



Operator:

Good morning. Welcome everyone to TOTVS's 2Q13 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 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.

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's 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's 2Q13 results conference call. Firstly, I will start talking about the acquisition of RMS, announced last July, presented on slide two. RMS develops enterprise management software for retail and supermarket industries and was appointed two times in a row as the first software company in the "Top of Mind" ranking published by the Supermercado Moderno Magazine, a standard publication in the Brazilian industry.

This is another acquisition that addresses our specialization strategy, strengthening our position, in this case in the retail segment, especially for supermarkets. We see a very interesting potential in this segment, especially in the integration of the value chain comprising Manufacturers, Distributors, Wholesalers, Cash & Carry, and now supermarkets. Today, TOTVS has a dominant and unique positioning in all these stages of the value chain, and we want to explore this huge potential.

Besides this M&A transaction involving RMS, we also had two acquisitions made by TOTVS Ventures since the 1Q13 earnings release. First, an investment of US\$16 million in GoodData, a company based in San Francisco, California, focused on providing solutions for business analytics in the cloud, with Big Data technology offered in the SaaS model.

It is important to highlight that, in addition to the investment made, TOTVS now has a seat on the Company's Board and the distribution exclusivity of GoodData solutions in Latin America, bringing this new technology to the region and TOTVS clients. This operation reinforces TOTVS Ventures' capacity of adding value through synergies in every transaction made, since TOTVS Ventures goes beyond the role of being just a financial investor. In addition, it also confirms on a global basis the value of our presence and distribution capacity.

Second, Zeropaper, a company focused on providing cloud solutions for individual entrepreneurs. We do believe in this kind of solution that addresses the base of the pyramid of the Brazilian market, where the market is still fragmented and with a very attractive growth potential.

Before presenting our financial performance, I would like to reiterate that we remain focused on executing our strategy of enhancing the specialization by industry and by company size, organically and via M&A, with additional surgical investments made by TOTVS Ventures in initiatives related to the TOTVS's core business strategy.

Going now to the financial performance on slide three, we highlight the total net revenue growth of almost 16% year on year, higher than the last 12 months growth and the last five years CAGR. I highlight here that this faster growth came from all revenue lines. We continue to expect an adverse year for the Brazilian economy, which may affect the potential of doing business as a whole. This leads us to predict the year with a good degree of caution.

However, we also reaffirm that we will continue to seek, through a broad portfolio and strong presence in the region, the maximization of opportunities in regions and industries that show higher business potential.

On slide four we will drill down a little more, relative to the license revenue growth, which exceeded 12% year on year. This growth in license revenue came from the combination of the 18% growth in number of sales with the average ticket decrease of 5%. The larger number of sales was mainly driven by sales to existing clients, which grew almost 23%.

The downturn of average ticket was more concentrated in sales to new customers, which was almost 11% lower. However, on the other hand, in the last 12 months there was an increase in the average ticket to new customers of more than 23% and a 7% decrease in the average ticket to existing clients.

I reiterate that short-term fluctuations in average ticket are common, because it represents the average size of projects sold in the specific period. In our view, the last 12 months show more clearly the market dynamics.

Moving to Service Revenues on slide five, this line of revenue had the highest growth of the quarter, with a 19.5% growth. In the last 12 months, the growth reached 13.6%, exceeding the last 5-year CAGR. This line's performance was mainly due to the partial productivity recovery of implementation services, besides the higher number of working days in the quarter.

Going to the maintenance fee revenue on slide six, we see that, for another quarter, this revenue line overcame 15% of growth year on year and 13% in the last 12 months. This performance reflects our focus on customer loyalty, which is reflected in the consistency and in the recurrence of this revenue line.

By the way, talking about recurrence and consistency, on slide seven we present the total recurring revenue, which grew 12.6% year on year, accounting for more than 56% of total revenues in the 2Q.

It is worth mentioning that the changes of this line, as a percentage of total revenues, is due, among other factors, to the growth pace of other lines of non-recurring revenues, which in the 2Q had a faster growth, especially in licenses and implementation services, changing the revenue mix in the quarter. For this reason we focus on the growth rate of recurring revenue, period by period.

Recurrence is part of TOTVS's business model and strategy. In the short term, recurring revenues can reduce the average growth rate of total revenues, given the flow of monthly recurring payments. But on the other hand, it brings more predictability and sustainable growth in the longer term.

Now, I invite Maia to proceed from slide eight.

Gilsomar Maia:

Thanks, Alexandre. Good morning, everyone. Now, talking about the costs and expenses on slide eight. The group of license cost, service cost, and R&D grew 2.9 p.p. as a percentage of net revenue in the year-on-year comparison. Approximately half of this increase is due to higher investment in R&D. We understand that even in most adverse scenarios like this, we must maintain our investments in innovation in order to enhance our competitiveness in the future, making our growth sustainable in the long term. The other half is due to lower margin of services, reflecting the lower level of efficiency of service team in 2013.

In the quarter-on-quarter comparison, this group of costs and expenses fell 0.4 p.p. This decrease is partly due to the better margin of the 2Q, but still below the levels

seen in 2012, and the lower relevance of third-party solutions reflected in the cost of license fees.

Moving forward to the second group, which concentrates advertising, sales, and commissions expenses and allowance for doubtful accounts, the increase from 19.4% to 21.1% between the 1Q13 and 2Q13 was mainly due to the seasonality of the marketing campaign, which is intensified in the 2Q, and due to the allowance for doubtful accounts, which returned to the level of 2012.

It is important mentioning that in the 1Q13 the decrease was mainly due to the overdue credit recovery that was accrued in previous quarters. In this line of allowance for doubtful accounts, we still notice a concentration on few clients facing financial difficulties.

On the third and last group, representing G&A and management fees, the reduction, both in the year-on-year and quarter-on-quarter comparison, is mainly due to the efficiency gains in this structure and the search for productivity. We emphasize here that we keep seeking efficiency gains in this group of expenses.

Moving to slide nine, the EBITDA increased 6.7% year on year, amounting R\$98.9 million in the 2Q13, with EBITDA margin of 25%. In short, this reduction of 2.1 p.p. on the margin, when compared to the 2Q12, was mainly due to the maintenance of investments in R&D and advertising, and the decrease of sales and profitability in the period. We reiterate our commitment to preserve investments in R&D and to keep improving the efficiency of the servicing teams given the marketing potential.

We also reiterate that over the years, the EBITDA margin may fluctuate, that the combination of TOTVS's business model and its target markets leads to margin expansion in the long term. This fact is highlighted in the last 12 months EBITDA presented in this slide.

On slide ten, we highlight the net income growth, in line with the net revenue growth, in both quarterly and last 12 months comparison. In the 2Q13, the net income reached R\$54 million, 14.3% higher than the EBITDA, mainly due to the lower level of both financial expenses and the effective tax rate.

Moving to slide 11, the net cash position changed from R\$84.5 million in the 1Q13 to R\$18 million in the 2Q13. The main reason for this reduction are the dividend payment, the GoodData investments reflected in intangibles, and the generation of operating cash flow of R\$86.3 million, corresponding to 87% of EBITDA in the quarter. Here, it is also worth noting that the increase in gross debt is mainly due to the obligations from acquisitions.

Now the conference returns to Alexandre, to proceed to slide 12.

Alexandre Dinkelmann:

Thanks, Maia. On slide 12, we would like to close the presentation by referring to the three strategic pillars of growth, loyalty, and margin that guide the management's agenda, aiming to value creation for the Company in the long run. Regarding growth, we highlight the 16% growth of net revenue in this quarter, besides executing the specialization strategy, combining organic investments with the most recent acquisition of RMS.

At loyalty, we emphasize the growth of 15% maintenance revenue and the recurring revenue growth of almost 13%, both in the quarter. And for the margin pillar, we highlight the EBITDA margin of 26.1% in the last 12 months, in order to see the trend in margins for the Company in recent quarters, minimizing the natural margin volatility on a quarterly basis.

Regarding the margin, we continue to seek efficiency and cost-discipline, with emphasis in the service and administrative areas, as well as maintaining our investments in innovation, reflected in the R&D line, which are key elements for TOTVS to capture sustainable and long-term growth in our market. We understand that in times of crises or in more adverse scenarios, we must invest in our business with the proper discipline to capture all market opportunities.

The management reiterates its view on the relevant potential of the Brazilian market of management systems, especially amongst small- and medium-size enterprises, and keeps deepening the specialization strategy with the goal of increasing the Company's ability to capture market opportunities, even in adverse economic scenarios, such as the one in the beginning of the year. Thus, increasingly we are becoming stronger, both internally and externally, for the next cycle of growth in our markets.

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

Michel Morin, Morgan Stanley:

Good morning. Alex, I was just wondering if you can talk a little bit about the trends that you saw in the underlying business in the quarter, because this was a little bit of a noisy quarter, you had the impact of some acquisitions, you had some calendar effects. But I am trying to understand if you – and I know that you do not provide organic growth rates – but is it fair to conclude from the results that you really did see on an underlying basis increased activity obviously from your existing clients, but also increased activity and interest from potential clients?

Alexandre Dinkelmann:

Good morning, Michel. Thank you for your question. As we were saying since the 1Q, we have a pipeline spread across very different industries and also regions, and in this

2Q we were able to close some of the deals of this pipeline. So, when we analyze what happened in Brazil, of course that there is a level of activity, stronger depending on the industry that we are talking about. And TOTVS, with all this massive distribution network and continental presence, coped with also a very large portfolio in terms of industry, it gives us good possibilities of grabbing business opportunities where they are. So, this is what happened this quarter. Of course we are working hard in order to keep the pace, the cautiousness is the name of the game for the remainder of the year, so it is really difficult to say if we will have good quarters ahead of us, because of all these complex scenarios that we are facing in Brazil in terms of level of confidence, of consumers, and also entrepreneurs and business people.

So, actually what we are doing in time is to really maximize business opportunities where they are in terms of regions and in terms of industries, and that is our job here.

Michel Morin:

Alex, you started off by talking about the pipeline. So, did you replenish the pipeline as well? I mean, if you concluded, if you were able to execute on what was in the pipeline, is there still a decent pipeline out there relative to where you were three months ago?

Alexandre Dinkelmann:

Yes, we have a decent pipeline. What we see is that, you know, the cycle is longer than our historical pattern mainly when talking about new clients. But the pipeline is positive and we are working hard to conclude it.

Michel Morin:

OK, great. And is there any color that you would be willing to share with us in terms of industry trends? We know that you have big exposure to the manufacturing sector, and I would assume that with a weaker Real that might be a part of the economy that might start to feel a little bit more confident. Are you seeing signs of that happening?

Alexandre Dinkelmann:

Yes, depending on the niche. Because, you know, the vertical manufacture is too broad, so our strategy is at the sublevels, so we have to really define our strategies depending on the niche, and we are trying to capture business opportunities also with manufacturers. But in order to help you in understanding our big strategy and how we see this portfolio in terms of industries evolving, we believe that in Brazil and in Latin America, but mainly in Brazil, industries that are more non-tradable, they tend to present better growth prospects in terms of new licenses. So, we are talking about education, we are talking about computers, we are talking about logistics, retail. These are industries that are going very well for us, and these industries are supporting our growth performance.

When we talk about manufacturers, structurally, despite the exchange rate performance, its recent performance, we know that in general they also face structural challenges, and we are here investing also with them in order to help them beat these challenges, but we see structurally also that they are very important, not only in recurrence, we are talking sometimes about big clients, but also the process of expansion of part of these manufacturers into other fields, such as logistics, distribution, sometimes retail. So, TOTVS, in our understanding, has a unique position to connect all this value chain from manufacturers, going to logistics, wholesalers, distributors, and retail. And we want to capture this kind of opportunity. So, that is why, even if manufacturers are not, you know, presenting huge prospects in terms of new licenses in the short term, they are very strategic for us for this concept of recurrence and also this connection process of value chains in Brazil.

Michel Morin:

All right. OK, thank you. And Alex, if I may just a quick second question here is, the management fee in the cost structure, we almost never talk about it because it is small, but it is running lower than year-ago levels, and I am just wondering: should we read anything into that? Is this how you as a management team are provisioning less because you are not hitting targets?

Alexandre Dinkelmann:

No, we are not seeing any big difference in terms of prospects of having our variable compensation for the Company.

Michel Morin:

OK. Thank you very much.

Mauro Forman, BTG Pactual:

Hi, Alex. A quick question, I do not know how much you can disclose at this point, but what about GoodData and maybe the plan for Brazil? My understanding is that it is not a very good software, you could have a lot of added value here for clients in Brazil. But I do not know if you can disclose more of the timing and the plans of incorporating the GoodData technology into the platform here in Brazil.

Alexandre Dinkelmann:

OK, Mauro. Thank you for your question. GoodData is a company that is really moving the industry in the United States in terms of bringing a new business model to the BA industry, Business Analytics, using big data technology and cloud solutions. One of the biggest aspects or items of the value proposition is that they can provide something

that is cheaper, you know, faster to be implemented, so it tends to be disrupted for the industry.

In this sense, we believe it had great fit to Latin America and to our base, and that is why we established this strategic relationship. We want to lead this process of branding innovation to our continent here. So, this semester is important for us because we are training our people, exchanging skills. We have people in California being trained and also they are coming to Brazil to train our sales force. In parallel, we are investing in order to have our product totally integrated to GoodData. By the end of the year, we believe that we have the built market strategy.

Mauro Forman:

OK. Thank you.

Michel Morin, Morgan Stanley:

Thank you a lot. I will just keep on asking questions, Alex. So, listen, on TOTVS Ventures, I am just curious, can you share with us kind of what the vision for this is, how significant could this become in terms of how much capital are you willing to put into this business? And how are you going about screening for the opportunities and managing these opportunities? Because it is a very different kind of skill that you need and I do not know if you have kind of recruited people who maybe have a venture capital background or how you are going about running that part of the business. Thank you.

Alexandre Dinkelmann:

OK, Michel. Thank you for your additional question. TOTVS Venture is very important for our strategy, not necessarily in the short term with the financial impacts, but when we see our future in terms of portfolio, in terms of technologies, in terms of offering innovation, it is good also to bring innovation from the outside and to work together with very talented entrepreneurs. The way that we screen opportunities starts always from the strategic feat, the same way we do in terms of M&A. So, we have our strategy and we always use the driver in order to filter; the first filter is how adherent is the startup of these companies in their early stage, how can they help us with our own strategies.

We could say some things that are driving our initiative, such as mobility, big data, analytics, corporation, SaaS in general, cloud business model, so these are the things that we are pursuing and we want not to be positioned just as a financial investor, but also bring all the business network and distribution fields that we have here in order to speed up the startup of these early-stage companies. That is the strategic driver.

When we talk about the team, yes, we brought people that have worked before within the industry. We also have people with technology background in the team, so again we try to be bigger than a typical venture capital. So, we have the same financial discipline, but also bringing our deep technological knowledge and experience to the table.

Michel Morin:

And in terms of size, Alex? I mean, if you were to take a guess as to how much money you might have invested in terms of face-value investments over the next three years? What kind of range are we talking about?

Alexandre Dinkelmann:

We have a figure, we are not disclosing so far, but in order to help you with some color, we are pretty flexible in terms of size of deals, so we can move back in really early-stage companies, and Zeropaper was the case, a small ticket of investment, and we can also work with deals at the level of GoodData, involving US\$16 million. So, we are pretty flexible in this sense.

The idea here is not to really make as many deals as possible; the idea is to really be very qualitative and strategic in the choices. So, you should expect the same level of activity in the future.

Michel Morin:

OK, that is very helpful. Thank you, Alex.

Nick Estrada, NCM:

Hi. Can you just give a little bit of guidance just to kind of what you expect for the rest of the year in terms of revenue growth margins?

Alexandre Dinkelmann:

Hi, Nick. Thank you for your question. As a policy, we do not disclose our expectations about the year in terms of revenues or EBITDA, but I will try to help you with some qualitative points. So far, when we analyze what is happening at the macro level in Brazil, it is really hard to figure out the turning points of expectations. So, we are still facing a complex scenario, more risk averse, the level of confidence is not going up.

So, in this sense we are cautious in terms of the 2H, and what is in our hands is to still work hard on grabbing business opportunities in terms of regions or industries, and we have a very strong position in order to capture business opportunities where they are, but cautiousness is the name of the game so far.

In terms of margins, as we told during the presentation, what is the most important driver for us is to make the right investments in order to pave the way for the long term. That is the main driver of the management and the Board. We are not concerned about the short-term margins, so you could see that this 2Q we have margin compression when we talk about percentage, but when you see the bottom line in terms of absolute numbers, we believe in strong results.

It is also important to mention that we expand all R&D investments are in the OPEX. We do not capitalize our R&D, which is good for you, because you have the visibility of what we are doing for the short, medium, and long term. That is the way that we drive our business.

Despite this current scenario, we see very good opportunities of investing in terms of R&D, organic and also M&A.

Nick Estrada:

Great. Thank you.

Operator:

This concludes our question and answer session. I would now like to turn the conference back over to Mr. Alexandre Dinkelmann for any closing remarks.

Alexandre Dinkelmann:

I would like to thank you all for your time with us. We are available to answer any questions that you may have. And also I would like to thank TOTVS's team. We are here in order to really capture business opportunities, despite this complex scenario that we are facing in Brazil.

It is also worth mentioning, as I just answered Nick's question, that we, managers and also the Board, we are driven by long-term decisions. That is the way that we manage our business, we are concerned about making the right investments in terms of R&D, in terms of brand building in order to have better possibilities of revenues in the future. That is the name of the game for TOTVS. We are not here to manage just short-term margins.

Thank you very much.



Operator:

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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