

Operator:

Good morning. Welcome to TOTVS's 4Q14 and 2014 results conference call. Today we have Mr. Laércio Cosentino, CEO and Board Member, Mr. Alexandre Mafra, CFO, and Mr. Gilsomar Maia, IRO and Corporate Finance Officer.

We would like to inform you that all participants will be in a listen-only mode during the Company's presentation. After TOTVS's remarks, there will be a question and answer session for investors and analysts, when further instructions will be given. Should any participant need assistance during this call, please press *0 to reach the operator.

Today's live webcast may be accessed through TOTVS's website at ir.totvs.com.

Before proceeding, we would like to mention that during this conference call, forward-looking statements may be made relating to TOTVS's business prospects, operational and financial estimates and goals, based on the beliefs and assumptions of TOTVS's management and on information currently available. Forward-looking statements do not guarantee performance. They involve risks, uncertainties, and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur. Investors should understand that general economic conditions, industry conditions, and other operational factors could also affect TOTVS' future results and could make these results differ materially from those expressed in such forward-looking statements.

Now, I will turn the conference over to Mr. Laercio Cosentino, who will begin the presentation. Mr. Cosentino, you may begin the conference.

Laércio Cosentino:

Good morning everyone. Thank you for participating in this conference call and for giving us the opportunity to discuss TOTVS' 4Q and 2014 results.

In 2014, TOTVS was able to combine growth in revenue, net profit and in cash generation once again, despite the specially challenging environment created by the deceleration in the activity and the productivity of the Brazilian economy, which was also enhanced mainly by the World Cup and the presidential elections.

In parallel to this deceleration, cost inflation remained above the inflation adjustments on recurring revenues during the year, requiring higher discipline in cost and expenses management.

While the last 12 months IGP-M index ended the year in 3.67%, the IPC-A index reached 6.41% in the same period. The IGP-M is the index used to readjust the majority of TOTVS' recurring revenue contracts. The IGP-M shown more volatility in the short term than IPCA, but both indicators tend to converge in the medium term.

Although we haven't reached our internal goals of revenue growth and EBITDA margin for the year and the quarter, we believe that the results were significant, considering the Brazilian GDP growth close to zero.

We are not happy with the results. We are taking action to strengthen TOTVS as a company, but aware of the adjustments that are necessary for Brazil to grow again.

Now I invite Maia to comment on the quarter and annual results, starting on slide two.

Gilsomar Maia:

Thanks, Laércio, and good morning everyone. I would like to start by commenting on the recent events of the period. The first one is the payment of interest on equity related to the second semester on January 14th, 2015, in the amount of R\$ 19.5 million, corresponding to approximately R\$0,12 per share.

All the shareholders at the end of the trading session on December 22th, 2014, were entitled to this interest on equity.

The second event regards the second release of the BNDES financing line contracted in 2013, in the amount of R\$227.6 million, on November 2014.

With this inflow, the BNDES has already released 72% of the total amount approved in 2013. I remind you that the amortization period of this financing line is 72 months, including a 24-month grace period counted from the hiring date.

Starting the comments on the quarter and the year-end results, I ask you to move to slide 3. The net revenue grew 10% in 2014 and 5.6% in the quarter year on year, both below the last 5 year CAGR.

The services revenue was the most affected line by the reduction in the number of working days in 2014. Nonetheless, it grew 9.1%. When analyzed per working day, the average service revenue grew 11.9% in 2014.

On slide four we can have a better understanding of the revenue growth in the most representative market industry sectors.

The chart on the left shows the representativeness of each industry sector in the total net revenue. The chart on the right shows the year on year growth of each of these industries.

Retail grew 22.2% and increased its representativeness from 7.4% in 2013 to 8.2% in 2014.

The differential of TOTVS offerings to this market industry comes from the integration of TOTVS' back office solution with point of sales, credit analysis, queue management and inventories solutions, integrating the retailers with the other members of their value chain.

Financial Services grew above the average in 2014, increasing its share to 8.5% of net revenue. This industry is a traditional information technology investor, with relevant contribution to the recurring revenue and to the integration of other market industries.

On the other hand, manufacturing grew less than the average once again. Thus, its participation in the net revenue, which was 35% in 2011 and 32% in 2013, reached 30% in 2014.

This is a very important industry sector too, since it also contributes relevantly to the recurring revenues and plays an important role in the value integration approach. Among the other industry sectors, that in aggregate grew faster than the total net revenue, the highlight was the healthcare sector, which grew almost 40% year on year.

On slide five, which shows the dynamics of license revenue in 2014, we can realize that starting from the graph in the top left side, we see that the growth of 3.7% of license revenues resulted from the growth of 6.5% in subscription and 3.1% in traditional licenses sales.

On the right, we see that the growth in revenues from subscription was driven by sales to new clients, which grew 147% in the year. It is important to highlight that these sales represent only the first monthly subscription, since the second one becomes part of the recurring revenue of existing clients.

Thus, the subscription revenue from existing customers, which grew 5.8%, takes approximately 12 months to fully capture the growth of each new client added.

In the lower left corner, we can see that the growth of the traditional license revenue was concentrated in sales to new clients, which grew 10.9%. These sales were most impacted by larger projects, which is evident in the 30% increase in the average ticket per transaction and in the 20.6% decrease on the number of clients added, shown in the chart on the right.

Also in this same chart on the right, we can note that the subscription model added 849 new clients, 89.5% more than in 2013, with emphasis on the 4Q14 when 295 clients were added, accounting for a growth of 156% over the 4Q13.

It is part of our commercial strategy to improve the subscription sales and consequently, the recurring revenues.

Now, let us move to slide six to talk about the recurring revenues. In 2014, the total recurring revenue exceeded R\$1.0 billion and reached 58.9% of the total revenue. Between 2013 and 2014, the recurring revenue grew 14.4%, while maintenance grew 13.3%.

Excluding the non-recurring effects of approximately R\$11.7 million booked in maintenance revenue in 4Q13 and R\$33,2 million of revenues of acquired companies not fully consolidated in 2013, the growth in maintenance revenue was 10,7% in 2014.

The Company's recurring contracts are adjusted every 12 months in the "anniversary" of their signing dates, mostly by the IGP-M index of the last 12 months. Thus, the recurring revenue captures the inflation of the current year, and the immediately preceding year.

On slide seven there is a chart with the history of the IGP-M. If we assume a linear distribution of anniversaries throughout the year, the recurring revenue would have captured 5.8% of adjustment in 2014. This percentage represents the midpoint between 6.2% and 5.4%, which are the 12-month IGP-Ms of 2013 and 2014, respectively.

Thus, the 10,7% of maintenance growth in 2014, as mentioned before, accounted for almost 5 p.p. of growth above the average IGP-M for the period.

Still in the chart, we have the IPCA history, which is the index used by the Brazilian government to measure country's inflation. Note that the average 12-month IPCA of 2013 was 6.2%, the same as the IGPM level of that year. However, the average 12-month IPCA of 2014 was 6.3%, 0.9 p.p. higher than the IGP-M.

Thus, it is clear that there was a mismatch between the revenue inflation and the cost inflation in 2014. Now I turn this presentation back to Mafra, so he can comment on the cost and expenses, on slide eight.

Alexandre Mafra:

The operating costs and expenses grew 10.4% in the year and the direct personnel costs and expenses accounted for 49.3% of the total operating costs and expenses.

The collective bargaining agreements of 2014 resulted in a weighted average salary readjustment of 7.2%. In São Paulo, this process didn't allow personal layoffs for 10 months. Personal layoffs historically occur naturally along the year in order to adjust the cost and the salary structure.

This process caused a higher number of layoffs in the 4Q14, resulting in additional costs of approximately R\$5.8 million.

These layoffs, summed up with the salary readjustments from the collective bargaining agreements closed between September and November, resulted in approximately 3.4% of growth in payroll between the 3rd and the 4th quarter.

The cost group related to license fees, cost of services and R&D expenses, presented in the first line on the top of the chart, concentrates the major part of the personnel expenses, and, consequently, was the most affected in the 4Q14.

Besides these impacts, the growth in this cost group as a percentage of net revenue is mainly due to: the headcount growth, mostly related to technical support and the consulting division; the maintenance of investments in industry sector specialization; and the innovation in technological platforms in 2013 and 2014.

The decrease in the marketing and selling expenses group's relevance, as a percentage of net revenues, is chiefly related to the communication strategy that was more concentrated in the pre-World Cup period.

Now, going to the group of administrative expenditures. The growth in these expenses is mainly due to the integration of the administrative teams from the companies acquired between 2013 and 2014.

This group's reduction in the 4Q14 is basically due to the reduction in the G&A expenses, that were affected in the 3Q14 by additional M&A expenses of approximately R\$2.7 million.

Here, it is worth mentioning that we will maintain our efforts to enhance the administrative efficiency in both the daily basis activities and in the integration of acquired companies.

Going to the consolidated EBITDA on slide nine. The EBITDA margin ended the year in 24.6%, 30 basis points below 2013. This reduction was mainly caused by the mismatching in the inflation indexes mentioned before by Maia.

Besides the inflation indexes mismatching, the fourth quarter margin was also affected by non-recurring expenses from the payroll adjustments and by the impairment provision of R\$ 1.6 million related to the Umove.me intangible assets valuation, booked in the other expenses line. When the non-cash impact of this impairment is adjusted, the 4Q EBITDA margin will reach 23.7%, a growth of 30 basis points over 4Q13.

Now, let us move to slide 10 to discuss the net profit. The net profit totaled R\$69 million in the quarter, 13.7% higher than the same period of the last year, with net margin of 15.2%, or 110 b.p. higher than 2013.

In 2014, net profit grew 17.8%, 9.1 p.p. above the EBITDA growth, with a margin of 14.8%, 100 basis points over 2013. 2014 net margin is the highest margin ever achieved by the Company in a fiscal year since its IPO in 2006.

This net profit growth, above the EBITDA growth is chiefly due to: a better financial result in 2014; a lower effective tax rate; and a lower depreciation and amortization growth. The positive financial result was affected by the combination of financial revenue growth due to a higher financial investment position during 2014 and the reduction in the mark to market expenses from the convertible debentures.

The lower effective tax rate was mainly due to higher fiscal benefits from “Lei do Bem”, due to the higher relevance of R&D expenses over the net revenue and the EBIT, and due to the nondeductible debenture mark to market financial expenses commented before.

Now talking about dividends on slide 11. On January 26, 2015, the Board of Directors approved the proposal for distribution of dividends to be submitted for deliberation at the General Shareholders' Meeting. The proposal provides the distribution of R\$124.4 million in dividends for 2014, resulting in R\$0.77 dividend per share.

Assuming the total dividend proposal – sum of interest on equity and dividends – the Company will pay R\$ 1.02 per share, representing a payout of 63% and an increase of 6.9% on the remuneration per share over 2013.

On slide 12 we have the evolution of the cash position during 2014. We started the year with nearly R\$87.5 million in net cash and R\$533 million of gross cash.

The main reasons that caused this variations in cash position were: the Operating cash generation of R\$332 million, corresponding to 76.1% of 2014's EBITDA; investments in intangible assets of R\$102 million, related to the acquisition of Ciashop, the payment of PC Sistemas' earn-out in the 1Q14, and the acquisition of Virtual Age in the 2Q14; the payment of R\$158 million of dividends and interest on equity related to the first nine months of the year; and the second release of the BNDES financial line contracted in 2013, net of other amortizations, in the amount of R\$174 million.

TOTVS ended 2014 with a net cash position of R\$68 million and a gross cash of R\$698 million, which shows our potential for cash generation and our financial capacity to implement the organic and inorganic investment plans.

Now, I invite you to move to slide 14 for the final remark of Laércio.

Laércio Cosentino:

Overall, even considering the context explained during this conference, the Company ended 2014 showing: 14.4% of recurring revenue growth; 90% of growth in clients added under the subscription model; 10.0% of net revenue growth; 17.8% of net profit growth; and 17.7% of growth in operating cash generation.

We continue to believe in the potential of Brazil and its entrepreneurs. Even with the potential short-term negative effects that the recent measures taken by government's new economic team may cause, this adjustment in policy should be very important for the country to regain the market's confidence, the confidence of entrepreneurs and to establish the basis for a new cycle of growth and investment.

We will maintain our investments in innovation, specialization by industry sector and in quality, having the client as our main focus, without losing sight of cost discipline. Technological innovation is a key tool for increasing productivity and the competitiveness in companies, especially medium and small ones.

In this sense, we have decided to expand our sales efforts in software subscription models during 2015. We will continue to work hard to make TOTVS even: simpler – in its processes and structures; more agile – reducing the development and implementations cycles; more connected to our clients; more cloud – promoting integrated platforms and management solutions in the cloud; more essential – to the core business of our clients.

From now on, we are available for the Q&A session.

Michel Morin, Morgan Stanley:

Good morning. Two questions, if I may, Laércio. I was wondering, 2014 was a more difficult year, clearly. Do you feel confident that there has been no change in your competitive position in the marketplace? In other words, are you maintaining your market share or do you even think that you practically even gained market share in a difficult market environment?

And the second question would be around the pricing. You mentioned the impact of the inflation adjustment factor being lower in this particular quarter, but, more broadly, do you have the ability to raise prices irrespectively of that inflation adjustment? Can you go above and beyond that? What flexibility would you have to do that at some point? Thank you.

Laércio Cosentino:

Hi, Michel. The position market seems unchanged for TOTVS in the 4Q. If you analyze the Brazilian market and the net revenue growth of 10%, I think the Brazilian market in technology information grew less than us.

Gilsomar Maia:

And the second question regarding inflation, based in our history, we understand that we have a completely good capacity to pass through the inflation impact.

Especially in times like these in which we see inflation spread all over all sectors in the economy, we see a similarity in terms of condition of our customers, also, passing through their inflation with their customers. In this way, we understand that we have this ability to pass through the inflation.

Michel Morin:

Great, thank you very much.

Gilsomar Maia:

You are welcome.

Ivan Hernandez, Scotia Bank:

Hello. Just one question. Obviously, the growth on the subscription model was very strong, 156%; I think that is very strong. However, my question is whether those new clients are also buying maintenance licenses, I mean, those plans are also paying for installation fees.

In other words, whether the acceleration of new clients on the subscription model should also impact maintenance services, because obviously maintenance services were slower on a quarterly basis, actually, maintenance fell 0.4% on a quarterly basis, which does not seem to be matching the fact that you are accelerating sells, for me planned on the subscription model.

So, I was just wondering if you are expecting that the subscription model should also help you accelerate not only license fees revenues in the future, but also maintenance services.

Gilsomar Maia:

In this quarter, we brought a breakdown of our license revenues, separating what is the portion related exclusively to that traditional license sales model and the subscriptions sales model. The subscriptions regarding the license generally affect the maintenance, statically.

Getting back to your question, if we consider that part of our traditional license sales growth tends to be captured by the subscription models, yes you are right, it can affect not only the license revenues growth, but also the maintenance, because the license brings the maintenance growth in the moment just after the license sales. You are right.

But we understand that, in the case of subscriptions, we have a recurrent model similarly to maintenance; that is the reason why we separated the figures. So, actually, when you see in our earnings release that line describing the subscription model revenues from the existing customers, that, in fact, is a recurring value, because that comprises the second subscription on. Only the first one is reflected in the new clients sales and from the second one on we consider as sales to existing customers. I do not know if it is clear to you or not.

Ivan Hernandez:

It is clear that after the first month the revenues go to recurring inside licenses, right? But I was wondering if, normally, what we are seeing in the market is that new plan on the subscription is also paying for installation and maintenance in addition to its license.

Gilsomar Maia:

Our subscription comprises already maintenance there. The installation, you are right, it separates in the service revenue line, but if you take into consideration that most of those customers under subscription seem to be smaller customers, the volume of implementation services that those projects generate are proportionally much lower than sales of traditional license models, at that point.

In our understanding, in the beginning of this process of adoption for subscription, we will more probably see other companies adopting firstly the subscription model, and consequently can produce less impact in terms of services growth. Big customers, normally supported by our private division and under traditional license models demand more for services, proportionally, much more than the smaller companies under subscription.

Ivan Hernandez:

OK. Thank you.

Sunil Rajgopal, HSBC:

Sorry, I just wanted to check: the company had stopped giving guidance for the future and particularly considering the weak macro backdrop in Brazil and then there is a shift in the strategy in the business model as such. So, I wanted to check what are your expectations for this year in terms of revenue growth and EBITDA margin. Are the 4Q levels the new levels or should we think that there could be an improvement in the overall environment for this year?

Gilsomar Maia:

Actually, one of the motivations for the transitions to subscription was the different scenario in terms of macro-economy compared to our projects in the past. So, when we projected our targets, our goals, margins, we took into consideration a certain level of revenues, obviously, to scale up our operations and provoking some margin gain.

As we saw the economy in a much lower level of activity, this compromised our sales and revenues and, consequently, the scale was lower than it was imagined at that time.

Being frank, for this year we have the economy as an external factor that affects not only TOTVS but all companies in the market.

We understand that our model is a resilient one, not just because we have a relevant portion of our revenues as recurrent revenues, but also because we have a low concentration of customers. We have a very spread presence all over the country, in segments and companies in different sizes and, in our view, we understand that subscriptions should keep that performance, growing.

It is hard to be precise now because we are just in the early stage of that subscription process. And, being clear, we do not expect license to bring, annually, any very relevant growth. Of course, it will depend on the demand of the market for license.

We believe that medium to large enterprises will keep their demand for license, and in that specific term, historically, what we see is sales to new clients under traditional license models being more affected by the macro-scenario than subscriptions.

Actually, we do not understand that we can have a big change in our topline dynamics. Especially if you consider that we are already running our maintenance with a low level of IGPM. If any of the measures taken by the government increases IGPM in the near future, it can, in the future, have a response in the maintenance line in the other recurring revenues. That is relevant for our revenues and can probably at least partially compensate any negative side of the macro-scenario economy.

Sunil Rajgopal, HSBC:

Right. And do you have any update with regards to the EBITDA margin progress or should we expect this year to be... I mean, in comparison to 2014, do you think it will be more of a level of 4Q or do you think there is a scope for accelerating the margins, because I understand that there is substantial pressure on the personnel costs, which are going up higher than what the inflationary cost could be passed on to the consumers?

Gilsomar Maia:

Look, in terms of cost pressures, we have two big moments in the year: one is the Q4, as you could see in this quarter – when we have almost 50% of our payroll being adjusted – and the other 50% is adjusted in the 1Q. So these two moments of the year are the most pressured moments in terms of costs. And we have the rest of the year to “capture” inflation over our revenues.

In terms of EBITDA margin, which was your question, probably we tend to have a little bit more pressured margins in the beginning of the year because the other half of our payroll will be adjusted. And if you take a look in our historical figures, you are going to see that in the 1Q we have one event called incremental license fee from the corporate module. That historically represents about 20-30% of our license revenues in the 1Q.

So we depend on the performance of that corporate module in the 1Q. In the rest of the year I believe that the dynamics of our revenues can probably recuperate part of the effect of this pressure from the beginning of the year. It is hard to establish here if it is going to be completely stable, a little bit higher, because it will depend on the dynamics

of traditional license sales and also the adherence or the adoption of subscriptions from the market.

Sunil Rajgopal:

Sure. Thank you very much for that.

Operator:

I will turn the conference over to Mr. Laércio Cosentino.

Laércio Cosentino:

I want to thank you all for participating in this conference call and I want to say that we will continue developing ourselves during 2015.

Operator:

Thank you. TOTVS' 4Q results conference call is over. Have a nice day.

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