

**Operator:**

Good morning. Welcome everyone to TOTVS' 3Q13 results conference call. Today with us we have Mr. Alexandre Dinkelmann, Executive Vice-President of Strategy and Finance, and Mr. Gilsomar Maia, 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 [www.totvs.com/ir](http://www.totvs.com/ir).

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 Dinkelmann, who will begin the presentation. Mr. Dinkelmann, you may begin your conference.

**Alexandre Dinkelmann:**

Good morning, everyone, welcome to TOTVS' 3Q13 results conference call. I would like to start on slide two, talking about the new financing lines hired from the National Bank for Economic and Social Development, BNDES, amounting to R\$659 million. Of this total, R\$597 million will come from the line called Prosoft, for funding the research, development, and marketing of TOTVS solutions.

This line bears interest at 1.5% per year plus long-term interest rate, TJLP, which is currently at a nominal rate of 5% per year. R\$59 million will come from the financing line called PFI, with interest of 3.5% per year, for funding the research, development, and marketing investments of our agnostic platform Fluig, for process, collaboration, and identity management.

The remaining R\$3 million will come from a social credit line, which bears TJLP, in order to finance investments made by the Institute of Social Opportunity, which is maintained by TOTVS and aims to support and monitor the employability of youth in need and people with disabilities.

The amortization will occur in 72 months with a grace period of 24 months for the principal amount amortization. These lines establish funding for the already planned investments in innovation and specialization of TOTVS solutions and also improve our capital structure efficiency and strengthens our financial capacity for inorganic investments.

Still on slide two, we have Intelie as the winner of TOTVS Start It Up, a contest of startups launched by TOTVS Ventures in April of this year. Intelie develops real-time data analytic solutions. It is worth mentioning that the contest had over 1,100 startups enrolled. The winner's award is an immersion of five days in TOTVS' lab, in Silicon Valley, as well as a

potential capital investment of R\$1.7 million by TOTVS Ventures. An MOU is signed with the company and the due diligence process is on the way.

I reinforce that TOTVS Ventures is the venture capital arm of TOTVS, which seeks to leverage the value creation through investments in high growth potential companies that have relation to the core business strategy of TOTVS.

In addition to the contribution of financial resources, our differentiation is the creation of synergies between invested companies and our business ecosystem, from the standpoint of technology, solutions, and distribution, as well as approaching TOTVS to entrepreneurs with ideas that can further accelerate the innovation pace for our customers.

Going now to the financial performance, on slide three, net revenue grew 14% year on year, higher than the LTM growth in the last five-year CAGR. In the same period, license fee revenue grew 8%, mainly due to sales to existing clients, which grew 28.5% year on year. This growth came not only from the natural growth of our clients, but specially from our ability to offer additional solutions that meet their needs, including the core ERP itself.

In the sales to new clients, the average ticket decreased 22% when compared to the 3Q12, and increased 34% when compared to the 2Q13. This quarterly variation of the average ticket is common about TOTVS, as the average value reflects the average size of projects sold in the period.

LTM average value is more stable and reflects in a better way the market behavior. Our sales pipeline remains very consistent, with a lot of opportunities, especially in industries that are service oriented. However, the sale cycle remains longer, especially the opportunities related to large clients, which affect our short-term visibility on the conversion rate of these opportunities into new sales.

Moving to service revenue, we had a growth of 15% year on year, also overcoming the growth in the LTM and the average growth of the past five years, showing that the increase in the service team's productivity is still on going. Over the past 12 months this revenue line increase was around 13%, also reflecting the strong growth in consulting service, e-learning, and services related to cloud computing.

Maintenance revenue remains strong, showing the high level of loyalty of the Company's client base, which is composed mainly of small- and mid-size clients. It is worth mentioning that the performance of this line is very important to keep our level recurring revenue.

Now, on slide four, we have the recurring revenue consisting primarily of maintenance contracts, software licenses leases, subscription, and cloud computing. Recurring revenue grew more than 13% in the quarter compared to the previous year.

For example: assuming that the 4Q13 recurring revenue is equal to that of the 3Q, recurring revenue of the full year 2013 would have grown 13.5% over 2012. In practice, the stability of the recurring revenue reflects the long-term relationship we have with our clients, allowing us to expand the solutions and services provided to them overtime.

TOTVS will keep the specialization process of its solutions and its sales team, intensifying investments, both organic in inorganic, in sectors and regions with greater business opportunities, in order to continue capturing the growth of the Latin America software markets.

Now I invite Maia to proceed from slide five.

**Gilsomar Maia:**

Thanks, Alexandre. Good morning, everyone. Now talking about costs and expenses, on slide five, the group of licenses costs, services costs, and R&D had its participation of net revenue increased by 2.5 p.p. in the quarter when compared to the previous year. About 2/3 of this increase are related to R&D, which has its increase as a percentage of net revenue mainly explained by the fact that these investments in innovation and specialization are in line with the plan for the year, unlike sales, which are below the plans. We are confident about maintaining our investments in R&D, even in a still complex macro scenario, because of our medium- and long-term vision about business opportunities related to technology is encouraging.

Another line that grew as percentage of net revenue was the cost of licenses, which represents the cost of solutions provided by partners. This growth is due to the expansion of the ecosystems of partners maintained by TOTVS, which is more important to convert opportunities into industry-specialized sales. Most of these costs does not have the same relevance when analyzed with the recurring revenue.

Finished this first group of costs, the cost of services decreased when compared to the previous quarter, having the gross margin of the quarter reached the same level of one year ago. The Company reiterates that it will continue its efforts to gain efficiency in each service operation, recovering from a below-than-expected performance in the 1H13.

Going to the second group of expenditures, in advertising, sales, commissions, and allowances for doubtful accounts, there was a decrease of 0.4 p.p. as a percentage of net revenue when compared to the previous quarter, and 0.7 p.p. in the year-on-year comparison. This change is mainly due to the reduction in participation of commission expenses as a percentage of net revenues, which was affected by the sales mix in the period.

This third group, comprising G&A and management fees, remains stable in the quarter, and has been decreased as a percentage of net revenue historically. These efficiency gains over the years result from the combination of administrative efficiency in managing the daily operations, and the integration of acquired companies. We understand that there is room for efficiency gains in this group, and we will continue to pursue these gains.

Moving to the evolution of EBITDA, on slide six, for the first time in the history of TOTVS the quarterly EBITDA surpassed R\$100 million, totaling almost R\$105 million in the 3Q13. Moreover, when the decrease of margins, EBITDA for the last 12 months already exceeded in 4.5% the amount of the entire year of 2012. Here, the history of the last five years help us to illustrate that margin shrink in the short term may occur, since investments in advertising and R&D are not capitalized and follow the medium- and long-term planning, contributing directly and indirectly to the revenue generation.

We will continue to seek increase in the Company's operating efficiency, while keeping a strict cost management discipline. Given its target market and its continental presence on the ground, TOTVS has a business model that leads to margin expansion in the long term.

Moving to slide seven, net income reached R\$56.4 million, representing 31% growth year on year. This growth was positively affected by a better financial result due to the lower gross debt and by the income tax reduction arising from the payment of interest on equity in August.

Also, it is worth to highlight the historical growth of recent years above 20%, as well as the expansion of almost 4 p.p. in the net income margin.

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Now the conference returns to Alexandre so that he can proceed from slide eight.

**Alexandre Dinkelman:**

Thanks, Maia. The Company's net cash position changed from R\$18 million in the 2Q to R\$38 million in the 3Q13, even with the payment of interest on equity in August, the semi-annual amortization of the Prosoft financing line obtained in 2008, the semi-annual amortization of debentures issued in 2008, and the payment of the acquisition of RMS.

Here, I would like to remind you that the gross debt shall present an increase of R\$250 million in the 4Q, due to the release of the first tranche of the financing line recently hired from BNDES, as mentioned earlier in the call.

Before we move on to the Q&A session, I would like to reiterate the pillars that guided the management's agenda in the Company's value creation in the long term, as well as the ongoing initiatives presented on slide nine. In innovation, the launching of Fluig, our agnostic platform that operates in different environments and with different systems for identity processes, content and collaboration management, which is becoming the natural interface of management systems used by the Company. These investments reflect our vision about the software market future, enhancing the clients' productivity, as well as bringing a lighter and more natural interface for management systems. We are excited about the potential adoption of this platform.

The specialization of our solutions to address the core business demands of companies. As mentioned, more and more we need to deepen the adherence of our solutions for the customers' core business. We are moving forward according to our plans, investing in several verticals that we are currently serving. TOTVS Ventures initiatives to attract disruptive innovations in the industry of information technology to our ecosystem. And finally, the financial support from BNDES for investments in innovation and development of TOTVS Solutions portfolio. This fund brings us more firepower to make our organic and inorganic investments.

In growth, the revenue is growing 14%, in line with our historical CAGR, and the organizational structure being guided to capture opportunities by sector and region, especially in sectors more service oriented, both organically and by acquisitions.

In loyalty, some evidences of the high level of our clients' loyalty, such as the growth of 13.3% in recurring revenue and 28.5% in sales to existing clients, and the maintenance of investments in brand building, which is also a key element for the future of both loyalty and growth.

And in margin, the focus on service efficiency and the commitment to the expenditures discipline, combined with scale gains of the Company's business model, tend to lead to margin expansion in the long term.

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

**Fabio Levy, BTG Pactual:**

Good morning, guys. A quick question on your recent acquisitions: if you could talk more about on how is the integration with all the acquisitions that you have made, especially during the 1H13, and what is the strategy for each segment that we can stretch that on the overall operations.

**Alexandre Dinkelmann:**

OK, Fabio. Good afternoon. Thank you for your question. We are talking about PC Sistemas, a company that was focused on the wholesale segment, they were very strong also in the cash and carry market; and we are talking about PRX, a company that was totally focused on agriculture. These were the two acquisitions made in the 1H13, with this orientation of specialization.

Both are being well run from the integration standpoint. What we do in any process is to assess weaknesses and strengths of these targets, and how we can add value in the weakness and try to really keep the strengths of the company for a while.

In the case of PC, from the administrative standpoint it is totally integrated. We could work with them in order to make the offering available throughout the country, it was also very important. From the R&D perspective, we are now talking with them in terms of how we will evolve the technology, the platform, and the product. So, the teams are working together.

And the main point about the integration process is that as these companies are vertically oriented, they are easily integrated in the structure that we have here in the Company. Now, we see PC as our hub of the wholesale and distribution industry in Brazil. The headquarter of the company is in Goiânia, in the Midwest of Brazil, and there we concentrate all the efforts of this industry in this hub. The same is about PRX in the agriculture industry. They are located in the countryside of São Paulo, and we want to keep the expertise there locally, it is very important to keep this concept of hubs.

So, from the administrative standpoint, in the very short run we were able to integrate operations, we also worked very hard in the short run in order to train all the sales force and the service division in getting this knowledge from these companies, with the same process that we have.

This is the way that we think about integrating vertical companies. We have a road map of integration in the short run, in the mid run, and in the long run. But there are important assumptions that we always use: we do not want to create disruption internally in the targets, in the sense of losing talents. On the contrary, we work very hard in keeping the balance, and showing them that it is new phase, but it is a better phase. And mainly, we avoid any disruption in terms of clients.

We always reassure our policy of keeping the product and evolving that, and giving a better support for the client, given them a sense that we can really scale the business and reinforce the investment capacity of the company. This is the mantra for us whenever we talk about M&A.

**Fabio Levy:**

OK, great. So, we saw a strong relative growth in this quarter, partially because of the full consolidation of those two companies, but, at some time, are you seeing any reacceleration on organic growth related to this new acquisition, meaning that if you are accessing new addressable market because of those acquisition, are you seeing already some impact on revenues related to these new acquisitions, when hunting for new clients?

**Alexandre Dinkelmann:**

Yes, this is our history. In most of the cases our experience is that just after the completion of the deal we are able to accelerate the sales performance of the targets, because we insert this

target into our ecosystem. We can expand the capillarity of this offering into the market, we train very fast our distribution network, and we also migrate all opportunities in the industry towards this new hub acquired.

So, we really try to exercise the complementarity approach, in order to really gain or add more value to the acquisition. In this sense, they become the natural hub of the business. That is why we see a very good impact since the beginning of any transaction.

**Fabio Levy:**

OK, great. Thanks.

**Marcelo Santos, JPMorgan:**

Good afternoon. Thanks for taking my question. I would just like a little bit more color, or your views on the trends of clients demanding more technological solutions to their core business in opposition to the traditional ERP solution, which is more to the back office. As we see penetration increasing in Brazil, I think clients start to have more ERP and then they might go for an analytical solution. I would like to understand better how you see this trend and what are you preparing to cope with that. Any color would be nice.

**Alexandre Dinkelman:**

Marcelo, thank you for your question. This is a very important point in our strategy. We see that having in the SMB market, in the high-end markets, and that is what is driving our strategy in reinforcing specialization within TOTVS.

Why that? We see that Brazil is a very competitive market for everybody, any client is facing competition, so we have a diversified economy, we have a private sector driven economy, a lot of new companies trying to grab market share. So, nobody has easy life in terms of competition in Brazil. And that is a good driver for us, because business models are evolving a lot because of technology, companies are trying to establish new ways to achieve their clients, new distribution channels using technology and digital channel.

There is also a big challenge in terms of productivity in Brazil; labor force is expensive and not necessarily productive. That is why we are seeing very different industries in Brazil adopting technologies, some of them late adopters. In general, non-tradable industries are late adopters in terms of technology, and that is one of the vectors that we want to capture more in Brazil in the next cycle of five to ten years.

What does it mean? That even if a company, technically speaking, is 100% penetrated in terms of software, they want upgrade, they want to switch from an internal developed software to a new software, addressing their core needs. This is what we are seeing for smaller, mid size companies, and also big companies.

In terms of the back office ERP, the driver behind that is about companies that are growing so intensely that they need more robust solutions. In general, they start using very small solutions provided by very local vendors, and then this typical vendor is not able to scale up and to follow the intense growth for their clients, and then there is also addressable market in terms of new needs for back office activity. These two dimensions combined project very good prospects for our market.

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**Marcelo Santos:**

OK. Thanks a lot.

**Carlos Siqueira, BTG:**

Good afternoon, Alexandre and Maia. My question is on the competitive landscape, if you can tell us a bit how the market is today. I mean, breaking it into the different types of clients, like the large clients, medium and smaller clients, how the competitive environment is.

And as a follow-up question, if you can tell us a bit more about the Fluig project, how it is evolving and what we can expect from it. Thank you.

**Alexandre Dinkelman:**

Thank you, Cadu, for your question. So, starting from the first one, the competitive landscape, we have to analyze it by segment, as you said. So, starting from the high-end market, it is a pretty well penetrated market. Here I do not see big momentum in terms of topline growth for ERP.

What we see in terms of potential demand is about vertical solutions that can be connected to existing solutions. So, this is a drive to explore and from the competitive landscape there is no one that is really addressing this specialization process. In general, big international companies have a more horizontal approach. And you know, the customization of the solution in terms of industries is made by channels. And we are seeing good opportunities to explore in the high-end vertical solution adoptions.

But it is time, because they tend to be more affected by the current macro scenario. So, what we see nowadays is a big difference between the dynamics of the SMB market and the high-end market. Having said that, when we go to the SMB market, then competition is totally connected to the industry that we are talking about.

So, competition in health care is very different from the competition in education or any other industry that we cover in our portfolio. So, we are able to cover nowadays the ten biggest industries in Brazil, in the Brazilian economy, and then for each industry we have different competitors. Most of them, I would say 100% of them are smaller than us, even looked from the perspective of the industry. But they have strengths in terms of specialization, in terms of focus, that is why we have been investing in specialization.

There are two ways to tackle with this competitive landscape in the SMB market. One is to invest more organically, and the second is to buy companies that are good competitors and that could have a good fit in terms of not only strategy, but also cultural perspective.

In terms of Fluig, it is being launched this semester. We have been investing in this solution in the last couple of years. It is a combination of investments made in Brazil and also in the Silicon Valley, at TOTVS lab. And it is a new way of seeing software adoption by companies and individuals within the companies.

So, the value proposition here is to create a new layer for the client, so combining tools for collaboration, tools for workflow management, tools for content management, and identity management.

So, the idea here is to really improve or increase productivity within the company, providing a more natural and user-friendly interface for any software. Not only TOTVS, but any software that is used within the company.

And then we can really put these functionalities in this layer, which can be deployed in the cloud or on premise, and we can make the ERP really lighter, more flexible, and more scalable. So, that is the idea, it is something that is very innovative. Nobody is having this holistic approach, and we want to start that trend, and it is very adherent, in our view, to the clients' needs.

This first phase that we are exploring this offering with our clients, developing some pilot projects, it is evolving very well. We will have the chance to talk with you specifically about Fluig, making demonstrations in the future in TOTVS Day that we will have here in Brazil and New York next week. So, I invite everybody to join us in this presentation.

**Carlos Siqueira:**

OK. Thank you, Alexandre.

**Operator:**

It appears that we have no further questions at this time. We will go ahead and conclude today's Q&A session. At this time I would like to turn the floor back over to Mr. Alexandre Dinkelmann.

**Alexandre Dinkelmann:**

I would like to end this conference reminding everyone that TOTVS has a unique positioning in the market due to the combination of both our continental coverage and the very relevant presence we have in major industries of our economy. So, this positioning allows us to innovate with solutions, which integrate value chains. When we talk about innovation, I mean R&D investments, which puts TOTVS among the five main Brazilian investors in R&D worldwide. So, it is very relevant.

So, we will keep investing to be even more essential to our clients. So, thank you very much for your participation in the conference, and most importantly, thank you for TOTVS team for its daily hard work in order to make us the strongest firm in the industry.

**Operator:**

We thank you, sir, and to the rest of the management team for your time today. TOTVS' 3Q results conference call is now over. Thank you everyone for your attendance, take care, and have a nice day.

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