Operator: Good morning. Welcome to the TOTVS conference call to discuss the results of the third quarter of 2016. Today we have with us Gilsomar Maia, CFO and IRO, Alexandre Appendino, Chief Sales Officer, and Douglas Furlan, IR Manager.

Note that all participants will be on listen-only mode during the presentation. After that, we will start the 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.

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

Gilsomar Maia: Good morning everyone. Thank you for participating in our conference call to discuss the results of the third quarter of 2016.

Starting with the recent event, on **slide 3,** related to the integration of Fly01 Start application ready for the smart POS Lio and SmartRede, provided by Cielo and Rede respectively.

Fly01 Start App is part of our business platform for micro and small businesses, and plays the role of POS already integrated with the new generation of acquirers Pin Pad. Besides having the features of a point of sale, the solution also comprises back office features in the cloud to register products and access business management data.

The Fly01 Start runs stand alone, but also comes fully integrated with Bemacash, and then can be used as an additional point of sales.

This initiative is another example of joint work between the teams of TOTVS and Bematech, and put us in a market never reached before even by Bematech, which are the mom-and-pop shops that only use the Pin Pad as technological support to their businesses.

Now, I will start my comments on the quarterly results on **slide 4**. Just to remind you that, for better comparison, the consolidated pro forma figures (unaudited) for 3Q15 include the results of Bematech in said period.

Note also that the figures for the quarter do not include the August and September results of TOTVS RO, a company that provides BPO services in HR, sold in August 2016.

By the way, the sale of this operation was an important factor for the 0.4% quarter-on-quarter reduction in our total recurring revenue (chart on the left) and the 6.7% reduction in service revenue (chart on the right).

Year-on-year, total revenue fell 6.9%, mainly due to the 22% decline in non-recurring revenues, as shown in the chart on the left.

By contrast, recurring revenues grew 5.8% year on year and reached 62.3% of total revenue, increasing by 7.5 percentage points from the same period in 2015.

When analyzed by business line, as the chart on the right shows, we see that the year-on-year decline in total revenue was concentrated in hardware and services.

In relation to software revenue, shown on the left side of **slide 5**, the 1.4% year-on-year reduction shows that the 36.7% decline in license revenue was almost fully offset by the growth in recurring revenue, especially by the 22.6% growth in subscription.

In the quarter-on-quarter comparison, software revenue remained stable, showing that the accelerated growth of the subscription model is already able to more than offset the drop in license sales.

The reduction in license sales in previous periods, coupled with the churn of maintenance contracts, whether due to default or partial cancelations because of the economic crisis, has been reducing maintenance revenue.

In addition to these factors, 27 licensing clients migrated to the Intera subscription model this quarter, reducing maintenance revenue in the quarter by approximately half a million reais.

Moreover, Intera sales have been very important for the growth of subscription revenue, which in this quarter outpaced license revenue by R$21 million. To comment on this transition to the subscription model, I now invite Alexandre Apendino.

Alexandre Appendino: Thank you Maia. Good morning everyone.

We have very good news about subscription to share in this conference call. The growth of subscription by 23% year on year and 8% quarter over quarter, as Maia mentioned, was positively impacted by the sales of Intera, our subscription model launched in June 2015, in which the client set and manages the number of identities (or IDs) to have unrestricted and simultaneous access to TOTVS' management, productivity and collaboration solutions.

With a little more than one year from Intera lauching, we are even more convinced that we made the right choice. Intera has shorter sales cycles due to the lower initial investment, which is also very positive for new sales to clients under this model, since the client won't have to buy new licenses to add more IDs, but merely adjust the Intera monthly fee in accordance to the new number of IDs.

Besides, Intera's monthly fee already includes the standard cloud infrastructure, access to the fluig platform and the e-learning center, key elements to the digital transformation we are promoting in the market. Today we already have more than 90,000 active Intera IDs.

This quarter, we had impressive numbers of clients added. We added 846 clients mainly in Intera and Fly01, and sold almost 1.000 units of Bemacash, 127% more than in the second quarter of the year.

Bemacash combines Fly01, our solution for micro and small companies contracted under the subscription model, with Bematech's commercial automation equipment and fiscal solutions.

It's important to mention that Bemacash sales in the quarter and Intera sales in September did not affect our quarterly subscription revenue.

From the 8th month of hiring Bemacash, the client starts paying subscription for the management software. In Intera, the first billing is done in the following month after the sale.

To sum up, recurring revenue in the quarter does not reflect our entire subscription base at the end of the quarter.

To address this issue, the Annual Recurring Revenue (ARR), presented in **slide 6**, is the most popular metric in the SaaS world to measure the evolution of Recurring Revenue over the next 12 months of contracts signed up to the end of the current period, deducting any cancelation already requested.

Total ARR of software, in the chart on the left, grew 9% year-on-year, or 3.2 percentage points above the growth in recurring revenue of software in the quarter.

Meanwhile, ARR Subscription, the chart on the right, grew 25.2% year on year, despite of the crisis, or 2.6 percentage points above the growth in subscription revenue in the same period, showing that subscription sales are growing much faster.

Now, I turn the call to Douglas.

Douglas Furlan: Thank you Apendino. Good morning everyone.

Still on slide 6, another way of looking at this speed up of the subscription model is through the quarter-on-quarter ARR growth, which was 3.8% in the 2Q and 9.8% in the 3Q, resulting in a net addition of R$21 million this quarter, versus R$7.7 million in the previous quarter.

Going now to **slide 7**, software contribution margin closed the quarter at 62.1%, down 310 basis points year on year, mainly because of the combination of lower software revenue and the maintenance of investments in R&D, client services and support.

Compared to the previous quarter, the 70 basis-point reduction in the contribution margin is primarily related to the wage increases in the quarter in Belo Horizonte and Rio de Janeiro, and their impacts on provisions for vacation and Christmas bonus, coupled with the alignment made in the classification of Bematech's costs with TOTVS, which mainly impacted the research and development line.

Please turn over to **slide 8**, to discuss Services and Hardware.

In Services, the decline in contribution margin year on year reflects the 8% decrease in revenues from software implementation in the period, mainly on the lower volume of sales, and the 29% decrease in services not related to software implementation, especially consulting.

Both were negatively impacted by the higher number of holidays in Rio de Janeiro because of the Olympic Games.

We are also using this period of lower allocation and putting more effort on the training of service professionals, in order to increase their productivity.

The wage adjustments in the 3Q in Belo Horizonte, Rio de Janeiro and Recife also had a negative impact on service contribution margin in the quarter.

In hardware, we recorded an extraordinary expense of R$2.4 million related to an adjustment of average cost in the quarter. Without this adjustment, hardware contribution margin reached 35.1%, which is an improvement of 230 basis points from the second quarter margin.

This margin of 35% still represents a decline year on year, mainly because of 3 factors:

(i) The reduction of tax subsidies in the state of Paraná since September 2015;

(ii) The non-capitalization of R&D projects since the 4Q15; and

(iii) The Changes in state tax laws, especially in the state of São Paulo, where the fiscal printer was replaced by the S@T fiscal equipment, which has a lower unit value and margin, but on the other hand helps to increase recurring revenue from software fiscal solutions, and has been sold as part of Bemacash, which has been growing consistently, as already mentioned by Apendino.

Now talking about selling and administrative expenses, please move to **slide 9.**

Starting with the chart on the top left, selling expenses and commissions jointly grew 6.1% year on year and 3.9% quarter on quarter.

Compared to the previous quarter, the decline mainly reflects additional expenses to adjust the compensation model of the sales team, due to the transition to subscription, as already commented in previous quarters, and the decline in license and service sales in the period.

On the top right, advertising and marketing expenses corresponded to 2.7% of total revenue in the quarter, compared to 2.2% in the 2Q, chiefly reflecting the higher investments in marketing in the 3Q with the launching of the new advertising campaign.

The 12.2% decrease year on year was mainly due to the revision of the Company's general marketing plan and the integration of TOTVS and Bematech.

Allowance for doubtful accounts, on the bottom left, corresponded to 4.8% of total revenue in the quarter, compared to 1.5% in 3Q15. The increase in this quarter is mainly due to the additional provision of R$17.2 million related to the higher credit risk of a large client in the Services segment. Excluding this additional provision, allowance for doubtful accounts corresponded to 1.6% of net revenue.

Finally, on the bottom right, G&A expenses plus management fees and other expenses fell 10% quarter on quarter, mainly due to the R$9.2 million gain from the sale of the BPO operation.

Excluding this sale, expenses increased their ratio of net revenue by 90 basis points because of the decrease in net revenue and the additional expenses related to the post-migration of internal systems in the quarter, and to higher non-recurring expenses with lawyers.

Now I'd like to turn the call back to Maia, to discuss EBITDA, on **slide 10**.

Gilsomar Maia: EBITDA in the quarter, adjusted for (i) the sale gain from the BPO operation; (ii) inventories adjustment; and (iii) additional bad debt provision, went to R$86.5 million, down 26% from the same period in 2015 and 10.7% from the second quarter.

As shown throughout this conference, this reduction in Adjusted EBITDA was mainly due to a combination of the transition to the subscription model, which reduces software contribution margin initially, and the lower sales due to the economic scenario, affecting more clearly the service contribution margin, as well as tax issues that affected hardware margin.

Now, talking about net income on slide 11.

The year-on-year decrease in adjusted net income higher than the decrease in Adjusted EBITDA is mainly due to the company’s current net debt position compared to a net cash position in 3Q15.

Quarter-on-quarter, adjusted net income grew 18.9%, thanks to tax effect from interest on equity declared and paid in the quarter.

Moving now to slide 12, I'll comment on cash flow and debt.

Despite the increase in working capital in this quarter, Gross Cash decreased by R$79 million in the period, mainly due to the following payments:

(i) investment in fixed assets in the amount of R$19.8 million, of which R$5.8 million is related to investments in the Company's new campus. It`s worth mentioning that the total amount of investment originally estimated by the Company in R$90.0 million has been reviewed to R$80.0 million, of which around 50% to be financed in at least 3 years.

(ii) investment of R$11.8 million in intangible assets, especially related to the creation of TOTVS Digital, a new integrated digital environment to interact with clients, prospects, channels and partners, scheduled for launching in the first quarter of 2017.

(iii) payment of interest on equity for the first half of 2016, in the amount of R$ 43.6 million; and

(iv) amortization of R$48.0 million referring to the principal outstanding of debentures issued by the Company in 2008;

Thus, Net Debt amounted R$478.4 million in 3Q16, equivalent to 1.2 times pro forma Adjusted EBITDA in the last 12 months.

Now, I move on to slide 13 for my final remarks.

In summary, the transition to the subscription model accelerated this quarter. Subscription revenue grew 22.6% year on year and reached 17% of software revenue.

Taking into account the subscription sales in September, the annual subscription revenue increased by 25% year over year, with an annualized net addition of R$21 million quarter over quarter, thanks mainly to Intera sales.

Bemacash sales grew 126% quarter over quarter, with almost 1000 units sold. Moreover, hardware contribution margin, excluded the adjustment of inventories ended the quarter at 35%, a growth of 230 basis points over the 2Q.

More recently, fly01 Start has been integrated to smart POS Lio and SmartRede.

We remain aware that this accelerated transition to the subscription model imposes margin challenges in the short term, especially in a still recessionary economic environment and high cost inflation.

However, we remain convinced that this transition also generates value relevantly and makes TOTVS and our clients much more prepared for the recovery of the Brazilian market.

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 Susana Salaru, Itaú.

Susana Salaru: Hi thanks for taking our question. The first question if you guys could elaborate a bit more on the perspectives of margins in the next quarter and when will we see an inflection point in margins? That would be our first question.

And second on the trend of the migration or adoption of this prescription model how do you evaluate the speed that is happening now? Do you think it is what you were expecting when you first did the business model or is it faster or slower than you were expecting? Thank you.

Gilsomar Maia: Good morning Suzana this is Maia speaking thanks for your question. I will start from the second question regarding the subscription model. Actually the subscription model in this point specifically is going faster than in our plans originally.

Of course it is important to remind that it is a kind of first time we experienced this transition our life here at Totvs and all the projects we made we knew it would not be exactly. On the other hand we know that the downturn in the sales of licenses also came much stronger than we were expecting too; but in terms of subscription and that was your question specifically, it is moving faster than we were planning.

Part of this acceleration we can attribute to a more familiarity of our salespeople to the subscription model since we just completed more than one year as… mentioned on his speech.

In terms of margin, and that was your first question, as I mentioned in my final remarks we know that this transition at this point specifically encloses some additional challenges for us, especially because the gap we had in license sales reflecting maintenance and specially services at this moment is not fully compensated or offset by the sales of subscriptions. Although when we take into consideration the annual recurring revenue we start to see that in one year we can see more clearly the benefits of this transition.

On the other hand, we have… Cost inflation is still high especially in our market where our labor is a specialized one. Even though we have a high level of unemployment rates in our market specifically in our industry of technology it is not so true because people are technical people and our market is always under a good demand.

And we knew when we started that transition that these first two years would be those more complicated, more challengeable and more clearly from the third year on it would be more clear and show the improvement of margin. But of course there are lots of different variables in the table to see that inflection point as you asked.

Susana Salaru: Thank you Maia very clear.

Gilsomar Maia: You are welcome.

Operator: Ladies and gentlemen, as a reminder to pose a question please press star one.

Our next question comes from Diego Aragão with Morgan Stanley.

Diego Aragão: Hi thanks for taking my question. Two questions if I may, the first one is regarding our cash flow. It seems that your cash generation is deteriorating as you lose license sales and maybe because maintenance revenue growth decelerated as well. So I was wondering if you could add more color on how we should think about your cash generation during the transition on your business model? Thank you.

Gilsomar Maia: thank you for the question. This is a very good question in terms of cash flow and you are right. This transition besides the results impacted also bring some impact in our… especially working capital because every time we sell a subscription instead of a license it creates some gap in terms of the downpayment related to the license upfront.

But if you take a look in our working capital this quarter it was a positive working capital and if I am not wrong maybe this is the first working capital positive in the cash flow in the last four quarters if I am not wrong. So gradually we are getting part of the benefits of this transition.

Of course there is another element helping significantly this improvement in working capital related to the level of inventories at Bematech. We ended 2015 with a much higher level of inventories and as we were at equating the production to the reality of the market we could have more reasonable levels of inventories.

Delinquency is still putting some pressure in working capital and if we see some recovery in the economy it would be in my personal view one of the first main fronts of improvement because clients under delinquency they should first try to regularize what they do to us and then they can be back to purchase or to buy new users, new identifications.

Diego Aragão: Okay perfect very clear and the second question is actually a follow-up on what Suzana has just asked regarding subscription revenue model. You just said that it is growing faster than expected and so my question is is this happening because of a faster cannibalization of the traditional business model or because it is getting more traction among segments or even clients that maybe you would not be serving via the traditional model? Thank you.

Gilsomar Maia: Specifically in terms of what you call cannibalization I would say that in the beginning it was more true; but more recently what we are seeing we are achieving more and more clients, smaller clients that probably in this moment would not require a license, that is my feeling enough. Smaller companies probably they would not acquire licenses because they would have a relevant disbursement in the key.

But of course when we see the pipeline if you mean cannibalization of sales of subscription if we did not have a new model and we sold under the traditional licensing model yes we have part of it. But more and more we will be able to achieve a kind of a new market I would say comparing to a scenario in which we would have just the license model

Diego Aragão: Okay very clear Maia thank you.

Gilsomar Maia: You are welcome.

Operator: 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 Mr. Maia to proceed with his closing statements. Please go ahead Sir.

Gilsomar Maia: : I would like to say thank you for everyone that participated in our conference call and reinforce that we are convinced that this transition is going to be a positive generation terms of value for the company, for investors and clients and we stay focused in this transition and the cost control.

So thanks again and have a good day, bye.

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