

Operator: Good morning and welcome to the TOTVS conference call to discuss the results of the 3rd quarter of 2018 (3Q18). With us today we have Gilsomar Maia, CFO, Juliano Tubino, Vice President of Business and Digital Strategy, and Sérgio Sérgio, Investor Relations Manager.

Note that all participants will be on listen-only mode during the Company's presentation. After the presentation, we will start the question and answer session for investors and analysts, when further instructions will be given. If you need any assistance, please dial star zero (*0).

The audio is being simultaneously webcast at ri.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. Tubino, who will begin the presentation. Mr. Tubino, please go ahead.

Juliano Tubino: Good morning everyone. Thank you for participating in our earnings conference call. I will begin the presentation by commenting on the main recent events, starting on **slide 3**.

Taking one more step forward in the Bemacash strategy, that we started last year with the project that involved smart device desing, software innovation and integration with means of payment, in October we launched the Bemacash Smart POS.

Using the same software platform already available in the Bemacash tablet, the Bemacash Smart POS is a complete solution for points of sale, that contains: (i) cloud-based financial management software with sales inventory and accounts receivable control, (ii) artificial intelligence solution, that help the bunisness owner in princing, sales forecast and other business insights, (iii) as well as receipt printing, and (iv) integration with means of payment.

Developed with the micro and small businesses in mind, the combination of management technology and means of payment enable control of sales and management of the business from end to end, from anywhere and any device, including smartphones.

Following the same distribution model of other Bemacash solutions, the entire Bemacash Smart POS sale process will be supported by TOTVS Store, whether the customer buys directly or through the Bemacash channel, we will be providing a one hundred percent digital purchase experience for them.

With that, we want to provide to Small Business, besides a solution that integrates smart devices, POS software and means of payment; we also want

to offer business management and artificial intelligence solutions, therefore broadening the access to technologies that until were only available to large enterprises.

Moving to slide 4, we are also celebrating iDEXO 1 year of operations.

With an operating model focused on connecting startups, entrepreneurs and developers to costumers in the pursuit of inovative business solutions, iDEXO already has 30 startups actively engaged with us in business development, integrating to our portfolio solutions from fintechs (such as payments, receivables collection and digital currencies), and also Industry 4.0, Retailtechs, and Back-Office, we will be increasing out ability to take innovatives solutions to our base customers. By the year-end, the community will have 45 high-growth startups under a revenue share model.

Also note that all the startups in the iDEXO community will have their solutions sold directly by TOTVS Store. Therefore increasing our portfolio of solutions that will be contracted digitally.

The evolution of iDEXO's operation will enable the Institute to increasingly become a major incubator of the new corporate venture model in Brazil, especially for TOTVS, expanding the company's capacity in its future initiatives that focus on innovation, business and product development.

Now, I will hand over the presentation to Sergio Serio, who will comment on revenue performance in the quarter, starting from slide 5. Sergio, please go ahead.

Sergio Serio: Thanks Tubino. Good morning everyone.

Software Revenue was the key driver of growth in Total Net Revenue, both for the 2.6% quarter-on-quarter growth and the 4.8% year-on-year growth.

As we can see on slide 6, the quarter-on-quarter growth in Software Revenue was mainly driven by the 21.8% growth in License Revenue. This growth is essentially associated with the higher share of sales to larger clients in the period. Positively impacted by the increase in the IGP-M inflation index in the last 12 months, the growth in Maintenance Revenue was one more factor that contributed to the growth of Software Revenue in the period.

In the year-on-year comparison, it is worth highlighting the 26.7% growth in Subscription Revenue that, combined with Licensing and Maintenance Revenues growth drove the 4.8% growth in Software Revenue during the period.

Note that this quarter, for the first time, Subscription Revenue surpassed the barrier of R\$ 100 million. This is an important milestone for the Company in the transition to the Subscription model.

As shown in the graph on the left in slide 7, despite the growth in Licensing and Maintenance Revenue, represented by the blue bars in the graph, Subscription Revenue has consistently increased its share of Software Revenue over the quarters and has already reached 25% of this revenue line.

In 3Q18, thanks to the higher number of client additions, especially in the TOTVS Intera model, Subscription Revenue grew 2.9%, surpassing the R\$ 97.2 million in the previous quarter, reaching the R\$100 million already mentioned.

Annualized Recurring Revenue from Subscription, shown on the right chart of the slide, totaled R\$444.9 million, up 4.5% quarter-on-quarter, and 33.2% year-on-year, essentially due to: (i) the higher volume of sales of products with lower average ticket related to the strategy of management and business open platforms, such as Fluig and Gooddata; (ii) and the cancellations of Bemacash due to defaults on the units sold before 2Q18, when the sales model was changed.

Moving to **slide 8**, the year-on-year reduction in Adjusted Contribution Margin from Software is due to: (i) ramp up in Research and Development, reflecting the new investments in innovation, and the FX rate impact on TOTVS Lab structure; (ii) the additional Support costs to meet higher demand from new clients added in the period and new regulations that took effect in 2018, such as e-Social, whose compliance deadline was extended; and (iii) the increase in Software Costs due to the increase in sales of partner solutions.

The quarter-on-quarter reduction in Adjusted Contribution Margin from Software is mainly due to the increase in R&D, which, apart from the reason mentioned above, also reflects the salary adjustments resulting from collective bargaining agreements in several regions where TOTVS operates, which represents around 20% of the total R&D payroll.

Regarding Services, on **slide 9**, Adjusted Contribution Margin from Services grew 110 basis points compared to 3Q17. As mentioned in previous quarters, the growth in Service Revenue continues to reflect the higher pace of sales of service registered in recent quarters.

If we take the last 12 months as the basis for comparison, the 1.8% decline in costs of services is due to the restructuring carried out during the second half of 2017. This reduction, coupled with sales, led to margin of 5.8% in the last 12 months of 2018, which is 320 basis points higher than in the same period last year.

Moving now to hardware on **slide 10**, Adjusted Contribution Margin from Hardware decreased by 300 basis points in 3Q18 from 3Q17 and by 470 basis points quarter on quarter. As already reported in previous quarters, this reduction reflects the lower pace of fiscal printers sales, whose margin are higher, due to the change in the tax laws in several Brazilian states, replacing the fiscal printer with other solutions, such as S@T in São Paulo and the electronic invoice in other states.

Comparing the last 12 months, apart from the aforementioned reduction in Hardware Revenue caused by the decline in sales of fiscal solutions, the decrease of 580 basis points in Adjusted Hardware Margin was due to the increase in R&D expenses in the period. This increase is related to: (i) the effect of FX rate in relation to the R&D teams based outside Brazil; and (ii) investments in the development of the new BemaGo platform designed for smart devices for the Internet of Things (IoT).

Moreover, in 3Q18, Bemacash sales totaled 672 units, compared to 691 units in 2Q18. The maintenance of Bemacash sales volume is due to the changes made in the sales model in 2Q18 to simplify the purchase process and reduce defaults inherent to this market segment. Also worth noting that since April 2018, purchases using the Brazilian Taxpayers ID number (CPF) are made exclusively with credit card through the TOTVS Store.

I now hand over the presentation to Maia who will comment on selling and administrative expenses on slide 10.

Gilsomar Maia: Thank you Sérgio. Good morning everyone.

The 0.2 percentage point variation in selling and commissions expenses in the quarter is mainly associated with the performance of license sales in the period. Year-on-year, these expenses went from 17.3% to 16.2%. mainly due to the reduction of recurring personnel costs in 4Q17 and the dilution by the growth of software revenue; and also by the deferral of variable compensation as a result of IFRS-15. It is important to note that the level of these expenses in this quarter is lower than that observed in the last 12 months, which also dropped compared to the same previous period.

Regarding General and Administrative Expenses, Management Fees and Other Expenses, the reduction of 0.8 percentage point from 2Q18 is related to: (i) the integration of Bematech's administrative operations concluded in 4Q17; and (ii) the lower Provision for Contingencies this quarter due to the progress of the lawsuits in the period. Here, it is also worth mentioning that, in the last 12 month, this line of expenses fell 1.0 percentage point, illustrating the focus on cost control.

And concluding with the allowance for doubtful accounts, which remained at 2.0% of Net Revenue, the same level as in 2Q and in the last 12 months. This quarter, the still high level of defaults was worsened by a large account that entered in judicial reorganization.

Now to talk about EBITDA, please go to slide 11.

As can be seen in the charts, the quarter-on-quarter growth in EBITDA was due to the increase in Software Result, net of selling expenses, combined with a decrease in Hardware Results and in the Administrative Expenses.

In the year-on-year comparison, adjusted EBITDA grew 43.7%, passing from R\$62.3 million to R\$89.5 million, due to the increase in Software Result and the decrease in Selling and Administrative Expenses in the period.

In the last 12 months, apart from the factors just mentioned, it is worth noting the growth in Services Result. In this period, Adjusted EBITDA totaled R\$341 million, 15.6% growth, and margin was 14.9%, representing an increase of 160 basis points from the same previous period.

Moving now to slide 13, the performance of EBITDA combined with the reduction in Depreciation and Amortization Expenses and a lower effective tax rate, led to 39% growth quarter-on-quarter in net income.

In the year-on-year comparison, the 83.5% growth in Net Income was driven by EBITDA growth, since the reduction in Amortization Expenses, related to

intangible assets arising from M&As was more than offset by the effective tax rate.

I'll now move to **slide 14** for comments on cash flow and debt.

Free cash flow generation grew 52% year on year, mainly due to: (i) the 215% increase in EBIT; and (ii) the reduction in working capital.

Quarter-on-quarter Free Cash Flow grew 27.3%, due to: (i) the reduction in working capital in accounts receivable and tax recoverable; and (ii) the lower income tax and social contribution paid.

Moreover, despite the payment of dividends and interest on equity this quarter, reflected in the financing activities, net debt declined more than 70% year on year and 51% quarter on quarter. This decrease led to a net debt to adjusted EBITDA ratio of 0.3 times in the last 12 months, the lowest since the merger of Bematech in 4Q15.

Moving now to **slide 15** for the closing remarks.

During today's presentation, we saw that:

Three years after we started the migration process to the subscription model, in spite of an economic scenario still in a recovery stage, the results show that the company has reached a turning point, with growth acceleration in Revenue and EBITDA Margin increase.

The last 12 months view makes this trend even clearer. The adjustments made to the cost structure, combined with the growth in software revenue, specially by a 32.5% growth in Subscription, led to a 15.6% growth in adjusted EBITDA.

In addition, the financial position has also presented significant improvement, with free cash flow generation 52% higher, led to a net debt declining by half year-on-year, reaching 0.3 times EBITDA, the lowest level since the the transition process started.

To sum up, TOTVS is increasingly better prepared for a new growth cycle.

Now, we are now available for the Q&A session.

Operator: Ladies and gentlemen we will now begin the question-and-answer session. To ask a question please press star one and to remove your question from the queue press star two.

Our first question comes from Gabriel Rezende of Bradesco BBI.

Gabriel Rezende: Good morning. My question is about the smart POS, the launch of this new Bemacash solution. We wish to understand whether you consider the possibility of this product facing the same distribution difficulties as other Bemacash solutions and how you plan to deal with that.

Tubino: this is definitely a business – and thank you for your question, Gabriel – in which distribution is very important. The performance and our focus on the channel has historically been one of the strengths of TOTVS, our distribution capacity and solutions for our clients.

This performance has been growing significantly within the SMB market and we've been using our operation also for SMB – micro and small businesses. One

of the most important points will be addressed through partnerships in the distribution channels, since the offering we are launching is not just hardware and not just software, but also includes acquisition and payment capabilities, we have a diversity of channels to be explored and accelerated. So we are quite optimistic about our capacity to multiply the units sold through smart POS.

Gabriel: I see. But is there already any distribution partnership for payment means with acquirers?

Tubino: The smart POS starts with a partnership with Stone, and this partnership starts from the use of Stone as the acquirer, as a payment means model integrated to the smart POS, to joint distribution efforts.

Gabriel: Got it, perfect, thank you.

Operator: the next question comes from Maria Teresa Azevedo of UBS Bank.

Maria Teresa Azevedo: Hi everyone, thanks for taking the question. I'd like to understand from you how you see this dynamic of higher revenue from license sales compared to subscription revenue. Do you expect this to be a trend for the coming quarters or is it just a one-off event? Thank you.

Gilsomar Maia: good morning Maria Tereza, Maia speaking. As we've mentioned in previous quarters, Maria Tereza, this is how we see it: the transition to subscription has caused the average client profile that chooses the license model to be larger than those who choose subscription, and this causes the licensing model to depend more on these large accounts.

These large accounts, due to their characteristics, take a very long time to be closed in general. They are quite complex in terms of the scope of the project sold, and often the predictability of closing of this pipeline is much lower than what we normally see in our main SMB market.

What I'm try to say is that it's harder for us to read the performance of licenses in a quarter, both in a strong quarter, such as the last one, or in a weaker one, to read it as a trend for the coming quarters.

Every time we talk about trend, I tend to pay more attention to the last 12 months. In the last 12 months, we can see license growing by around 4.5% to 5% in this period, which shows that, after declines of 15,16, quite sharply, and stabilizing at 17, the market recovery itself has created an opportunity to resume sales of licenses and to grow a little.

If we continue to see this scenario of market recovery, we may see license growing in future periods, but that does not change, whatsoever, the trend that the model in the future will be the subscription model.

So, just as a more clear market recovery could boost these license sales that were repressed and drive the growth in license, this is will also certainly favor – perhaps proportionally much more – subscription sales.

So, to sum up, I don't see the behavior of license this quarter as a trend, as I don't see it for subscription either. I think it is much more an issue of the current macroeconomic scenario than anything structural.

Maria Tereza: Thanks Maia.

Operator: the next question comes from Felipe Cheng of Credit Suisse.

Felipe Cheng: Good morning all. My question is related to new opportunities. We recently saw competitors such as Lynx entering the sub-acquirer market through Lynx Pay. Since TOTVS always has significant market share in retail, with 20% of its revenues coming from this segment, would it make sense for the company to take a similar step in this direction? Is it something the company considers in the short term? Thank you.

Tubino: Thank you Felipe. TOTVS continues to focus mainly on simplifying its clients' businesses by offering them the best solutions so that they can grow their businesses. The Bemacash smart POS is our first product we launched in the market that exemplifies this fusion, this mission. In other words, it is not just a combination of point-of-sale software and integrated payment capability, but it also includes artificial intelligence and cloud business management, all this in a form factor, a proprietary device focused on a specific segment such as micro and small businesses.

If we stop for a minute and see also a huge opportunity when we analyze TOTVS as a company that is the leader in ten segments other than retail, and when we add this mission of continuing to use technology to support the operation and growth of these businesses, the integration with new capabilities, such as artificial intelligence and payments, it is in line with our mission of continuing to help our clients grow their businesses.

These capabilities will be made available to the market, whether through partnerships, through the extension of existing partnerships, or through the creation of new capabilities. And we are working on it - this entire project is under construction.

Felipe: Perfect, thank you.

Operator: As a reminder, if you would like to ask a question, please press star one.

Our next question comes from André Baggio of JP Morgan.

André Baggio: Good morning. I have a follow-up on the question regarding payment means. Maia, we talked yesterday, but could you add some color as to what is needed for TOTVS to start earning a percentage of the sales at stores, I mean, to earn MDR and not just be a provider of software, where it doesn't earn anything from the transaction itself.

Maia: Good morning Baggio. In our opinion, I think we basically had to take a few steps and the Bemacash POS was one of them. To have the solution ready for us was important and it's a real solution, it's not an idea. It is on sale even on the company's website, if you go to the TOTVS website you can see the smart POS offering. If I'm not mistaken, the standard offering is ten installments of R\$139.00 and a monthly subscription of R\$59.00.

So, once we have the real offering on course to building these partnerships, as Tubino mentioned in his reply to Felipe, these become viable options. I think we could even work like you mentioned, of participating in the transaction itself, this also becomes a viable option.

Now, I think it's basically a matter of us working on two fronts: one, of generating volume, expanding the distribution channel, as Tubino said, having a multi-channel strategy to be able to gain scale and volume; and the other of having the offering ready, having the final solution, such as the one that was built. Now, I think it's basically looking at these partnerships. I don't know if you want to add anything, Tubino?

Tubino: That's it. Completing the execution format, each solution that has the integrated payment capability - once again, like Maia said - more than an ambition plan, we've launched the product in the market that has exactly the business model where, through the partnership a percentage of the MDR will stay as profit for the client and for creating value.

All the solutions that will integrate the new capabilities, in addition to the management system, to the POS system, will have a business model based on the transaction. So, we're absolutely aligned with what you said and what I keep stressing is that from TOTVS' perspective, this is an opportunity that goes beyond retail and it leverages opportunities and assets and the relationship TOTVS has in another ten segments, which have similar unique features as retail in a transaction that is carried out at the point of sale, others where these transactions are made in a value chain. In both scenarios, there is a very important opportunity for us to continue adding value to our clients.

André: Great. Thank you.

Maia: Thank you Baggio.

Operator: To pose a question, please press star one.

We now conclude today's question and answer session. I'd like to invite Mr. Gilsomar Maia to proceed with his closing remarks.

Maia: Just before my closing remarks, I think Tubino would like to complement the answer to the first question from Gabriel, from Bradesco.

Tubino: Actually, I agree that distribution is indeed one of the pillars for the success of the payments business, a business that involves, helps clients close the transaction. The thing we've been working on and already delivering is, apart from leveraging the optimization of our existing channel, whether it's the software channel or the hardware channel that came from Bematech, the fact is that today we've been making these new solutions available through 100% digital contracts.

So, today you can place the order and receive everything, from cloud-based software to hardware, in a few minutes through a B2C channel, i.e. we're combining the purchase of corporate solutions with the ease of e-commerce, which is so important for micro and small businesses.

Maia: Well, I'd like to thank everyone for listening to our conference call and tell you that the Investor Relations team remains at your disposal. Have a great day, thank you.

Operator: That concludes TOTVS conference call today. Thank you for participating. Have a good day and thank you for using Chorus Call.