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.

Operator:

We are now available to take your questions in the Q&A session.

Susana Salaru, Itaú:

Good morning. You just reiterated your goal of reaching an EBITDA margin of 27%. What are the key drivers you think you will use to reach this margin, among efficiency gains, R&D levels, and marketing expenses? Thanks.

Gilsomar Maia:

Good morning Susana. As for the 27% margin, I think most of you remember that this is our guidance that we have been forecasting for a few years now, for the period between 2013 and 2016. We are currently in this period and are targeting an EBITDA margin of between 27% and 30%.

As discussed in the previous quarter, last year ended up below this range but we continue to pursue it this year. Obviously, 27% is challenging for us, given the margin last year, especially in the last quarter, but this is our target for this year. As Mafra concluded, we are actually sharing the metrics that are being internally pursued by the whole team.

How do we plan to reach this margin? There is a cost management aspect, especially of fixed costs as well as administrative expenses, and even R&D. Of course, I consider R&D, not from an accounting standpoint, but from a financial standpoint, as CAPEX, which is where the Company really invests. So, I have to be careful when looking at R&D as investment but seeing it as an expense in terms of dilution. I have to make good investments that will bring me revenue and dilution.

For example, last year there was a gap between the increase in R&D and revenue growth. Within this rationale, we will seek to dilute costs as a whole, and R&D is no different.

As for service costs, we have been saying for a few quarters now that we are taking efforts to gradually improve service margins. And if we manage to maintain the brisk sales pace and achieve our internal sales targets for the year, there will be a dilution of our cost structure as a whole, including our selling expenses.

I would say these are the main aspects, in addition to our growth target for the international market. As you know, we have a history of negative results in the international market. In 4Q11 we set the target of breaking even the international market in 4Q14 and have progressed in the past two years by reducing the negative results and increasing revenues. So, this year the international market too could make a contribution.

Suzana Salaru:

Perfect. The breakeven in the international market you are aiming at is in the second half?

Gilsomar Maia:

Yes.

Suzana Salaru:

Thanks.

Daniel Federle, Credit Suisse:

Good afternoon. My first question is about license sales. During the whole 2013 you mentioned a lot about market demand and that the pipeline was growing, but the conversion was increasingly taking longer, as the negotiations. I would like to know if this scenario is getting better, whether conversions are taking less time now, or whether the orders in this 1Q were conversions of older ones that were already in your pipeline.

My second question is about costs, just to shed a little more light. Is there a possibility of a nominal reduction in costs, or is this margin gain really originating from a lower increase in costs than top line growth? Thank you.

Gilsomar Maia:

Good morning Daniel. Starting with licenses, which was your first question, we had a slightly higher concentration in larger accounts in the pipeline this quarter than in the past few quarters. Signing up large accounts usually takes longer, and we had been working on these large accounts since last year.

As mentioned in our presentation, this situation of a higher ticket concentration is typical to our business. This is normal. At times, when you are close to signing up number of large accounts, the team's attention could momentarily shift away from other accounts, which is natural.

But the pipeline as a whole has been quite consistent. I don't know if I would call it a progress in the pipeline. Our efforts have been focused on shortening the process of converting these opportunities into sales.

Overall, the quality of the pipeline is neither better nor worse than it was a year ago. It is similar. Nevertheless, as you have been noticing, we are gradually reaping the benefits of all our efforts in recent years, both in our portfolio of solutions and in building teams, all in line with the segmentation strategy. This is gradually gaining momentum and that is our vision: to gradually see the results of our efforts.

As for the nominal reduction in costs, I don’t see it because of the following: as I told Susana, now and what we even mentioned in 4Q, because of the decisions we took last year to continue the projects and maintain our investments even if they were not in line with our revenue at the time, we are well prepared and have a more robust structure for this year. However, our challenge this year is to do more with the structure we have. I don’t see much room for nominal reduction.

There could be some reduction in one line or the other in one or more quarters, but I don’t see much room for nominal reduction especially because, as we mentioned late last year, our main cost is related to personnel and we are making a huge effort to attract the right people to the company, and to train and retain them. For us, thinking about nominal reduction is not an alternative for our day-to-day operations.

Alexandre Mafra:

Let me just emphasize one point: obviously when we have acquisitions – and we have resumed acquisitions - there are always opportunities to capture synergy from them. These opportunities will arise over time and we will have some sort of nominal reduction in the most obvious lines, such as administrative expenses, among others.

I just want to emphasize something we have already mentioned before: there is no discussion on this - we will continue to invest in innovation and segmentation. We believe this kind of investment is extremely important for us to have new growth cycles in the company.

The benefits we are starting to see in this first quarter are, of course, directly related to our courage in continuing to invest last year despite an extremely adverse economic scenario.

So, we will make every effort to ensure strict discipline on costs and expenses, and you be sure that we will take every opportunity to continue innovating and investing in our Company's future.

Daniel Federle:

Great. Thank you very much.

Diego Aragão, Morgan Stanley:

Good morning. My question is about Fluig. During Universo TOTVS, the company talked a lot about this new platform, this new system. I wish to know what your expectations are in terms of its implementation in your own base, what is the revenue potential of this new platform, and how you see the TOTVS business model changing based on this new system. Thank you.

Gilsomar Maia:

Thank you for your participation and your questions, Diego. As you mentioned, Fluig is one of our latest initiatives in terms of innovation. It is, in my opinion, a unique proposition compared to what we have seen in the market.

There are countless possibilities for Fluig. It has an open architecture and it is a platform that runs on management systems. It is agnostic in the sense that it works with both TOTVS and third-party solutions.

The proposition of this software layer is to provide a unified and differentiated experience with the most advanced technology available so that users can get the most from their systems, using tools such as Single Sign-On, which increases user productivity. It also has workflow functionalities. You can turn off these functionalities in the system you already have and have a single workflow management tool.

It has content management, so the content you produce within the company, even if it is not an output from your system, such as Excel spreadsheets, e-mails, PowerPoint presentations and Word documents, can be stored inside an organized repository.

It also enables the creation of communities with those corporate social network and process management functionalities available in by You, which some of you might probably remember.

It is a layer that brings a series of tools so that users can get the most out of management systems and reorganize their internal processes.

Looking at TOTVS' base, the possibilities include being able to provide this to our clients. And we are making tremendous efforts for this to happen more instantly with our own solutions.

Our efforts are focused on not limiting it to the TOTVS base alone but that companies which use other solutions too can use this. In fact, it opens up many possibilities for integration with other platforms and technologies.

Fluig's business model is highly based on subscription. There is the question of implementation as well, but we are talking about payments per identity, which are payments that are individually small but involve many more people than we have seen in exclusively management systems.

It is a different model, launched in August last year, and its universe is still small compared to our base - we are talking about roughly 100 clients with whom we are working on at different project stages.

We have high expectations for this model, but it is still in the start-up phase. It is still too early. Perhaps it's still too early for us to guess its impact.

We need to let things flow and see what happens. Going forward, however, if it gains significance for our business, it will further increase the Company's recurring revenues.

Diego Aragão:

Understood.

Daniel Federle, Credit Suisse:

Thank you for the opportunity to pose another question – two, actually, but I'll be quick. The first question is about acquisitions. Could you give us any guideline if they are something for the short or medium term, and whether they will be in Brazil or abroad?

And in terms of segmentation and innovation, can you explain which phase of this cycle you are in at the moment? I understand that the R&D and sales teams have already expanded, but I would like to understand what still has to be done to reach the point you consider excellent in terms of segmentation. I imagine that the expansion of the R&D team is only the first step in this direction, after which it should be an effort spanning a few months or years to develop more segmented products. I'd like to understand this cycle as a whole. Thank you.

Gilsomar Maia:

Daniel, this time I will talk about segmentation first, and then we will talk about acquisitions, because one thing is related to the other.

As for segmentation, this vision of segmented solutions, packaging the entire management system into a single pack that addresses all that you need to manage a company in that specific segment, is not a recent vision. We have been developing this for at least the last three or four years.

This is something that has been transforming the Company. It is not simple; it requires a change in people's mentality. Consequently, it also became an organizational change in the company.

Today, the software and segments area has heads for each segment, who conceive the segment's strategy, who have groups for discussions with clients of these segments, who have specialists that understand the day-to-day activities of these sectors and the business trends in these sectors, so that we can also provide tools that help companies to remain closely aligned with these new trends.

And this permeated the company not only in R&D in recent years, but also, as you mentioned, the sales and services areas. This has already permeated these areas. I would not say they are inflated; I would only say there is a natural gap between the investment flows and the benefits that these bring.

I think we are still far from an optimum stage, as you mentioned. Perhaps we may never reach that, because we will always see room in this dynamic of segment heads that I mentioned before, of industry trends. We will always seek to provide cutting edge solutions in these ten segments to our clients. So, I think we will never reach this optimum stage.

From the viewpoint of internal development, a lot has already been done, but in a natural process of evolution we will still go a long way.

I will be more objective, because I think you are trying to understand how much this could affect the company's cost structure, from an organizational viewpoint. As I mentioned, we have already segmented the entire development, support and service structure. The service and sales areas are also segmented, naturally perhaps to a slightly lower degree so that we can evolve in line with the results obtained in the segments. This is because there will naturally be some loss of synergy at first, but as we reap the benefits of this segmentation, having more segmented structures will be justified.

I wouldn’t say this would have significant impacts on costs, as we saw in the recent past. Our baseline today is better established, but it is an evolutionary process.

Just like you brokerages too have your segmentations and sometimes, depending on a sector that grows, you could break it down. If an analyst, or a group of research analysts covering two or three sectors, sees that a certain sector is having a lot of IPOs, creating demand that did not exist before for that sector, it would make sense for them to split and segment their structure. If we follow this reasoning we will see that it is the same in our case.

As for acquisitions, one piece of data that guides our road map of acquisitions is segmentation itself. And I think that given the diversity of Brazil’s economy, we naturally have more targets for segmentation in Brazil than outside it.

A few things are in an advanced stage of maturity, so we might have some announcements in the short term. But I don’t want to make any promises, and you already know me in this sense, more so considering my M&A background.

There are two sides to this process. We respect the people we negotiate with in M&As, and we respect their timing as well. We know that this process is not solely dependent on TOTVS.

Alexandre Mafra:

Let me just underline one point, Daniel: we will not let go of any opportunity in the market. Obviously, closing an M&A deal does not depend on just one side, as Maia just said.

From our point of view, yes, M&A continues to be one of the focus areas. We have consistent cash generation to fund the investments that need to be made. You can be sure that we are observing the market and will not miss any opportunity of interest to our company.

Gilsomar Maia:

Apart from segmentation - and I know that many of you already have that in mind – we also have M&A initiatives that can address geographic presence, for instance, in the international market.

I know we have been talking about this for a long time, it has been our longstanding desire, but as I said before, it is a slow process that requires more effort. However, we expect to bring you some good news on this and also with regard to technology.

As we said in response to Diego's question about Fluig, TOTVS has always put in efforts, right since it developed the middleware to run its solutions in different environments. Today, we are facing the same challenge when we talk about having cloud-based solutions that can be connected to N number of other platforms and applications.

The world today is increasingly more connected, applications are integrated, and we cannot think differently.

I know my answer was long, but I hope I answered your questions.

Daniel Federle:

Excellent. Thank you very much.

Operator:

There being no further questions, I now turn the floor back to Mr. Alexandre Mafra for his final remarks.

Alexandre Mafra:

We thank you all for participating. On our part, we will remain focused on results, with strict discipline on costs and expenses, capitalizing on all the opportunities ahead of us.

Thank you all, have a great day.

Operator:

That concludes TOTVS' conference call. Thank you for participating and have a good day. Thanks.