Operator: Good morning. Welcome to the TOTVS conference call to discuss the results of the third quarter of 2017. Today we have with us Gilsomar Maia, CFO, and Douglas Furlan, IR Executive Manager.

Note that all participants will be on listen-only mode during the presentation. After the presentation, 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 ri.totvs.com.br.

Before proceeding, we wish to clarify that any forward-looking statements that may be made during the conference call, related to the 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, hence, depend on circumstances that may or may not occur. Investors should understand that general economic conditions, industry conditions and other operational factors could affect the future performance of TOTVS and could lead results to differ materially from those mentioned in such 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. I´d like to start the presentation on **slide 3**, where I will talk about the main recent events.
The first to highlight is the creation of iDEXO, an institute whose mission is to connect startups, entrepreneurs and investors with key companies from the main industry sectors, many of them already TOTVS clients, to develop innovative solutions together.

Located in an area specifically dedicated to its activities within the new TOTVS campus, iDEXO will provide to startups and the developers community both TOTVS' infrastructure and tech platforms. These companies can get investments from TOTVS and other iDEXO members, being also able to sell their solutions at TOTVS Store.

This initiative is part of TOTVS' strategy to increasingly open its platforms, such as ERP, HR, fluig and Carol, to team up with its partners and the developers community in order to help its clients to gain productivity through specialized business solutions, digital platforms, cloud infrastructure, mobile and Internet of things.

The second event I´d like to highlight is the issue of non-convertible debentures amounting to R$200.0 million, which will bear interest corresponding to 105.95% of the daily average interbank rate accumulated variation, which will be paid semiannually.
The principal will be amortized in a single installment on September 15, 2020 and will be used for working capital, investments within the scope of the Company's corporate purpose and prepayment

of other debt, as was the case of the full early redemption of R$20.7 million of the debentures issued by Bematech in 2014.

In short, the lengthening gross debt amortization resulting from this debenture issue leads to a better alignment with the operational cash generation resulting from the transition process to the subscription model that TOTVS is going through.

I now begin my comments on the quarterly results on **slide 4**. Note that to facilitate comparison, the consolidated proforma numbers for the 12 months ended in Q316 also include the results of Bematech.

This quarter, net revenue grew 4.6% year-on-year, which is 1.9 percentage point higher than the growth in the last 12 months, boosted by the 10% growth in recurring revenues. It is important to highlight that this double-digit growth is ORGANIC and comes mainly from subscription, which also boosted the 7.4% growth in software revenue shown on **slide 5**, where we will present the revenue breakdown by business line.

After few quarters of decline, service revenue grew again by 9% quarter on quarter due to the increase in software implementation services at larger clients, as a result of the license sales in previous quarters.

The year-on-year growth of 0.9% was driven by growth in services not related to software implementation, which accounted for 32.6% of service revenue in Q3.

In hardware, the 3% decline in revenues year-on-year was due to the 35% drop in fiscal printer sales, which led to the reduction in the share of fiscal hardware sales over hardware revenues to 17.4% in the last 12 months, down 2.7 percentage points from LTM-Q316.

In the other hand, revenues from other hardware solutions grew 2.0%, mainly driven by the growth in revenue from Bemacash units sales, that totaled 2,135 units in Q3, compared to 1,093 in Q2 and 998 units in Q316.

In Software, the growth sped up year-on-year for the 4th quarter in a roll and was 2.3 percentage points higher than the growth in the last 12 months. Compared to the previous quarter, software revenue grew for the fifth consecutive quarter, as shown on **slide 6**.

The year-on-year growth in software revenue was due to the combination of 1.8% growth in the licensing model, which includes license and maintenance revenues, and the 34.4% growth in the subscription.

The year-on-year growth of the licensing model is chiefly due to the 5.4% growth in licensing fee revenue, which was driven by the higher share of sales to new large clients. Maintenance revenue increased by 1.3% year-on-year, positively affected by non-recurring revenue of R$1.5 million related to the regularization of some contracts in the quarter.

It´s important to highlight that maintenance revenue continues to be affected adversely by delinquency, contract reductions and the decline in the LTM IGP-M index.

Subscription revenue continues to increase its share of net revenue from software. In Q3, subscription revenue accounted for 21.3% of total software revenue, up to 4.3 percentage points from Q316.

The year-on-year growth in subscription revenue was essentially driven by the growth in the number of small and medium clients of TOTVS Intera in the last 12 months. Note that this LTM subscription growth is in the same level of some main SaaS players´ growth, as shown on **slide 7**.

It is important to mention that Intera sales in September did not affect subscription revenue in the 3rd quarter, since in this model the first billing occurs in the month after the sale, but has already affected ARR from subscription.
ARR, which stands for Annual Recurring Revenue, grew 42% in Q3 and reached R$334 million.

We added R$30.1 million of ARR in the quarter, the highest amount ever added by the Company since the launching of TOTVS Intera in June 2015.

Now I will hand over the presentation to Douglas, who will comment on the software result on **slide 8.**

Douglas Furlan: Thank you, Maia. Good morning everyone.

Software contribution margin fell quarter-on-quarter, mainly reflecting the 5.8% increase in R&D. This increase was mainly due to: (i) the provisioning curve of bonus in the period; (ii) wage increases; and (ii) the higher innovation investments related to open platforms and the micro enterprise segment.

In the year-on-year comparison, the decline in software contribution margin was lower than in the last 12 months, mainly due to the speed up of the year on year software revenue growth in the last 4 quarters, as mentioned by Maia.

On **slide 9,** service contribution margin increased 470 basis points compared to Q2, mainly due to the 9.0% growth in service revenues and the better allocation of the service team in the quarter.

In the last 12 months, the reduction in service contribution margin was due to: (i) the lower allocation of service professionals due to the slower sales pace of projects; and (ii) the wage adjustments, which were not fully transferred to the price of service projects in the period.

On **slide 10**, hardware gross margin declined 130 basis points quarter-on-quarter, mainly due to the drop in the sales of fiscal printers, which have a higher gross margins.

The quarter-on-quarter decline in the hardware contribution margin is due to: (i) the lack of tax subsidies in the period, since the increase in the raw material volume acquired in the period was higher than the growth of hardware sales; and (ii) the higher expenses with R&D institutes booked in the quarter.

In the last 12 months, hardware contribution margin increased 360 basis points due to the combination of price adjustments and the impact of the exchange rate on costs during the period.

Now talking about the main selling and administrative expenses, please move to **slide 11**.

In Q3, selling expenses and commissions jointly increased their percentage of net revenue year-on-year, essentially reflecting: (i) the change in sales mix between franchises and own branches; and (ii) the higher volume of software sales in the subscription model.
Compared with Q2, these expenses raised their percentage of net revenues mainly due to higher license sales made by franchises.

G&A plus management fees and other expenses, excluding non recurring items, increased their percentage of net revenue year-on-year.

This increase is mainly due to: the R$7.4 million increase in provisions for contingencies when compared to Q316; the wage increases and the additional expenses with Bematech and Virtual Age integrations booked in the quarter.

In the quarter-on-quarter comparison, the increase was mainly due to the growth of provisions for contingencies in Q3, the reversal of bonus and profit sharing booked in Q2 and the additional expenses with the Bematech integration.

Moving to **slide 12,** EBITDA margin was 11.1% in Q3, down 380 basis points from Q2. EBITDA amounted R$62.3 million, as against R$82 million in Q2. The quarter-on-quarter decline in EBITDA was mainly due to the lower hardware results and the increase in selling expenses and provisions for contingencies, as shown in the left side of the chart.

In the last 12 months, the decline in EBITDA and EBITDA margin was mainly due to:

(i) the transition to subscription, which negatively affects the software revenue growth in the short term and, consequently, the dilution of costs and expenses;

(ii) the effects from the economic recession in Brazil on delinquency rates, cancellations and reductions of maintenance contracts and on the increase of provisions for contingencies, besides resulting in a lower services sales pace; and

(iii) the IGP-M, inflation index mainly used to adjust maintenance contracts, wich was significantly lower than cost inflation;

On **slide 13**, despite the reversal of income tax due to the deduction of the announced Interest on Equity, the decrease in adjusted net income quarter-on-quarter was mainly due to the decline in EBITDA, as shown in the left side of the chart.

I now return the presentation to Maia to comment on cash flow and debt on **slide 14**.

Gilsomar Maia: The operating cash generation in Q3 declined less than EBITDA and adjusted net income year on year and quarter on quarter. In the last 12 months, operating cash generation grew 32.6%, also in contrast to the reductions in EBITDA and net income in this period.

Free cash generation for the quarter grew 7.4% year-on-year, mainly due to the higher level of fixed assets investments made in 2016 on the Company's new campus in São Paulo.

Net debt decreased 25% year on year and reached 1.2 times Adjusted EBITDA in the last 12 months, already taking into account the issue of TOTVS debentures amounting to R$200.0 million, which is part of the generation of R$125 million in financing activities in the quarter.

Moving now to **slide 15** for the closing remarks.

We are making significant progress in the transition to subscription in 2017. This year, the share of subscription sales through franchises increased, contributing to the growth of this model among small and medium companies.

We added almost 5 thousand new subscription clients in 2017, which led to 33% growth in subscription revenue in the last 12 months and to 42% growth in ARR, which already corresponds to 33% of annual maintenance revenue.

This performance gives us the confidence to maintain the subscription growth guidance of at least 30% for 2017.

As a consequence of this transition to subscription, we have seen more than proportional growth in commercial expenses, while we build our installed subscription client base. As this client base gains relevance, commercial expenses with new sales tend to be diluted.

Additionaly, the effects of the Brazilian economic recession have been felt in the sales to existing clients, in the delinquency rates, in the maintenance churn and in the increase of provisions for contingencies, in addition to the relevant IGP-M decrease in the year, contributed negatively to EBITDA in 2017.

Based on this scenario, we reviewed our projections and removed the Adjusted EBITDA guidance for the year of 2017.

In Q4, we are performing a reduction of recurring expenses with personnel of about R$30 million per year. Also in Q4, we will conclude the backoffice integration of Bematech. These actions combined with the growth of recurring revenues aim to adapt our structure to a SaaS reality in order to recover profitability without compromising the Company's growth and innovation capacity.

Now we are available for the questions and answers section.

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

Gilsomar Maia: I would like to thank you all once again for participating in this conference call and have a good day, bye-bye.

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