Operator:

Good morning. Welcome everyone to TOTVS' 1Q14 results conference call. Today with us we have Mr. Alexandre Mafra, Human Relations and Organizational Infrastructure Vice-President, Executive and Financial Vice-President, and Mr. Gilsomar Maia, Investor Relations Officer 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' 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' website at ir.totvs.com.br.

Before proceeding, we would like to mention that during this conference call, forward-looking statements may be made relating to TOTVS' business prospects, operational and financial estimates, and goals, based on the beliefs and assumptions of TOTVS' 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 cause these results to differ materially from those expressed in such forward-looking statements.

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

Alexandre Mafra:

Good morning, everyone. Thank you for participating in TOTVS's 1Q results conference call. Before we talk about the results, I would like to comment on the main events presented on slide two that occurred after the 4Q13 results. The acquisition closing of 70% CiaShop's shares on February 6th, which became the TOTVS SaaS solution of cloud platform to support its clients' e-commerce operations in several industry sectors.

The reelection of the Board of Directors' members mandates for the next two years, approved by the Shareholder's Meeting held on March 14th. Just recalling, the Board is formed by Pedro Passos, as Chairman, Germán Quiroga, as Vice-Chairman, Laércio Cosentino, founder and the current TOTVS's CEO, Luis Carlos Afonso, Sérgio Földes, Maria Helena Santana, who also chairs the Audit Committee, and Pedro Moreira Salles, who also chairs the Remuneration Committee.

This same meeting also approved the distribution of R$115.9 million in dividends, corresponding to R$0.71 per share, totaling R$155.8 million of total shareholders' remuneration for the financial year of 2013, corresponding to R$0.95 per share. This total remuneration is 31% higher than the one approved in the previous year.

We also held "TOTVS Universe" on April 15th, the Company's biggest annual event, which was attended by more than 2,700 guests, including clients, prospects, partners, franchisees, journalists, buy-side and sell-side analysts, who could know a little bit more about our solutions and strategy, as well as the main trends of the software market.

Now, I turn the call to Maia, who will proceed by sharing with you our operating and financial results on slide three.

Gilsomar Maia:

Good morning, everyone. Before starting the comments on the results, I would like to remind you that the financial information regarding this quarter and the last 12 months already includes CiaShop's full 1Q figures. The total net revenues grew more than 15% in the quarter, compared to the same period of last year. In the last 12 months, the 16% growth also exceeded the last 5-year CAGR. The three revenue lines grew relevantly, with 16% growth in licenses fees, 17.5% in services, and 14% in maintenance fees.

Moving on to slide four, on the left, we have the breakdown of license revenue between the incremental license from corporate model and other licenses. The incremental license from the corporate model totaled R$20 million in the 1Q14, an increase of 20% over the same period of the past year. Besides the higher amount of the incremental revenue, the number of clients under this model that had to pay for an incremental license fee increased 7.6%.

It is important to recall that clients under this model pay an incremental license fee in the 1Q of the year, based on their real growth in the previous year, and also have unlimited number of accesses to TOTVS management systems. Thus, there is only incremental licenses if these clients grow. Since most of the clients under the corporate model are medium and small companies, historically this model has been able to accelerate its growth in times of economic expansion and also be resilient to economic downturns.

It can be seen in the graph on the right side, which compares the incremental licenses revenue from the corporate model with the previous year's Brazilian GDP growth in a 5-year period. Returning to the graph on the left side, we also see that the other licenses grew 15% in the quarter. This growth was mainly due to the sales to new clients, which grew 98% year on year. This performance was positively boosted by larger sales closed in the quarter, shown by the 104% increase in the average ticket over the 1Q13.

Relevant short-term variations in the average ticket are typical for TOTVS and reflect the Company's capacity to provide solutions for clients of different sizes and industry sectors, as well as the historical non-linear distribution of large accounts closed during the year. This becomes more evident when we take into account the 4% growth in the 12-month average ticket of sales to new clients. In the same 12-month period, license sales grew by 10.7% as a whole, with a 6% lower average ticket and an 18% higher number of sales.

This higher number of sales, combined with lower average ticket, shows the investments fractionation made by clients, who are reallocating resources from short to long-term. In practical terms, it means less investment in licenses in the short-term, more implementation projects with reduced scope, and more resources allocated to recurring monthly maintenance payments over the years.

This fractioning approach is typical of small and medium companies, though larger companies have also adopted it recently. Example of that is the lower growth in license fee revenue, compared to services and maintenance revenues in the last three years.

The commercial and technological flexibility, reflected in the diversity of commercial models and in the solutions portfolio, also encourages this fractioning behavior and it is one of the main attributes that explains the Company's market leadership and the revenues consistency.

Some examples of this flexibility are the license sales per concurrent user or under the corporate model; the possibility of implementing solutions in stages, respecting the client's maturity and needs; and the recurring monthly maintenance payments.

Speaking of recurring revenues, on slide five we present the total recurring revenues, which grew 12% in the quarter, reaching almost R$1 billion in the last 12 months. The recurring revenues expansion is part of the Company's strategy for growth and margin expansion. Monthly payments of maintenance, subscription, and cloud computing services tend to gain more relevance in our net revenue, contributing to the costs dilution in the medium and long term.

Regarding costs and expenses, I invite everyone to go to slide six, where we have the costs and expenses as a percentage of net revenue. The collective negotiation process regarding the wage increase of participants from São Paulo affected costs and expenses in the 1Q14. This year, this process has yet to be concluded, but the Company conservatively accrued a wage increase of 7%, as of January 1st, in accordance with trade association proposal.

Moving to the costs and expenses groups. The first group, which represents the cost of our solutions, decreased when compared to both the 2Q13 and the 4Q13. This reduction can be seen in the three lines of costs – licensing fees, services, and R&D. In R&D, the reduction is mainly due to the consolidation of RMS's results from August to September in the 4Q13, additional provisions for vacations and 13ths salary in the 4Q13, and the conclusion of some projects in the 4Q13 in which more development partners participated.

In the last 12 months, R&D expenses increased 27%. Here, once again, we reiterate our commitment with costs and expenses discipline without putting new growth cycles at risk, and always taking into account the return on invested capital.

The reduction in cost of license fees in this quarter reflects the lower share of embedded complementary third-party solutions and infrastructure solutions provided by our partners in the software sales. And, concluding comments on this group, cost of services expanded at a lower rate than service revenue both in the 1Q14 year-on-year and in the last 12 months comparisons, reflecting the greater efficiency of services teams.

These productivity gains are positive for TOTVS and especially for our clients. To address this matter, we have initiatives such as the expansion of simultaneous implementations performed remotely; investments in developing implementation templates, which aim to make implementations faster and more effective; in addition to the growth of cloud services.

This second group, linked to sales, represented a higher share of net revenue, both in the 1Q14 year-on-year and in the last 12 months, mainly reflecting higher expenses with allowance for doubtful accounts. This growth in allowance for doubtful accounts is mainly due to the overdue credit recovery in the 1Q13 and to financial problems faced by large clients in the 1Q14.

Selling and commission expenses together grew less than net revenues in the 1Q year-on-year comparison and in the last 12 months. These expenses are directly related to sales by own branches and franchises, as well as the breakdown of net revenue in the period, considering the different commission levels on the revenue lines.

Moving to the last group, administrative costs maintained their representativeness over net revenue in the quarter, when compared to last quarter, even with the accrual for São Paulo's wage increase and for management variable compensation.

Now, I turn the presentation back to Mafra, who will continue from slide seven.

Alexandre Mafra:

The efficiency gains in the main groups of costs and expenses raised the EBITDA margin to 26.5%. This margin represents an increase of 40 b.p., compared to the 1Q13, and 310 b.p., compared to the 4Q13. EBITDA increased 17% and amounted R$114 million. This growth is higher than the last 5-year CAGR, which demonstrates the relevance of the evolvement presented in the 1Q14.

On slide eight, we have the net income increase, which was higher than EBITDA's, both in the year-on-year and the LTM comparisons. In the quarter, despite the adjustment of the debentures interest accrual, the net income increased 18%, mainly driven by the EBITDA growth and lower depreciation and amortization in the period. Thus, 1Q14 net margin reached 14.3%, representing an increase of 40 b.p. over the 1Q13.

Now, on slide nine. The Company ended the quarter with almost R$0.5 billion in cash. Net cash totaled R$90 million, about R$3 million higher than the 4Q, even with the amortization of R$26 million of the financing line hired from BNDES in 2008, the payment of R$19 million as interest on equity related to the 2H13, and the disbursement of R$37 million in acquisitions, mainly related to the acquisition of 70% of CiaShop's shares and the earn-out payment of PC Sistemas.

It is worth mentioning the dividends approved at the Shareholder's Meeting held on March 14th, totaling R$115 million, were paid on April 10th. Thus, the impact of these dividends will be reflected in the 2Q14 cash flow.

The Company's cash balance, combined with its next period's cash generation and its debt profile, which is very cost and term competitive, reinforces our financial capacity for organic and inorganic investments, aiming primarily to reinforce our operations in more prominent industry sectors, in terms of growth, in our technology platform, and in our presence in Latin America.

Now, I invite everyone to go to slide ten. In summary, the 1Q results highlights were the 15% growth in net revenue, the 20% increase in incremental licenses from the corporate model, the 14% growth in maintenance fee, the 17% growth in EBITDA, the 40 b.p. expansion in the EBITDA margin year on year and 310 b.p. quarter on quarter, the 18.7% growth in net income. We know that 2014 is an unusual year, but the intensity, which we started the year, shows that we are on the right track.

The entire TOTVS team is committed to the challenge of driving the EBITDA margin to a level of at least 27%, projected in our guidance. Moreover, the variable compensation of our executives and participants is based, among other metrics, on the achievement of this level of operational efficiency.

The challenge is to enhance the efficiency in a sustainable way, without putting at risk the investments for new growth cycles, especially those related to the innovation of our technology platforms and the industry specialization process.

In the end, our innovation and efforts aim to make our clients more competitive in their businesses and TOTVS simpler, more agile, more connected, more cloud, and more essential, because we know that our success relies on our clients success.

Now, we are available for the Q&A session.

Vera Rossi, Goldman Sachs:

Hello. I have two questions. My first question is about the license revenues, do you think the level of growth we saw in the 1Q in the mid-teens is sustainable for next quarters?

And my second question is about your provisions for bad debt. Is that: what is causing these increases in provisions of bad debt as a percentage of revenues, and also the increase in number of days in accounts receivable? Thank you.

Gilsomar Maia:

Good morning, Vera. Thank you for the questions. Starting from license, your question was relating to the sustainability of this license growth we had in this quarter. In practical terms, it is hard to state here that this percentage of growth is going to be absorbed in the following quarters. Really, we always try to drive ourselves more based on last 12 months vision than based on a single quarter, and we understand that the market is pretty similar. We have not seen any deterioration in our pipeline, but we understand that things we did in the past have gradually been converted into results, and in our understanding we have a chance to be better in license and in the other lines, this will be more a consequence of our own efforts than a matter of market enhancement, if I am clear in my explanations. So, actually what I mean is we understand that we can do better this year as a whole, in license. It is not a simple challenge considering all the events we have this year and the particularities they bring to the market. But to achieve our goals, we have to go in that direction.

Going to bad debt. Bad debt is running, specifically in this quarter, in 1.8% of our performance revenue. It is one of the higher levels we had. It is a little bit above the percentage of net revenue we had on full-year figures from last year; that was about 1.6%. We have seen really some financial difficulties, especially among large companies. And really, it is not a systemic problem. It is more concentrated in some specific and a few list of names.

We are not comfortable with that level since 2013, but really conservatively, the Company has to have a provision for allowance for doubtful accounts. We have no option at all. So, in our view, we have to stay conservative. But in other hand, of course, we will try to control as much as we can. But really, since we have seen some financial difficulties from customers, it is hard to give to you now some signal that we can change that reality in the short term.

And going to the last question relating to specifically the days of our accounts receivable. There is a connection between accounts receivable and specifically license. Because breaking down our total revenue into the three lines, maintenance is a monthly payment; services, depending on the moment, we have about two months of accounts receivable, I would say; and then part of our revenue that we have more tenor is related to license. So, in a quarter in which we have that performance in license, it reflects some incremental accounts receivable. It is more connected to the revenue breakdown, and also thematically we have been able to give credit for customers, historically, especially for small and medium, but it is more connected to the license performance of the quarter. I do not know if I addressed properly all of your questions.

Vera Rossi:

Yes, thank you very much.

Michael Morin, Morgan Stanley:

Yes, thank you. Good morning. I was hoping to talk a little bit about the license revenue growth. First of all, thank you for the apt disclosure on the contributions from M&A over the last 12 months. That is very helpful. I am wondering, has the M&A had a disproportionate impact on your license revenue growth this past quarter? Does that create a little bit of noise in the number that we are looking at?

And then regarding your gain of some large new accounts, what can you tell us about the competitive landscape? Are you picking up these accounts from competitors? What is driving the performance there? Thank you.

Gilsomar Maia:

Good morning, Michel. Really, in terms of acquisitions, the impacting license is very low. Really that impact is more concentrated in services and maintenance. So, just for a kind of generical calculation, if you assume like trying to break down that R$11 million we disclosed in our total net revenue, excluding license and trying to infer how that revenue could be breaking services and maintenance, based on the relevance of those two lines in our total net revenue, probably it would give you a good sense about the contribution, but really the contribution license is almost nil.

In terms of competitive landscape, we have not seen significant changes in this quarter specifically. Again, in our view we understand that measures we took in the past related to industry specialization and things related to training programs for people related to that strategy, enhances our capacity here.

In terms of acquisitions helping us on that, indirectly in some cases, yes. And companies we acquired that are already considered in the previous year's figures are also performing well. And in the aggregate, you know that after the acquisition announcement, we helped companies we acquired and, on the other hand, they also help us organically. In our organic view, the performance of license is pretty related to our organic performance.

Michel Morin:

Great. Thank you very much.

Richard Dineen, HSBC:

Thanks and good morning, everyone. Just actually a follow-up, I think really, to Vera's question earlier, on the maintenance revenues. In the drivers of the maintenance revenue growth this quarter, you talked about the sort of flow through from the license sales in previous quarters. I guess, just given your comments on some of the difficulties that you might face with license, maintaining this current rate of license growth, what is the implication there for the maintenance revenue as a result of that? If you could maybe just help us sort of explain how one could impact the other if we are going to be taking down those expectations in future quarters? That would be helpful, if that makes sense. Thanks.

Gilsomar Maia:

Hi, Richard. Really, in terms of performance of this license and connecting them to maintenance specifically, before entering this cause and effect of license and maintenance, I just want to remind you about that R$9 million we had in the 4Q in the maintenance. We disclosed that R$9 million was a non-recurring event, even though relating to maintenance.

Because we were regularizing some contracts relating to maintenance at that moment. So, if you exclude that R$9 million in the 4Q and compared it to the 1Q, you are going to see that the real performance of maintenance. In our comments related to maintenance, we realize that but I just want to remind you about that.

Richard Dineen:

Yes. Right, thanks.

Gilsomar Maia:

Going back to license now. In our business model, yes, there is a cause and consequence effect relating to maintenance and license. Of course, the previous performance we have been having about license you are right, it impacted also maintenance. But what we mentioned in our earnings release is, there is a fractioning behavior of our Company. The companies are trying to invest upfront less in license, and in those negotiations, they are opener to say even higher level of maintenance. So, preserving the recurring revenue in the negotiations.

So, we are flexible sometimes in this sense, and what creates in a longer term is slightly changed in the correlation between license and maintenance. So, we take the last three years, we have seen license growing much less than maintenance, for example. I know that part of that comes from inflation adjustments, but another part is related to these fractioning behaviors of the sales we have been able to close. Projecting the potential impact of these license performance recently, we have a lag from license sales to maintenance impact. In average, historically, it is about two quarters. Specifically, when we talk about large accounts, this lag is a little bit larger because projects related to the implementation of those large accounts sometimes takes more time than normally it takes in small and medium accounts. So, it tends to take a little bit longer to reflect the maintenance.

But on the other hand, we have been able to pass through inflation in a very good shape. And also the retention of our customers is also pretty stable. So, in my view, since we have a good base line of maintenance, it is not going to be simple to keep the same performance of maintenance, but on other hand, we have good attributes to conduct maintenance in a good shape for the rest of the year.

Richard Dineen:

Right, OK. Thanks for helping us on this. Just a super quick follow-up, if I may. You talked before, we had the *marco civil* signed by the President last week. And then in the past you kind of played down any significance of that on your business. And that is quite understandable that it is not obviously directed mainly in your part of the market. But I am just wondering, given that there may be a few little sort of changes, I just wanted to confirm that is still your expectation, or is there anything that you have seen that could potentially have some bearing on TOTVS in the near or indeed long term from that pretty important bit of legislation? Anything there will be helpful as well.

Gilsomar Maia:

OK. So, there is no direct impact from that in our business. Indirectly, it can affect all companies in the market. But directly, no, it does not affect us directly.

Richard Dineen:

Right, OK. I guess that is what we can see. Thanks for the clarification. Thank you, gentlemen, and thanks for the call.

Operator:

This concludes today's question and answer session. I would like to invite Mr. Alexandre Mafra to proceed with his closing statements. Please, go ahead, sir.

Alexandre Mafra:

Thanks again for your participation and have a great day.

Operator:

Thank you. TOTVS's 1Q results conference call is over. Have a nice day. Thank you.