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.

Our next question comes from Tales Freire of Bradesco.

Tales Freire: Good morning Maia, good morning Douglas. My first question is related to ARR. We saw a very strong addition of annualized ARR distribution in the quarter despite the weaker monthly revenue from clients added. Considering the ARR concept, it seems the subscription sales volume was very strong in September, probably 30 to 40% higher than in previous months.

I wish to know if this interpretation makes sense? Is this interpretation correct?

Gilsomar Maia: Good morning Tales, how are you? This is Maia speaking. Yes, you're right. This is a metric we have been presenting for over a year now. It's a metric we believe helps to better understand the sales performance in the period, because subscription has the characteristic of, depending on how this sale is distributed throughout the months in the quarter, you get a different perception of the closing of the quarter.

I will give an example. Take the 3Q. Sales in July were counted towards revenue in August and September, so they contributed with two months of revenue in the quarter, sales form August in September. Consequently, one month, sales of September in October, in other words September does not impact the quarter.

When we look at annualized subscription revenue, we put sales from these months in the same comparison base, and when you compare with previous quarters using the same metric, it's easier to see what the actual sales performance was in the period.

As such, when you compare ARR with the subscription revenue in the quarter from new clients, you see the growth in the third quarter was substantial.

So, your analysis is correct. The third quarter is usually affected by a very weak July, usually the month of vacation, with some impact stretching into the beginning of August. August is usually stronger than July and the big month of the quarter is usually September. So, your reading of ARR compared to subscription revenue is correct.

Tales Freire: Just a follow-up question: given this stronger performance in September, can you add some color as to the performance in October as well, whether it remained as strong as September was?

Gilsomar Maia: It did. September and October are usually strong months as they are farther away from the vacation period. August, for instance, has no holidays and September and October have few holidays, but these months already anticipate the period of year-end festivities, industries usually register high production volumes, service activity also improves, it's overall a good time of the year and October confirmed this trend.

Tales Freire: Great, and my second question is related to recurring costs, which increased a lot from the prior quarter and prior year to reach R$ 500 million.

I understand that there were a series of factors supporting this strong growth, including the variation in some more volatile lines, such as provision for contingencies, but I was wondering if you could shed some light as to why the level of recurring costs and expenses for the coming quarters has normalized this cost volatility, and even already considering the 30 million in cost savings that you expect to capture with the integration of Bematech and internal adjustments.

What would be the normalized level of recurring costs and expenses?

Gilsomar Maia: Tales, I think your question is very interesting, because usually we talk a lot about recurring revenue, even because of the change in the model that the company has undergone in the past two years, and usually we don't talk about recurring costs, which also exist.

These behave similarly, although the distribution of recurring costs over the year is different. I'd say recurring revenue has a dynamic of restatement, let's say by inflation, that is evenly distributed throughout the year, more normalized, while recurring costs, and more specifically payroll, have peaks throughout the year.

More clearly, in São Paulo in 1Q of the year, which is the base date of January, when we have almost 50% of our payroll, then we have concentrations in September, October and November. So, these are two important periods of the year when costs, for example with personnel, are adjusted.

As you saw in previous quarters, in São Paulo, for instance, we had an adjustment very closely related to the collective bargaining agreement that was based on inflation in 2016, and ended up resulting – considering the sum of bonus and salary increase – in an impact for the company of around 7% in 2017. And as months went by and with inflation declining, we can see the collective agreements are following this downward trend.

So, these collective bargaining agreements, for example settled in Belo Horizonte and other cities in September and October were now lower than 2%.

So, back to your question, what I see in our current structure of recurring costs, less this reduction of 30 million that we are causing now looking ahead in the next year, coupled with inflation from salary adjustments that we may have next year, which, in my opinion, based on information currently available, everything points to a significant from this year.

In relation to other costs, we are talking more about variable costs, such as commissions, which vary according to revenue, and fixed costs related to infrastructure, which I believe also follow the same dynamic, perhaps between IGP-M inflation and personnel costs. I'm not sure if answered your question.

Tales Freire: Yes. But the point is that this 500 million had a higher percentage of sales from franchises, and franchises have higher commissions. There was also a higher level of provisions for contingencies and also an impact from provisioning for bonus payment.
This 500 million, given the payroll increases you mentioned in October, November, December and January, this 500 million would grow based on these inflation indicators or is this 500 million not a good reference for the coming quarters?

Gilsomar Maia: I believe it's a good reference. Maybe the exception would be contingencies, because it's actually not something completely under the Management's control, it depends a lot on new leaders, new cases that could come up, and the progress of existing ones.

But, except for this line, the others are under our control, under our management, so the initiative to reduce the structure aims exactly at trying to better align the company's structure to this more recurring revenue profile, more specifically towards subscription.

I think these costs tend to grow more in line with inflation. In the specific case of commissions, these are direct expenses related to sales, because I think what we had this quarter was perhaps out of the curve in terms of concentration of license sales – not intentionally, but more strongly concentrated in franchises.

But if we analyze on a 12-month basis this is no longer the case so much, and basically the growth that we had in commercial expenses came from selling expenses, which is more closely related to the direct team, and then we have what we mentioned in previous periods, a mismatch between the remuneration of the commercial team and the flow of recognition of revenue from subscription.

Tales Freire: Perfect, it's clearer now. Thank you Maia.

Gilsomar Maia: You're welcome.

Operator: The next question comes from Marcelo Santos of JP Morgan.

Marcelo Santos: Good morning everyone and thanks for taking my question. First, I'd like to know your opinion as to when the subscription model should start contributing more substantially to EBITDA. I imagine it's not something for 2018, but maybe you see it for 2019? How do you see this? Because it's a model that really has higher margins once you have a large implemented base. So, I was wondering if you have any idea and could shed some light on that.

My second question is an update on the competitive landscape, what you've seen in the market, how this is going.

Gilsomar Maia: Good morning, Marcelo. Starting with your first question regarding subscription and EBITDA, I can't attribute the EBITDA behavior, for example of this quarter, to subscription growth. I think that when we talk about subscription and the company's profitability, we are always thinking more in terms of a base, in a 12-month horizon at least, and I think we remove this volatility, these one-off items that may impact any specific quarter of the year.

But, looking specifically from the structural viewpoint of subscription and EBITDA, the way we see the behavior of this model is very much aligned with the comment. There is an effort to build the subscription base and, while this base is being built, the relevance of expenses with acquisition of this base compared to the size of the base is quite relevant. And as you expand this base, this acquisition cost of new clients tends to become less relevant.

So, it is highly related to the size of the installed base. If we continue to grow at these rates that we've been growing, at around 40%, this obviously brings the additional challenge of dilution, because I continue to add a substantial number of new accounts and paying upfront and this somewhat hinders dilution. But once I have a larger installed base, the relevance of this additional cost tends to decrease gradually.

So, to be more objective, I would new to have a very clear view of the sales performance in 2018, for example. With what I have today, I don't see a slowdown of subscription in the short term, but of course, mathematically, as you grow your base, the natural trend is for this percentage to decrease in relation to the base.

So, we should see a gradual benefit from the model in the coming years for the company as a whole. Now, it's true that we have been adjusting the company to the reality of software as a service. We have to work very hard on the company's internal process to capture efficiency gains in all accounts, but especially among smaller accounts, where the ticket is lower.

We have to aim for greater efficiency, both in terms of generation of opportunities and conversion of these sales opportunities, so we can also reduce this acquisition cost per sale, since I no longer have the upfront license revenue to fund by cost of sales.

So I have to think differently, I have to think of different ways to sell more efficiently, to reduce the acquisition cost, and that is not limited to the commercial activity, this also goes to the rest of the company's structure. So, in addition to selling, we have to implement faster, because among lower tickets– if you look at our history, we've never had really a relevant level of profitability in services – so in a certain way, the service funded the sale of software throughout our history and so it's important that we can capture efficiency gains in the implementation of our software, so that we can be more profitable also in this new reality of software as a service.

The same goes to the administrative areas of the company in general. I think the change in the model causes a change of mindset of the company to revise all of its processes and try to do things differently to become more efficient.

I'm sorry for not answering your question objectively, because I'd actually love to have a binary answer to it, focusing on a single item that, if we address everything, it resolves everything, let's put it that way, but it's a transformation the company is going through. But the benefit should be captured as the base grows.

Marcelo Santos: Perfect.

Gilsomar Maia: Regarding the competitive landscape, your second question, we have nothing new to tell you other than what we've been saying about the matter in previous quarters. It's a very competitive market, we face different players, including in the various market segments of large companies. There is a different scenario when we talk about small and medium businesses and a more recent market for us, which is microcompanies, which is also an entirely different thing.

I think we understood that, that we have to compete differently in these different segments, and I don't see any new fact in terms of names of players, solutions that cause any structural change in these three segments this quarter.

Marcelo Santos: Perfect, thank you.

Operator: As a reminder, if you would like to ask a question, press star one.

Our next question comes from Daniel Federle of Credit Suisse.

Daniel Federle: Good morning everyone. My first question is about sales of subscription. I'd like to know whether most of them are already under the Intera model and include cloud computing, IT platform or is the majority still a billing model instead of the structure as a whole?

My second question is regarding the churn rate: can you add some color as to the profile, if companies are still reducing the number of licenses or are companies closing down, and if there are companies that reduced the number of licenses in the past and are now beginning to add new users to the base. Thank you.

Gilsomar Maia: Good morning Daniel. Starting with your first question regarding subscription, it's true that today in terms of revenue the growth is basically from Intera, because the other offerings that we had of subscription are very traditional offerings, such as that for the financial sector, which, as I mentioned before, is a sector that perhaps was the pioneer in subscribing to software instead of buying it, and this market specifically is not a user of cloud computing, for instance. So, we are talking more of on-premise subscription basically.

This type of market has a very low growth rate. If we take only what I added, what we added of Intera in the last two years, we are talking about very strong growth rates, even higher than those West Coast players we listed in our comparison slide, so we are talking sometimes of triple-digit growth of Intera.

But, yes, back to your question, growth comes basically from Intera. Today, we are talking about around 70-75% of new clients coming to our cloud solution, especially smaller clients, I think that have been showing less resistance to adopting cloud computing. There is a universe of clients that still appreciates the idea of paying for software as subscription, but not with the idea of running it fully cloud-based.

This is decreasing. I think the trend is to see clients increasingly more receptive to the cloud idea, and also to transferring this burden of managing an internal infrastructure to a solution provider.

Regarding the churn rate, which is your second question, I continue to register similar churn levels, very similar to in previous quarters, close to 9%, even though the churn profile has changed a little. If we look from the end of last year to the beginning of this year, we had an issue of reduction of contracts, layoffs at clients, all of which resulted in requests to reduce their contracts with the company, which was very significant.

During this quarter, for example, we have already seen a very significant decline. So, the number of companies asking to reduce the number of users in maintenance contracts has decreased a lot and today it is not that relevant.

On the other hand, the delinquency component was another important factor for the increased churn rate in the recent periods, as it continues to be an important issue. We are already seeing some improvement in some clients that went through difficulties and delayed payments, some of them are already paying these outstanding amounts, we even commented on that in maintenance, that we received payments on a few contracts that were overdue.

On the other hand, clients that did not recover are faring even worse, many of them filed for court-supervised reorganization, for bankruptcy, that even includes medium-sized businesses. So, we see a mixed scenario and the net balance is that it's still not positive for us this quarter.

Daniel Federle: Thank you Maia.

Operator: As a reminder, if you would like to ask a question, please press star one. Once again, to place a question, please dial star one.

We now conclude today's question and answer session. I'd like to invite Mr. Gilsomar Maia to proceed with his closing remarks. Mr. Maia, please go ahead.

Gilsomar Maia: Thank you all for participating in our conference call. The final message I'd like to leave, to reinforce what I said, because due to the comments we made regarding the revision of our structure and everything, I just wanted to make it clear that the company is not comfortable with its current profitability level and we will work to increase this profitability.

But, like I said before, we have to do that very carefully, because it's not just a matter of addressing profitability, we must have growing profitability, but in a sustainable manner.

I'd also like to remind everyone that on December 4 we will host here at the company's new headquarters the TOTVS Day, and we're counting on your presence. For those who have already registered in our Investor Relations website, you will receive the alerts, reminders and invitations.

For those who haven't done so, I suggest you register on the website so you can receive all of our alerts. We'll be waiting for you here in the new headquarters, I think this will be an opportunity to show in greater detail the renovations the company has made and also the unification of the structure we had in the new site in São Paulo.

Thank you once again and have a good day.

Operator: That concludes TOTVS conference call today. Thank you for participating. Have a good day and thank you for using Chorus Call.