

Operator: Good morning. Welcome to the TOTVS conference call to discuss the results of the fourth quarter and full year 2017. Today we have with us Lercio Cosentino, CEO, Gilsomar Maia, CFO and Sergio Serio, Investor Relations 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. As usual, I will begin the presentation by commenting on key recent events on **slide 3**.

The first was TOTVS' presence once again as the only Brazilian tech company in the global ranking published annually by the consulting firm Strategy&, which ranks the 1,000 public companies that most invest in research and development.

This is further evidence of the importance of innovation for TOTVS as a driver of its own transformation and also to bring to clients solutions that simplify the business world.

The second event was TOTVS Day, the investor day held at the beginning of last December at the new headquarters of TOTVS, where presentations were made on the latest developments in the Digital Journey and Transition to Subscription strategies.

Also, the over 60 analysts present in the event had the opportunity to visit the new facilities and had demonstrations of some of the solutions for the Education and Manufacturing segments, as well as Carol, our artificial intelligence platform.

The third event was the Board of Directors' decision, in December, regarding the distribution of interest on capital for the second half of 2017, in the amount of R\$17.4 million.

Now, I'll begin my comments on the results on **slide 4**.

In 2017, net revenue grew 2%, while recurring revenue grew 8.7%, corresponding to 67.5% of net revenue in the quarter and 65.8% in the year, which is 4 percentage points higher than in 2016.

As shown on **slide 5**, this revenue growth is mainly driven by software revenue, which grew 6.2% in the year and 5.6% in the 4th quarter.

Software revenue, in turn, was driven by the 34% growth in subscription revenue, shown on **slide 6**, which accounted for 20.7% of software revenue in 2017 and 23.2% in 4Q17.

The growth of 9.5% in subscription revenue in comparison with the 3rd quarter represented the highest growth rate in this line in a quarter since the beginning of the transition to subscription 2 years ago, when TOTVS Intera was launched.

This transition brought challenges related to the reduction in licensing revenue and its adverse effects on maintenance revenue, which were worsened by the economic recession in Brazil. On the other hand, subscription sales accelerated and software revenue already returned to the growth trend during 2017, as shown on the chart on the left side in **slide 7**.

However, we don't consider revenue as the best metric to measure the performance of subscription sales in the quarters. The first monthly fee billing of TOTVS Intera is made in the following month after the sale. Thus, revenue in the quarter is positively affected by two monthly fees from subscription sales closed in the first month of the quarter, by one monthly fee from the sales closed in the second month, while sales in the third month contribute only to the revenue of the subsequent quarter.

We believe that Annual Recurring Revenue (ARR), shown on the chart on the right, maintains comparability between the periods by annualizing all the subscriptions sold. Note that as ARR accelerates, subscription revenue accelerates in subsequent periods.

ARR from subscription totaled R\$368.0 million in 4Q17. This amount is 19.5% higher than the subscription revenue of R\$309 million in 2017, which already represents revenue growth in 2018 resulting from sales made throughout 2017.

Now, I turn the presentation to Sérgio Serio, which will comment on the software result on **slide 8**.

Sérgio took over the position of Investor Relations Manager earlier this year. He's in TOTVS since 2006 and has led the area of institutional relations in the past 3 years. Please Sérgio, proceed the presentation.

Sérgio Serio:

Thanks Maia and good morning everyone.

The decrease of 40 basis points in adjusted contribution margin of 2017 resulted mainly from the increase in research and development expenses above the adjustment level of recurring software contracts.

This cost increase is essentially related to wage adjustments resulting from collective bargaining agreements in the period and additional investments in innovation, especially those related to the specialization of business solutions, open platforms and the microenterprise segment.

In the quarter, the increase in adjusted contribution margin from software chiefly reflects the growth in subscription revenue and the reduction in costs due to layoffs in the quarter.

Turning now to services, on **slide 9**, the adjusted contribution margin decreased in 2017 mainly due to the 3% drop in revenue from implementation services, and by the 11% decline in revenue from consulting services. These decreases were mainly due to the slower pace of sales and consequently, lower allocation of professionals, especially in the first half of 2017.

In the quarter-on-quarter comparison, the decreases in service revenue and adjusted contribution margin were essentially due to fewer business days.

In the year-on-year comparison, the adjusted contribution margin from services in the fourth quarter increased mainly due to the restructuring, which resulted in a negative impact of R\$3.9 million from layoffs.

Moving now to hardware on **slide 10**, the decline in adjusted contribution margin from hardware in 2017 and in the 4th quarter was mainly due to the decline in sales of fiscal printers, whose gross margin is higher, and to the drop in revenue from economic subsidy, especially in the 3rd quarter, due to inventory levels.

Revenue from sales of other solutions grew 2.3% in the year, mainly driven by the growth in revenue from Bemacash sales. In 2017, more than 6,500 Bemacash units were sold, compared to almost 2,800 units in 2016.

To discuss about selling and administrative expenses, please go to **slide 11**.

The year-on-year increase in selling expenses and commissions as a percentage of net revenue essentially reflects the growth in software sales in the subscription model.

As subscription revenue expands its recurring base, and as new sales reduce its share in this base, selling expenses will get diluted.

In the year, the increase in general and administrative expenses plus management fees and other expenses as a percentage of net revenue was mainly due to: (i) wage adjustments resulting from collective bargaining agreements, which were higher than inflation adjustments obtained on recurring revenues; and (ii) additional expenses with the merger of PC Sistemas and Virtual Age, and the administrative integration of Bematech, all of which contributed to the structure adjustment carried out in 4Q17.

The decline in comparison with the 3rd quarter was chiefly due to the structure adjustment and the effect on bonus provision related to the achievement of individual and overall targets.

With regard to allowance for doubtful accounts, the increase in recent quarters, despite the gradual improvement in overall timely payment of the portfolio, reflects the additional provision made on account of the worsening situation of some companies in difficulty, such as petitions for judicial reorganization.

Now I'll turn the presentation back to Maia, to discuss EBITDA, on **slide 12**.

Gilsomar Maia:

Thanks Sérgio.

In 2017, the decline in adjusted EBITDA resulted from the combination of the following factors:

- (i) the more than proportional increase in selling expenses due to the transition to the subscription model;
- (ii) the decline in service revenue caused by the reduction in sales of projects until the first half of the year and the lower allocation of professionals;
- (iii) the decline in sales of fiscal printers and lower economic subsidy on hardware; and
- (iv) the increase in general and administrative expenses, mainly due to the inflation adjustment on costs, and in additional expenses with the operational integration of the companies acquired in previous periods.

In the quarter, EBITDA grew 13.8% year-on-year and 11% quarter-on-quarter.

The structure adjustment carried out in the 4th quarter, combined with the growth in recurring revenues, should adjust our structure to the SaaS reality in order to recover profitability without compromising the company's capacity to grow and innovate.

And to conclude the comments on the result, on **slide 13**, apart from the variation in adjusted EBITDA, as commented, the decline in adjusted net income this year is mainly related to the increase in depreciation, resulting from investments made, especially in the second half of 2016.

In the quarter, the tax on financial income calculated on the investment of proceeds from the issue of debentures in the 3rd quarter and the inflation adjustment on provisions for contingencies are reflected in the financial results. The variation in income tax and social contribution is essentially linked to the reduction in the interest on capital during the period. Now I'll move to **slide 14** for the comments on cash flow and debt.

Despite the decline in net income, as commented in previous slides, operating cash flow grew 26% in the year and 34% over 4Q16, mainly due to the 92% reduction in working capital requirements.

This growth in operating cash flow, combined with the 49% reduction in capex in 2017, resulted in the 57% increase in free cash flow.

As a result of this cash flow generation, net debt declined 33% in 2017, corresponding to 1.1 times adjusted EBITDA in the year.

I now turn the presentation to Laércio for his closing remarks on **slide 15**.

Laércio Cosentino:

Thanks Maia. Good morning everyone.

Based on all that was presented in this conference call, we can affirm that the year 2017 marked the return of growth off TOTVS.

We registered 6% organic growth in software.

Subscription revenue grew 34% and annualized fourth quarter subscriptions exceeded the subscription revenue in 2017 by 19.5%.

Challenges related to the beginning of transition to subscription, coupled with the remaining effects of the economic recession in Brazil, prevented us from achieving our EBITDA and net income targets in 2017.

We made adjustments to the cost structure to align it better with the growth in recurring revenue but without compromising the company's capacity for growth, profitability and innovation.

Despite these challenges, the continued financial discipline enabled us to increase operating cash flow and, consequently, reduce net debt.

The year was also marked by significant advances in the 3 pillars of the TOTVS Digital Journey, among which I highlight the following:

In Culture and Environment - the inauguration of the company's new headquarters in São Paulo, a technological campus specially designed for TOTVS and inspired by the most modern working environment for technology companies around the world;

In Processes and Service – the use of agile development and project management methodologies; and

In Offering and Portfolio - the launch of our artificial intelligence platform Carol and the inauguration of iDEXO, an institute whose mission is to connect startups, entrepreneurs and developers in the pursuit of new business solutions.

In 2018, TOTVS remains focused on the success of its clients, with the mission of “Simplifying the Business World,” supporting our clients in the digital journey, offering the best business solutions for companies of all sizes and segments.

Now we are available for the questions and answers session.

Operator: Excuse me ladies and gentlemen we will now begin the question-and-answer session. If you have a question please press the star key followed by the one key on your touchtone phone now. If at any time you would like to remove yourself from the questioning queue please press star two. Once again if you would like to pose a question please press star one.

Our first question comes from Andre Baggio with J.P. Morgan.

Mr. Andre Baggio: hi Laercio and Maia. Could you talk a little bit about the development of new features, new software that you have in the pipeline? For example how is going the Carol - artificial intelligence and maybe other initiatives that you are taking?

Mr. Gilsomar Maia: good morning Baggio thanks for the question. In terms of new solutions and features based on our announcements in previous quarters I will highlight first Carol, our intelligence platform. So when we have our investor day here at Totvs we had the opportunity to show you guys some of the usages we are seeing for this kind of technology.

That is somehow a kind of agnostic technology that can complement all of our solutions we have in our portfolio and actually it can work together with solutions provided by our competitors, too. So in case of Carol we can also use it as one element to convince clients to move to cloud.

And besides Carol I should highlight too the solution we have to the in cloud. We have developed a kind of a platform that manages the infrastructure of cloud. It is not a solution itself to clients, but it is more of future as you ask me. So actually, that platform gives us the flexibility to offer more than one single option to a client in terms of what infrastructure they want to run our solution.

So looking to the rest of our portfolio I would also highlight solutions related to mobile applications and more recently we have launched mobile Apps to our research, human resource solutions here and basically using services of our traditional solutions for HR, but giving more flexibility to the end user to get information on their hands. I do not know you want to highlight any other?

Mr. Laércio Cosentino: Baggio Laercio speaking. We can complement this list with Fluig, the new version of Fluig. We believe so much that we need to develop platforms that can use in different systems. We believe that the persons share informations and nowadays the companies start to share information. The new technology that Totvs, we develop right now is based on platforms that you can connect different softwares and you can join and make the convergence of software. This is one aspect that is very important.

We work so much that many of our customers have so many solutions and can use Fluig, Carol or cloud platform of Totvs and our Apps in the top of the old solutions.

Mr. Baggio: okay and a related question: can you discuss a little bit the competitive environment? Let's say do you think you are market share among your clients is being maintaining more or less similar to new competitors pressures?

Mr. Maia: actually Baggio one thing that has changed in our market is in terms of who is the owner of the client. In the past in our industry players used to say that the client is mine. In our view it is not applicable anymore this kind of view. So today we see more and more companies using more than one technology provider, and in this sense part of my answer could say yes we see more competitors surrounding our clients; but on the other hand we have more opportunities to explore with our clients and the clients of our competitors, too.

One example I gave was the case of Fluig. So we have some clients that are now using our classical solutions like ERPs and vertical solutions and the use Fluig on top of it and Carol is going in the same way. It is some of good examples we can give that this is more in line with this new way to consume technology. So I hope I have been clear but actually yes, we see more names coming to the market, but on the other hand the market is more flexible to consume more than one solution you know together.

Mr. Baggio: okay thanks a lot Maia.

Operator: Once again if you would like to pose a question please press star one save it. As a reminder if you would like to make a question please press star one. This concludes today's question-and-answer session. I would like to invite Mr. Cosentino to proceed with his closing statements. Please go ahead sir.

Mr. Cosentino: Thank you for participating in this conference call and have a nice day and have a nice year, too. Thank you.

Operator: That does conclude Totvs's audio conference for today. Thank you very much for your participation and have a good day.