

Operator: Good morning. Welcome to the TOTVS conference call to discuss the results of the first quarter of 2016. We have with us Laércio Cosentino, CEO and Gilsomar Maia, CFO and IRO.

Note that all participants will be on listen-only mode during the presentation. After that, we will have a question and answer session for investors and analysts when further instructions will be given. If anyone needs assistance during the call, please press *0 to reach the operator.

The audio is being simultaneously webcast at ir.totvs.com

Before proceeding, we wish to clarify that any forward-looking statements that may be made during the conference call, related to business outlook, operational and financial projections and targets of TOTVS are based on beliefs and assumptions of the Company's management as well as information currently available. Forward-looking statements are not guarantee of future performance. They involve risks, uncertainties and assumptions as they refer to future events and, therefore, depend on circumstances that may or may not occur. Investors must understand that general economic conditions, industry conditions and other operational factors could affect the future performance of TOTVS and could lead to results that differ materially from those mentioned in these forward-looking statements.

Now, I will turn the call over to Mr. Cosentino, who will begin the presentation. Mr. Cosentino, please go ahead.

Laércio Cosentino: Good morning everyone. Thank you for attending the Company's earnings conference call regarding the first quarter of 2016.

I wish to kick off with the main recent events, shown on [slide 3](#).

On February 15, 2016, the São Paulo IT Companies Association and the IT employee's union signed a collective bargaining agreement that fixed a 10.7% wage increase, of which 8.5% with effect from January 1st, 2016, and 2.2% with effect from November 1st, 2016. Note that São Paulo represents about 43% of TOTVS' total payroll.

On April 26, 2016, the Annual Shareholders Meeting approved the distribution of dividends in the amount of roughly R\$66.6 million, equivalent to R\$0.40 per share, for the fiscal year of 2015, to be paid on May 11th, 2016. This dividend amount, added to interest on equity paid on August 19th, 2015 and January 13th, 2016, corresponds to 65% of 2015's net income.

The same shareholders meeting also approved the composition of the board of directors, consisting of nine members, including eight independent members, with mandate up to the annual general meeting of 2018. In addition to myself, Pedro Passos, Germán Quiroga, Pedro Moreira Salles, Maria Helena Santana, Sérgio Földes, Danilo Ferreira da Silva and Wolney Betiol were reelected, and Mauro Rodrigues da Cunha was elected to the board.

At the first board meeting after the shareholders meeting, Pedro Passos and Germán Quiroga were re-elected chairman and vice-chairman, respectively, and also were

indicated the board members who will be part of the Company's committees. For the Personnel and Compensation Committee, Pedro Moreira Salles and me, as CEO of TOTVS. For the Audit Committee, Maria Helena, Danilo Ferreira and Mauro Rodrigues da Cunha. And for the Strategy and Technology Committee, Germán Quiroga, Wolney Betiol and me.

I now turn the floor to Maia for his comments on the results of the quarter, starting from **slide 4**.

Gilsomar Maia: Thank you Laércio. Good morning everyone.

The consolidated results of 1Q16 presented in the Quarterly Information report include Bematech's results for the period. In order to preserve comparability, we have presented the pro forma unaudited consolidated results that combine the results of TOTVS and Bematech corresponding to three-month period for 1Q15 and 4Q15.

Total revenue in the quarter declined 1.0% year on year and 3.5% quarter on quarter, mainly due to the non-recurring revenue decrease of 12.9% year on year and 12.2% quarter on quarter, as shown in the chart on the left. In contrast, recurring revenue grew 8.7% year on year and 3.1% quarter on quarter.

This behavior of recurring and non-recurring revenues led the share of recurring revenues to 60.6% of total revenue in 1Q16, which is 5.4 percentage points above the 1Q15.

When analyzed by business, the chart on the right, software revenue increased its share of total revenue to 64.4% in the quarter, mainly due to: (i) the decrease in the share of hardware revenue in the period, which corresponded to 10% of total revenue in 1Q16; and (ii) the growth in software recurring revenues, as shown on **slide 5**.

As shown in the chart on the left, software revenues maintained their performance of previous quarters, that is, growth in recurring revenue from subscription and drop in the share of non-recurring revenues from license fees.

Subscription revenue grew 16.3% year on year and, and for the first time, exceeded the quarterly license revenue, even the latter having incremental license from the corporate model in the quarter.

The growth in subscription revenue was due to the higher share of sales to new small and medium clients, especially under the TOTVS Intera model, which also helped to increase the average new monthly subscription of the quarter.

Maintenance revenue grew 5.6% year on year, despite the lower volume of license sales in the previous periods and the higher volume of partial maintenance cancellation due to the economic crisis.

Together, subscription and maintenance revenues offset the license fee fall and led the recurrence of software revenue to 85.5% in 1Q16, which is 6.2 percentage points above 1Q15.

In the chart on the right side, we see that the software contribution margin fell 2.5 percentage points year on year, mainly due to license fee fall and the mismatch between

the inflation passed in maintenance revenue, measured by IGP-M, and the cost inflation for the period.

In the quarter on quarter comparison, the contribution margin grew 3.2 percentage points, despite the 8.5% wage increase in São Paulo, with effect from January 1st.

This margin growth is mainly due to the reduction of recurring labor costs as a result of the restructuring promoted by the Company during the second half of 2015.

In the chart on the left side of **slide 6**, license fee revenue fall 30.2% year on year and totaled R\$51.5 million in 1Q16. The drop in licenses was mainly due to: (i) the economic crisis in Brazil, which affected most notably the sales dynamics to large clients; (ii) the migration of part of the sales pipeline to new clients to the subscription model, especially among smaller clients; and (iii) the 40% decrease on the incremental license fee of the corporate model.

In the corporate model, clients have unlimited access to management solutions, for which they pay an incremental license fee at the beginning of each year based on their real growth of the previous year. Thus, this reduction is a consequence of the lower growth of the clients under the corporate model in 2015.

In the chart on the right side, we see that the number of software clients added decreased by 21% year on year and by 4.4% quarter on quarter. The year-on-year decline is mainly due to the lower level of new subscription sales to microenterprises on account of the economic crisis in Brazil.

In the quarter-on-quarter comparison, the decline was mainly among new licensing clients added, which, besides the economic moment, reflects the migration of part of the sales pipeline of new clients to subscription.

Now, I invite you all to move to **slide 7**, to discuss services and hardware.

In the chart on the left side, services declined by 0.9% in 1Q16 compared to 1Q15, and by 4.5% when compared to 4Q15. The year-on-year variation is mainly due to the 8.3% decline in software implementation services in the period, due to the lower pace of sales in recent quarters; and the 14.2% increase in services not related to software implementation, which accounted for 37.7% of the services revenue in 1Q16.

Services contribution margin increased by 9.4 percentage points in 1Q16, when compared to the previous quarter, despite the wage increase in São Paulo and the reduction in service revenue in the period. This recovery in service contribution margin is chiefly due to the reduction in personnel costs resulting from the restructuring carried out during the second half of 2015.

In hardware, in the chart on the right side, the year on year drop of 4.6% in revenues is due to the lower number of new establishments openings as well as the changes in tax legislation, especially in São Paulo, where fiscal printers were replaced by the fiscal equipment named S@T, which has lower price.

It is worth mentioning that changes in tax legislation should collaborate to grow recurring revenue from tax software solutions, reducing the share of non-recurring hardware revenue in total revenue.

In the quarter-on-quarter comparison, the 25.3% decrease in revenues is also due to the seasonal effect on hardware sales in the period.

This trend in hardware revenue, combined with the increase in hardware costs due to the FX rate during 2015 and the reduction in the income grant by the Paraná state government since September 2015, resulted in the decline in the hardware contribution margin during the period.

For comments on selling and administrative expenses, please move to **slide 8**.

Starting from the chart on top left corner, selling and commission expenses taken together dropped 1.8% year on year and 6% quarter on quarter, declining by 0.4 percentage point their share of net revenue in 1Q16 in the quarter-on-quarter comparison.

This reduction was mainly due to: (i) the decrease in commission expenses, mainly resulting from the sales mix between license and subscription fees and the sales mix between franchises and own units; and (ii) the restructuring in personnel costs carried out during the second half of 2015, despite the wage increase in São Paulo already mentioned.

It is also worth mentioning that we have recently adjusted the remuneration model of our sales team in order to align the incentives mainly related to the subscription model, which tend to cause a short-term increase in selling expenses at a higher rate than total software revenue.

On top right corner, advertising and marketing expenses corresponded to 1.5% of net revenue in 1Q16, versus 1.8% in 1Q15. The decrease is chiefly due to the revision of the Company's general marketing plan and the beginning of the integration of TOTVS and Bematech marketing activities.

Expenses with allowance for doubtful accounts, on bottom left corner, corresponded to 1.4% in 1Q16, compared to 1.8% in 1Q15 and 2.0% in 4Q15. This allowance reflects the level of delinquency observed in the operation during the period.

It is important to mention that, considering the current level of delinquency in the market, the Company will continue its credit analysis policy and its efforts to recover the debts already provisioned.

Finally, on bottom right corner, general and administrative expenses plus management fees and other expenses increased 2.2% year-on-year but decreased 3.5% quarter on quarter, after excluding the non-recurring items of 4Q15.

In the quarter-on-quarter comparison, the decline chiefly reflects the headcount reduction carried out in 4Q15 and the beginning of the integration of administrative areas of TOTVS and Bematech.

Moving now to EBITDA and Net Income on **slide 9**.

In the chart on the left side, EBITDA in 1Q16 totaled R\$114.6 million, down 12.4% year on year and up 34.8% over the adjusted 4Q15.

EBITDA margin in the quarter stood at 20.8%, which means a reduction of 270 bases-point year on year and an increase of 590 basis points quarter on quarter.

This year-on-year decline was mainly due to: (i) the decrease in software contribution margin, resulting from the decline in license sales; (ii) the mismatch between the revenue inflation and recurring cost inflation; and (iii) the decrease in hardware contribution margin, specially by the of FX rate effects over price and costs and also the reduction in the income grant by the Paraná state government.

The quarter on quarter growth resulted primarily from the recovery of software and service contribution margins, and the optimization of administrative structures.

In net income, chart on the right side, the year-on-year decline was largely due to the negative financial result in 1Q16, primarily due to: (i) the increase in net debt; and (iii) the financial revenue from the sale of minority interest in ZeroPaper in 1Q15.

In the quarter-on-quarter comparison, adjusted net margin increased by 30 (thirty) basis points, mainly due to the growth in EBITDA margin in the period.

Now speaking about cash flow and debt on **slide 10**.

Gross cash decreased by R\$71 million in the quarter mainly due to:

- (i) the net income, excluding non-cash items, in the amount of R\$102 million
- (ii) the working capital investments of R\$74 million, impacted by the pre-payment of solutions hired for cloud operations, in the amount of R\$18 million, and the increase in inventories in the amount of R\$8 million in the period;
- (iii) the payment of interest on equity for the second half of 2015; and
- (iv) the partial amortization of the principal of the BNDES loan hired by TOTVS in 2013 and the partial amortization of principal amount of Bematech debentures issued in 2014.

Thus, net debt ended the quarter at R\$473.5 million, corresponding to 1x adjusted EBITDA for the last 12 months.

I now turn the presentation back to Laércio for his closing remarks on **slide 11**.

Laércio Cosentino: Thank you Maia.

In 1Q16, the economic scenario in Brazil combined with the transition from the licensing model to the software subscription model resulted in a year-on-year decrease of 1% in the Company's total revenue. Subscription revenue grew 16% and, as a percentage of total revenue, overtook licensing fee revenue, which declined 30% year on year.

EBITDA margin ended 1Q16 at 20.8%, 590 basis points higher than adjusted EBITDA margin in 4Q15. Margin recovered quarter-on-quarter despite the 3.5% decline in total revenue and the seasonal effect of wage increase in São Paulo, mainly because cost and expenses structure adjustments rolled out by the Company in the second half of 2015.

We believe that the economic situation is complex, but we are confident that we are on track in the integration of Bematech operations, that is part of the execution of our strategy, which has as pillars:

- i) Segmentation – providing business solutions even more essentials, that is, specialized in the client core business;

(ii) SaaS – providing solutions based on the subscription model, prepared for cloud through mobile devices; and

(iii) Fluig platform - by integrating things (IoT), individuals and businesses in an agnostic way.

Now we are available for the Q&A session.

Operator: Ladies and gentlemen we will now begin the question-and-answer session. If you have a question please press the star key followed by the one key on your touchtone phone now. If at any time you would like to remove yourself from the questioning queue please press star two.

Our first question comes from Andres Coello, Scotia Bank.

Andres Coello: Yes, thanks for taking my question. I was wondering if you could give us some update on your international operations and perhaps if you are thinking in diversifying abroad or to enhance your strategy of diversifying abroad?

And my second question is on the seasonality of the Olympic Games. If I recall correctly there was certain seasonality during the World Cup and I was wondering if the Olympic Games are probably going to have a similar impact during the second half of this year, thank you.

Gilsomar Maia: Good morning Andres, this is Maia speaking. Starting from the last question related to the seasonality, the eventual seasonality related to the Olympic Games, in our view we can have some impact in operations, but basically related to the Rio de Janeiro operation, because the Olympic Games are going to be concentrated in that city and certainly it will affect the routine of the city especially in terms of mobility and public transportation, what can create some specific mess there.

But out of Rio de Janeiro we do not believe we should see a similar impact in the whole operation, because when we compare to the soccer World Cup we had all regions in Brazil being affected by the games, even The Amazon for example, what is out of these events now.

Going forward to the first question related to the international operation...after Bematech we have less than 5% of total revenues coming from international operations, what is still small, and especially in this moment it would be interesting to have a more relevant operation abroad; but that is our reality now.

We still see a lot of work to do internationally especially in Latin America; but being more specific to your question in terms of diversification, it is always a possibility. Throughout our history we have been approached by companies in other regions and that is why we have clients in Europe, in the US and other regions - but normally we do not start an international operation in a region not having a relevant installed base or not having someone else that can explore adequately the region.

Yes eventually you can see Totvs exploring other regions but not in a kind of a greenfield approach by itself. Have I addressed your question properly?

Andres Coello: yes. So basically you are not thinking in launching greenfields but perhaps you remain alert for acquisition opportunities, perhaps in certain niches or certain industries, but you do still see international expansion as something relevant in the long-term if I understand correctly?

Gilsomar Maia: yes, you are right, in the long-term yes. In the short to medium term it is more difficult to see relevant things in this front because we are keeping our focus in this transition to the subscription model especially here in Brazil, and then after that we can move forward to this kind of discussion.

Andres Coello: okay thank you.

Gilsomar Maia: you are welcome.

Operator: the next question comes from Diego Aragão, Morgan Stanley.

Diego Aragão: Hi guys, thanks for taking my question. My question is related to Bematech, please, correct me if I am wrong, but apparently results were weak in 2016 and somewhat missed your expectations, I guess.

And in this quarter from what we can see the hardware segment contracted on the top line side while the contribution margin contracted strongly year on year for some reasons including FX.

So my question is the following: was this scenario somewhat based into your numbers at the time of the acquisition? And if not, how it should impact the timing for this acquisition to pay off?

Gilsomar Maia: Hi Diego, this is Maia speaking. Regarding the hardware operation, there are some variables we already knew before the transaction like the discontinuation of the fiscal printer, especially in São Paulo that is the largest location for this kind of market.

Other element we already knew is the FX rate impact in this business; but what we were not expecting was the commercial decision of Bematech not to transfer the FX impact into price in 2016; and obviously the fiscal change in Paraná State that reduced the tax incentives in that region.

So the last two elements were out of our plans and the first two were a part of our plans. When he exercised the projections of Bematech we did some kind of stress scenarios having FX rate even higher than we have now, and so we cannot be surprised now for cost impacts.

But in terms of top line we were also expecting some decline in sales because of the fiscal printers. I confess you that we were somehow positively surprised about the performance of hardware, because after this discontinuation of fiscal printers in São Paulo we could expect a more relevant decline in hardware sales, and if you take a look in the figures we are talking about a 5% decline.

So if you compare to 4Q and 3Q hardware revenue was somehow flat year-on-year and what demonstrates that Bematech has been able to replace "fiscal printers" for other products, what is important because Bematech's product is occupying that space left by the fiscal printers.

In our daily operations what we are doing? We are gradually adjusting prices to recompose the FX element as we mentioned in the previous quarter when we disclosed 4Q results; we announced that we were adjusting prices and we are doing that gradually, because we are measuring the price sensitive of the market.

And in terms of the cost structure, more specifically the tax incentives in Paraná State, we are studying alternatives even in Paraná or in other places; how we can surpass this element. Because in this specific term of hardware our main worries are in terms of quality and cost, so we have to assure that any alternative we consider about the hardware business, we have to preserve the high quality of Bematech's equipment and have a competitive cost of production.

Diego Aragão: okay and sorry if I have missed it; but can you share with us the timing for the acquisition to pay off? I mean, what was the plan at the time and how those things that you mentioned will impact the ability to put this plan in place?

Gilsomar Maia: to have the full return normally in acquisitions we consider 3 to 4 years at least, and Bematech is not different. Of course these two elements I mentioned that were out of our plans can take us a little bit out of this projection; but on the other hand, as I told you, the performance of hardware sales are positively surprising us.

And then some initiatives in terms of solutions integration are also running faster than we were originally expecting. Recently we had some market perceptions about Bemacash solution, having the equipment of Bematech together with the software of Totvs, embedded in the equipment; and that is a kind of mobile point-of-sales solution combining software and equipment for commercial automation.

The first reaction was very positive and we are now following the performance of sales for the next months.

Diego Aragão: perfect Maia, very clear. Thank you.

Gilsomar Maia: you are welcome.

Operator: the next question comes from Sunil Rajgopal, HSBC.

Sunil Rajgopal: Hi, thank you for taking up the question. I am sorry if I have to re-ask this question. I was positively surprised with the margin recovery in this quarter, going up compared to 4Q.

I would like to understand if this is the new level that we should be expecting for the quarters going forward and also if there are any costs or savings items we should be considering for 2Q and afterwards? Thank you.

Gilsomar Maia: hi Sunil, thanks for the question. Actually Sunil, when we disclosed 4Q and we had that 14.9% Ebitda margin, even after excluding the nonrecurring items, at that time we mentioned that we did not see that margin level as the normalized one of our company.

Again, and we do not have a guidance of margin in our company, and here I have to be careful not to give you guidance. But we understand that taking all the elements on the table from the market and the internal measures we are taking to adjust the structure to the new reality of the market, we understand that we can present this year a more stable performance than we presented last year.

So we expect to have less volatility in our quarterly results and what can give us more confidence that we are pressing the right buttons, let us say, in our daily operations. Of course I cannot state that this is the new margin level of our company because, as I told you, we do not have a margin guidance; but we understand we can have much less volatility in this kind of measure this year. OK?

Sunil Rajgopal: sure, thank you. And if I can just follow-up: during this quarter I did see some personnel expenses going up because of the renegotiation of the salaries, which account for about 40% of your total personnel base; and when does the rest of the 60% become due and what is the kind of impact that we should be expecting for 2Q? Any color on that would be great.

Gilsomar Maia: São Paulo is isolated the larger location in terms of payroll distribution and it is concentrated in 1Q. So it affects the full 1Q results.

The other... the remaining 60% is more concentrated between September and November, so it affects partially 3Q but more relevantly 4Q. So there are two moments in the year that we see more relevantly this kind of wage increase affecting results: 1Q and 4Q.

As the general inflation in Brazil is coming down a little bit, eventually we can see the next negotiations closing in a lower percentage, and also taking into consideration the current moment of the employment market in Brazil. That is my view.

Of course we have to wait a bit and see; but São Paulo, because of its relevance, somehow works as an important indicator for the rest of the market. But basically in São Paulo the negotiation was following the inflation index and that was a mutual sensibility about the moment of the market, trying to split that adjustment into two parts: one part on the base date in January and the second one in November; and I think this kind of flexibility will be observed and eventually followed by the other places the market.

Sunil Rajgopal: thank you Maia.

Gilsomar Maia: you are welcome. Have a good day.

Operator: the next question comes from Daniel Federle, Credit Suisse.

Daniel Federle: Hello, good afternoon, thank you for taking my question. My question is related to SaaS: and I would like to know which kind of client has been more interested in SaaS and if it has been a decision from the client or from the salesperson. Thank you very much.

Gilsomar Maia: hi Daniel, Maia speaking here. Software as a service and, let say subscription, more clearly is being more popular among the smaller companies. That was one of our assumptions when we launched the subscription model. We were believing that larger companies would stay on the license model for a while - and it is being confirmed.

We are seeing more and more smaller companies naturally following the subscription, because it requires a much lower level of initial investment; and existing clients, since they have already acquired the license, especially in this moment that the market is like "freezing", they are assuming a more conservative positioning and maybe it is not an adequate moment for trying to convince those clients to move from license to subscription; and then, as a consequence, we have seen subscription being more focused on new clients, smaller companies, and license becoming more concentrated on existing clients and larger companies. That is the profile of companies choosing subscription at this point.

Daniel Federle: thank you Maia.

Gilsomar Maia: you are welcome.

Operator: Ladies and gentlemen as a reminder if you would like to pose a question please press the star key followed by the one key on your touchtone phone now. Once again if you would like to pose a question please press star one.

This concludes today's question-and-answer session. I would like to invite the speakers to proceed with their closing statements. Please go ahead sirs.

Laércio Cosentino: I thank you all for taking part of our conference call and wish to state that we remain focused in executing our strategy, have a nice day everybody.

Operator: That does conclude the Totvs audio conference for today. Thank you very much for your participation, have a good day and thank you for using Chorus Call.