

Operator: Good morning. Welcome to the TOTVS conference call to discuss the results of the fourth quarter of 2016 and full year 2016. Today we have with us Mr. Laércio Cosentino, CEO, Mr. Gilsomar Maia, CFO and IRO, and Mr. Douglas Furlan, IR Manager.

Note that all participants will be on listen-only mode during the presentation. After that, we will start the question and answer session for investors and analysts when further instructions will be given. If anyone needs assistance during the call, please press *0 to reach the operator.

The audio is being simultaneously webcast at ir.totvs.com.

Before proceeding, we wish to clarify that any forward-looking statements that may be made during the conference call, related to the business outlook, operational and financial projections and targets of TOTVS are based on beliefs and assumptions of the Company's management as well as information currently available. Forward-looking statements are not guarantee of future performance. They involve risks, uncertainties and assumptions as they refer to future events and, hence, depend on circumstances that may or may not occur. Investors should understand that general economic conditions, industry conditions and other operational factors could affect the future performance of TOTVS and could lead results to differ materially from those mentioned in such forward-looking statements.

I will now turn the call over to Mr. Maia, who will begin the presentation. Mr. Maia, please go ahead.

Gilsomar Maia: Good morning everyone. Thank you for participating in our conference call to discuss the results of the fourth quarter and full year of 2016.

Before starting the presentation, I would like to remind everyone that, to preserve comparability, 4Q15 and 2015 numbers are pro forma, as they include Bematech's three-month and full-year results respectively for these periods.

Now, I begin my comments on the quarter's results on slide 3. Net revenue grew 2.3% over Q3. Year on Year, net revenue fell by 3.7% in 4Q and 3.5% in the year, due to a 16.8% drop in non-recurring revenues. Recurring revenues grew 7.2% in the year and accounted for 61.8% of total net revenue in 2016, or 6.2 percentage points above 2015.

When analyzed by business, on slide 4, we see that the year-on-year drop in net revenue was concentrated in services and hardware revenues.

In Services, the reduction resulted from a drop of almost 6% in software implementation services, due to the slower pace of sales to larger clients throughout the year, as well as a reduction of 13.5% in services not related to software implementation, negatively affected by the sale of the HR BPO operation in August, 2016 and by the lower sales volume of consulting services in the second half of 2016.

In Hardware, the decrease reflects the recession in the Brazilian economy and the mix variation resulting from the changes in state legislations, such as in the State of São Paulo, where fiscal printers were replaced by the fiscal equipment S@T, which has a lower unit price.

Software revenues closed the year at R\$1.4 billion, despite the transition to subscription model and the economic recession in Brazil. In the quarter, software revenue grew 2.3% over Q3, mainly due to the 9% growth in subscription that I will now talk about, on slide 5.

Subscription revenue totaled R\$64 million in 4Q16 and already accounted for 18% of the software revenue. This is the second quarter in a row that software revenue grows over the previous quarter, mainly due to the acceleration of subscription growth throughout the year.

This acceleration in subscription growth more than offset the drop in license sales and the lower maintenance growth over the last two quarters, as shown in the left chart of the slide.

The growth in subscription is mainly a result of more than 4,000 clients added organically in this model in 2016. Among these new clients, we can highlight microenterprises with our Fly01 software, and the small and medium companies in the Intera model, our subscription model launched in June 2015.

Intera has a shorter sales cycle due to its lower initial investment, which also tends to be very positive for new sales to existing clients, since the clients do not need to buy new licenses to add identities, only the value of the Intera monthly fee is adjusted to the new number of IDs.

In addition, the Intera monthly fee includes standard cloud infrastructure, access to the fluig platform and access to the e-learning center, key elements for the digital transformation we are promoting in the market.

It is important to mention that Intera's sales in December did not affect the 4Q subscription revenue, since the first billing is made in the following month, but has already affected the Annual Recurring Revenue (ARR) of Subscription, presented on the chart on the right side of the slide.

In 4Q16, the subscription ARR totaled R\$260 million, 28% higher than 4Q15. The net addition of ARR was R\$25.1 million, against R\$21.0 million in the 3Q. The ARR is a common metric used in the SaaS world to measure the evolution of recurring revenue over the next 12 months, based on contracts signed up to the end of the period.

ARR's growth reflects, in addition to the growth of Intera and Fly01, the migration of 45 clients from maintenance to subscription in the 4Q and the acceleration of Bemacash sales, which I will comment now on slide 6.

Bemacash includes Fly01 software and Bematech's tax and commercial automation solutions. Most of Bemacash's sales made over the the year did not affect the subscription revenue yet, since new Bemacash clients become software clients between the 8th and 11th month after contracting the solution, when they start paying for the software subscription.

We have sold nearly 2,800 Bemacash units in 2016 for the Retail, Apparel, Bars and Restaurants and Food Truck segments, and certified more than 300 resellers throughout the year. In 2017, we will continue the training program to resellers with the goal of ending the year with 1,000 certified Bemacash resellers.

Bemacash is another initiative from TOTVS to explore Brazil's microenterprise market, which comprises more than 4 million formally established companies, and is also an entry point to our business solutions, contributing to generate new software sales opportunities in the medium-term for micro-enterprises that become small and medium in the future.

Now, I invite Douglas, which will comment on the software result on slide 7.

Douglas Furlan: Thank you, Maia. Good morning everyone.

The software contribution margin closed the year at 62.6%, when excluding the additional costs of R\$1.0 million with layoffs from the structure adjustment in fourth quarter 16.

The decrease in the adjusted contribution margin is a consequence of the stability of software revenue in the year, already mentioned by Maia, combined with the increase in the cost of support and R&D expenses due to wage increases from collective bargaining agreements, investments in the integration of Bematech's solutions portfolio and the renewal of clients service and support processes.

In the quarter, the adjusted contribution margin fell mainly because of the wage increases in Joinville, Porto Alegre and São Paulo, where the Company has development centers.

On slide 8, the service contribution margin fell by 190 basis points in the year, when excluding the additional costs of R\$2,0 million with layoffs from the structure adjustment in the fourth quarter 2016.

This reduction in service margin was mainly due to the lower volume of sales from consulting services, already mentioned by Maia, in addition to the collective wage increases throughout the year.

In 4Q16, in addition to these factors, the reduction in the service margin was mainly a consequence of the remaining wage adjustment from the collective bargaining agreement signed in the first quarter 2016 in São Paulo.

It is important to mention that the additional costs with layoffs from the structure adjustment represents a reduction of recurring labor costs of about R\$1.8 million per quarter.

On slide 9, the hardware contribution margin, excluding the non recurring items, was 34.2% in 2016, against 40.3% in 2015.

This reduction was due to the decrease in hardware revenue, combined with the lower economic subsidies established by the Government of the Paraná since September 2015, and Bematech's R&D capitalization in 2015.

It is important to mention the evolution of the hardware margin throughout the year, most notably in the third and fourth quarters, when margins were above the full year margin.

In 4Q16, the contribution margin was 37.5%, 240 basis points higher than the 4Q15. The year-on-year growth in contribution margin, despite the 8.8% drop in hardware revenue, was mainly due to the growth in hardware gross margin and the increase in economic subsidies resulting from the change in the sales mix during the period.

Now talking about selling and administrative expenses, please move to slide 10.

Selling expenses and commissions, excluding the additional costs with layoffs from structure adjustments, increased their proportion of net revenue mainly due to the growth of selling expenses.

This growth is a consequence of the change in sales mix between franchisees and own branches and the higher volume of software sales in the subscription model.

In the fourth quarter 16, the quarter-on-quarter growth was mainly due to the growth in software sales and the wage increases in São Paulo.

G&A expenses plus management fees and other expenses, excluding non-recurring items, increased its proportion of net revenue by 160 basis points in 2016, mainly explained by the additional provision for contingencies of R\$19.7 million in the fourth quarter 2016, as a consequence of the review of the past outcomes of lawsuits and the circumstances of new proceedings in which TOTVS is the defendant.

The combination of the decline in the Company's net revenue and the wage increases made throughout the year also collaborated for the increase of these expenses as a percentage of net revenues.

Advertising and marketing expenses corresponded to 2.2% of net revenues in 2016, compared to 2.5% in 2015, chiefly due to the revision of the general marketing plan and the synergies from the integration of marketing activities of TOTVS and Bematech.

Now I'd like to turn the call back to Maia, to discuss EBITDA, on slide 11.

Gilsomar Maia: Thank you Douglas.

In Q4, the Adjusted EBITDA totaled R\$60.7 million, a 28.5% decrease year on year, and the margin was 11%. This reduction is mainly a consequence of the additional provision for contingencies mentioned by Douglas.

In the year, the Adjusted EBITDA decreased by 21,5% and totaled R\$358.7 million. Adjusted EBITDA margin for the year was 16.4%, compared to 20.2% in 2015.

As presented in this conference, this reduction in margin came mainly from the software and services businesses, once we can see a clear hardware margin recovery in the last 3 quarters.

The growth of the subscription model reestablished an upward trend in software revenue, that ended the year stable. In parallel, labor inflation and investments in the portfolio integration and customer service resulted in an increase of costs and expenses. This dynamic, combined with the Brazilian economic recession, explains the margin pressure we've been having.

The acceleration of Subscription ARR, which ended the year 28% above the 4Q15, together with the structure reductions that we've been conducting, give us the confidence that we are close to reach a turning point in the software and service margins.

Now, talking about net income on slide 12.

The decline in Adjusted Net Income in 2016, at a faster pace than the decrease in Adjusted EBITDA, is mainly due to the change in the Company's capital structure, from a net cash position in 3Q15 to a net debt in 4Q15, and the higher Long-term Interest Rate (TJLP) in 2016, which is the main index for financial costs of debentures and financing lines from BNDES.

Moving now to slide 13 to talk about cash flow and debt.

In 2016, Gross Cash decreased by R\$212 million, chiefly due to:

- (i) Working capital investments of R\$124 million;
- (ii) Net investments in fixed assets of R\$53,6 million, of which R\$22,6 million related to investments made in the Company's new campus;
- (iii) The payment of R\$50,0 million related to intangible assets, including the payment of part of the acquisition price of Unum, a Bematech invested company; and the investments for the creation of TOTVS Digital;
- (iv) Amortization of principal amount of financing lines taken from BNDES in 2013; and
- (v) Amortization of R\$48 million referring to the remaining principal amount of debentures issued in 2008.

Net Debt totaled R\$479 million in 4Q16, equivalent to 1.3x 2016 Adjusted EBITDA.

Now I turn the presentation to Laércio to continue on slide 14.

Laércio Cosentino: Thank you, Maia. Good Morning everyone.

In 2016, we took another important step towards promoting digital transformation and becoming a "Single Subscription Company". We invested even more in the innovation of our solutions, especially in platform, mobility and cloud, and we grew more than 20% in subscription in a year of economic recession in Brazil.

We evolved in the alignment of commercial incentives related to the subscription model, as well as in the elaboration of a new marketing plan, increasingly digital, aiming to increase sales leads, especially in the subscription model.

We also made progress in the development of TOTVS Digital, to be launched in the first quarter of 2017. TOTVS Digital is a completely new digital environment focused on the interaction between TOTVS, distribution channels, salespeople, clients, prospects and partners.

We renewed a part of the senior management in 2016 and hired new executives aligned to the culture of a subscription-based company, as part of the Company's succession plan.

Today, we have a collaborative, digital and results-driven team that uses technology and business knowledge to promote innovation and understands that the client success is our success.

We will continue our journey to turn TOTVS into a Single Subscription Company, developing solutions for clients of our clients and increasingly connecting people, things and businesses.

The progress made in the transition to subscription over the last 18 months, combined with the Company's investments and the opportunities in Brazil, give us the confidence that TOTVS is on the right path to resume growth and profitability in 2017.

Now we are available for the Q&A session.

Operator: Ladies and gentlemen, we will now begin the question and answer session. If you have a question, please press the star followed by the one key on your phone now. If at any time you would like to remove your question from the questioning queue, press star two.

As a reminder, if you would like to pose a question, please press star one.

Once again, if you would like to pose a question, please press star one.

This thus concludes today's TOTVS Question and Answer session. I would like to invite Mr. Laércio to proceed with his closing statements. Please go ahead, Sir.

Laércio Cosentino: As I just said, 2016 was very important in the journey to transform TOTVS into a "Single Subscription Company". It is also important to mention the creation of the Governance and Designation Committee, whose function is to evaluate the appointment of new members to the Board of Directors and increasingly reinforce the Company's corporate governance practices.

For 2017, the guidances disclosed reflect our confidence that we are on the right track to resume growth and profitability.

Operator: This thus concludes today's TOTVS conference call. Thank you for listening. Have a good day and thank you for using Chorus Call.