Operator: Good morning. Welcome to the TOTVS conference call to discuss the results of the fourth quarter and full year 2017. Today we have with us Laércio Cosentino, CEO, Gilsomar Maia, CFO and Sérgio Sério, Investor Relations 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 ir.totvs.com.

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. As usual, I will begin the presentation by commenting on key recent events on **slide 3**.

The first was TOTVS' presence once again as the only Brazilian tech company in the global ranking published annually by the consulting firm Strategy&, which ranks the 1,000 public companies that most invest in research and development.

This is further evidence of the importance of innovation for TOTVS as a driver of its own transformation and also to bring to clients solutions that simplify the business world.

The second event was TOTVS Day, the investor day held at the beginning of last December at the new headquarters of TOTVS, where presentations were made on the latest developments in the Digital Journey and Transition to Subscription strategies.

Also, the over 60 analysts present in the event had the opportunity to visit the new facilities and had demonstrations of some of the solutions for the Education and Manufacturing segments, as well as Carol, our artificial intelligence platform.

The third event was the Board of Directors' decision, in December, regarding the distribution of interest on capital for the second half of 2017, in the amount of R$17.4 million.

Now, I'll begin my comments on the results on **slide 4**.

In 2017, net revenue grew 2%, while recurring revenue grew 8.7%, corresponding to 67.5% of net revenue in the quarter and 65.8% in the year, which is 4 percentage points higher than in 2016.

As shown on **slide 5**, this revenue growth is mainly driven by software revenue, which grew 6.2% in the year and 5.6% in the 4th quarter.

Software revenue, in turn, was driven by the 34% growth in subscription revenue, shown on **slide 6**, which accounted for 20.7% of software revenue in 2017 and 23.2% in 4Q17.

The growth of 9.5% in subscription revenue in comparison with the 3rd quarter represented the highest growth rate in this line in a quarter since the beginning of the transition to subscription 2 years ago, when TOTVS Intera was launched.

This transition brought challenges related to the reduction in licensing revenue and its adverse effects on maintenance revenue, which were worsened by the economic recession in Brazil. On the other hand, subscription sales accelerated and software revenue already returned to the growth trend during 2017, as shown on the chart on the left side in **slide 7**.

However, we don't consider revenue as the best metric to measure the performance of subscription sales in the quarters. The first monthly fee billing of TOTVS Intera is made in the following month after the sale. Thus, revenue in the quarter is positively affected by two monthly fees from subscription sales closed in the first month of the quarter, by one monthly fee from the sales closed in the second month, while sales in the third month contribute only to the revenue of the subsequent quarter.

We believe that Annual Recurring Revenue (ARR), shown on the chart on the right, maintains comparability between the periods by annualizing all the subscriptions sold. Note that as ARR accelerates, subscription revenue accelerates in subsequent periods.

ARR from subscription totaled R$368.0 million in 4Q17. This amount is 19.5% higher than the subscription revenue of R$309 million in 2017, which already represents revenue growth in 2018 resulting from sales made throughout 2017.

Now, I turn the presentation to Sérgio Serio, which will comment on the software result on **slide 8**.

Sérgio took over the position of Investor Relations Manager earlier this year. He's in TOTVS since 2006 and has led the area of institutional relations in the past 3 years. Please Sérgio, proceed the presentation.

Sérgio Sério:

Thanks Maia and good morning everyone.

The decrease of 40 basis points in adjusted contribution margin of 2017 resulted mainly from the increase in research and development expenses above the adjustment level of recurring software contracts.

This cost increase is essentially related to wage adjustments resulting from collective bargaining agreements in the period and additional investments in innovation, especially those related to the specialization of business solutions, open platforms and the microenterprise segment.

In the quarter, the increase in adjusted contribution margin from software chiefly reflects the growth in subscription revenue and the reduction in costs due to layoffs in the quarter.

Turning now to services, on **slide 9**, the adjusted contribution margin decreased in 2017 mainly due to the 3% drop in revenue from implementation services, and by the 11% decline in revenue from consulting services. These decreases were mainly due to the slower pace of sales and consequently, lower allocation of professionals, especially in the first half of 2017.

In the quarter-on-quarter comparison, the decreases in service revenue and adjusted contribution margin were essentially due to fewer business days.

In the year-on-year comparison, the adjusted contribution margin from services in the fourth quarter increased mainly due to the restructuring, which resulted in a negative impact of R$3.9 million from layoffs.

Moving now to hardware on **slide 10**, the decline in adjusted contribution margin from hardware in 2017 and in the 4th quarter was mainly due to the decline in sales of fiscal printers, whose gross margin is higher, and to the drop in revenue from economic subsidy, especially in the 3rd quarter, due to inventory levels.

Revenue from sales of other solutions grew 2.3% in the year, mainly driven by the growth in revenue from Bemacash sales. In 2017, more than 6,500 Bemacash units were sold, compared to almost 2,800 units in 2016.

To discuss about selling and administrative expenses, please go to **slide 11**.

The year-on-year increase in selling expenses and commissions as a percentage of net revenue essentially reflects the growth in software sales in the subscription model.

As subscription revenue expands its recurring base, and as new sales reduce its share in this base, selling expenses will get diluted.

In the year, the increase in general and administrative expenses plus management fees and other expenses as a percentage of net revenue was mainly due to: (i) wage adjustments resulting from collective bargaining agreements, which were higher than inflation adjustments obtained on recurring revenues; and (ii) additional expenses with the merger of PC Sistemas and Virtual Age, and the administrative integration of Bematech, all of which contributed to the structure adjustment carried out in 4Q17.

The decline in comparison with the 3rd quarter was chiefly due to the structure adjustment and the effect on bonus provision related to the achievement of individual and overall targets.

With regard to allowance for doubtful accounts, the increase in recent quarters, despite the gradual improvement in overall timely payment of the portfolio, reflects the additional provision made on account of the worsening situation of some companies in difficulty, such as petitions for judicial reorganization.

Now I'll turn the presentation back to Maia, to discuss EBITDA, on **slide 12**.

Gilsomar Maia:

Thanks Sérgio.

In 2017, the decline in adjusted EBITDA resulted from the combination of the following factors:

(i) the more than proportional increase in selling expenses due to the transition to the subscription model;
(ii) the decline in service revenue caused by the reduction in sales of projects until the first half of the year and the lower allocation of professionals;
(iii) the decline in sales of fiscal printers and lower economic subsidy on hardware; and
(iv) the increase in general and administrative expenses, mainly due to the inflation adjustment on costs, and in additional expenses with the operational integration of the companies acquired in previous periods.

In the quarter, EBITDA grew 13.8% year-on-year and 11% quarter-on-quarter.

The structure adjustment carried out in the 4th quarter, combined with the growth in recurring revenues, should adjust our structure to the SaaS reality in order to recover profitability without compromising the company's capacity to grow and innovate.

And to conclude the comments on the result, on **slide 13**, apart from the variation in adjusted EBITDA, as commented, the decline in adjusted net income this year is mainly related to the increase in depreciation, resulting from investments made, especially in the second half of 2016.

In the quarter, the tax on financial income calculated on the investment of proceeds from the issue of debentures in the 3rd quarter and the inflation adjustment on provisions for contingencies are reflected in the financial results. The variation in income tax and social contribution is essentially linked to the reduction in the interest on capital during the period.
Now I'll move to **slide 14** for the comments on cash flow and debt.

Despite the decline in net income, as commented in previous slides, operating cash flow grew 26% in the year and 34% over 4Q16, mainly due to the 92% reduction in working capital requirements.

This growth in operating cash flow, combined with the 49% reduction in capex in 2017, resulted in the 57% increase in free cash flow.

As a result of this cash flow generation, net debt declined 33% in 2017, corresponding to 1.1 times adjusted EBITDA in the year.

I now turn the presentation to Laércio for his closing remarks on **slide 15**.

Laércio Cosentino:

Thanks Maia. Good morning everyone.

Based on all that was presented in this conference call, we can affirm that the year 2017 marked the return of growth off TOTVS.

We registered 6% organic growth in software.

Subscription revenue grew 34% and annualized fourth quarter subscriptions exceeded the subscription revenue in 2017 by 19.5%.

Challenges related to the beginning of transition to subscription, coupled with the remaining effects of the economic recession in Brazil, prevented us from achieving our EBITDA and net income targets in 2017.

We made adjustments to the cost structure to align it better with the growth in recurring revenue but without compromising the company's capacity for growth, profitability and innovation.

Despite these challenges, the continued financial discipline enabled us to increase operating cash flow and, consequently, reduce net debt.

The year was also marked by significant advances in the 3 pillars of the TOTVS Digital Journey, among which I highlight the following:

In Culture and Environment - the inauguration of the company's new headquarters in São Paulo, a technological campus specially designed for TOTVS and inspired by the most modern working environment for technology companies around the world;

In Processes and Service – the use of agile development and project management methodologies; and

In Offering and Portfolio - the launch of our artificial intelligence platform Carol and the inauguration of iDEXO, an institute whose mission is to connect startups, entrepreneurs and developers in the pursuit of new business solutions.

In 2018, TOTVS remains focused on the success of its clients, with the mission of "Simplifying the Business World," supporting our clients in the digital journey, offering the best business solutions for companies of all sizes and segments.

Now we are available for the questions and answers session.

Operator: Excuse me 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. Once again if you would like to pose a question please press star one.

Our first question is from Vitor Tomita, Itaú BBA.

Mr. Vitor Tomita: Good morning Laércio, Maia and Sérgio. Our first question would be, since the synergies and G&A with Bematech were already delivered this quarter, I'd like to understand how much of this benefit was harnessed this quarter and how much in the coming quarters, and whether there are other Bematech synergies that can still be unlocked in the short term.

Our second question is about how has the sales cycle been during 2017, especially now at the beginning of 2018. Have you already seen any improvement due to improved expectations regarding the macro scenario. From us, that is it.

Mr. Maia: Good morning Vitor, this is Maia speaking. Well, starting with the first question regarding Bematech synergies, the administrative synergy case was one that we discussed at length last year, and just as we had planned, by the year-end we achieved greater administrative integration between the operations.

In that specific quarter we captured approximately half the benefit we could have over the coming quarters, since the adjustments we made happened mid-quarter.

In terms of synergies that we can still have with Bematech, of course that as days go by we will keep fine-tuning the operation. From the administrative viewpoint, I believe we can gain scale and have an operation better prepared to support growth.

From the actual business viewpoint, I believe this is where the tremendous potential for synergy that we still need to explore is located. When we made the deal with Bematech, we concluded the transaction at the end of 2015 and shortly thereafter the economic recession in the country worsened in the last two years, which created an unfavorable environment for exploring sales synergies.

So I understand that this part of the synergies, which is more significant than sales synergy, cross sales and the possibility of exploring the sales potential of Totvs' portfolio also in Totvs' installed base using Totvs' distribution system, we still haven't been able to actually explore this potential.

With the operational integration that happened during the course of 2016 and the administrative integration throughout 2017, and with the market's consistent improvement over last year, the same direction which it seems likely to go to this year, I think this presents a good opportunity for us to also explore synergies in terms of sales and business generation.

Mr. Laércio Cosentino: Victor, Laércio speaking. About the sales cycle, we're optimistic. I believe the difference between the beginning of 2017 and 2018 is in the scenario, where the probability is of bigger investments in software in diverse sectors. We see the service sector already making strides regarding this investment, and we also see micro and small businesses and manufacturers, especially in the SMB segment, already with the desire and with the budgets to make investments in 2018.

Thus we see a positive market, and that is because of all we've done regarding subscription with an adequate product, such as an appropriate offering to capture exactly this growth.

When we see a subscription growth of 34% in 2017, it shows that the direction is right, that the offering is adequate and that growth is back in the market where we operate.

Mr. Vitor: understood, thank you Laércio, thank you Maia.

Mr. Maia: thank you.

Operator: next question is from Fred Mendes, Bradesco.

Mr. Fred Mendes: good morning and thank you for the conference call. I also have two questions, related to the company's strategy. The first, and correct me if I'm wrong, but I think that as you put more clients in the cloud, the implementation period ends up being shortened and, consequently, the service revenue for your franchisee too gets reduced.

So I'd like to understand how is the relationship with franchisees and how is this going to be moving forward, since I imagine that as you rollout subscription this trend will only grow, and naturally their service revenue will go down. This is the first question.

The second one, looking at the company in the next three or five years, we have in the model a strong recovery of EBITDA margin. So looking at a more stable macro scenario and the transition to subscription already matured, do you believe this margin can go back to over 20%? I know that there is no guidance, but at least the trend?

Then, where would this expansion come from? More related to revenue or cost? How does Bemacash fit in this? How do you see the company in the next three to five years? Thank you.

Mr. Laércio: Hi Fred, Laércio speaking, how are you? About the cloud, it actually reduces installation services, but implementation and training will continue to exist, more so because our software, especially with the strategy we adopted to have segmented solutions, we gain entry into the daily operational routine of each of our clients.

So what is changing is the service of installation, generating databases and initial registrations, and so on, which was perhaps a commodity. The trend here is that as we progress in this cloud concept of having a simpler, easier and faster offering, this will diminish.

On the other hand, we begin to have a service with greater added value. So the relationship with franchises is firm and strong. A sizeable portion of growth in subscriptions comes from our units, but also from our franchises. And the fact that we are specializing our franchises also by segment is enabling them to deliver this greater added value.

So we could even increase our franchisees' revenues precisely because, instead of implementing or doing an installation at a lower cost, the franchises will have a service with the possibility of a higher value than what the previous service offered, OK?

Mr. Maia: regarding margin, Fred, I wouldn't say that we're in the matured model per se just yet. Of course, we already have a track record of two years to monitor and learn the lessons. We see an acceleration in sales over these last two years, but I believe we still have much to extract in favor of the operation, as Laércio put it: the franchisees are also increasingly improving their subscription sales and so is our commercial team. So I believe that we still haven't reached the maturity point, the maximum that we can get in subscription.

From the mathematical viewpoint we already discussed it at length on other occasions. The model switch entails a reduction in total revenue at first, and that is what happened during 2016. With the 2017 numbers, we were already able to reverse this trend, as is evident from software revenue. Today it is proven we can already add more subscription revenue than what we eventually give up in the licensing model.

Of course, in addition we also had the inflationary gap between cost and revenue. This will probably continue for some time as the IGPM is negative. Of course, the inflationary pressure on costs is apparently at a much lower level. So when we adjusted the cost structure in 4Q, we did it also looking at this context throughout 2018.

Well, I'll state the obvious here: we naturally are working to expand the margin, to recover the company's margins over the years to levels closer to what we had before the transition, but it's important to mention that we don't have any guidance in this regard, and I believe that only if we have consistency and show evolution in margins can we prove it. At this juncture I don't think any projection or guidance I offer may be more useful.

Mr. Laércio: here's what matters: the more subscription maturity we have, the more we can have stabilization and expansion of the margin itself. In other words, as we've said before, initially the more you grow in subscriptions, margin falls because there is a sales cost before subscription.

So as the ARR curve rises, there comes a time where you achieve critical mass of inflows to meet what you started to receive and what you paid way back. Thus the trend for the model is to work in a positive scenario of margin expansion.

And there is also the scale. As more people have subscription there is more cloud, service scale and so forth.

And the last point is about the convergence of products, solutions and so on, which is a point we will be addressing from 2018 and 2019. This means we will work hard not only on Totvs' digital transformation, but also on our clients' digital transformation and on convergence not only of our software, but also that of our clients.

So now the presence of Fluig and Carol themselves will help a lot in the convergence of solutions of our clients, including with software from Totvs. And this also has expected margin gains.

Mr. Fred: perfect, thank you Laércio, thank you Maia.

Mr. Maia: thank you.

Operator: the next question is from Maria Teresa Azevedo, UBS.

Ms. Maria Teresa Azevedo: thanks for the question. I wanted to understand the strategy of migration from the current base to the subscription model. Will you carry out an active migration incentive campaign or is the strategy about focusing more on new clients?

My second question touches upon the competitive landscape. Do you see more pressure from competitors or even churn due to less customization? Thank you very much.

Mr. Laércio: let's start with the latter, the competitive landscape. The solutions Totvs has today are segmented solutions that aren't simply ERP software, ok? This means that even if running solutions in the cloud is easy, our foreign competitors here do not have native solutions for each one of the segments – so you were talking mainly about SMB, small and mid-sized businesses.

As such, just so you can use a foreign solution here, you'll need the foreign software, plus another to do the tax part, and then another that does retail, another for logistics, yet another for services, and so on.

So this has not changed the scenario from what we had; much to the contrary. I think now we can be even more competitive for having everything integrated in a single solution, a single offering.

On the issue of migration of new (clients) base, we have been working on new subscriptions and what happens is this: the market growing right now is the one hungry for subscription. So we understand that it is easier to get a new client and put him in subscription than to take an older client and convince him that he has to switch to cloud and so forth.

We divided base migration into two stages: the first stage is to make all our clients adopt Totvs' latest version. So, to do this migration, it is important that they come to v.12. This was something we did in 2016 and, mainly, in 17. So today we have the majority, over 90% of our clients, already on v.12 and that is super positive.

At the same time we are recommending to our clients that they start the de-customization process, meaning that the older or more conservative the client is, the more customization he has. The difficulty to bring him to the cloud and so on scales with how much customization he has. So we have an intermediate stage, which is what we're working on now. How will he de-customize? Removing all software alterations in the core and putting them in the Fluig layer, in Carol, apps and so on.

And then comes migration. In migration this is also what happens, as we've said in another conference call: at the moment that several clients sought reductions in monthly cost you migrated them to cloud, put in a subscription; the trend was to at least have a price hike due to the cloud itself. So now that Brazil is getting off the ground, all clients are already on v.12, within a digital transformation in a de-customization period, we are starting to move.

But in 2018 we are very much focused on subscriptions of new clients. I believe that the more we expand our client base, the greater our success and leadership will be.

Ms. Maria Teresa: perfect, thank you.

Operator: the next question comes from Marcelo Santos, J.P. Morgan.

Mr. Marcelo Santos: good morning everyone and thanks for taking my question, which are actually two: the first is about the subscription sales at franchises. From what I understand, a large share of subscriptions is still sold by own units. I wish to know what your outlook is on that, what incentives and what the barriers are that keep franchises from selling more.

The second question is that I'd like to ask you to comment a bit on opportunities and the M&A environment.

Mr. Maia: good morning Marcelo. With regard to subscription, you are right. When we look at subscription sales, the largest share or more than half of sales still come through our own sales teams. This was even higher in the past, if we look at one year ago we had, I'd say, maybe over two thirds of sales from our own sales team. Franchises have progressed a lot in this subscription sale process.

I think there is a side to it, as I've commented earlier. I think there's a learning side for the teams that still remember much about the licensing model, which was a triumphant model for over three decades, and it is natural that you recall it.

But the market itself is also changing to subscription. More and more people see subscription and cloud as a more natural alternative. It is important to remember that when we talk about Brazil, we're talking about an continental-sized territory. The franchises are in regions that have many differences among themselves around cultural behavior, so sometimes what I am telling you here is more true for big cities such as São Paulo, Rio, Belo Horizonte and so on, while regions farther out tend to be a little slower in picking up new trends. I think there's also this cultural angle as well, this barrier to be overcome.

Some companies still have a traditional view of having ownership of the software, of owning the infrastructure, curiously some still feel safer running the solutions on their own infrastructures – but I think this is a matter of time, as culture doesn't change overnight. In some way I also think this is good, as it also gives us time, the evolution is gradual - and it has been gradual, although fast. For this year we already imagine that franchises may even surpass our own channels' relevance in the total subscription sales.

The second question you posed about M&A, I believe M&A is a very important trait in Totvs' history, it was a company that I believed proved to the market that software consolidation was something that made sense. I remember that when I joined the company there were still some doubts about this point, when the company had acquired Logocenter not long before. I think it has been proven that M&A in the sector among the world's M&As may be the most relevant segment.

If it's not the first, it certainly is among the top three, and I think it is a sector that benefits a lot from M&A since it doesn't have many logistical barriers. We're talking about a solution that runs over the Internet, an intangible solution, it doesn't have that logistic restriction, so you can develop software in different regions around the world and have it interact through cloud, offering the client a good experience.

So M&A continues to be an important item in the company's strategy. Of course that today the company is going through a different moment in time, from that when it carried out a consolidation you could call a more macro market. Today Totvs, as Laércio himself already said when answering previous questions, the company has quite a broad portfolio – which doesn't mean we have everything, I don't think we will ever have.

Part of what we need to develop will be made in-house and the other part will be outsourced, and this will always open up opportunities for us to also consolidate operations and expand the company inorganically.

One other initiative that maybe Laércio can touch upon, that I think complements our strategy – not that it precludes the M&A strategy, but I believe it is a complement, very much in line with the new reality – is the launch of iDEXO, in the sense that we work more openly with the development community, with our clients, based on topics that are relevant to our clients and to us.

With that I believe we will accelerate the development of innovations on one side, and on the other, who knows, maybe we can also create consolidation opportunities in the future.

Mr. Laércio: I believe the iDEXO point is important, as an increasingly larger number of people share information. We are working jointly with our clients and there is also the sharing of data, Carol comes exactly for that. Aside from Carol, we see great value in the development community around Totvs, which always existed, but now in a structured way through iDEXO, together with our clients also in this endeavor. We will bring better possibilities of peripheral solutions for Totvs, which end up strengthening our presence in clients even further.

Mr. Marcelo: great, thank you.

Mr. Maia: thank you.

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

We are now closing the question and answer session. I'd like to invite Mr. Laércio Cosentino to proceed with his final remarks. Mr. Laércio, please go ahead.

Mr. Laércio: I thank you all for participating in this conference call. I wish an excellent year for all. I think this is a year in which Brazil has some important choices to make, but also a year in which it will certainly show very good growth and investment trajectories. We are working on this and I'm sure we will reap all these good results, which isn't simple, but we will get there. Have a nice day.

Operator: That concludes TOTVS conference call today. Thank you for participating and have a nice day.