Operator: Good morning. Welcome to the TOTVS conference call to discuss the results of the second quarter of 2017. Today we have with us Gilsomar Maia, CFO, and Douglas Furlan, Investor Relations Executive Manager.

Note that all participants will be on listen-only mode during the presentation. After the presentation, 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. I´d like to start the call on slide 3, where I will talk about the artificial intelligence platform ***Carol***, another step taken to promote digital transformation among our clients.

Launched in June, ***Carol*** is designed to improve ownership of client data and expand the analytical capacity and speed of decision-making process in the face of a growing volume of information. Carol will also serve as a virtual assistant, answering questions and offering business insights.

Using deep learning techniques, neural networks and machine learning solutions, ***Carol*** already offers applications for the Retail and the Education sectors.

For Retail, the first application was developed together with the Bemacash team, using sales data captured through this IoT device and providing clients with information that help them in sales forecasting and product pricing.

In **Education**, algorithms that use internal and external information, such as social networks, were developed in Carol to measure the risk and financial impact of school dropouts, while also recommending actions to mitigate this risk.

Carol is now part of our portfolio as a platform already integrated with our industry management applications, as well as with the ERP, HR and productivity and collaboration platforms. Over the past year, the teams working in the development of these applications and platforms hired data scientists who are developing algorithms in Carol, which are being embedded into the industry vertical applications, many with the participation of clients.

Moving to the second recent event of the quarter, on July 31st, the Board of Directors approved the distribution of interest on equity related to the first half of 2017, in the amount of R$32.9 million, equivalent to about R$0.20 per share. Said interest will be paid on October 6 to shareholders of the Company as of August 3.

Now, I'll start my comments on Q2 results on **slide 4**. In order to maintain comparability, the proforma consolidated figures for the 12 months ended in Q216 also include Bematech's results.

Net revenue this quarter grew 1% year on year, resulting from the 8% growth in recurring revenue and the 10% drop in non-recurring revenue, with recurring revenue accounting for two thirds of total net revenue in the quarter, 4.3 percentage points higher than in Q216. **In the last 12 months, recurring revenue increased its share of total net revenue by 5.4 percentage points.**

When analyzed by business on slide 5, we see that the growth in software and hardware positively impacted the year-on-year growth in revenues.

In hardware, the year-on-year growth of 3.5% was driven by a 9% growth in sales of non-fiscal solutions, which accounted for 75% of hardware revenue in the quarter and more than offset the 7.6% decline in sales of the fiscal hardware.

The growth of non-fiscal solutions is a consequence of the Company's strategy to offer solutions that combine software and hardware and collaborate towards a more efficient management of its clients' businesses, making them increasingly competitive in their business segments.

The transition of fiscal solutions, before exclusively non-recurring, also creates opportunities for the growth of recurring software revenues.

In Services, the quarter-on-quarter variation reflects the decline in software implementation services at large clients, mainly due to the drop in license sales in previous quarters.

In the year-on-year comparison, the variation was also due to the 21.4% decline in services not related to software implementation, reflecting the lower sales of consulting services since the 2H16 and the sale of the subsidiary TOTVS RO in August 2016.

Software revenue in Q2 grew 6.6% year-on-year, 3.7 percentage points higher than the growth in the last 12 months, resulting from the combination of 1% growth in the licensing model, which includes licenses and maintenance revenues, and the 36% growth in subscription, that I will now comment on slide 6.

The licensing model moved from 84%-share of software revenue in Q216, to 80% this quarter. This drop is a consequence of lower license sales and factors that also negatively affected maintenance revenue, such as delinquency, contract reductions and the decline in inflation, especially in this quarter, measured by IGP-M accumulated in the last 12 months.

Subscription revenue accelerated the year-on-year growth for the sixth consecutive quarter and accounted for 20% of software revenue, up 4.4 percentage points from Q216. In the last 12 months, subscription revenue grew 30%.

This growth in subscription was essentially due to the growth in the number of small and medium clients under TOTVS Intera model in the last 12 months. Note that Intera sales in June did not affect subscription revenue in the quarter, since in this model the first billing is made in the month following the sale, but have already affected the ARR from subscription, as I'll explain on **slide 7**.

ARR, or Annual Recurring Revenue, grew 42% in Q2, reaching R$304 million, a net addition of R$23.3 million from Q1. ARR measures the evolution of recurring revenue for the next 12 months based on contracts signed until the end of the period.

Apart from Intera sales, ARR in the quarter reflected the migration of 27 maintenance clients to subscription, Fly01 and Bemacash sales in recent quarters. In Q2, we sold 1,093 new Bemacash units, which will become software clients as of the 11th month of contracting the solution, when they will start paying for software subscription.

I'll now hand over the presentation to Douglas, who will comment on software results on **slide 8**.

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

Software contribution margin dropped 100 basis points quarter on quarter. This variation was chiefly due to: (i) the increase in software costs, which reflected the share of complementary solutions provided by partners in the sales; and (ii) the stability of R&D expenses, which were already impacted by the provisioning curve of profit sharing in the period.

On **Slide 9**, in the year-on-year comparison and in the last 12 months, service contribution margin declined, essentially reflecting: (i) the lower allocation of service professionals due to the lower sales of projects; and (ii) the wage increases in the last 12 months, which were not fully transferred to service prices.

On **slide 10**, hardware gross margin grew 430 basis points year on year and 250 basis points in the last 12 months. The growth year- on-year and in the last 12 months is mainly due to the combination of price adjustments and the effect of exchange rate on costs.

The year-on-year growth in hardware contribution margin was lower than the gross margin growth, essentially reflecting the reduction of government subsidies in the quarter.

This reduction in subsidies was due to: (i) the change in the sales mix; and (ii) the reduction in presumed ICMS credit calculated in the quarter due to the higher increase of hardware components acquired, when compared the sales growth.

For comments on the main selling and administrative expenses, please move to **slide 11.**

In Q2, selling expenses and commissions jointly increased their share of net revenue year on year, mainly reflecting: (i) the change in sales mix between franchises and own units; and (ii) the higher volume of software sales in the subscription model. Compared to the previous quarter, the decline in the share is mainly due to the drop in licenses.

G&A plus management fees and other expenses reduced their share of net revenue quarter over quarter.

This decrease is mainly because of the reversal, in the amount of R$4.3 million, of the provision for contingencies related to the payment of PIS and COFINS made through judicial deposits by Bematech due to the inclusion of ICMS in the calculation base of these contributions.

This reversal follows the recent Federal Supreme Court (STF) decision determining the exclusion of ICMS from the calculation base of PIS and COFINS.

Advertising and marketing expenses corresponded to 2.4% of net revenue in Q2, as against 2.2% in Q216, because the growth in net revenue was lower than the wage increases and adjustments in contracts with suppliers.

Compared to Q1, the share increase in is mainly due to the seasonality observed in marketing investments.

On **slide 12**, adjusted EBITDA in Q2 totaled R$82.0 million and adjusted EBITDA margin was 14.9%. The quarter-on-quarter decline in adjusted EBITDA and adjusted EBITDA margin was due to lower software result in the period, mainly caused by the reduction in license revenue because of the incremental revenue from corporate model charged in Q1.

Year-on-year, the decline in adjusted EBITDA was essentially due to the reduction in services result and the increase in selling and administrative expenses.

On **slide 13**, the steeper year-on-year decline in adjusted net income than in adjusted EBITDA chiefly resulted from: (i) the increase in depreciation and amortization expenses, especially due to the start of assets depreciation of the Company's new headquarters in São Paulo; and (ii) the higher share of negative financial result over EBITDA in the period.

I now return the presentation to Maia to comment on cash flow and debt on **slide 14**.

Gilsomar Maia: Net debt corresponded to 1.3x adjusted EBITDA in the last 12 months, remaining unchanged from Q1. Free cash flow was 9.7% higher than in the previous quarter, especially due to the increase in operating cash generation.

Despite the increase in free cash flow, gross cash decreased quarter on quarter, mainly due to the payment of interest on equity and dividends in the second quarter.

Year-on-year, free cash flow grew 34%, as a consequence of higher operational cash generation and less cash used in investing activities.

I will now move to **slide 15** for the closing remarks.

In this quarter, software revenue accelerated its year-on-year growth to 6.6%, 3.7 percentage points higher than the growth in the last 12 months, boosted by the acceletarion in subscription for the 6th consecutive quarter.

Subscription revenue grew 36% year-on-year and already accounts for 20% of total software revenue. Annualized recurring subscription revenue grew 42% in Q2 and exceeded R$300 million, which already corresponds to 30% of the maintenance revenue of the last 12 months.

Non-fiscal hardware solutions grew 9%, contributing to one more quarter of year-on-year growth in total hardware revenue.

Moreover, some of these non-fiscal hardware solutions, such as Bemacash, play the role of IoT devices capturing data used int the development of artificial intelligence algotithms and applications.

Despite the instabilities of the Brazilian environment, companies have been looking for smarter solutions that help them to become more competitive and to make faster and more assertive decisions.

That’s why we remain committed to promoting digital transformation among our clients through specialized business solutions and platforms for productivity, collaboration, Internet of Things and now artificial intelligence with Carol.

We are also committed to achieve our goals for the year, both in subscription growth and EBITDA.

We are now available for the questions and answers 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.

Our first question comes from Diego Aragao, Morgan Stanley.

Diego Aragao: Hi good afternoon guys thank you very much for taking my questions. If we would separate your business, the traditional license sale and the subscription business model, should we think that maybe the competitive landscape is different among those two segments? Thank you.

Gilsomar Maia: Hi Diego this is Maia speaking. Actually no. We have some new offerings made to different markets as Bemacash for example and that is a new initiative and coincidently that is a solution that born under the subscription model in the pure SAS concept. So it is a cloud and subscription solution.

For that solution specifically we have a completely different market of micro enterprises and the competitive landscape is completely different. Actually there is no dominant player in this part of the market. The competitive landscape is based on very, very small players. Actually Totvs with Bematech is the only player that can be the full provider of a commercial automation solution.

And when we talk about our main market of small and medium businesses actually we face those names we have been talking about for all of our interactions, and everyone in this market is moving in the direction of subscription, of course each one in different ways, different manners; but everyone is moving to cloud subscription and so on.

Diego Aragao: Okay perfect Maia thank you very much. Another question if I may regarding the subscription business model. Once you achieve the breakeven with your customer what kind of profitability, what kind of margin could we expect from those customers? Thank you.

Gilsomar Maia: This model has an implied characteristic that in the beginning, if you make a kind of isolated cash flow actually in the beginning we have some cash burning because we spend more money than we make with that client, and retention of course is one metric in that case.
Even in our traditional license model maintenance has been always the most profitable revenue stream we have, and subscription in this case is not different; but it becomes even more relevant in terms of profitability. It depends on the solution we sell and the profile of sales with specific clients; but you are right after some months we reach a kind of break even with that client and from that point on we have a much, much profitable condition.

Talking about the company in general we see that in this transition, we have more pressure in terms of cash flow generation and consequently margin; but in the future conceptually speaking the company would be able to even present better performance of profitability and margin than it used to present before the transition to subscription.

Diego Aragao: Perfect Maia. Can you just remind us when exactly you reach the breakeven? I mean how much does it take for you to reach breakeven with your customers?

Gilsomar Maia: Actually Diego we have not disclosed that the market because it is very strategic data for competitors, because it can help people to make changes in their pricing process in order to create some constraints for competitors. It changes a lot depending on the solution we are talking about and the profile of our client and the usage that client will make - but it takes months actually, it takes months to reach that point okay?

Diego Aragao: Fine thank you.

Gilsomar Maia: Welcome.

Operator: Our next question comes from Fred Mendes, Bradesco.

Fred Mendes: Good afternoon everyone thanks for the call. I have two questions the first one looking at costs and already 2018 can we expect an improvement considering you are doing the integration with Bematech and I guess it also impacted this quarter; I mean looking ahead next 12 to 18 months how should we expect this line? That would be the first question.

And the second one when you look at the top line how do you see maintenance revenue for the next quarters and even in 2018 considering that IGPM continues to fall and it seems that you do not have a change in churn yet, of course as a follow-up if you have seen any change in churn I guess in July already? Thank you.

Gilsomar Maia: Hi Fred. I will start from the second question related to maintenance. Just to recap to everyone maintenance normally I use to say that maintenance has two main variables that can explain the behavior of that revenue stream: the first one is churn that affects the starting point of this becoming revenue.
This month… This quarter sorry when we annualize our churn it was slightly higher than we saw in the previous quarter. It was a little bit above 9% when we annualize that, what also impacted in this composition of maintenance as the first variable I am listing now.

The second one is the inflation update and as you mentioned IGPM that is the main inflation index used in our installed base has declined, strongly declined in recent months - actually in this quarter we have like two months of negative IGPM index, so one year ago IGPM was running like 10% in

12 months and now it is running below to 1%. So it gives you how strong was that a drop and actually I do not see today any relevant signals of recovery of that index to be frank.

And the third variable is the new flow of new contracts coming from license sales, and we can observe the behavior of license sales in recent quarters.

So putting all together our expectation - of course is hard to make predictions in this moment in Brazil, all kinds of projections are complex. Of course internally we work hard here to reduce churn; but it is true that part of the churn comes from externalities that we did not completely control, like delinquency and even indirectly the unemployment rates also can impact part of our maintenance churn.

But as much as we can, we try to be closer to our clients and work on this retention rate and trying to reduce as much as we can the churn. So in our plans here we are working to reduce churn.

The second part related to IGPM that is a variable that we do not control, completely we do not control. It is hard to create expectations here of an increase in this index; on the other hand what is positive so we can count on this scenario of a low, very low IGPM to the rest of the year and we can take our measures here to have more high control over costs, trying to push down some expenses. So it is part of our daily operations.

And the last one related to license based on the last two, three recent quarters we saw some slight, positive signals of recovery in license - but I have to confess that license tends to become even more difficult to predict because as the subscription model evolves it tends to drag small and medium opportunities among small and medium firms to the subscription model.

And then the remaining opportunities under the license model tend to be even more concentrated among large enterprises, and this kind of account has a longer sales cycle. It takes a more complex decision process from the client-side and it becomes even more complex to have a very assertive conversion rate, especially in terms of timeframe when the accounts are going to be closed.

But as we have talked to you guys in previous quarters we do not believe that license, since we have a very weak base for comparison in terms of license, we do not believe license is going to decline in the same way we had in the last two years for example. It depends on how the market evolves, we have a chance to see some small overload rate of growth in license this year, what can be positive also for maintenance as a consequence.

Talking about the first question related to cost we are very focused on our plan of integration with Bematech. This year we are working hard to put all the processes and systems in the whole Bematech operation and so it will give us more possibilities to have a more linear process and also to be able to extract some synergies for next years.

So 2018 based on our plans we will be running both operations in the same platforms and same solutions observing the same process, and it gives us more opportunities to have lower pressure in this cost line and as a consequence extract more synergies, since we see subscription evolving strongly and it creates good perspectives for cost dilution, too.

Fred Mendes: Perfect very clear Maia thank you.

Gilsomar Maia: welcome.

Operator: Ladies and gentlemen 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 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: I would like to thank you all once again for participating in this conference call and I would like also to kindly ask the analysts to update their projections available on new agencies like Bloomberg and Reuters, because we realized that the few projections available on those new agencies are really not updated and sometimes people can have the impression that these results we released are far from projections, and we have not seen that comparing to the reports issued by the analysts.

So once again thank you very much for your participation and have a good day, bye-bye.

Operator: That does conclude Totvs audio conference for today. Thank you very much for your participation, have a good day and thank you very much for using Chorus Call.