the restrictions adopted to combat the pandemic. Even so it performed well when compared with 2Q19 given the relevant growth of this business presented in the last 12 months.

In commercial and appliance motors as we had already informed in 1Q20 the demand reduction started in March extending throughout the beginning of 2Q20, a period in which important customers had 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 2Q20, a period in which important segments were affected due to the pandemic. At the quarter we saw a partial return of demand levels with emphasis on the activities related to agribusiness and road implements.

In the foreign market it is important to highlight that the exchange rate variation played an important role in the 23.2% growth in revenue measured in BRL. In local currencies considered according to the weight of each market net revenue from the foreign market dropped 4.8% when compared to 2Q19. 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.



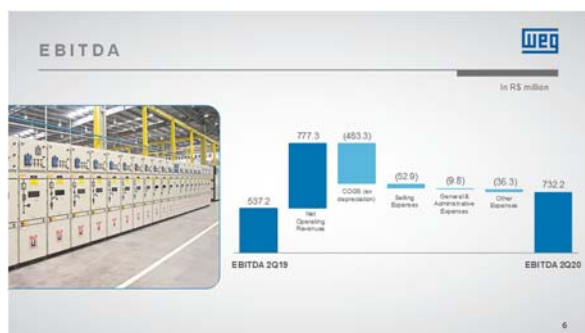
As for long-cycle equipment we continue to perform well, with important deliveries made in the oil and gas, mining and water and sanitation segments contributing positively to the quarter results.

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 operational 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 2Q TY. 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 paint and varnishes the stoppages in operations due to the restrictions adopted to define the pandemic especially in Argentina impacted our performance this quarter.



Slide six shows the evolution of EBITDA in 2Q20, where we presented the growth of 36.3% in relation to 2Q19. The EBITDA margin ended the quarter at 18% showing an increase of 1.7 p.p. in relation to 2Q19. We highlight the margin gain in long-cycle operations, mainly in GTD and high-voltage industrial motors 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 2Q20 investments reached 107.4 million BRL, 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 impacts of the business 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 finished my part and give the floor back to Andre.

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

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.



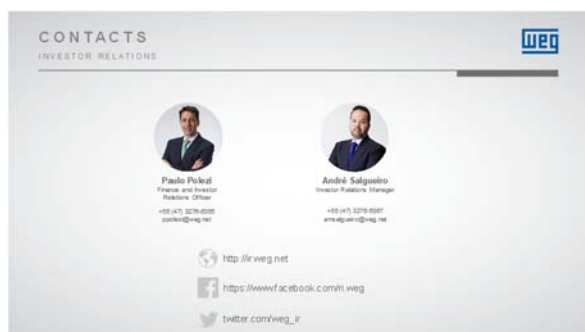
In June we announced the acquisition of control of Mvisia, a company specialized in artificial intelligence solutions applied to the computer vision for the industry, and earlier this month we announced the acquisition of BirminD, a technology company active in the artificial intelligence market applied to industrial analytics.

Despite a gradual improvement in the short-cycle business dynamics scene at the end of the quarter, we cannot yet say 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 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 is important to highlight that we also had some impact, occasional impact in this quarter such as reduced working hours, 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 impacts on our operations, as we have done since the beginning of the pandemic.

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



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## **Q&A Session**

### **Operator**

Thank you. Ladies and gentlemen we can now begin the question-and-answer session. To ask a question please enter star one. To remove the question from the list type star two.

Our first question comes from Mr. Alexandre Falcão, HSBC.

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### **Mr. Alexandre Falcão – HSBC**

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 zero imports to your business and what is 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? What do you expect in the future? Thank you.

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

Falcão good morning, thank you very much for your question, this is André Salgueiro speaking. I am going to answer the first question, the first part of your question related to solar energy and then the answer will be continued. Recently we announced the solar panels and other equipment and in fact this is a process that is valid not only for solar products but also can be applied to other pieces of equipment, but it is usually used for products which are not manufactured in Brazil. So there is no interference related to the products we produce in Brazil. In general it tends to be very positive to the market because the imported products will have their price pressed down just as the 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 has 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 is a business that has been evolving well and this is something we have been operating in for some time. As for short-cycle 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 there was a resumption in the operations, but the operations are lower than expected.

Anyhow the segment has good perspectives in the medium and long terms and we believe that by using our business model of using integrators and also considering that WEG is a well-recognized brand 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 do not know the speed it is 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 auctions 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 holding back so that they will then decide what they will do about those projects. 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 of the pandemic in the short term.

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

This is Andre 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 Solutions and our platform WEGnology and with the acquisition of Mvisia, which specializes in computer use 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, automates operations by means of management of software. And now considering all the acquisitions we have made we are going to use machine learning and artificial intelligence applied to the industries, such as the solutions provided by our acquisitions and we will use those technologies to promote continuous development of industry 4.0.

We informed that this businesses are businesses which are adjacent to what we already produce. We still have not reached the moment that we announce all the figures, but we have not 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 that we have been mentioning lately, and at this time around it is very important to close this ecosystem and this is what we have done. So one of our strategies so as to say is already completed and we have already offered some products in the market such as WEG Motor Fleet Management, which is a system that controls a motor fleet using all the knowledge that are offered by those companies and this is an initiative that is likely to grow together with the solutions which are associated.

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**Mr. Alexandre Falcão** – HSBC

I would like to understand the order of magnitude of those businesses; more than 100 million BRL, more or less? Just for me to understand the magnitude of the investment.

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

Falcao I can say that it is still very small and now we have work to be done so as to create synergies and involve all those businesses so that they can become more relevant along time.





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**Mr. Alexandre Falcão – HSBC**

Okay great thank you.

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**Operator**

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

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**Mr. Gabriel Rezende – Bradesco BBI**

Good morning everyone. I have two questions, one is related to long-cycle. Andre mentioned some companies are postponing their projects, solar energy projects, so that they will wait for the regulatory deadlines. How do you understand of 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 3Q. Have you adopted the regulation or not?

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

Gabriel this is Paulo speaking. As to your question related to long-cycle it is important to clarify and provide you with some additional information. First of all it is important to mention that our long-cycle portfolio has been made in the past quarters and it is very solid, very positive. It has reached one of the best levels 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 is difficult to make an estimate. We have been working under a reduction, which is normal and considering the time we are going through, but in the middle and long terms we will see something different as the pandemic ends. It is very difficult to provide you with a figure in this sense.

And lastly I would 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.

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

Gabriel in relation to the reduction of working hours, when we announced the results of 1Q 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 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 at WEG will resume their working hours, normal working hours. As I said the visibility for the portfolio is short, it will last two or three months at the most, so we see a justification to stop this reduction of working hours that we are going to analyze in three months whether this is going to be sustainable or not.

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**Mr. Gabriel Rezende – Bradesco BBI**

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



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

Gabriel I would not 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 continued to be placed and as I said these are projects which were, had already had their orders placed and they continued to be addressed at the company. So as I said we do not have enough visibility for the pre-pandemic levels, but the new orders from now one will continue to be monitored. I believe it is too early to provide you with any information of this kind.

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**Mr. Gabriel Rezende** – Bradesco BBI

Okay thank you.

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**Operator**

Our next question comes from Mr. Marcelo Motta with J.P. Morgan.

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**Mr. Marcelo Motta** – JP Morgan

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 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 operate in a more efficient manner?

And as for the long-cycle backlog as far as I could understand is that 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 expend throughout 2021. How big is the backlog you have in your portfolio?

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

Hello Marcelo this is Andre Rodrigues speaking. So let us talk a little bit about the main impacts on 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 T&D and the transformers that were delivered to projects related to the auctions that were held in Brazil and a growing demand of those products for renewable generations in the North America and also in Brazil and in the United States we are leaders in the market. As for automation there is a growing demand for panels and automation, I am 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 also have to mention the speeds that the company has always imposed to address any fixed costs 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 impacts were positive and 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 products. 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 not 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 WEG five years ago and visits our company now we can see that we have many more automated processes than we used to have in the past and this is a trend that continues, of course at a moment like this, where we especially in the beginning when we suffered from the absenteeism 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 the opportunities.

If you visited our company five years ago you would have a totally different view on today. So now we can see that many of the processes were automated and in your next visit you will be able to see that we have other units, whose benefit has been implemented and we are always looking forward new synergies in the purchase of raw materials. So these are all actions that we have been taking and they are going to continue.

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**Mr. Marcelo Motta** – JP Morgan

Perfect. As to the backlog?

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

Oh yes. This is Polezi speaking. WEG has different business units and so it is very complex to talk about a single indicator when we refer to backlog. We talked about wind generation, whose backlog is long, three or four years and also T&D that can reach even six years and we also have generation energy that has a backlog of one year and solar farms, which is, which has different periods.

So these are all portfolios that are being composed along the time and before the pandemic we were at a very positive moment when we were building our portfolios. Every year we have 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 are living. It is difficult to give you a single answer, but we are totally able to build a very positive portfolio for the future.

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**Mr. Marcelo Motta** – JP Morgan

Thank you Polezi.

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**Operator**

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

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**Mr. Victor Mizusaki** – Bradesco BBI

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 additional income. Does it make sense to expect for next years, considering the investments that can be made in 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 the 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.

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

Victor this is Andre Rodrigues speaking. So let us talk about the hallmark of the sanitation. So what is the information that is available to us? First WEG, as presented in WEG Day, water and sanitation is an important segment to the company. The company has been structured at a 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 inverters and other pieces of equipment. It is also important to mention that the solutions of industry 4.0 can also be used to help those projects.

It is difficult to quantify all those pieces of information because some of the governments are provided by the government. For example 2017 only 50% of households had sewage systems. So the investment may reach 700 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 very positive because when we talk about water we have to consider the equipment. But let us think like this: we need pumps and pumps need electrical motors and motors require electricity, electricity requires substation, transformers, automation panels, 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 is something for us to observe and all those, we will 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 right 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 is important to understand that ROIC can oscillate in the next quarters. In the past quarters we have managed to offer expansion in margin and growth in revenue and this has helped ROIC and margin, which also impacted the results and we also had the reduction in working hours as we said, the reduction in the business travels 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 and additionally we have to remind you that we will 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.

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**Mr. Victor Mizusaki – Bradesco BBI**

Thank you and just to follow-up on the question please: when we compare to solar solutions when you deliver a turnkey as to sanitation, I know it is too early to discuss this, but do you believe that there would be a way to sell a solution or do you believe they would work differently?

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

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.

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**Mr. Victor Mizusaki – Bradesco BBI**

Okay thank you.

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**Operator**

Our next question is from Catherine with Banco do Brasil.

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**Ms. Catherine Kiselar – Banco do Brasil**

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 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?



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

Catherine good morning this is Paulo Polezi speaking. WEG has a 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 good level of investment after depreciation and when we have a clear moment for 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 and China we saw that, and the company can do this in a very disciplinary way and this is a place where CAPEX has a very robust position and this allows us to grow and maintain ROIC at a sustainable level as Andre has just mentioned.

In 2020 in particular would be a year when we would reach a level of 700 million BRL of investment at a 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 prove to be more favorable they will go back to the proper levels of investment in order to support the growth as mentioned before.

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**Ms. Catherine Kiselar** – Banco do Brasil

Okay perfect. Would you allow me to ask a second question related to digital solutions? Last week WEG talked about the potential gains of industry 4.0 related to cost reduction, reduction in the use of energy, higher production and higher demand. We understand that although gains due to digital solutions are potentials to be considered, but if we remove the time from the context what can we expect as a benefit to WEG from those digital solutions as gains for the operations for the company?

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

Hi Catherine this is Andre Rodrigues speaking. Yes, without a doubt 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 Management and we applied this in one of the sites of WEG and we use 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 clients, so the product reaches the market at a very advanced phase when it is offered to the market. So without any doubt digital businesses were not developed only to be sold outside, but rather we are using all those benefits.

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**Ms. Catherine Kiselar** – Banco do Brasil

Okay perfect, thank you.

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**Operator**

Our next question comes from Regis Cardoso with Credit Suisse.

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**Mr. Regis Cardoso** – Credit Suisse

Good morning, thank you very much for taking my question. I have two quick questions on my part, the first one is to ask you, sorry if you have already answered because they 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 Congress, from 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 1Q, which was the devaluation of BRL, and I understand that this is the currency used for most balances, if not all of the companies and all the analysis. Do you understand that the margin of 1Q was helped by the stock level considering that the COGS were based on a BRL currency, which was more valued at that time?

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

Hi Regis this is Andre Rodrigues. The tax reform which was presented to the Senate this week we have a preliminary analysis of this reform. It is very recent yet and according to our 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 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 due 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 we evaluate the proposal. In a preliminary way we understand that there will be no impact in terms of 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 1500 hours to declare all these taxes aspect. So simplification is very welcome. So we also understand that we pay much more, many more taxes than businesses usually do.

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

This is Andre Salgueiro speaking. In terms of the currency exchange rates we made some regression calculation to show 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 currency tax rate in this calculation, but we understand that part of our cost structure is based 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 exports 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 a whole the correlation is relatively low because of all those aspects.

However, we cannot deny that when there is currency variation which is very strong, a devaluation that usually is very strong in a very short time as we saw in 2Q, 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 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.

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**Mr. Regis Cardoso** – Credit Suisse

Okay very complete answer, thank you very much.

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**Operator**

Our next question is from Fernando Leitão with JB Investimentos.

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**Mr. Fernando Leitão** – JB Investimentos

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 1 of this 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 phase 1 has been completed, what would be the next phases for 4.0 project? Thank you.

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

Hi Fernando. It is hard for us to say for sure which will be our share in the future, where we are going to place our bets as a first development. As you said battery storage keeping, which complements the renewables. So when we say that the sun does not shine at all times, the wind does not 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, 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 am sorry could you repeat that?

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**Mr. Fernando Leitão** – JB Investimentos

Yes, you said that phase 1 has been completed...

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

Oh yes phase 1.

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**Mr. Fernando Leitão** – JB Investimentos

In this ecosystem. So the question is will there be a second phase or other phases?

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

Yes. Why have we adopted this approach? The industry 4.0 is all connected in terms of technology and it is very broad. If you start investing in too many things you may lose your focus and if you lose your focus often times it is difficult to have a correct approach with the clients and 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 am 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 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.

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**Mr. Fernando Leitão** – JB Investimentos

Okay thank you and once again congratulations on your results.

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

Thank you.



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**Operator**

Our next question comes from Lucas Barbosa, Morgan Stanley.

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**Mr. Lucas Barbosa – Morgan Stanley**

Andre, Paulo, thank you very much for taking my question and congratulations on the result and my question is related to the distributors' 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?

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

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 elements 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 run into difficulties. As I said these are companies that have been operating for decades and they have a whole solid process already built and their risk is very low.

We saw no critical situation from them, but we have a close follow-up on them. 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.

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**Mr. Lucas Barbosa – Morgan Stanley**

Okay thank you Paulo. Another question: I am not sure if you can answer this, this is related to short-cycle

products. Can you tell us what is the profitability of short-cycle products as compared to history?

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

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 big variation in terms of price and margin regardless of 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 costs of raw materials. So, we have not been under any cost pressure due to the FX variation. So, it is likely to continue as it has been before.

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**Mr. Lucas Barbosa – Morgan Stanley**

Okay thank you.

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**Operator**

Our next question comes from Alexandre Falcão with HSBC.

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**Mr. Alexandre Falcão – HSBC**

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 100% hired by the suppliers. In 2021 theoretically you have a relevant number of those projects and you will need suppliers since your CAPEX 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?





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

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 we have other players which are integrators, an engineering company or 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 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 projects, but I believe that that most important is that when we talk about the auctions, let us consider 2018 and 2019 and the auctions we had A-4 and A-6. So, these projects have to be ready by 2023 and 2025. So, we have all those projects whose suppliers have not been defined yet: maybe the supplier who will provide the complete solution or the supplier who will provide separate pieces of equipment.

Maybe it is an opportunity that will happen in the future. As I said 2023 our 2025 and a solar farm will take about one year, two years to build it completely, so we can wait. So, the macro dynamics and scenario, the high cost of panel, the costs of energy, the energy is cheaper now and this is not an encouragement for them to sell the energy in the free market. So, this dynamics is closer to the date when the projects need to be installed. So, we believe that those projects are going to be implemented as the deadlines, regulatory deadlines come near.

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**Mr. Alexandre Falcão** – HSBC

Okay perfect, thank you.

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**Operator**

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

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

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

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**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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