Operator:

Good morning. Welcome to TOTVS's 1Q15 results conference call. Today we have Mr. Alexandre Mafra, CFO, and Mr. Gilsomar Maia, IRO and Corporate Finance Officer.

We would like to inform you that all participants will be in a listen-only mode during the Company's presentation. After TOTVS's remarks, there will be a question and answer session for investors and analysts, when further instructions will be given. Should any participant need assistance during this call, please press *0 to reach the operator.

Today's live webcast may be accessed through TOTVS's website at ir.totvs.com.

Before proceeding, we would like to mention that during this conference call, forward-looking statements may be made relating to TOTVS's business prospects, operational and financial estimates and goals, based on the beliefs and assumptions of TOTVS's management and on information currently available. Forward-looking statements do not guarantee performance. They involve risks, uncertainties, and assumptions because they relate 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 operational factors could also affect TOTVS' future results and could make these results differ materially from those expressed in such forward-looking statements.

Now, I will turn the conference over to Mr. Alexandre Mafra, who will begin the presentation. Mr. Mafra, you may begin the conference.

Alexandre Mafra:

Good morning everyone. Thank you for participating in the 1Q15 conference call.

Starting from slide 2, I would like to talk about the main events that took place since the disclosure of the fourth quarter results.

The first one is the acquisition of Neolog, a company focused on developing software solutions in the SaaS model for the Logistics and Supply Chain Management markets. Its solution aims to reduce costs and better match resources for clients throughout the whole supply chain.

This acquisition is also part of our specialization strategy and reinforces our position in the Logistics sector, adding Neolog´s solutions and business know-how which allow us to explore opportunities to optimize costs and increase efficiency in key sectors of the Brazilian market.

The second event is the launch of Fly01 platform with Redecard which aims to expand the penetration of management solutions in the micro enterprise market.

Fly01 is a complete cloud-based management solution available through monthly subscriptions, which has no need for investments in infrastructure, as it is sold in the form of apps available at the platform store.

The platform is present in the market initially through three complementary offerings:

(i) The e-commerce solution from Ciashop, which enables entrepreneurs to set up a virtual store in few minutes, already adapted to use Rede's means of payment;

(ii) TOTVS Series 1 management system, with automatic reconciliation of receivables originating from Rede's system;

(iii) mobile POS, that will allow entrepreneurs to get a consolidated view of their business in both the virtual and physical stores.

The third event is the dividends payment, approved at the Ordinary and Extraordinary Shareholders' Meeting held on March 30th, 2015, of R$124.368 million, corresponding to R$0.77 per share.

And the fourth and last event is the new share buyback program approved at the Board of Directors' meeting held on February 27, 2015, in the amount of 1.6 million shares, equivalent to 1.0% of the Company's total stock. The program's main purpose is to meet the stock options plan.

Now I invite Maia to comment on the quarter results, starting from slide 3.

Gilsomar Maia:

Thank you Mafra, good morning everyone.

Before entering in the financial comments, I would like to remind you that, as mentioned throughout 2014, from this quarter on, we will be providing some new breakdowns of revenues and costs.

In revenues, the subscription line was added, which comprises commercial models in which there is no ownership transferring of license fees.

The amounts presented in this line were reclassified mainly from license fees and, to a lesser extent, from maintenance and service lines.

In costs, we added a new line for the software technical support conducted by telephone and/or Internet, which was previously part of the cost of services.

With these new breakdowns, we could also provide the contribution margins of software and services businesses.

On slide 3, we see that total revenue grew 6.3% year on year and 0.7% quarter-on-quarter.

This chart presents the revenue breakdown between recurring and non-recurring and shows that the growth of total revenue came primarily from recurring revenues, which grew 11% year-on-year and 3% quarter-on-quarter.

It's worth noting that, this growth of 11% is higher than the 4-year CAGR of total revenue and the recurring revenue represented 60.7% of total revenue, the higher recurring level ever achieved by TOTVS in a quarter.

In addition, from the R$278.4 million of 1Q15 recurring revenues, over 90% are software revenue.

On slide 4, total revenue is broken between software and services businesses.

Service revenues grew 8.3% year-on-year. When analyzed by working day, service revenue grew 11.4%.

Software revenues accounted for 70% of total revenue and grew 5.5% year on year, below the 11% growth in total recurring revenue mentioned in the previous slide.

On slide 5, we note that recurring revenue from software, which is the sum of maintenance and subscription, grew 11% year-on-year.

Maintenance revenue increased by 3.5% quarter-on-quarter. Year-on-year, this line increased by 7.4%, exceeding by almost 2 percentage points the average 12-month IGP-M from April 2014 to March 2015.

This maintenance performance is even more relevant when taken into account the 10% decrease in license revenue.

Approximately 2/3 of license sales on the 1Q15 were due to existing customers. These sales fell by 4.6% year on year, mainly due to the 12% reduction of the incremental license fee of the corporate model in 1Q15, reflecting the slower pace of economic growth in 2014.

Slide 6 illustrates the transition that the Company's revenue model is undergoing, especially when compared to the growth of license fees and subscription.

While subscription increased 47% year-on-year, license revenue decreased 10%.

The customer addition of both models helps to understand the decrease in license and the increase in subscription. Year-on-year, License sales had less 189 customers than 1Q14. On the other hand, subscription sales had more 262 customers than in 1Q14.

Since the subscription revenue is still lower than license revenue, the positive effect of subscription is still not enough to offset the negative effect of the license decrease in the composition of total revenue growth, especially the revenue deferral effect that the subscription model has.

On slide 7, we can see the impact of this revenue model transition on the software contribution margin to the extent that the reduction of short-term revenue growth reduces cost dilution, especially in cost of support and in research and development.

Even with this transition in course, we see the software business sustaining a relevant contribution margin. In the medium to long-term, the higher level of recurring revenue tends to positively impact revenue and contribution margin of software.

Moving to slide 8, we have the service margin contribution. Quarter-on-quarter, the service margin has strongly recovered, mainly because of the additional costs of lay-offs that occurred in 4Q14. In the last 12-month period, service margin remained stable, but the year-on-year comparison shows that we are able to be more efficient in this business.

Now I return the presentation to Mafra, who will continue from slide 9.

Alexandre Mafra:

Thank you, Maia.

In this slide, we present the selling and administrative expenses of the period.

The first group, related to sales and commissions expenses, decreased by 30 bps in 1Q15 compared to 1Q14, as a percentage of net revenues. Compared to 4Q14, these expenses increased 130 bps, mainly due to: (i) the investments in training of the sales team to sell subscription to small and medium companies; and (ii) the change in the sales mix, both among franchises and own branches, as well as among client size, which impacted the commissions expenses.

Next, the group of administrative expenses and management fees, which reduced its participation on net revenues 20bps quarter on quarter, mainly due to the lower provisioning for bonuses related to financial and individual targets of our executives, and to the provisioning for stock option plan. In the last 12 months, this group remained stable, mainly due to the merger of the administrative teams of the acquired companies.

Then, advertising and marketing expenses grew 50 bps year on year and decreased 50 bps quarter on quarter, as a percentage of net revenues. This variation in the growth pace of expenses is mainly explained by the atypical distribution of these expenses in 2014, due to the soccer World Cup in Brazil.

Lastly, allowance for doubtful accounts reached 1.8% of total net revenues, the same level as in 1Q14. In the last year, the Company adjusted its credit policy and maintained its efforts to recover provisioned credit losses, driving this line down to 1.5% in the last 12 months. The Company will continue these efforts over the course of 2015.

On the next slide, we present the EBITDA margin, which ended the 1Q15 in 25%, down 150 bps year on year and up 160 bps quarter on quarter. The EBITDA margin increase quarter on quarter was mainly due to the higher contribution margins from the Software and Services businesses and the lower administrative expenses as a percentage of net revenues.

The EBITDA margin management in this quarter was also impacted by some challenges, such as: (i) the 12-month average inflation measured by IGPM, of 3.8%, when compared to the 12-month average inflation measured by IPC-A of 7.5%; (ii) the wage increase of 7.0% resulted from the collective bargaining agreement in São Paulo; and (iii) the 12.4% drop in the incremental licenses from the corporate model.

On slide 11, we present the net income, which totaled R$70.9 million in the quarter, a 15.1% growth year on year with net margin of 15.4%, that is 110 bps higher than in 1Q14. In the last 12 months, net income grew 16.9% and the net margin was of 15.1%, expanding 120 bps on the 12 months ended in 1Q14.

Net income outgrew EBITDA due to the net financial income of R$14.657 million in 1Q15, compared to a net financial loss of R$2.078 million in 1Q14, reflecting mainly (i) the higher financial results, driven by an increased balance of financial investments; (ii) the lower financial expenses in the year on year comparison, resulting mainly from the non-recurring adjustment of the debenture interest provision in the amount of R$2.807 of the 1Q14; and (iii) the result from the sale of a minority interest in ZeroPaper in January, 2015.

The net income was also impacted by the increase in the effective tax rate due to (i) an adjustment to the 2014 income tax provision related to TOTVS´ subsidiaries; and (ii) the smaller share of R&D projects eligible to “Lei do Bem”, in relation to Earnings Before Taxes.

On slide 12, we present the cash growth of the period, which amounted to R$733.6 million, with net cash of R$90.5 million.

The cash growth of R$35.7 million was mainly driven by:

(i) the operating cash flow of R$84.7 million, corresponding to 119.5% of net income;

(ii) the investments of R$10.2 million in fixed assets, mainly related to the acquisition of machinery and equipment;

(iii) the payment of R$23.2 million for acquisitions, including the acquisition of Neolog and the payment of previous acquisitions installments; and

(iv) the payment of R$19.4 million of interest on equity related to the second half of 2014.

The financial health of the Company is evident here, as well as the ability for organic and inorganic investments in order to strengthen our industry sector approach and technology platform.

Now, I invite you to move to slide 13.

In this slide, we note that the Company's efforts to expand its recurring revenues, especially through the expansion of sales in the subscription model, are already generating results. In this quarter, we expanded the recurring revenues by 11% and subscription revenues by 47%.

TOTVS expanded its EBITDA margin by 160 bps in the quarter on quarter comparison even with (i) the expansion of the subscription model, which tends to negatively impact EBITDA in the short term due to the deferral of the revenue recognition, (ii) the fall in the incremental licenses from the corporate model, (iii) the 7% wage increase in São Paulo, and (iv) the lower number of working days in the quarter.

This result shows that the Company will not lose sight of its cost and expenses discipline, especially in this initial period of greater emphasis on software sales in the subscription model.

It´s important to keep in mind that TOTVS will maintain its investments in innovation, specialization by industry sector and quality, because raising the productivity and competitiveness of our clients is also essential to our sustainable growth.

From now on, we are available for the Q&A session.

Operator:

Ladies and gentlemen you will now begin the question-and-answer session. If you would like to make the question please press star one and if at any time you would like to remove yourself from the questions you please press star two.

Our first question comes from Bernardo Teixeira with BTG Pactual.

Bernardo Teixeira:

Hi guys good morning. My question here is in subscription revenues just trying to understand here, to get a better breakdown of it actually, impressive the growth you guys had in YoY terms (47%). I am just trying to understand how much of this came from organic growth and how much of this came with the help of the acquisitions you guys made? Thank you.

Gilsomar Maia:

Hi Bernardo. Could you just repeat your question a little bit?

Bernardo Teixeira:

Certainly. The growth in YoY terms of the subscription revenues was a 47% right? I am just trying to figure out how much of this came from organic growth and how much of this came from... Well, let us say help from the M&A you guys did in the previous years? That is it.

Gilsomar Maia:

Okay. In our earnings release we provided the number of the consolidated figures from the acquired companies, primarily virtual age. If I am not wrong the figure we consolidated was about 10 million BRL in total revenue and in recurring revenue it was about 1.5 million BRL that can be primarily allocated to subscription.

But here it is important to bear in mind that most of the acquisitions we do we help companies to enhance their performance just after the acquisition and then part of our sales pipeline is driven to those companies. So in our internal view we do not consider 100% of those sales as inorganic because certainly part of those sales the acquired companies closed certainly would be closed by Totvs individually, that is the point.

Bernardo Teixeira:

Thank you.

Gilsomar Maia:

You are welcome.

Operator:

Our next question comes from Sunil Rajgopal with HSBC.

Sunil Rajgopal:

Thank you very much. I just had two questions, one is on your expectation of revenue growth for this year and next. What is your view on the growth trades?

And then also in terms of margins this quarter the margins were on 25%. Do you expect the margins to hold on to these levels or would there be any pressure coming in incrementally as the market slows down? Thank you.

Gilsomar Maia:

Hi Sunil good morning this is Maia speaking. In terms of margins people that are following us for a long time they know that quarterly we can have some volatility in our Ebitda margin mostly because of some sales performance especially in licenses. So what I mean by that? If we have a similar level of license sales every quarter we should have a more stable Ebitda margin. In year-end figure, normally we have a pretty stable one; but quarterly it is really depending on these quarterly sales.

In terms of year-end figures I do not believe we should see big volatility in our margin. The only possibility is if we have a huge conversion or transferring of sales from licenses to subscription. But taking into consideration that the transition is going to be more diluted or smooth I do not believe it can happen.

On a quarterly basis in 1Q we have a strong impact from salaries readjustment in which we have about 45% of our payroll under adjustment and in 4Q we have about other 45% being adjusted. Those two quarters are more affected in terms of cost pressure and in terms of top line the seasonality of our industry shows that 1Q is the weaker normally in our sector and historically the sales are stronger in the second half of the year. Normally that is the behavior of our industry.

Have I addressed your question?

Sunil Rajgopal:

Yes yes, but just a little bit more color on what is the kind of growth levels that you are projecting or budgeting for this year. Is there any numbers that you are actually projecting for this year in terms of growth?

Because excluding the inflation angle the growth rates were nearly 0% excluding inflation and M&A. So I just want to know what is your view on the growth rates if we exhale the inflation in the environment?

Gilsomar Maia:

First of all it is important to bear in mind that part of that deceleration of revenues is due to the transitioning to the subscription model. So if you take the revenue, the recurring revenue growth that is about 11% and even excluding inorganic elements you are going to see that our growth is about inflation okay?

But secondly last year we decided to not disclose guidances especially in this transitioning period because we have too many forces working together at the same time and so we have this transitioning course; we have some volatility in inflation costs and revenues; we have deceleration in the Brazilian economy - that is more important variable.

So because of that high number of important variables we decided at this moment not to provide any kind of guidance to the market in terms of top line and margin as well. But I believe that taking into consideration our historical figures and performance and considering the level of recurring revenue we have and the predictability we can have in terms of even the services, for example that are a relevant portion of our nonrecurring revenue, it is not really very complicated to estimate how the company can grow.

Of course it will depend more on your projections of economic growth for the region and then also how fast this transitioning can be. At this moment unfortunately I cannot share any kind of internal projection with you. Okay Sunil?

Sunil Rajgopal:

Thank you.

Operator:

Our next question comes from Michel Morin with Morgan Stanley.

Michel Morin:

Hi everyone. I was wondering if you can give us a little bit of color on how you exchanged your sales force incentives in order to incentivize, to properly incentivize growth in subscriptions and how that has gone?

Are there still any lingering issues there that might allow you even to accelerate the growth here on subscriptions? That is the first question.

And then the second question is I know subscriptions are still to be small; but from an accounting standpoint as you grow that revenue stream and as you sign new contracts should we expect to see some deferred revenues show up on the balance sheet? Thank you.

Gilsomar Maia:

Good morning Michel. Starting from the second question regarding deferred revenues in our balance sheet it is not on the table now. Really I understand your point because there is a sales booking internally and so we know how much of our annual recurring revenue we brought selling new subscriptions.

But in our revenue recognition practices we do not disclose it in our balance sheet. Eventually what we can do is provide it as a complementary information in our earnings release. We have a similar situation when we talk about service projects because we have a "backlog" of projects sold to be performed and then it is more a matter of execution to recognize that services (as percentage of completion).

It can be some complementary information we eventually can provide but I do not believe it can be disclosed in our audited financial statements. At least at this moment I do not see any chance for that.

Going to your first question regarding sales force incentives first we have two different forces, sales forces: one is our direct team and that direct team we have… What we try to preserve is the total compensation of our sales executives and then consequently we have some mismatching between our expenses and revenues because we have a relevant revenue deferral and we cannot defer the remuneration of our executives the same way.

And since we are doing a relevant effort reducing the initial investment of our customers we are making the lives of our sales executives "easier". So they should be able to sell a little bit more than if they were 100% under a license model. What do I mean by that? In the end if our salespeople sell a little bit more than they should if they were just under the license model they can have even a little bit higher compensation. So in the end we are trying to incentivize people to bring more customers because futurely we can have a better dilution of our costs and expenses.

In terms of franchisees… in the franchisees the exercise is a little bit different because franchisees are incentivized, are commissioned by our recurring revenues and so they are very attracted also by the subscription because they can get benefits on that.

In the short term we have to be smart enough to identify what are the best opportunities to offer the subscription. In my view the subscription probably will not be the best option for all sales opportunities, and we are helping our franchisees and our salespeople to work smartly in this sales pipeline breakdown identifying opportunities in which subscription can be more adequate, can eventually unlock some conversations and speed up the sales process; and in other that are really based on the profile of that potential customer the license is more appropriate.

So in the end our franchisees are very aligned with us. They make more money with subscription and we understand that the transition to subscription is going to be... Will not be a disruptive one in the short term and so it gives a good balance between license and subscription even for our franchisee. So they probably would not have a disruption in their cash flow as well. I do not know if I addressed properly your question but we have different publics here to incentivize in different manners.

Michel Morin:

That is interesting, that is great color. Go ahead Mafra.

Alexandre Mafra:

We try all the time to align the incentives because we know especially in this economic scenario that we have nowadays the subscription model is very good for our workforce, commercial force. So we have allied incentives and in the end it is the client's choice okay?

Gilsomar Maia:

Actually it is helpful for the sales team, our own and franchisees because we believe that parts of all sales would not be closed without subscription and no sales is the worst scenario for salespeople and so in the end they recognize that TOTVS is doing an effort to help them to sell more in the end. That is the point.

Michel Morin:

That is great color thank you and maybe just a follow-up on that: are you actually trying to convert some of the existing subscribers to the subscription model or is this really just targeting new subscribers/clients?

Gilsomar Maia:

At this moment Michel we are directing more for new customers. We understand that we should defocus our routine with too many changes at the same time and at this moment we are orienting our team to focus subscription more in new customers.

Existing customers eventually they can choose subscription; but we understand that it tends to be less fast, a less fast process and I think in a second moment eventually we can study an approach to our existing customers also.

Michel Morin:

That makes sense thank you.

Gilsomar Maia:

You are welcome.

Operator:

Ladies and gentlemen as a reminder if you would like to make a question please press star one.

Our next question comes from Ge Sun with Invesco.

Ge Sun:

Hi. I have just a quick question on the tax: I know probably it is early but the potential tax increase from 2 to 4.5% for the IT sector what is the company's plan for that? Maybe it is too early to say; are you able to pass the tax increase to the end customers or are you able to... You just absorb by yourself?

Gilsomar Maia:

Sorry really I could not hear you so well; but if you could repeat it a bit louder your question it would be great.

Ge Sun:

Okay sorry, sorry about that. Just on the tax issue. So the potential increase of tax from 2 to 4.5% is the company planning to pass on those tax increases to the end customers? Are you able to pass on those tax increase or are you just going to absorb by the company?

Gilsomar Maia:

Look actually we are waiting a little bit more to see how this discussion in the Congress is going to be finished. The 2 to 4.5% increase is the proposal of the Executive Government. Following the previous proposal for the Congress we have seen most of the proposals have not come out exactly the same way of the proposition.

But trying to be more objective to your question we have contractually eventually some condition to do that; but would prefer not to assume a position at this moment because there are some variables as market conditions on the table and we should wait for the final text of this new law after the Congress analysis and the President’s approval.

Maybe it is too early to state here a clear positioning but what we try to be very clear … to always what are the elements under discussion and so with those elements you can estimate how much it could impact in a worse scenario in which we should not be able to pass through anything. So anything we can pass through can be an upside over that exercise.

Alexandre Mafra:

We did a lot of scenarios but now we have to wait for the final approval of the Congress.

Ge Sun:

Okay so I understand the different scenario analysis; but in your contract, in contract terms, it is not set in the contract terms that if the tax increases you will pass on a certain percentage to the end customer to show the cost or is it not such... Probably it is too early to say right?

Gilsomar Maia:

Yes, look, contractually we have elements to do that; but we have to take into consideration market conditions and the moment of the economy and so it would be much simpler for me to say "yes we have instruments in hand"; but we have to consider the practical reality okay?

Ge Sun:

I understand thank you.

Gilsomar Maia:

You are welcome.

Operator:

Once again if you would like to make a question please press star one.

This concludes today's question-and-answer session. I would like to invite Mr. Alexandre Mafra to proceed with his closing statements. Please go ahead sir.

Alexandre Mafra:

I want to thank you all for participating in this call and I would like to say that we will keep working to expand our recurring revenues maintaining our costs and expenses disciplined while improving the efficiency of our operations. Thank you very much.

Operator:

That does conclude Totvs's audio conference for today. Thank you very much for your participation, have a good day.