

Operator: Good morning. Welcome to the TOTVS conference call to discuss the results of the second 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 second quarter of 2016.

I wish to kick off with the main recent events, shown on **slide 3**.

On May 11, the Company paid to its shareholders the dividends approved at the Shareholders Meeting held on April 26, 2016, in the amount of R\$66.6 million, related to fiscal year 2015.

On August 1st, the Board of Directors approved the distribution of interest on equity related to the first half of 2016, in the amount of R\$43.6 million, equivalent to about R\$0.27 per share, which is 49% higher than the interest on equity paid related to the first half of 2015. Said interest will be paid on August 24 to shareholders of the Company as of August 4.

Also on August 1st, TOTVS sold its Human Resources BPO operation to Propay, a company that has been providing this BPO activities for over 15 years. With this movement, TOTVS reinforces its strategy of specialization, bringing a focused partner in this activity to boost sales of TOTVS solutions and provide greater value to its clients.

In May, TOTVS signed a partnership agreement with National Computer Corporation (NCC), the biggest technology company in Russia, to set up National Platform, a company that will develop and market in Russia a new management system that will be developed based on TOTVS' technology platform. With this project, TOTVS is testing a

new way of exploring opportunities in the international market, without losing focus on Brazil.

Also in this quarter, we took an important step in the reorganization of our organizational structure, with the election of Gustavo Bastos and Marcelo Eduardo, that together have over 30 years of TOTVS, and will be responsible for the macro-segments of Supply Chain and Services respectively.

These management changes are part of the Company's strategy, which established a divided organizational structure in macro-segments through core-business solutions integrated with back-office solutions, which contribute to the integration of the major value chains.

Finally, on **slide 4**, we started our investments in the facilities of our new head office. As announced to the market on October 16, 2013, the Company signed a built to suit agreement for its new head office. It is a 10-year agreement starting from the delivery of the building, scheduled for February 2017.

In addition to tangible and intangible administrative synergies to be captured with the concentration of the main Company's administrative, development and sales departments in the São Paulo area in just one place, this new campus will contribute to a faster spread of our culture between employees, especially between those that became recently part of TOTVS, like Bematech.

The new campus will also have an exclusive area of client service and will provide an innovative environment to help reinforcing mobility and cloud, which are essential elements in our strategy. The total investment in facilities is estimated at approximately R\$90 million.

I now turn the presentation to Maia for his comments on the results of the quarter, starting on **slide 5**.

Gilsomar Maia: Thank you Laércio. Good morning everyone.

Before starting my comments, I wish to remind you that to preserve comparability, we have presented the consolidated pro forma unaudited figures of 2Q15, which include the results of Bematech during that period.

This quarter, total revenue decreased by 2% year on year and by 1% quarter on quarter, mainly due to the decrease of 15% year on year and 4% quarter on quarter of non-recurring revenue, shown on the chart to the left.

Recurring revenues grew 8% year on year and reached 61.7% of total revenue, which represents an increase of 5.8 percentage points over 2Q15.

When analyzed by business, as the chart on the right, we see that the drop in total revenue was concentrated in hardware and service revenue. On the other hand, the



decline from 1Q16 was concentrated on the 3% drop in software revenue, which I will comment now on [slide 6](#).

Software revenue remained stable year on year since the growth in recurring revenue from maintenance and subscription offset the 32% decline in non-recurring license fee revenue.

The 17% growth in subscription revenue in this period was largely due to sales to new small and medium clients under the TOTVS Intera model, which completed one year last June.

In this first year of TOTVS Intera, the growth in subscription revenue exceeded the decline in revenue from the licensing model, represented by license and maintenance revenues, as shown on the chart to the left.

Compared to 1Q16, the 4.2% growth in subscription revenue was not sufficient to offset the decline in revenue from the licensing model, especially the 23% drop in licenses revenue.

In fact, the decline in license sales in earlier periods, combined with the suspension of maintenance agreements due to higher default levels and partial cancellation of maintenance due to layoffs at clients, resulted in a 0.6% decline in maintenance revenue during the quarter.

Despite all these short-term effects on software revenue associated with the transition to the subscription model, the Company did not reduce its R&D investments. Actually, TOTVS has made new investments in client service and support, involving adjustments in internal routines, teams and software solutions.

As a result of this combination, software contribution margin fell by 4.4 percentage points year on year. In the quarter-on-quarter comparison, apart from all that I just mentioned, the 2.8 percentage points drop in contribution margin mainly resulted from the incremental revenue of R\$10.7 million from the corporate model reported in 1Q16, as shown on the chart to the left on [slide 7](#).

Excluding this incremental revenue from the corporate model, the quarter-on-quarter decrease in licensing fee revenue came to 3%, mainly due to the 9% drop in new client additions during the period.

As already commented in previous quarters, the decline in license sales has mainly been the result of the economic downturn in Brazil and the partial migration of the sales pipeline among new clients to the subscription model especially smaller ones.

Despite this market momentum, we added 847 new clients in the licensing model, 900 new clients in the subscription model, and 440 new clients of Bemacash in the quarter.

The Bemacash solution combines TOTVS' management software for microenterprises (Fly01), under the subscription model, with commercial automation and fiscal solutions of Bematech.

It's worth mentioning that sales of the Bemacash solutions did not affect the subscription revenue in 2Q16, since new clients of Bemacash become software clients

from the 8th month of hiring the management solution, when they start paying the subscription.

To conclude our comments on software results, we share on **slide 8** an exercise carried out internally, which simulates the impact on growth in software revenue if the Company had chosen to sell its software solutions exclusively through the subscription model since 2013. In this hipotetical exercise, the quarterly license revenue was deferred in 16 quarters and any impacts of churn, inflation adjustment and migration fee were not considered.

In short, if the Company had chosen to sell its solutions only through the subscription model since 2013, the growth in software revenue in 2Q16 would have been 11%, which reinforces the med/long-term financial benefits of the subscription model.

I now invite you all to move to **slide 9** to discuss services and hardware.

The chart on the left shows that service revenue fell 4.8%, compared to 2Q15, and remained stable quarter-on-quarter. The year-on-year variation is mainly due to the 7.8% decline in software implementation services in the period, which accounted for 62% of the service revenue in the quarter, chiefly due to the lower pace of sales in recent quarters.

As in 1Q16, service contribution margin increased from the previous quarter, growing 140 basis points in 2Q16. This recovery in service contribution margin is chiefly due to the reduction in recurring personnel costs resulting from the cost and expenses structure adjustments carried out by the Company during the second half of 2015.

In the case of hardware, shown on the right side of the slide, the 7.8% drop in revenue compared to 2Q15 chiefly reflects the economic downturn in Brazil and the changes in tax legislation, especially in the state of São Paulo, where fiscal printers were replaced for the S@T equipment, which has a lower value per unit, but in the other hand helps drive the growth of recurring revenue from fiscal software solutions.

Apart from the decline in revenue, hardware margin was adversely impacted by the year-on-year comparison by the reduction in tax subsidies in the state of Paraná.

In the quarter-on-quarter comparison, the 7% growth in revenue reflects the seasonality of hardware sales and the price adjustments related to FX rate, which also helped drive the growth of 190 basis points in the contribution margin.

For comments on selling and administrative expenses, please move to **slide 10**.

Starting with the chart on the top left, selling expenses and commissions jointly grew 3.6% year on year and 0.4% quarter on quarter.

This increase mainly reflects the higher volume of software sales under the subscription model, since the transition to subscription does not impact the sales team compensation.

On the top right, advertising and marketing expenses corresponded to 2.2% of total revenue, versus 3.1% in 2Q15 and 1.5% in 1Q16. The year-on-year decrease is chiefly due to the revision of the general marketing plan and the integration of the marketing

activities of TOTVS and Bematech. The quarter-on-quarter growth reflects the seasonality of this expense line.

Expenses with allowance for doubtful accounts, on the top left, corresponded to 1.3% of total revenue, compared to 1.6% in 2Q15 and 1.4% in 1Q16.

Note that considering the current level of defaults in the market and the increase in the balance of accounts receivable past due, the Company will follow closely this matter and will work on the recovery of the debts already under provision.

And finally, on the lower right corner, general and administrative expenses plus management fees and other expenses increased 7.5% year on year, mainly on account of wage increases, net of layoffs.

Moving now to EBITDA and Net Income on **slide 11**.

The chart on the left shows that EBITDA in 2Q16 totaled R\$96.9 million, down 20.8% year on year and 15.4% quarter on quarter. EBITDA margin in the quarter reached 17.8%, down 420 basis points year on year.

The year-on-year decline in EBITDA was chiefly due to the drop in contribution margin from software and hardware, both already commented before.

In the quarter-on-quarter comparison, the decline in EBITDA is mainly due to the drop in software revenue, largely reflecting the reduction in licenses revenues.

In the case of net income, shown by the chart on the right, the year-on-year decline was largely due to the negative financial result in 2Q16, primarily as a consequence of the reduction in financial revenues due to the payment of the transaction with Bematech in 4Q15.

In the quarter-on-quarter comparison, the decline in net income compared to the drop in EBITDA largely reflects the increase in the Company's net debt during the period, as shown on **slide 12**, where I will make my comments on cash flow and debt.

Gross cash decreased by R\$60 million in the quarter, mainly due to:

- (i) the payment of dividends regarding the 2015 fiscal-year; and
- (ii) the partial amortization of the principal amount of the BNDES loan hired in 2013.

Net debt totaled R\$493 million in 2Q16, equivalent to 1.2 times pro forma adjusted EBITDA in the last 12 months. It is important to remember that the remaining R\$48 million regarding the principal amount of the debentures issued in 2008 will be amortized in this month of August, 2016.

I now turn the presentation back to Laércio for his closing remarks on **slide 13**.

Laércio Cosentino: Thank you Maia.

In short, the additional revenues from the 17% growth of subscription revenue exceeded the decline in revenues from the licensing model and kept the software revenue stable in the year-on-year comparison.

In June this year, TOTVS Intera completed 1 year of its launching, the subscription model in which clients define and manage the number of identities they will be enabled to gain unrestricted and simultaneous access to all management, productivity and collaboration software solutions from TOTVS.

This first year has shown that we are on track. We already have more than 600 clients in the Intera model, which corresponds to more than sixty-five thousand identities using our management systems and collaborating with our subscription revenue growth.

It is also worth mentioning that the 2Q16 subscription revenue did not reflect the Bemacash sales recorded in 2016. Bemacash, as mentioned by Maia, combines TOTVS management software for micro-companies "Fly01" in the subscription model with automation hardware and fiscal solutions of Bematech.

In this quarter, Bemacash sales for new clients reached 440 units, a 48% increase over the amount sold in 1Q16. This growth is mainly a consequence of the Company's hard work in training its resellers in order to increase subscription sales among smaller companies.

In summary, these two initiatives brought over 1,000 new clients and shown that the subscription is important for our growth and for increasing the efficiency of our operations, especially in a more adverse economic scenario, in which the combination of subscription and cloud can be an alternative to clients and prospects to reduce costs and, at the same time, increase their operations productivity.

Despite these impacts in revenue associated with the transition to the subscription model and the Brazilian economy momentum, we did not reduce our investments in innovation. On the contrary, we carried out new investments to innovate support to our clients, and we were recently elected by Valor Econômico newspaper as The Most Innovative Company in the IT industry.

We are close to moving from a mostly B2B for a B2C company, directly connected with individuals and in a much more relevant way with things, through sensors that will integrate our technology in various environments. That is, we are developing solutions used by clients of our clients.

We also raised our services and hardware margins quarter on quarter and started to invest in our new headquarters, reinforcing our strategy on cost discipline and on the continuous search for efficiency gains in our operations.

We are working to make TOTVS and our clients much more prepared for the recovery of the Brazilian market. We have seen some initial signs of market activity recovery, that hasn't translated into sales yet, but we are confident that Brazil will come out of this much stronger.

Now we are available for the Q&A.

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 Claudia de Beralдини, Credit Suisse.

Claudia de Beralдини: Hello good afternoon thanks for taking my question and given the current leverage what do you imagine for dividend distribution going forward?

And my second question is the BRL appreciation should not have taken the hardware margin to a better level? Thanks.

Gilsomar Maia: Hi good morning Claudia. Starting from the last question related to... Could you just repeat your second question please?

Claudia de Beralдини: yes sure. I was thinking about the BRL appreciation. Should not that have taken the hardware margins to a higher level?

Gilsomar Maia: in terms of the hardware margin we have some elements impacting this kind of contribution margin. The first one is the FX rate that we have been adjusting our prices gradually in order to recup and recompose the FX impact we had in our costs in the last year.

The second element is related to the tax excise regarding the Paraná State, which was changed last September, September of 15 and actually we do not see any kind of possibility to be reversed. So in practical terms in my view what we can have for the forward periods in terms of hardware margin is a matter of efficiency, volume and convergence of costs and price, because having this more stable FX rate is favorable to address this part of gross margin of hardware.

Related to the first question of dividends the payout ratio historically is about 60% of net income/year. Up to now we do not see any trend to change this historical level; but actually we should never exclude any possibility to have some slight change in this percentage in one specific year for example. But up to now I do not have anything else to change this level.

Your second question.

Claudia de Beralдини: okay thanks Maia.

Gilsomar Maia: you are welcome.

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

Diego Aragão: Hi Maia hi Laércio, thanks for taking my question. My question is regarding your license sales that declined 30% YoY. I was noting that license revenue reached the lowest level since 2007 if I am not wrong, and given the recent trend this is likely to keep impacting your service; but more importantly your maintenance revenue growth in the next few quarters.

So the question is are you close to stabilizing it? And I apologize for that but I am asking this because maintenance revenue is still 45% of your total revenue and probably the most profitable part of your business; and if we would assume a scenario where you will continue to generate very little revenue from license I think it will be very hard for you to grow maintenance revenue - actually it could eventually decline given the total or partial turn rate among clients.

Once again I apologize for the long question but I just want to understand your view about this and whether this is a fair assumption thank you.

Gilsomar Maia: Hi Diego this is Maia speaking. Regarding the license you are right. It is probably the lowest level we have been running... of revenue and there is one important element affecting license sales and that is the downturn in the economy especially because after the new subscription model launched last year those smaller and medium clients gradually they started to choose the subscription model, and then the license model became more concentrated among larger enterprises which are afraid of investment for a long time and as a consequence as we said it affects the sales of license and maintenance performance.

In our view if we see some recovery in the Brazilian economy it can be very helpful to unfreeze those opportunities, especially larger enterprises, regarding licensing and eventually we can see some specific recovery of license sales in some quarters.

But the trend excluding the specific elements related to the downturn of the Brazilian economy, the long-term trend is clear: there is a declining trend in the license sales; and on the other hand we see the subscription sales in a contrary trend. So as I told you gradually smaller and medium clients are migrating from license to subscription and we should see some kind of offset in maintenance when we compare to subscription.

So in summary what I mean is one thing we try to demonstrate in our earnings release when we compare the performance in 12 months of our license model putting together license, revenue plus maintenance, comparing to the subscription revenue and even in this very early stage of the... model we already see that subscription revenue was able to offset the negative impacts of license decline.

So again what I am saying is you are right: depending on the performance of license sales we can see some negative impact in maintenance; but on the other hand that is a natural

flow of opportunities migrating from license to subscription, and conceptually subscription should be able to more than compensate that negative impact in license and maintenance.

Diego Aragão: ok Maia thank you very much.

Gilsomar Maia: you are welcome.

Operator: as a reminder if you would like to pose a question please press star one. As a reminder if you would like to pose a question please press star one.

Our next question comes from Diego Aragão, Morgan Stanley.

Diego Aragão: Hi guys thank you for the follow-up question. I just wanted to understand after a year you launched the TOTVS Integra how the franchisees are dealing with this new product? If you could just comment on how is the relationship with franchisees at this point and during this transition to a subscription business model that would be very helpful thank you.

Gilsomar Maia: Hi Diego. It is important to remind when we launched this model a year ago we started selling subscription just from our direct sales force. As a consequence when we compare the maturity of our sales force including the franchisees our own team is a little bit more advanced than the franchisees'.

But in the meantime franchisees were completely adherent to the subscription model. Today when we compare, when we assess the productivity of our sales force including franchisees in terms to measure their productivity and to see if they reached are not the sales target we translate every sale to subscription, even when they sell licenses.

So for the franchisee it is important to remind you that one of the key elements to keep the exclusivity, the regional exclusivity of our franchisees, is the sales target. So of course franchisees are concerned about the financial aspect of everything; but they also concerned, they take care about their exclusivity trying to find ways to execute the action plan and reach the targets because that as I said that is one of the main items they have to follow in order to preserve the exclusivity.

And that is why I am saying franchisees are completely convinced that this is the future, that there is no regret about... From the franchisees side about the subscription model. Actually they see this movement of TOTVS as an effort from TOTVS to help everyone to sell more. They know if we did not have the subscription model in our hands probably they would be selling less than they are today.

And the last comment that is important from the franchisees perspective: the largest revenue stream of a franchisee is service; and the second is the recurring commission over the recurring revenues of TOTVS; and then comes the commission over license.

So the license is not so... did not use to be so relevant in their P&L as it used to be in our P&L. And differently than some time the guys can think about it the resistance from the franchisee to accept the subscription is not in this way because they know that if they sell a solution quickly under the subscription model as a consequence they will make money in service. That is the largest revenue for them.

But in some way this relationship is very good and there is no concerns about the subscription from the franchisees side.

Diego Aragão: okay thank you Maia.

Gilsomar Maia: you are welcome.

Operator: As a reminder if you would like to pose a question please press star one.

This concludes today's question-and-answer session. I would like to turn the conference over to Mr. Consentino for his final considerations. Please go ahead sir.

Laércio Consentino: I'd like to thank you all for participating in this conference call. Good morning everyone.

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