Operator: Good morning. Welcome to the TOTVS conference call to discuss the results of the first quarter of 2017. Today we have with us 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 first quarter of 2017. Starting on slide 3, where we have the recent events related to the general meeting and TOTVS new campus in São Paulo.

The Shareholders' Meeting held on April 20 was attended by shareholders representing 75.7% of total shares, with 35.2% of total shares being represented via remote voting form. All matters in the agenda of the meeting were approved, of which we highlight:

(i) the unanimous approval of the dividends distribution proposal in the amount of R$7.4 million for the year of 2016, to be paid to the shareholders on May 10, 2017. This dividend amount, together with the interest on equity announced in 2016, totaled R$91.6 million and corresponds to 60% of the net income from the fiscal year of 2016;

(ii) the unanimous approval of the proposed management annual global compensation for the fiscal year of 2017;

(iii) the election of Gilberto Mifano, Maria Letícia de Freitas Costa and Henrique Andrade Trinckquel Filho as new independent members of the Board of Directors, with 70.7% approval of total shares.

Another recent event that deserves to be highlighted is the moving of TOTVS to the new head office in March. In this new campus , TOTVS houses in a single location almost 3,000 employees, who were earlier spread across 7 locations in São Paulo city and the metropolitan region.

The new head office is a technology center specially designed for TOTVS with more than 21,000 square meters, inspired by leading technology companies in the Silicon Valley in California.

Apart from the benefit of concentrating in a single location the Company's development, sales and administrative operations in Greater São Paulo, the new head office has an exclusive area for customer service in an environment designed to provide innovative experience on major technological trends, such as mobility and cloud computing, which are key components in the Company's strategy to promote digital transformation among its clients.

Now, I begin my comments on the results of the quarter on slide 4. It is important to remember that, in order to maintain comparability, the proforma consolidated figures for the 12 months ended in Q116 also include Bematech's results.

In this quarter, net revenue increased by 1.6% year-on-year, as a result of the 8.0% growth in recurring revenue, which corresponded to 64.4% of net revenue in the quarter, 3.8 percentage points higher than in Q116, and of the decrease of 8.3% in non-recurring revenue. In the last 12 months, recurring revenue increased its share of total net revenue by 5.7 percentage points.

When analyzed by business, slide 5 shows that the 5.3% growth in software revenue and 2.8% in hardware revenue positively impacted the net revenue growth year on year. Services revenue reduced its share of total net revenue by 2.5 percentage points year-on-year and totaled R$128.6 million in Q117, the same level of 4Q16.

In hardware, the year-on-year growth is mainly driven by sales of automation solutions in the period, especially Bemacash. It is worth mentioning that the automation solutions growth is a consequence of the Company's strategy of offering solutions that contribute to the more efficient management of our clients' businesses, making them increasingly competitive in their business segments. In comparison with the previous quarter, the reduction in revenue is mainly a consequence of the seasonality of sales in the period.

In services, the year-on-year decrease is a result of a 1.0% decline in software implementation services, chiefly due to the lower pace of sales observed in recent quarters, and a 20.5% decrease in services not related to software implementation services, mainly reflecting the lower sales of consulting services since 2H16 and the HR BPO operation sold in 2016.

Software revenue in Q117 grew 5.3% year-on-year, 4 percentage points higher than growth in the last 12 months, mainly due to the growth in subscription revenue and the increase in the corporate licensing model, which I will comment on slide 6.

Revenue from the software licensing model, which combines license and maintenance revenues, grew 5.7% quarter-over-quarter, was sazonaly driven by the incremental license from the corporate model, which totaled R$13.9 million in this quarter, 29.5% higher than the incremental license from Q116.

In the corporate model, clients have unrestricted access to TOTVS management solutions, for which they pay an incremental license fee at the beginning of each year based on their real growth in the prior period, which also results in an adjustment in the monthly recurring maintenance fee of these clients.

Thus, this growth in the incremental amount reflects the quicker pace of growth among clients under this model in 2016, especially in the Agribusiness, Manufacturing and Healthcare industries, despite the worsening economic scenario in Brazil and the fewer clients added in licensing model during the period.

Subscription revenue grew 31.3% year on year and 6.7% quarter on quarter, boosting software revenue growth, which grew quarter on quarter for the third consecutive quarter.

This growth in subscription revenue was due to the higher share of sales to new small and medium clients in the last 12 months, especially under the TOTVS Intera model.
It is important to mention that Intera's sales of March did not affect the quarter subscription revenue, since the first billing occurs in the month following the sale.

However, the ARR or Annual Recurring Revenue, shown in the chart to the right of the slide, has captured sales of March, since this very common metric in the SaaS world measures the evolution of recurring revenue over the next 12 months, based on contracts signed up to the end of the period.

In Q1, the ARR of subscription totaled R$280.7 million, 36.2% above the Q116, representing a net addition of R$20.7 million in the quarter.

ARR's year-on-year growth over the last 5 quarters shows that we are evolving in the transition from the licensing to the subscription model, a key element to reach our goal of turning TOTVS into a "Single Subscription Company" and promoting digital transformation in our clients.

In addition to the growth of Intera and Fly01, the ARR growth reflects the migration of 69 customers from maintenance to subscription on Q1 and the acceleration of Bemacash sales in the last quarters, which I will comment now on slide 7.

Bemacash is another initiative from TOTVS to explore Brazil's microenterprise market 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.
In the quarter, we have sold 1,073 new Bemacash units, despite the negative sazonal effect of sales in this quarter. It is worth remember that most of Bemacash's sales made in recent periods

did not affect the subscription revenue yet, since new Bemacash clients become software customers between the 8th and 11th month after contracting the solution, when they start paying for the software subscription.

Now, I invite Douglas, which will comment on software result on slide 8.

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

Before starting my comments on software results, I would like to remind you that TOTVS' costs and expenses in Q117 were fully impacted by the 6.29% wage increase established by the collective bargaining agreement to São Paulo employees, who represent about the half of TOTVS' total payroll.

In addition to the salary adjustment, the collective bargaining agreement also established the payment, in August 2017, of a bonus equivalent to 10% of one salary with reference date of December 2016. This bonus, in the amount of R$1.8 million, was fully provisioned in Q1.

The software contribution margin for the quarter dropped 210 basis points in comparison to Q116, reflecting the increase in software costs and the higher growth of R&D investments than the growth of software revenue during the period.

The year-on-year increase in software costs reflects basically the share of complementary solutions provided by partners in the period, whereas the increase of R&D investments mainly reflects the wage increases in the last 12 months.

Compared to Q416, the increase in the software contribution margin was mainly due to the combination of the software revenue growth, already commented by Maia, with the reduction in R&D investments, mainly due to the conclusion of innovation projects specifically for the Healthcare segment and Cloud, besides the additional expenses with the restructuring carried out by TOTVS in Q416.

On slide 9, the Q117 service contribution margin increased by 80 basis points quarter on quarter, despite the wage adjustment in São Paulo, mainly due to the organizational restructuring carried out by the Company, which resulted in additional costs with employee termination in Q416 but in reduced recurring personnel expenses in Q117.

In the year over year comparison for Q1 and for the last 12 months, the reduction in service contribution margin mainly reflects the lower allocation of service professionals due to the slower pace of projects sales, as well as the collective wage adjustments made, which were not fully transferred to service projects prices in the period.

Moving to slide 10, hardware result in the quarter grew 24.9% year-on-year, with a contribution margin of 37.5%, 660 basis points higher than in Q116. This growth is largely due to the convergence of price adjustments made by the Company and the FX rate variation in 2016.

In the last 12 months, results from hardware dropped 10.8%, mainly due to the decline in net revenue from hardware, decrease in economic subsidies and the capitalization of R$5.7 million of Bematech's hardware research and development expenses in 2015.

Now to talk about selling and administrative expenses, please move to slide 11.

In Q1, selling expenses and commissions jointly increased their proportion of net revenue by 160 basis points when compared to Q116, and by 70 basis points in the last 12 months.

This increase is due to the change in the sales mix between franchises and own branches, the higher volume of software sales in the subscription model and the adjustments to the compensation model of the sales team in 1H16.

In comparison with the previous quarter, the increase is primarily due to the growth in net revenue from software in the period and the wage increase in São Paulo.

In Q117, general and administrative expenses together with management fees and other expenses reduced its relevance of net revenue by 230 bps quarter over quarter, mainly due to the amount of R$19.7 million added to the provision for contingencies in Q416 and the reduction of the Company's management structure in Q1.

It is important to mention that this block of expenses was negatively affected by the non-recurring write-off of fixed assets in the previous facilities left behind during the migration to the new campus, in the amount of R$1.9 million.

The allowance for doubtful accounts corresponded to 1.6% of net revenue in Q117, the same level of Q416, reflecting the delinquency level seen in the operation during the period.

Advertising and marketing expenses corresponded to 1.7% of net revenue in 1Q17, as against 1.5% in 1Q16, chiefly because the growth in net revenue was lower than the wage increases and adjustments in contracts with suppliers made during the last 12 months.

On slide 12, EBITDA in Q117, adjusted by non-recurring write-off of fixed assets of the previous facilities in São Paulo, amounted R$90.1 million, 48.4% higher than Adjusted EBITDA in Q416, and the Adjusted EBITDA margin was 16.1%, up 510 basis points from the Adjusted EBITDA margin in Q416.

Adjusted quarter-over-quarter EBITDA growth was primarily a consequence of the growth in software revenue, mainly driven by revenues from incremental licensing fees in the corporate model and by subscription revenue, as commented earlier by Maia, and the reduction in G&A expenses.

Year-on-year, even with the software and hardware revenues increase, Adjusted EBITDA declined 21.4%. This drop is mainly due to the reduction in contribution margin from services and the increase in commercial and administrative expenses.

On slide 13, the year on year adjusted net income drop was higher than the drop of Adjusted EBITDA, specially because of the higher financial expenses mostly affected by the increase in the long-term interest rate that is used to update the main financing lines and debentures, and the decline in the financial revenues due to the reduction of the gross cash and debt.

In comparison with Q416, net income growth was lower than the EBITDA growth because of the lower tax rate of Q416 as a consequence of the fiscal benefit related to interest on equity approved in December 2016.

Now I'd like to turn the call back to Maia, to comment on cash flow and debt on slide 14.

Gilsomar Maia: Net debt dropped 7% year on year and 8% quarter on quarter, and represented 1.3x adjusted EBITDA in the last 12 months, same level of Q416.

Free cash flow in Q117 was 31.7% higher than in Q416, mainly due to the 59% decline in the working capital needs and the lower volume of investments in fixed assets. On the other hand, the financing activities used 26% more funds due to the partial amortization of the principal of debentures issued by Bematech in 2014, the payment of withholding income tax on Interest on Capital, as commented by Douglas, and the payments of financial leasing installments contracted in previous quarters, especially related to the investments in the new head office.
In comparison with Q116, free cash flown increased by 690%, mainly due to the 88% drop in working capital needs in the period.

In the last 12 months, free cash flow was positive at R$214 million, compared to a negative free cash flow of R$315 in the previous period, mainly a consequence of the reduction in working capital investments by 64% and the payment of R$474 million in the corporate reorganization with Bematech in 4Q15.

Despite the higher free cash flow, gross cash declined 39% in the last 12 months, mainly due to the start of the amortization in Q415 of the principal amount of the financing line taken by TOTVS from BNDES in 2013 and the amortization of R$48 million referring to the remaining principal of the debentures.

I now turn to slide 15 for my final remarks.

In this quarter, total software revenue accelerated year-on-year growth to 5.3% versus 1.0% in 4Q16. This was the third consecutive quarter of quarter-on-quarter growth, which shows that the transition to the subscription model has already passed the inflection point and established a growth trend in software revenue.

Subscription revenue grew 31% year-on-year and reached R$280 million in ARR, a 36% year-on-year increase, which also contributed to a 7% growth in recurring software revenue in the period.

We are determined to establish a turning point as well as a sustainable growth trend for the Company's profitability, just as we have done with revenue. Thus, the 48% growth in Adjusted EBITDA over 4Q16 should be understood as a sign of our determination.
Now, we are available for the Q&A section.

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.

Our first question comes from Mr. Fred Mendes with Bradesco.

Fred Mendes: Good morning everyone thanks again for the call. I have just one follow-up question. When we look at the breakdown of commercial expenses, there is a significant increase in the selling expenses YoY, of course there is a disconnection between selling expenses and commissions given the change in the compensation model.
Is it possible for you to give us a breakdown of direct and indirect sales or at least, tell us how indirect sales are involving and if you saw any improvement on this matter? Thank you.

Gilsomar Maia: Thank you Fred, this is Maia speaking. Regarding your question related to commercial expenses, we have in this block of expenses two lines: one is the selling expenses itself and the second one is commissions.
Selling expenses is basically the cost of our direct sales team and the commissions expenses are related to our distribution channels. Since we launched the subscription model we try to set up incentives of our sales people in order to align their incentives to sell license and subscriptions, in practical terms they can make the same amount of money selling both things and that creates some disconnection between selling expenses and top line is specifically in the case of the subscription model.
What is not the case for the commission expenses because commissions works like revenue share and so it is a percentage of our revenues and it is more aligned with our top line.
Talking about the participation of the sales via franchisees, i can tell you that in the past quarters we are seeing the franchisees increasing their participation over the total sales of subscription,

which is also helping us to increase the growth of subscription in the past quarters. Therefore, this model is getting more material among them and this is helping us to increase this participation.

Fred Mendes: Thank you Maia.
Just one more question, as you are changing the way how you sell, focused more on the subscription model rather than licenses, should we see a decrease in the provisions for bad debt? As we move forward since the guys in the subscription model are paying on a monthly basis and I guess their risk of bad debt at least in our mind should decrease? Do you think this line of thinking is makes sense?

Gilsomar Maia: It makes sense in the long run because it is important to remind that in the traditional licensing model the client acquires a licensed copy of our software and pays in a monthly fee; but in an extreme scenario a client can stop paying the maintenance and keep running our software because they bought the license.
Now under the subscription model they are just subscribing service and if they stop paying the subscription fee, after a while they don't have the software available anymore. So in this sense the subscription model can be helpful for delinquency, this level of delinquency that we have today is more related to the macroeconomic scenario as a whole, but partially we can correlate that the business model can be helpful. I should not create some expectations that just the change to subscription could address 100% of the delinquency problem that we have today.

Fred Mendes: Okay thank you very much Maia.

Operator: Our next question comes from Richard Dineen, UBS.

Richard Dineen: Hi thanks very much for taking my question and congratulations on some good sequential operating dimension. I was just questing if we should expect a sort of continuation of those improvements in the major revenue segments since the economy continues to recover.
I was just wondering how much visibility you have on 2Q and 2HTY and if it is going to be possible to now revalue your EBITDA guidance at any point. Any color on that would be helpful and then I will follow-up after that.

Gilsomar Maia: Thanks Richard for your question. Maybe it is good pass quickly through the main revenue streams we have.
So starting from license was benefited in 1Q because of this good performance of the corporate model. The remaining license out of the corporate model is still declining comparing year and year, it declined about 12% although when we compare the environment today with one year ago, we see a little bit more optimistic humor in the market, so can be favorable for license performance throughout this year.
I don't mean that the declining trend in the traditional license model can be reverted; but in my personal view we should not see this year a strong declining license as we saw in the previous two

years what can be helpful for the short term in terms of margin. Probably you remember in the last two years the strong declining license hurt our bottom line a lot.

The second line related to maintenance is a good correlation with license sales. I always try to remind people that we have three main variables in the equation of maintenance: the first one is churn, that still high and we saw a very little improvement in this quarter, nothing relevant in terms of churn;

The second variable is inflation that is coming down consistently, specifically last month we saw an IGPM been negative and it can be unfavorable for adjustments throughout the year; and the third variable is the addition of new maintenance contracts coming from new license sales.

Then I can connect this comment to my previous one related to the license performance. If license performance is more stable during this year, eventually we can offset the eventual negative impacts coming from inflation rates in a lower pace and we can see some improvements in terms of churn throughout this year.

Maintenance probably will not perform so well as it performed in 1Q because the corporate model provoked a very positive impact in 1Q; but we have a good chance to see maintenance more stable throughout the year too.

Services are really under pressure yet. We have a matter of technicals allocation, our sales technicals are not fully allocated for a while, and it has been a problem to have a better shape in terms of services results. Measure we being taken here is basically trying to sell smaller projects of services because we can quickly see the implementation moving forward and as a consequence the results in services too; we are trying to have a more efficient implementation of services too. So it is somehow structural and we should see some improvements throughout this year but in a gradual way.

And the last one is hardware, hardware has a very clear seasonal behavior in 1Q that is a negative seasonality for the hardware business everywhere. We see a hardware business really improving consistently. There is a structural change in the hardware business of Bemacash after the merger of Bematech with Totvs and you probably remember, we had a discontinuation of our fiscal printers in the middle of 15 and it impacted negatively the results of hardware.

From that point, we have been able to enhance the quality of the hardware business of Bematech trying to sell more business solutions than fiscal solutions, and that can explain the good performance of hardware and we have good expectations for the hardware line for this year, as well as we have been able to create more and more cross selling for our existing clients in Totvs trying to take more advantage.

In terms of bottom line, the lower inflation also creates some possible expectations to have lower levels of salary adjustments for the rest of the year and it can have a lower pressure over costs as a consequence if we see this positive trend in terms of software revenue.

So the new subscription model is adding more revenues than affecting negatively top line and it can recover part of our margins throughout the year, and we see this as a possibility to be in that range of the EBITDA guidance that we gave last quarter. I don't know if I am clear in my explanations?

Richard Dineen: Yes, I thought that is fantastic, very detailed. I just wonder if I could have one very quick follow-up on the Brasil Maior tax benefit that you mentioned. Is there any way of weighing the probability of changes to that benefit? And if there are any other tax benefits that you get right now that could be under risk if the government is getting through the different taxes and seeking to increase tax revenue? I was just wondering if there is anything else we should be having at the back of our minds.

Gilsomar Maia: Okay good. After the launching of that provisional measure from the federal government, the association of technology firms started to move trying to interact with the government, with the executives and the legislative to explain for the government that if the aim is to enhance tax collection they are going the other way, and they are moving to tax the payroll instead of text the consumption of technology.
The whole technology industry is more and more moving to an automation in which the labor tends to become a less relevant element in the cost structure of technology firms. So if tax authorities change the taxation to payroll, to development, in the mid-to long-term they will collect less taxes and so it makes no sense. It makes no sense on their side to collect more taxes and also it makes no sense especially for local developers. Every time the government considers to tax the development, the payroll, it descentivates the local developers that it stimulates people to develop technology abroad. It makes no sense and it creates some disadvantage to local developers of technology.
I know that is not an easy conversation because the government is in a great pressure in terms of fiscal accounts; but we are trying to sensibilize them in order to realize that they are taking a wrong measure.
Personally I believe it is gone be analyzed in about one month and not more than that because the provisional measure is going to be in place in July 1 and so if they do not take a final decision about that matter it will be too late, and if that provisional measure is kept as it is today what we have seen from most of the companies in our market - and that is what is in our mind - we have to transfer into price, there is no other choice.
This change in terms of taxation is going to affect more than 50 different sectors in our economy and so it changes structurally the cost structure of sectors and companies in our economy. So it is difficult to accept that companies will just absorb that cost, so there is no chance and in our case when you take a look at our figures, you clearly identify that our big challenge is related to service and so that is the most concentrated “problem” we have to address.

Richard Dineen: Right, that is helpful, congratulations again.

Gilsomar Maia: Thank you.

Operator: Excuse me. Once again, if you would like to pose a question please press star one. As a reminder if you would like to pose a question, please press, star one.
This concludes today's question-and-answer session. I would like to invite Mr. Gilsomar Maia to proceed with his closing statements. Please go ahead Sir.

Gilsomar Maia: So thanks everyone to be part of our conference call today. It was a good beginning of the year comparing to the beginning of last year. We know that we have a lot of work to do here but our main challenge today is trying to establish, as i mentioned in my final remarks before the Q&A session, is trying to establish a growth trend in the bottom line as we were able to do in the top line.
So I thank everyone again for being part of our conference call today and desire a good day for everyone thank you.

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