Operator: Good morning. Welcome to TOTVS second quarter of 2018 conference call. Today we have with us Gilsomar Maia, CFO, Eros Jantsch, Vice-President for Small Businesses, and Sérgio Sério, 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.br.

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 will begin the presentation by commenting on the main recent events on **slide 3**.

The first event is the increase of Bematech's interest in RJ Participações by the incremental acquisition of 20% of the capital stock of RJ for R$4,3 million. As a result, Bematech now holds an 80% interest in RJ and the remaining 20% call option was extended to 2021, based on RJ's business and succession plan.

The second event to be highlighted is THE MAINTENANCE OF THE IT SECTOR IN THE TAX RELIEF OF PAYROLL until 2020, based on a Federal Law enacted on May 30, 2018. The Law establishes that, from 2021, the employer's social security contribution will no longer affect the revenue at a rate of 4.5% and will again be levied on the payroll at the rate of 20%.

We focus this theme on the services operation, given its predominance of payroll as a cost component. The deadline established by law contributes to prepare the service operation, both in terms of efficiency and in pricing, in order to mitigate possible effects from 2021.

And, the third event is the Board of Directors approval for the distribution of DIVIDENDS AND INTEREST ON CAPITAL for the first half of 2018 in the total amount of R$32.7 million, corresponding to R$0.20 per share, of which R$18,0 million refers to dividends, corresponding to R$0.11 per share, and R$14.7 million refers to Interest on Capital, corresponding to R$0.09 per share. Both, dividends and interest on capital will be paid on October 3, 2018 to the Company's shareholders on August 1st, 2018.

Turning now to **slide 4**, we also highlight the study "Enterprise Application Software" released by Gartner in June, which reiterates TOTVS leadership in the ERP market in Brazil, with a participation of 50.5% in 2017, which represents an increase of 0.9 percentage point compared to 2016, and 0.2 percentage point from 2014, which is the last year before switching to the subscription model.

The same study also points TOTVS in the first position in Latin America with a 31.6% share of the ERP market, which represents an increase of 0.7 percentage point compared to 2016.

I now turn the presentation to Eros, who will comment on revenues in the quarter on **slide 5**. Eros, please go ahead.

Eros Jantsch: Thanks Maia. Good morning everyone.

The 2% quarter-on-quarter growth in net revenue was driven by a seasonal increase in hardware sales and the progress of service projects in the second quarter.

In addition to the seasonal evolution, the increase in service sales in previous quarters also contributed to a year-on-year growth of 11% in service revenue, which added to the increase in software revenue, led to a 4.4% year-on-year growth in net revenue.

On the other hand, the quarter-on-quarter reduction of 3.9% in software revenue was mainly due to the 33% drop in license revenue shown on **slide 6**, particularly related to the incremental license revenue from corporate model in first quarter, that is also a seasonal element as shown on the year-on-year growth of the quarter and the last 12-month period.

And, by the way, year-on-year comparison shows that software revenue growth has been generated by Subscription Revenue, which grew 31% in the quarter and almost 35% in the last 12 months.

In the chart on the left of the **slide 7**, it becomes clearer. We can see that the blue bars in the chart, representing the sum of licensing and maintenance revenues, have not grown in the past 3 quarters, and all software revenue growth has come from subscription revenue represented by orange bars.

Subscription revenue grew 2.7% this quarter, rising from R$94.6 million last quarter to R$97.2 million this quarter. This performance of the subscription was negatively affected by the higher concentration of sales in June, due to the strike of truck drivers in the last week of May. The sales of June will contribute to the third quarter revenue and are included in the annualized subscription exercise on the chart to the right of the slide.

Additionnaly, revenue growth and subscription ARR were also negatively impacted by two factors linked to adjustments in the Bemacash sales model: (i) higher volume of cancellation due to delinquency coming from units sold before first quarter of 2018, when sales by credit card were implemented; and (ii) the reduction in sales resulting from the change in software chargeability from the first month of subscription.

Despite these factors, subscription annual recurring revenue (ARR) totaled R$425.6 million in the second quarter, an amount that represents 40% growth year-on-year and 5.7% growth quarter over quarter.

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

Sérgio Sério: Thank you Eros. Good morning everyone.

The year-on-year reduction in the Adjusted Software Contribution Margin is a result of the combination of R&D and Support Costs.

Despite the reduction in recurring costs with personnel performed in 2017, the growth of these lines reflects the wage increase resulting from collective bargaining agreements, in addition to the new investments in innovation made by the Company in the period.

The quarter-on-quarte reduction in the Adjusted Software Contribution Margin is associated with the reduction in Software Revenue commented by Eros and the increase in costs due to the higher volume of participants in holidays in 1Q and the additional costs of Support to meet the demand from new customers added in the period and from the existing customers, due to new regulations that came into effect in the first half of this year, such as e-Social.

Turning now to services, on **slide 9**, the Adjusted Service Contribution Margin grew 600 basis points over 2Q17, and 310 basis points over 1Q18. The growth in Service Revenue was mainly due to the higher pace of service sales observed in recent quarters and the higher allocation of service professionals in the quarter.

When we use the comparison of the last 12 months, the reduction of 2.1% in service costs is a consequence of the adjustment of the structure promoted throughout 2H17. This reduction led to a margin of 5.6% in the last 12-month, or 340 basis points higher than in the same period of last year.

Turning now to hardware, on **slide 10**, the Adjusted Hardware Contribution Margin was 580 basis points lower than in 2Q17 and 570 basis points lower in the comparison of the last 12-month. The main elements that resulted in this decline were the increase in R&D, as a result of expenses with the institutes hired to comply with the IT Law and the drop in sales of tax solutions, which have a higher gross margin.

The 240 basis points quarter-on-quarter increase in the Adjusted Contribution Margin reflects the increase in sales of fiscal solutions in 2Q18, due to the maintenance of tax solutions in Minas Gerais and the incentive by the Government of Santa Catarina to regularize the use of fiscal printer, and also the recover of sales volume due to the negative seasonality in 1Q18.

Such negative seasonality of the 1st quarter can be seen in the chart on the left on **slide 11**. On the chart to the right of the same slide, we show the increase in the share of fiscal solutions in the product mix caused by the demand commented on the previous slide. The increase in sales of tax solutions, as shown, which have a higher margin, led to an increase in the margin of hardware results in 2Q18.

In addition, in 2Q18, Bemacash sales totaled 691 units, compared to 1,093 in 2Q17. As commented previously by Eros, this reduction is a consequence of the changes in the sales model of Bemacash, which aim to simplify the sales process and reduce delinquency.

To talk about selling and administrative expenses, please go to **slide 12**.

In the quarter, selling and commissions expenses as a percentage of net revenue declined in relation to the previous quarter, due to the mix of sales between own channels and franchises and the revenue mix.

Year-on Year, the reduction of 5.7% in selling expenses is explained by the reduction in recurring costs with personnel in 4Q17 and the deferral of variable compensation as a consequence of IFRS-15.

Regarding general and administrative expenses, management fees and other expenses, the year-on-year reduction is mainly associated to the provision for contingencies in 2Q17 being lower than the quarterly average of the same year, and also to the additional expenses with the incorporation of PC Sistemas in 2Q17 and the integration of Bematech's administrative operations during last year, both contributed to the reduction of recurring costs with personnel in 4Q17.

Turning to the advertising and marketing expenses, the year-on-year and quarter-on-quarter variations reflect the Company's annual marketing plan.

And, the allowance for doubtful accounts represented 1.9% of Net Revenue in 2Q18, compared to 2.3% in 1Q18 and 1.4% in 2Q17. This provison reflects the higher level of current delinquency, which resulted in a negative effect of R$3.2 million with the adoption of IFRS-9. Excluding the IFRS-9 effect, the provision represented 1.4% of net revenue, the same level observed in the second quarter of 2017.

I now return the presentation to Maia, who will comment on EBITDA on **slide 13**.

Gilsomar Maia: As we can see in the charts, the quarter-on quarter reduction in Adjusted EBITDA was due to the reduction in Software results, partially offset by higher service and hardware results and reductions in commercial and administrative expenses.

Year-on-year, Adjusted EBITDA increase came from software and services results that more than offset the decrease in hardware results.The change in the product mix continues to reduce hardware results, with the discontinuation of fiscal printers in a more advanced stage than the development of higher value-added solutions such as Bemacash and smart devices for the Internet of Things.

In the last 12-month comparison, the increase in software and services results, even partially offset by the reduction in hardware results, has not yet resulted in EBITDA growth, due to the amount still required by the allowance for doubtful accounts, part of the commercial expenses, and by the provisions for contingencies, part of the administrative expenses.

Moving now to **slide 14**, the EBITDA performance is the main element that, even with the improvement in financial results and income tax and social contribution, led to a reduction in net income quarter-on-quarter.

In the year-on-year comparison, the 7% increase in net income came mainly from the EBITDA improvement, since the reduction in amortization expenses, linked to lower expenses related to intangible assets arising from acquisitions of companies, was more than offset by the higher net financial expenses, and the higher effective tax rate in this quarter.

Now, I'll move to cash flow and debt on **slide 15**.

Free cash generation grew 20% year-on-year, mainly due to the growth in earnings before Income Tax and Social Contribution and the reduction of funds invested in working capital.

Quarter-on-quarter, the free cash generation grew 66% and the operating generation grew 53%, mainly by the reduction in working capital investments, and the lower volume of interest payments, given the interest amortization of debentures occurred in 1Q18; and also the lower CAPEX level.

Additionaly, net debt fell almost 50% year-on-year and 23.5% quarter-over -quarter, even with the payment of dividends and interest on equity reflected in the 2Q18 financing flow. This reduction led net debt to the level of 0.7x last 12-month Adjusted EBITDA, which is the lowest level since 2Q15.

I'll now turn to **slide 16** for the closing remarks.

Throughout this conference, we saw that:

Net revenue grew 4.4%, driven by software and services revenues that grew 4.4% and 11% year-on-year respectively

Subscription revenue grew 31% year-over-year, already accounting for more than 25% of software revenue.

Adjusted EBITDA increased year-on-year by 4.5%, with stable margin.

Free cash flow generation grew 66% and net debt fell by half year on year, reaching 0.7x EBITDA.

We are now available for the Q&A session.

Operator: Ladies and gentlemen, we will now begin the questions and answers session. To ask a question, please press asterisk and one, and to remove your question from the list, press asterisk and two.

The first question comes from Fred Mendes of Bradesco.

Mr. Fred Mendes: good morning and thank you for the conference call. I have two questions, the first regarding Bemacash: could you say something more about this business, starting from strategy, as there was a change now that sales are made through the Totvs Store, up to the current sales performance. Are you happy with this performance? Do you think it will improve? And, regarding its structure, how is Bemacash nowadays - talking of micro retail as a whole, how is that structure within Totvs? That would be my first question.

As for the second question, I think the line that caught my attention was R&D, and it’s difficult to understand it. I know that it’s also not that simple for you, but can you give any breakdown of how much went towards new initiatives vis-à-vis for updates. I don’t know if that is possible, but any information would be great, thank you.

Mr. Eros Jantsch: Good morning, Eros speaking, thank you for the question. I’ll give an overview of this initiative. I think it is in fact important, and then I'll discuss the structure a bit. It’s important to start off by saying that this movement that Bemacash is driving here in Brazil, it’s a global movement.

Basically, micro and small-sized retailers around the world traditionally had their business management software and hardware kept totally separate from payment methods, and with current technologies you can have a solution that delivers a much better experience to the client, an integrated solution that already uses the technologies of big clients, cloud, mobility, so on and so forth.

This global trend is testing many business models. We have business models that fix the price for the client focusing more on the payment part, there's software subscription subsidizing hardware, there are players working with monthly software and hardware payments, which was the model Totvs used before this change, and there are also players that practice software subscription and hardware sales separately. So there's a variety of models around the world being tested.

Fact is that this kind of solution already integrated with payment makes much sense to clients. The technologies are available and I think the big change coming in the medium term is about data. It was never possible to have access to data of these client profiles and in the future this certainly will be possible.

We have been following this trend and to give you some reference on installed bases, we're talking today about installed bases of 20,000 to 50,000 clients. That is the level of some references we see in the US, of companies who have this project that is more mature than ours at the moment.

In Brazil, Totvs leads this movement. It's our third year of operation. We recently implemented this change in the business model. It came in May, we made the change in April; but it actually came in May because we believe we have a better model considering all we've learned.

What did we see, basically? Clients that were already for a longer time in the base, clients that entered in the first year of operations, had started to ask "Well, but I'll keep paying this monthly amount for the whole contract?" These were higher monthly payments that encompassed hardware and software, they started questioning and it showed up more. We noticed that if it escalated it could be a problem, in other words, an outright rejection of the model.

The other thing is that we understand we need to have the flexibility used in the solution also with hardware. Bemacash was born largely based on tablets. We recently launched and are now beginning to run Bemacash in a smart POS, an Android card reader that is a product that Bematech brought to the market, and certainly this Bematech can run even on the client's own smartphone sometime in the future. So we needed to have more flexibility in the model for choosing this hardware.

And, lastly, it's a market with certain mortality, there's a delinquency inherent to it. We were operating 100% of the sales through bank payment slips for monthly payments and we moved 100% of this business to credit card or upfront bank payment slips and some financing methods. So we believe we have a model that better protects the business for Totvs, a model better suited to the client and which allows flexibility in choosing hardware.

Note that at this stage, in this change of models we also made great strides in the store. Today we have a Bemacash page directing to a store that enables digital sale. We're making advances in product deployment, digital installation and we already practice digital support. At the same time, we have been working on this digital journey from sale to support.

The moment we are at now is the moment to scale this model. The results we had were better than those we planned, despite the fall in comparison with prior periods, but we are at a moment of scaling this business. July already saw a reaction, we're getting into the third month of operations in July.

As for the channels, we are continuing to work with the developed channels. This is a channel that didn't exist in Brazil, so it had to be created. We continue to work with it, but we're also looking at other distribution methods, for instance channels with greater focus on payments. There is a payment channel in Brazil and we have been working more and more with this channel profile, and so are buyers. Since last year we have plenty of initiatives with buyers, we have been improving interactions with buyers and we understand that at some point this should result in Bemacash's final distribution model.

Regarding structure, I have strong focus on small businesses and especially in Bemacash. The entire product development and support structure, channel sales is exclusively for micro and small businesses. And for back-office areas, we offer services such as shared service centers for micro and small enterprises. We have a team focused on it and we're investing more and more especially in product and sales.

Mr. Fred Mendes: Thank you Eros.

Mr. Gilsomar Maia: Good morning Fred, this is Maia speaking. Regarding the second question about R&D, in R&D we have some issues that are being addressed, some of them we have already mentioned in previous periods. One thing I can recover is the investment we have been making in developing a software platform for infrastructure management in the cloud. That is part of the strategy we call the "cloudification" of our software, of our solutions, which were originally solutions designed for the on-premise world. Part of the strategy is about changing the products somewhat, both in terms of interface and in terms of the architecture of some solutions so that they behave more efficiently in the cloud.

On the other hand, we also have been developing an intermediate layer between these applications and the cloud infrastructures, so that we can have some independence of architecture of our solutions and the software architecture of the public clouds available in the market. That will also provide a level of autonomy and automation when we run our applications both in our own cloud and the cloud of partners. It is something we have been making efforts towards.

Part of the R&D investment has also been related to some innovations more related to verticals. One of these innovations we have brought over from our more manufacturing-oriented solutions and connected to what is being called manufacturing 4.0 by the market, which is a new trend, a new wave of technological innovation more directed to a more traditional segment such as manufacturing, but that has also been creating a lot of opportunities for us.

And lastly what I'd list in terms of innovation, it's already a continuation of the plan we put forward last year with Carol, is increasingly bringing resources related to artificial intelligence to our solutions. Bemacash itself is an example of what Eros was talking about. Last year we also gave some examples of using Carol with Bemacash, but that has also been evolving day after day.

These are initiatives that most related to R&D and other than that there are the incremental product improvements that are also related to day-to-day issues such as regulation, ancillary obligations. Companies are experiencing strong demand this year in terms of auxiliary obligations and many of them related to E-social, Reinf, and now we have the electronic 4.0 invoice.

So, it's a year in which we have demanded a lot from the R&D team and especially from support so that we can also follow this pace of change in regulation, especially considering many things were made available by the government at the beginning of the year and throughout this semester too.

Totvs and many companies in the sector have been talking and making efforts to follow these changes.

Fred Mendes: Perfect Maia, thank you. If you could make a quick follow-up, going back to the Bema part. In this new sales model – I don't know if you can call it new – but maybe perhaps a new strategy, at least through Totvs Store, what is the role of resellers? Do you still believe they are a competitive advantage? Lastly, are you trying to adapt them for some other service? What is the strategic outlook today for the role of the 5,000 resellers that came with the Bema acquisition?

Mr. Eros: Fred, these resellers play a very important role. We see that as with all businesses, SaaS has a very strong tendency of sales becoming increasingly digital. But Bemacash specifically is a concept that clients are not familiar with, so you still need a lot of investment in sales and marketing to spread the concept and so the channels have a very important role.

And we believe that the channels have a very important role even in the future, given the issue of installing and setting up the product until it reaches a level of installation and support maturity that is 100% digital. So we continue to believe that this is an important channel, but we are making great advances in digital sales to allow for a more fluid and digital process for clients.

Mr. Fred Mendes: Perfect, thank you.

Operator: The next question comes from Valder Nogueira of Santander.

Mr. Valder Nogueira: good morning, everyone. This quarter we had strong revenues on the majority of fronts despite the negative collateral effect of the strike. Actually this strike must have affected in different ways the billing dynamics of your different segments, the smaller client, the SMB client.

What was the collateral effect of this strike, both positive and negative, and what can we expect from the blocked revenue? As you said, there were a lot of things that were only closed in June and that actually can end up in the third quarter – and of course, looking also to the second half of the year, this is the first question.

Mr. Maia: Good morning Valder, this is Maia. Well, about the truck drivers' strike, I believe that, in terms of billing, the direct impact it had in the quarter was because it happened in the last week of May. I think most of you are already familiar with the behavior of our market, which has strong concentration of sales in the final week of the months, so that certainly had an impact.

What also happened is that part of it migrated to June. June was a good sales month, May that was supposed to be a very strong sales month wasn't, and a part of it we attribute to the strike. But our sales in June, consequently, wasn't enough to equal the sales of June plus what should have been registered in May. June was a good month, very good; but not good enough to compensate this.

What we can see is that propagating itself in revenue looking forward, because what was sold in June did not imply billing in the quarter, I think this is more visible when we look at the ARR growth rate from one quarter to another and the growth of subscription revenue itself from one quarter to another. We see that subscription revenue grew around 2.7%, a little less than 3%, while ARR rose by more than 5% in the period. So I think this difference between the growth of ARR and revenue from one quarter to the other gives us something on the measure of the mismatch we had due to this movement from May to June.

Valder, the actual fact that we look at in relative terms – I believe it's more the feeling, because it's also based on the month of July – the feeling of the sales team is that the specific effect of the strike was contained to those ten days of strike, but the post-strike feeling is that the market's mood is not as good as at the beginning of the year.

It's not that it turned sour, I believe that in relative terms it still is better than last year, the improvement is clear; but compared to what we had at the start of the year we see certain deterioration.

License sales, despite the fact that we can have quarterly volatility as we have been talking about for several quarters now, as the model migrates to subscription, what remains of sales under the license model tends to be increasingly concentrated, to depend more on large accounts. If you look in this quarter we also had a significantly lower license ticket, which shows that the large accounts too didn't have good dynamics in this quarter.

I'm only saying this to give you an example of what I mean exactly with the mood before and after the strike. The sales dynamics with smaller companies remain good. However we feel that in general, even when combining with the larger ones, the dynamics are not the same as in the start of the year.

At this time, we're also watching cargo transport companies a little more carefully. We're the leader in this market, it is a segment that I believe has great strategic value in the logistics sector. It's not one of our big segments in terms of revenue – the company's revenue is highly across sectors – but it's a niche that we have been watching closely because these companies, from what we have been monitoring, they have been suffering more. I think the effects of the strike hit these companies harder.

Mr. Valder Nogueira: Thanks, and we also had a positive surprise in contribution margin from service revenue. How sustainable is this 7.7 moving forward?

Mr. Maia: Look, Valder, services have a natural a lag between sales and revenue, and the result. So it usually takes some time from the sale of the project for us to be able to actually start the project at the client and execute the service. So it's part of the fruits we've been reaping now, since services result from the sales we made in previous quarters.

The fourth and first quarters are unfavorable for services because you of end-of-year holidays, vacations at the end and start of the year, many companies closing their books at the start of the year, and then projects don't start in this period. These are moments that don't help us show the benefits of sales that we have made of services.

So now the second quarter may have been the first quarter better suited for it. We continue with a good level project sales. The pace of project sales, I believe, has remained at levels that give us the conditions to continue having a good volume of service delivery in the coming periods, and I believe we need to continue watching service sales. At least in the short and medium terms I believe the volume of services sold provides us with good conditions.

Valder Nogueira: Even if you end up not having in the coming quarters some external factors that made your clients hire services, whether consulting or implementation on top of the loop to be able to implement these external factors, especially in government-related things, right?

Mr. Maia: Yes, yes. That also helps, brings us additional flows. We're talking about these specific cases you mentioned, these are shorter projects, very quick and emergency stuff – but which too certainly contribute. But the fact is that sales from previous quarters, they actually generated a good services "inventory" for us, which I believe that at least in the short term creates good conditions for the services team. Obviously we have to talk about it, as I did a little while ago, watching how sales will behave going forward, because that can pose some hindrance looking a bit more into the future.

Mr. Valder Nogueira: Thank you very much Maia.

Mr. Maia: You're welcome.

Operator: The next question comes from Susana Salaru of Itaú.

Ms. Susana Salaru: Hello everyone, good morning and thank you for taking the question. Actually we have two questions. First, could you tell us how the subscription, maintenance churn was? There's no need to tell us the number if you can't, but just how the delta behaved in relation to the previous quarter and year.

The second question is about Bemacash, Eros said it currently has three payment methods: bank payment slips, cards and he also mentioned financing methods. Can you elaborate further on these financing methods?

And if I may, a third one very quickly: the discussion about R&D, which was more than what we expected, can we consider that going forward it's going to be higher, given these initiatives Maia described? Thank you.

Mr. Maia: Susana, I'll start off with the first one about the churn. There was no improvement to the overall churn. It remained high, close to 9% this quarter. We had a higher level of churn in subscription this quarter, and maintenance was a bit lower than in previous quarters.

The churn in subscription, excluding other factors, the one I can even link with what Eros commented, is also related to Bemacash, including the changes in model he commented and he can tell you more about this question of financing, they were also intended to address issues related to delinquency. This has an effect both on revenue after IFRS 15 and ARR. I'm afraid that maybe it can't be entirely understood here, but in terms of ARR, way back then when we sold Bemacash we looked at the twelve months forward and we incorporated the expectations we had for receiving monthly payments for Bemacash into the ARR. So, for delinquency cases relating to Bemacash, when I cancel these contracts I take it all out of ARR at once, and that disrupted our ARR.

After the turn of the year from 2017 to 2018, with the adoption of IFRS 15 I also have a somewhat similar effect in subscription revenue, since the accounting standard requires us to "linearize" the revenue over the life cycle of the contract. What I mean in practical terms – and maybe the Bemacash example will help me explain what I mean exactly – if we take Bemacash sales back then we were talking about a 36-month contract that had no software payment in the first ten months.

What did we have to do after implementing IFRS 15? We calculated considering the 36 months of the contract lifespan, we took the software revenues starting from the 11th month up to the 36th month and divided that by 36 months, and we recognized revenue since the initial moment of the contract. So, if you look at the turn of the year, one of the adjustments we made against equity was a recognition of subscription revenue.

In the same way that ARR, when this contract is cancelled, that revenue I recognized in the first ten months without any billing and that afterwards would become a higher billed amount than the revenue I'd recognize, because I return that revenue I recognized in the first ten months, when the contract is cancelled I refund it, I return all that revenue that I recognized all at once.

So this had an effect in both subscription revenue and ARR, and that was also calculated as part of the growth in churn in subscription as well. Naturally, that wasn't the only event, I think we're even studying it better, understanding the reasons; but that was the actual fact.

Regarding R&D, I think that the R&D level we have serves as a reference for the rest of the year, because it's a year that still has lots of requirements to be met, and the innovation fronts I listed to Fred on his previous question are fronts we are going to keep working on for quite some time. I see no possibility for us to reduce R&D now in the medium term.

The third one about Bemacash financing methods I'll leave it for Eros.

Mr. Eros: Perfect. Susana, with regard to the payment methods, I'll start off by explaining how clients contract Bemacash.

The client contracts it, you have some hardware options and the client signs the contract acquiring this hardware and paying for software subscription. So regardless of whichever hardware it is, the client can purchase this hardware in up to ten installments on credit card. But it just so happens we use their credit cards limit for the ten installments, and as such some clients felt a bit pressured by that.

We offer the option to pay for the hardware upfront with bank payment slips – all of it through an automated store – and we understand that it is important for this client profile that we have a way to finance this hardware acquisition, but this is done through partners, and that's where we are evolving and seeking more and more partners, because we understand that it makes sense for this client profile.

Software is also contracted since the first month, and software is always paid by credit card. So we stopped bank payment slips for these recurring software payments, and in hardware we're seeking this flexibility because the market demands this payment method.

Mr. Maia: Financing of hardware over a longer term, we see it as something we're working on to support Eros on this front because we understand that the credit to finance this hardware over a longer period is certainly a critical factor and might also help us accelerate sales of Bemacash.

I don't have anything solid yet to tell you in this regard. We're working on some options but it's something about which we'll probably have some news in the next quarters.

Ms. Susana Salaru: Perfect, and just a quick question: you talked a lot about the fact that the Bemacash client has to pay for the software since the first month, this is a factor that changed the dynamics with the client. Just so I can have an idea of the magnitude of it, in financial terms for the client I don't know exactly how much is an installment for the first month, how much would you say is for hardware and how much for software? Is that a significant increase for the client in that first month that he has to pay subscription?

Mr. Eros: Susana, in the previous model we charged a monthly fee for hardware and software, so I'll give you some reference numbers: the client on average used to pay R$250/month. In the current model he can pay for the hardware in ten installments, so the most accessible model for Bemacash today we're talking about ten installments of R$199.00 for instance, and he pays R$99.00 for the software since the first month.

So he notices a bigger installment in the initial months, but after that there's obviously only software left. This was the model we saw that had traction. It wasn't that 100% of clients were complaining, it was a minority; but we realized that, if it escalated, it could become a problem and we decided to make this change now.

Ms. Susana Salaru: Perfect, thank you.

Mr. Maia: You're welcome.

Operator: The next question is from Maria Tereza Azevedo of Banco UBS.

Ms. Maria Tereza Azevedo: Hello everyone, thanks for the question. Actually, I wanted to know more about channels. You mentioned that there was an impact on the commission mix and I'd like to understand if you're seeing any trend of change in the mix moving forward, and if it is possible to quantify the difference in margin among the different channels, and also if you have been seeing any resistance from franchisees in adhering more aggressively to the subscription model.

And following this first question, the second is about the base migration strategy. Do you think that with the elections and the macro still a bit unstable, there is any risk of postponing this migration process and concluding this transition? Thank you.

Mr. Maia: Good morning Maria Teresa, Maia speaking. Talking first about the channels, when we refer to the variation in commissions in the period, the sales mix between franchised channels and our own sales team interferes on the level of commissions. So, if I sell more through franchises I tend to have a higher level of commissions and probably a lower level of selling expenses.

On the whole we probably won't have a very big change. When we refer to the channel mix, it's largely in this sense. In the month-on-month, quarter-on-quarter bases, it's very normal that we have volatility between the sales distribution that happens through one kind of channel or others, in other words, via franchises or own team - but this does not represent any kind of resistance with regard to SaaS.

The simple fact that we had licenses, for example, stronger in the first quarter, that carries over commissions from the first quarter to the second quarter. So, there's a combination of the sales mix by channels also compared to the revenue mix we have in the period. Thus, the fact that I had less "contribution" from license revenues in the 2Q also makes me have less commissions.

And the share of franchise sales in SaaS sales continues to grow well. We still sell more through our own sales team, but as I discussed, in the last quarter, or the one before that, we understand that this looking a bit farther into the future, we see franchises at some point accompanying the importance of our own sales team.

There are also some reasons related to regional characteristics. We see that the acceptance of the subscription model is higher in large urban centers than in regions that are farther out, and our own operations are concentrated in large centers. And it is also related to client profiles.

It is clear that this is a matter of time, we see that this behavior of clients in large centers also tends to spread across other regions and that at some point we will have a very small difference – maybe there won't even be a difference between clients – but today it still exists. We still see a view in some regions that are a bit more traditional of some clients who still prefer licensing.

Regarding the second question, can you repeat it?

Ms. Maria Tereza: It's about the base migration process.

Mr. Maia: On migration. There was nothing new regarding migration this quarter. We didn't make any moves in this regard. Your question was in connection to the election process happening now in the second half, if that can make us hold back a bit and I believe it can.

I think we need a clearer picture about clients' confidence levels. Maybe if we see a clearer scenario this year, we may be able to start something, even if to get a feel of the clients; but today I'd tell you we're still on standby.

Ms. Maria Tereza: Thank you Maia.

Mr. Maia: You're welcome.

Operator: The next question comes from André Baggio of JP Morgan.

Mr. André Baggio: Good morning everyone. The first question, Maia, is related to maintenance. By our calculations, an estimate here, maintenance churn remains high, maybe close to 8%. What do you ascribe that to… if Brazil isn't registering that GDP any longer… that it did in 2016, 2017…in fact, churn is high in subscription and what do you think may be causing that?

Mr. Maia: Good morning Baggio. If you could just repeat the maintenance percentage that I couldn't hear?

Mr. André Baggio: We estimated churn of around 8% per year, but I don't know if it's a reasonable number.

Mr. Maia: Yes it's reasonable, and as for the second part of your question…

Mr. André Baggio: What causes churn to be at such a high percentage, given that GDP is much better than it was in the last two years?

Mr. Maia: Baggio, I believe it's related a bit with the sales dynamics. Despite licenses having had a 2017 that was better compared to what we experienced in 16 and 15, these were sales especially in 17 that were more concentrated in bigger sales, and the "conversion" rate for license sales to maintenance, it has an average conversion a bit lower in terms of maintenance.

What do I mean by that? The maintenance payment percentage in large accounts is a little lower than what we normally obtain in SMB. Therefore, I notice it's more related to the dynamics of this public.

Regarding clients, and you surely have that in mind too because you follow us for quite some time now, sales in the base have also always been a pretty important component, and it still hasn't started registering strong dynamics. So, these sales in the base are another factor that could contribute a lot for a stronger maintenance performance, and we haven't seen it happen.

So clients, especially in 2016, reduced contracts due to adjustments to company size and structure. We still haven't seen these companies recompose these reductions in users. Maybe the moment when this happens can also be an opportune moment for us to discuss their migration to subscription, and which is connected to the last question from Maria Tereza.

Mr. André Baggio: Thank you. Regarding this revenue migration both from new clients as well as the bases to subscription, is there possibly some pressure from clients with higher prices, in other words, I understand that today you have been able to get a subscription price in a SMB base, in other words, of smaller clients to which you can, let's say, dictate the price.

When you now talk about larger clients you already say that there is a matter of the bigger client wanting to pay less maintenance in the future in relation to the license price. This, let's say, greater bargaining power of a larger client, can we at some point start noticing that in subscription too?

Mr. Maia: Baggio, you're right. This bargaining power of larger clients isn't something new, it has always existed. That's why when we said that the SMB client was more profitable to the company, one of the factors aside from a lower service component involved in SMB is the average percentage of maintenance, since as the large client usually buys large number of users, on average it can get a lower percentage.

They are clients that sometimes are even willing to pay a higher licensing fee, but they are not willing to pay a higher maintenance fee, especially because the players competing in this market practice very low maintenance fees as well.

As for them practicing the same thing in subscription, I believe we'll have to experience some of this reality for some time, Baggio. We haven't experienced it. Yes, they might probably exert pressure on prices due to volumes; but the concrete fact is that in the model in which you don't have the license and you're simply discussing monthly fees, the case is that often the client's perception, even the large ones, is that the gain he may get on a monthly basis is small.

So, I believe this profile of large clients wanting to bargain an average lower price will continue to exist, but perhaps less aggressively because the gains in absolute terms that the client may obtain wouldn't be that big. Anyway, that's what we see, but maybe we'll have to experience this reality a little to be able to state it categorically.

Mr. André Baggio: Thank you Maia.

Mr. Maia: You're welcome.

Operator: Ladies and gentlemen, a reminder that if you wish to ask questions just press star and one, star and one. Once again, to ask a question, please press star one.
The question and answer session is now over. I'd like to invite Mr. Maia to proceed with his closing remarks.

Mr. Maia: I'd like to once again thank you all for participating in our conference call and say that we, together with the Investor Relations team, remain at your disposal if you have any additional questions. I wish you all a good day, thank you very much, goodbye.
Operator: That concludes TOTVS conference call today. Thank you for participating. Have a good day and thank you for using Chorus Call.