



**Translation of the transcript
of the conference call in Portuguese
for the 1Q13 results
TOTVS (TOTS3 BZ)
May 3rd, 2013**

Operator:

Good morning. Welcome everyone to TOTVS's 1Q13 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.

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:

Alexandre Dinkelmann:

Good morning, everyone. Welcome to TOTVS's 1Q13 results conference call. First, I will start talking about the acquisition of PRX, announced last April, presented on slide two.

PRX develops and implements TOTVS solutions for the agribusiness industry, serving approximately 60% of the Country's sugarcane mills, as well as several grain cultures.

With the acquisition of PRX, aligned with our specialization strategy, we will create a center of excellence for Agribusiness, which will combine TOTVS' solutions portfolio with the expertise of more than 180 PRX's employees.

Brazil is a global benchmark in agribusiness and with this move we aim to raise TOTVS to this level, and thus explore the opportunities in this sector, both in Brazil and abroad.

Going now to slide three, we have the total net revenue, which grew 8.7% in 1Q and 10.8% in the last 12 months, both periods excluding the social contribution impact from Brasil Maior Plan.

Much of this growth is a recurring revenue result, which has grown above the average of total revenue over the past 12 months, as shown on slide four.



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Between 1Q12 and 1Q13, recurring revenue grew by 13.8% and reached almost 59% of total revenue, compared to 56% in 1Q12. In the last 12 months, recurring revenue increased more than 11%, reaching 57% of total revenue.

The recurring model may reduce the total revenue growth rate in the short term, since it is recognized in a monthly-base, but on the other hand it brings greater predictability and growth in the long term.

Just to illustrate, if the 1Q13's recurring revenue is annualized, it would result in approximately R\$900 million for the full year, or 10.5% growth over 2012, even not counting the inflation adjustments that would be captured over the period.

The expansion of recurring revenue is part of the Company's strategy, addressing both pillars of growth and loyalty, since we believe that a model favoring the recurrence is more effective, especially among the small and medium companies, adding greater predictability of revenues to the business.

Now on slide five, we see the evolution of license fee revenue, which grew by 6.8% in the last 12 months and decreased 1.7% over 1Q12.

This quarter is influenced by charging the incremental license of the corporate model, which can see on slide 6. Remembering, customers under this model pay an incremental license to TOTVS in 1Q based on their actual growth of the previous year. That means, only if there is real growth there is incremental license.

In 1Q13, the increment amounted to R\$17.3 million, 4.7% lower than 1Q12, indicating that the clients under this model kept growing above the overall average of the economy in real terms, since the deceleration of the incremental license was much lower than the deceleration of the Brazilian GDP.

Sales to new customers were almost 27% lower than in 1Q12, mainly due to the decrease of 22.0% in average ticket. However, in the last 12 months, sales to new customers grew 23% and average ticket grew 23.4%.

In summary, short-term fluctuations in average ticket are common, because it represents the average size of customers added in the specific period. In our view, the last 12 months shows more clearly the market dynamics.

But the beginning of the year has been more challengeable than expected, so sales came below our expectations. We are not happy with this performance.

Historically, sales to new customers are more sensitive to economic scenario, especially larger companies that reduce investments in the short term, lengthening our sales cycle. When slowdowns like these extend, this more conservative approach is also observed in medium and small-sized companies.

Moving to slide seven, service revenue ended the quarter with 6.8% growth over 1Q12. In the last 12 months, this line grew by 11.4%.



The growth of this revenue stream in 1Q13 at a slower pace than in the past 12 months is mainly due to the sales mix of licenses with greater participation of franchises and as well as to the established basis for comparison in 1Q12, when this line grew almost 22.7% over 1Q11.

Concluding comments over revenue on slide eight, the maintenance revenue ended the 1Q with 15.2% growth over the same period of 2012. In the last 12 months, this line grew by 12.4%.

This growth was due, among other factors, to the emphasis on recurrence, especially with smaller customers, and focus on the loyalty of the customer base, enhanced by the creation of the Clients Vice-Presidency.

Now, I invite Gilsomar Maia to proceed from slide nine.

Gilsomar Maia:

Thanks, Alexandre. Good morning, everyone. Now, on slide nine, we have the evolution of the three main groups of operating costs and expenses as a percentage of total net revenues.

The first line of the chart represents the group of license cost, services cost and R&D, which concentrates most of the personnel expenses.

Once again, I remind that TOTVS does not capitalize its investment in R&D, so the reported result presents the entire investment performed, with no deferred effects.

In 1Q13, this group reached 46.8% of total net revenue, representing an increase of 0.7 p.p. over 4Q12, mainly because of the 7% wage increase due to the collective bargaining agreement in São Paulo, which was higher than the overall growth of net revenue for the same period.

The second line refers to the group of advertising expenses, sales commissions and allowance for doubtful accounts, representing 19.4% of 1Q13 total net revenues, a decrease of 0.3 p.p. over 4Q12.

The decrease in delinquency of consulting and implementation services provided to larger customers in Brazil was the main reason for the reduction of this group, since part of the provisions booked in previous quarters has been reversed in 1Q13.

The third and last line of the chart represents the group of G&A and management fees that declined 0.4 p.p. primarily by the combination of scale gains and reduction of certain statutory positions eliminated in 2Q12, after changes of hiring regime for some officers.

Moving to slide ten, the EBITDA margin of 26.1% was stable compared to 1Q12. When analyzed over the last 12 months, the EBITDA margin reached 26.7%, up 1.8 p.p. over the previous period.



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The 12 months view illustrates well that over the years the Company's EBITDA margin may fluctuate, but the combination of TOTVS' business model and target-market leads to a margin expansion in the long-term.

On slide 11 we have a summary of the quarter presenting, among others, a net income of R\$51.9 million in 1Q13 and R\$209 million in the last 12 months, which means an year-on-year growth of 4% for 1Q12 and 12.6% for the last 12 months period respectively. In 1Q13, the growth difference between EBITDA and net income is mainly due to the higher effective tax rate.

Moving to slide 12, the chart shows the net cash position changing from R\$162.7 million in 4Q12 to R\$84.5 million in 1Q13. The main reasons for this reduction are the payment of PC Systems of acquisition, considered as intangibles, the payment of interest on equity declared in 4Q12, and the amortization of a financing line with BNDES, denominated Prosoft.

The Company's capacity for cash generation and leverage, through competitive credit lines in terms of cost and tenor, supports the execution of the Company's investment plan, which has presented its first results with the acquisitions of PC Systems, UMove.me and PRX.

Now, the conference returns to Alexandre, who proceeds from slide 13.

Alexandre Dinkelmann:

Thanks, Maia. Ending with slide 13, we summarize how the management guides its agenda and analyzes the operation's performance, seeking a balance between the three pillars of growth, loyalty and margin, with the goal of creating value for the Company in the long term.

Regarding growth, we highlight the 10.8% growth of net revenue in the last 12 months, besides reinforcing the specialization strategy with the acquisitions of PC Sistemas and PRX. On loyalty, we emphasize growth of 12.4% in revenue from maintenance and recurring revenue growth of 11.4%, both in the last 12 months. And for the margin pillar, we highlight the EBITDA margin of 26.7% in the last 12 months.

The management reiterates its view on the relevant potential of the Brazilian market of software and management systems, especially among small and medium 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 this 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.

Daniel Federle, Credit Suisse:

Good morning everyone. My question is related to the economic growth. I would like to know if this slowdown we saw in 1Q is concentrated in some segments, perhaps in the new segments to TOTVS, or in the segments of old clients that are growing less. And I would like to hear some more details related to vertical segmentation, if this is one-off or generalized.



My second question, which is related to the same topic, is if there is any plan of action, something that you are doing to overcome this economic slowdown, or if the economic activity does not pick up pace over the year, it is unlikely that you will have positive results in 2013. Thank you.

Alexandre Dinkelmann:

Good morning, Daniel. Thank you for your questions. I will try to give you some details like you asked, in relation to vertical segmentation, but I cannot reveal too much, because the market is very competitive, and, like I always say, today's competition landscape is very segmented. The competition is different in each segment. So we need to find an equilibrium between these two objectives, okay?

Without any doubt, some sectors had a worse performance than others in terms of verticals. It is too early for us to establish a trend. There were verticals that performed well in the quarter in relation to last year, which were: distribution and logistics – excluding PC, speaking of the original TOTVS portfolio, before PC – financial systems, banks, asset management was very strong, and retail did well too... The manufacture segment grew, but due to the large base it ends up bringing down the average, but we also saw a growth in this segment.

I would say these were the leading segments. The others also advanced, but perhaps they fell short of our expectations. But, again, it is too early to draw structural inferences.

In terms of segmentation, the quarter is a period of time that is too short for an analysis. Our experience shows that. For us, looking at the last 12 months from the vertical segmentation standpoint is much more interesting, and we can actually identify the trends.

I hope I gave you some details, even without being able to reveal too much in order not to harm TOTVS' business.

Regarding our plan of action, we continue steadfast on our strategy; on one hand, deepening segmentation, because we understand that this will strengthen TOTVS' positioning, allowing us to capture the market potential, and we are talking about many, many years ahead. So we are deepening the vertical segmentation.

Historically, TOTVS has always been disciplined in costs and this first quarter reflects this too. You can see that, despite a top line weaker than the average, we still managed to preserve our operations' profitability.

We are combining our strategy of deepening the vertical segmentation, and it is increasingly important for us to invest in innovation of clients, and, on the other hand, we are maintaining our discipline in costs structure.

I am not going to talk about the year, because this goes against our guidance policy, about what we are working on for the year, for coming quarters. We do not give a short-term vision, because it is against our policy.



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Our strategy continues with the same focus of deepening segmentation on one hand, keeping looking for interesting M&A opportunities here in Brazil and abroad, while maintaining our discipline in costs structure. This discipline is very important because it creates room for us to invest in innovation, and we believe this is essential in the software industry.

Our investments in innovation, all our investments, you will always see them in the quarter's results. TOTVS has a policy of accounting for all of its investments in innovation.

So, TOTVS's entire innovation investment policy is always reflected in the Company's income statement. Even if our top line is not very strong in the quarter, we have maintained our strategy, because we believe it will help us further consolidate our position.

Daniel Federle:

Excellent. Thanks, Alexandre.

André Baggio, JPMorgan:

Hello, Alexandre. My question concerns market potential. Do you still see this market as unexplored? Do you still believe there is a strong market whose demand is not being met by you and others? Or do you believe that, at some point, in order to grow you will have to 'steal' market share from other companies already established?

Alexandre Dinkelmann:

Good morning, Baggio. I would divide this question into three distinct dimensions. From the vertical standpoint, we see this on a global level. It is an industry that renews, innovates and reinvents itself each moment, because our clients have their own competition dynamics, they have their own needs, which are constantly changing.

So if we compare a school of today with a school of ten years ago, we will see the evolution of technological needs. The same is valid for a construction company, for a service provider, and even for a manufacturer, as well as for all sectors in which we operate.

This vision of ours of investing in vertical segmentation aims to strengthen TOTVS' positioning, so that we are able to capture the reinvention of the industry in coming years. This will never stop.

There is another dimension that we see. When you go down the base of the pyramid, towards small businesses, you find a segment that is less explored in terms of management software in general, integrated management software, and it is an important niche in the Brazilian and Latin American markets.

In relation to market share, stealing market share or fighting for it against other established companies, I would say that this is possible in the longer term, when the software industry will eventually enter a natural cycle of exchange of solutions. But I think this is something that could happen in the future. Today it would be difficult. There are some cases, but depending on the investment the client has made in his solutions, the switching cost is very high.



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So we see a great potential regarding vertical segmentation, specialized solutions that help our clients grow and become more competitive.

When you go to the universe of smaller companies, it is a sea of opportunities as far as the adoption of management software is concerned, not only in terms of client's competition, but also because the tax and accounting system in Brazil is becoming increasingly computer-based and Latin America is following the same trend. This creates many opportunities.

In the long term, obviously whoever is more competitive, whoever offers products that are stronger and more adequate on the technological aspect, will be able to 'steal' market share.

André Baggio:

All right. Thank you.

Bruno Mendonça, Santander:

Good morning. I would like you to talk about default levels. In previous quarters, you commented on a default level higher than the historical levels, and in this quarter there was a significant improvement. I would like to know what portion of this improvement is recurring and what to expect in coming quarters. Thank you.

Alexandre Dinkelmann:

Good morning, Bruno. We talked about this subject a lot in our calls last year, and we showed you an upward trend in default levels. This required of TOTVS to take several measures in relation to this subject, including stricter risk control, so depending on the project, we have raised the bar in relation to accepting new clients into our portfolio. Obviously, we worked on recovering that which could be recovered. In short, in 2012 we worked hard on that, and we can see the result of our efforts in 1Q13.

It is very difficult right now to say that this is a trend, okay? It is too early for us to say that this is a new level for the Company.

We are satisfied to have reached historical levels, but at this moment I prefer to be more conservative and not make predictions for the 2013 scenario in terms of provision for doubtful accounts.

Over the course of 2012, we saw an improvement in the large business segment, and we have a specific project that focuses on our major clients, since they are having an adverse impact on this line; then during the year we started to see an improvement in the SMB segment, since SMB was accounting for almost half of our provisions, and we managed to go back to historical levels.

Let's wait and see what's going to happen in 2013, how the economy will perform, and we will monitor the default rates of the economy as a whole, in order to find out if we will maintain this level.



Bruno Mendonça:

Excellent. Thank you.

Luiz Fernando Azevedo, Bradesco:

Good morning. My first question is about M&A. The Company has net cash, and has made some acquisitions recently, so I would like to know what the M&A pipeline looks like, how you see the potential targets in terms of price, and what the competition scenario for M&A looks like today.

My second question is sort of related to the first one. Alexandre said you are focusing on vertical segmentation, deepening the segmentation, increasing the specialization of your products, and I wonder if this will not make the Company lose scale in terms of R&D and will have to invest a little more in research. On the other hand, via acquisition, you could simply buy some competing businesses with know-how in some verticals, preventing the Company from having to make additional efforts towards deepening the verticals. If you could please talk about this – if I am wrong... – I would appreciate it. Thank you.

Alexandre Dinkelmann:

Good morning, Luiz. Thank you for your questions. Let's start with the first one, about M&A. As we always say, M&A is part of the Company's strategy; it is part of our DNA.

We know how to make acquisitions, and especially how to integrate the businesses creating synergies and without destroying value. We believe in this, in our capacity to create synergies through merger and acquisitions. Perhaps TOTVS is the major player in Brazil with capacity to create synergies on several fronts, including technology, distribution, product portfolio, on the administrative and financial fronts.

So we have an agenda of acquisitions and we will continue to have it. We have an active machine. We are constantly looking at market opportunities, and it is hardly possible for a deal to go unnoticed for TOTVS.

With regard to our net cash, we see it as a weapon in case we need to use it or work with the adequate financial leverage for the Company. For us, this will never mean to lose our discipline in the process of acquisitions.

In the last 12 or 18 months, we turned down several deals because they somehow were not in line with our financial, strategic, or leadership combination goals. So we do want to maintain our discipline, but we also want to continue making acquisitions.

About your second question, when you refer to the impacts from our focus on vertical segmentation, yes, potential acquisitions are always analyzed in the light of our internal efforts.

We have a restrictive governance model under which we analyze the "make or buy", that is, to make it internally versus to purchase. And we will continue to adopt this model.



We do not believe that our focus on vertical segmentation will affect our long-term vision in terms of R&D weight on our bottom line. That is not the way we see it.

The vertical segmentation strategy requires choices to be made. This is important, and our choices will always be connected to where we see greater long-term market potential. So I believe that our vertical segmentation efforts actually improve capital allocation in terms of innovation.

Lastly, regarding your question about the M&A competition landscape, for sure competition is increasingly strong in this market. The success of TOTVS also brought more attention to our market, especially on a global scale.

There are foreign players looking at the market, whether financial-oriented or strategy-oriented players, which confirms our vision of great potential in the Brazilian and Latin American markets. Perhaps today this is the region that attracts the most attention from the software world.

Anyway, we believe that TOTVS can be competitive within this environment. And I am not talking about exclusively on the financial aspect. Again, we prefer to turn down a business deal, even if it passes our standards of financial attractiveness.

I believe that the TOTVS project has capacity to attract a lot Brazilian entrepreneurs, since we have a model of valuing entrepreneurs, keeping them active in our business. I believe that this, obviously combined with our firepower to make interesting acquisitions, is still a differential of TOTVS in the M&A market.

Despite the speed-up of the M&A market, we do not see anything hindering our plans to make accretive acquisitions for the shareholders of TOTVS.

Luiz Fernando Azevedo:

Thank you.

Thiago Munhoz, Gerval:

Good morning. I have two questions. The first one is about the license sales being a little sluggish. I would like to know to what extent this was due to the economic slowdown and to stronger competition, or due to new market players entering the SMB segment.

My second question concerns TOTVS' international operations. You used to disclose in the earnings release the contribution of international operations to the margin, but this quarter there was no information about it. Could you please comment on that? Thank you.



Alexandre Dinkelmann:

Good morning, Thiago. Let's start with your second question. In the international market, we have a guidance to reach breakeven by the end of 2014, and we are totally confident in this guidance.

The idea of the Company is, as from this conference call, to disclose international operations information on an annual basis. We disclosed the growth in the international market in terms of revenue, and it was a substantial growth. The first quarter, in terms of result, is fully in line with what we are seeking, which is basically to improve our results until we reach breakeven.

Each year, we are going to show you our broken-down results in the international market. We are very confident and our efforts are already bearing fruits. Like I said, this is a medium-term process. A turnaround in the international market could never be achieved in a remarkably short space of time.

In relation to sales and competition, I will answer partially, and then Maia will complement my answer. Our market is highly competitive. There is not a major competitor of TOTVS, nor is there a specific competition level, so we need to look at it from a segmented standpoint.

In the high-end market, we have a competition level that is different from the one in the SMB segment, which is different from competition in the base of the pyramid. In the segment of small and medium-sized businesses, the competitive environment is increasingly specialized. It's a regional form of competition, a focused, niche competition. We don't see any major player positioning itself against TOTVS. And this competitive environment is the same as before, as tough as in 2011 or 2012.

I believe that the macroeconomic scenario was mostly responsible for the difference between our expectations and our results; I believe this factor was more important than anything else.

Gilsomar Maia:

I would complement Alexandre's answer by emphasizing that it is difficult to make an analysis based on one quarter. We even pointed out in our earnings release that sales to new clients are historically more sensitive to the macroeconomic scenario, especially sales to larger clients.

Again, new clients know that there is a certain amount of volatility. It is even a bit weird, because, if you look at the performance of sales to new clients in the quarter and in the last 12 months, you will see different trends. So it is not possible to establish a trend or something like that.

Thiago Munhoz:

OK. Thank you.



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Operator:

At this time I would like to turn the floor back over to Mr. Alexandre Dinkelmann for any closing remarks.

Alexandre Dinkelmann:

I would like to thank you all for your participation in the call, thank you for your questions. We are always available to clarify any doubts you may have. Especially, I would like to thank the TOTVS team. It is a hardworking and motivated team. We have challenges ahead of us and an amazing market, so we will strive in order to maintain TOTVS as the best software Company in Brazil and one of the best in the world. Thank you very much.

Operator:

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

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