Q1 2012 Earnings Call

Company Participants

- Alexandre Dinkelman, Deputy CEO, CFO, IRO
- Gilsomar Maia, Planning Officer

Other Participants

- Michael Moran, Analyst

Presentation

Alexandre Dinkelman {BIO 16100739 <GO>}

Good morning, everyone. Welcome to Totvs First Quarter 2012 Earnings Conference Call. We ended this First Quarter at a significant higher level than that obtained in 1Q '11, taking the first step towards the achievement of our annual internal goals.

The main highlights of the First Quarter were margin expansion, reflecting our actions to increase our profitability, international market, strategy and action plans to make the turnaround of operations outside Brazil, revenue growth, growth according to our internal expectations on all lines.

Now I would like to invite Maia, Totvs' Planning Officer, to proceed with the presentation of the results.

Gilsomar Maia {BIO 16400533 <GO>}

Thanks, Alexandre. Good morning, everyone. I'd like to ask you to proceed to page two. The Company's net revenues grew 15% in first Q 2012, amounting BRL351 million. The left chart shows the robustness of Totvs' business model, with the unbroken stream of revenue growth.

On the right, the comparison between first Q's and fourth Q's shows that the negative seasonality was broken again by Totvs in first Q '12 with a growth rate higher than that observed in the same period last year.

Moving on to page three, we can see that the revenue breakdown in first Q '12 was in line with the historical differently from first Q '11, when the license represented 26.4% of total revenue or approximately 200 basis points above the historical average share for this line. Turning the first Q '11 it was strong base to compare first Q '12 license.

On page four on the left, please note that the license in first Q '12 grew 6.5% over first Q '11, when a new record of license in the First Quarter was established, growing 41% over 4Q '10. In the chart on the right, we can also observe that the first Q '12 license increased 14.7% over 4Q '11, the same growth rate between the first Q '11 and the fourth Q '10, breaking again the industry seasonality, which traditionally presents a contraction sales after the fourth Q. In this context, the commercial flexibility and Totvs' business model has proven to be effective and seasonal[ph] tools.

On page five, the chart on the left illustrates the last year GDP evolution and the first Q's incremental revenues from the corporate-license model. Incremental revenue of BRL19 million in the first Q '12 represents 3.1% over first Q '11, taking into consideration that the GDP growth in 2011 was significantly lower than in 2010. The 3.1% growth becomes even more relevant, since incremental license is charted in first Q based on customers' real growth from previous years.

On the chart on the right we highlight that the other license revenues -- that means excluding incremental revenue from corporate module grew 7.5% in first Q '12 over a strong base established in first Q '11, showing that Totvs business model is not an exclusively almost single commercial mode.

On page six, the left charge shows that revenues of services increased 22.7%, meaning 540 basis points above the historical CAGR of this line. The chart on the right shows the reduction of negative seasonality of sources in first Q.

The pace of growth comes from efforts done by the management to increase the efficiency of services teams aiming margin improvements, in addition to faster growth of consulting services and infrastructure. They are contributing to increase the customer base loyalty and the expansion of the Company's consolidated margin.

Moving to page seven, both charts show the consistent growth of recurring revenue, which reflects the high-level customer-base retention and potential growth of medium and small companies. Here we also highlight the growth of 16.9% in line with the historical CAGR.

Now, on page eight we have the costs and expense dashboard, in which we gathered the Company major expenditures just like last quarter. The upper left corner, we have consolidated R&D, cost of services and license costs. Monitoring these three lines of expenditure jointly is important to check whether the investments in R&D results in long-term margin gains through more efficient implementation and dilution of license costs and also in R&D investments.

The quarter, this group decreased again as a percentage of mass revenue, even with impact of wage increases resulting from collective agreement and some following the first Q '12. In the upper right corner we have the second block of selling expense, commission, net debt, and marketing. As a percentage of mass revenue, this group of expenditures declined by 110 basis points over the first Q '11 and decreased 80 basis points on the fourth Q '11 and remained a point of attention to the management in terms of efficiency.

In the bottom left block G&A and management fees are stable between first Q '11 and '12 as a percentage of revenues, increasing 50 basis points when compared to fourth Q '11. This increase was mainly due to the accrual of bonuses in 2012 proportional to the achievement of financial and nonfinancial goals of the period.

The bottom right corner, the last block, represents the line of ordering and expense, which is negatively impacted by fourth Q '11 by non recurring provision of BRL1.8 million to the restructuring process of international market operations.

On page nine, comparing first Q '12 versus first Q '11, we highlight the growth of 15.1% of net revenue, 29.1% of EBITDA, 48.7% of net income coming from additional 280 basis points from EBITDA margin, combined with a reduction of company's net debt. Comparing first Q '12 and fourth Q '11, we highlight the growth of 4.8% of net revenues, 5.8% of EBITDA, an additional 20 basis points of EBITDA margin.

Moving to page 10, the left chart shows the evolution of the EBITDA and the margins in first Q's. We highlighted EBITDA growth of 29.1% between first Q '12 and '11, the expansion of 208 basis points of EBITDA margin in the same period. And on the chart on the right, the long-term vision with 12 accumulated months in each First Quarter, demonstrating the solidity of the Company's business model.

Now I ask Alexandre to proceed.

Alexandre Dinkelman {BIO 16100739 <GO>}

Thank you, Maia. On slide 11, we provide visibility to our margin in three different layers. The purpose here is not to show any pro forma adjustments, neither non recurring effects on EBITDA. The purpose is to improve the visibility of the operation, which had different dynamics in terms of maturity and evolution. We broke down EBITDA margin into the Brazilian operation. That is our core business and the impacts of the digital TV venture called TQTVD and international markets.

On the first line we have the EBITDA margin of the Brazilian operation, which reached 26.6% in 1Q '12, representing 90 basis points over 1Q '11, indicating that Totvs started 2012 with more efficiency here.

On the second line, we have impact of TQTVD in the consolidated margin. In 1Q '12, TQTVD contributed with 20 basis points. Since the new legislation was enacted for the sector, we are internally realizing the business potential and the strategic options that we have to maximize returns of these operations for Totvs shareholders.

In the third and fourth lines, we see the impact of the international market operations, since the nonrecurring item refers to provisions related to the closure of some operations abroad. Consolidating these two lines, the international market had its negative impact on the consolidated margin decreased by 120 basis points, compared to the 1Q '11, and 140 basis points, compared to the 4Q '11. This improvement is a consequence of the fact of actions we had taken since the Fourth Quarter in order to make our international operations profitable.

In slide 12 we provide some of the guidelines we are using in the international plan. We reviewed internal processes in the organizational structure, replacing parts of the management team of this division. We reduced our exposure in Portugal, franchising this region to a local entrepreneur, who will take care of the current installed client base. We shut down two branches in Mexico, located in Guadalajara and Monterrey. Despite this closure, Mexico remains an important country for our expansion.

In this sense, we are expanding the role of local entrepreneurs, who are our franchisees in this country, which will help us increase the effectiveness of distribution with an adequate cost structure. We are searching and negotiating partnerships and new channels, reinforcing our popularity in these markets.

And we suspended our entrance in Australia and India, despite investments made on product roadmap in the past three years for these two countries. This set of actions is part of the revision of our international plan, aiming to stable growth and long-term profitability.

Additionally, it's worth mentioning that we will focus on Latin America at this time, specifically on the SMB markets within selected industry segments. Geographic selectivity combined with offering selectivity in segments with high growth potential and lower localization efforts allows us to create a competitive positioning in these markets.

Therefore, the Company expects that international markets operations reach breakeven of EBITDA in the second half of 2014 and represent between 3% and 5% of the Company's consolidated revenues in 2016.

We believe that international expansion is a strategic initiative that possibly impacts our long-term position in Brazil, among other reasons, due to the increased internationalization of the Brazilian economy and our clients. International expansion also aims to meet one of the main strategic objectives defined by the Company for its fifth phase of development, which is making Totvs a global reference.

For Totvs, being a global reference means being remembered by those who come to Brazil and who expands beyond its border abroad, providing solutions for selected countries in the roadmap for expansion, means being recognized in several parts of the world, does not mean having operations in the five continents and does not mean reducing attention to the countless business opportunities to our core business in Brazil.

Therefore, I reinforce the message that Brazil will remain the Company's driver for growth and profitability expansion in the coming years, considering the market potential shown in slide 13. In the left-hand side of this slide, we have an overview of how companies are distributed in terms of size.

At the top of the pyramid, where the larger companies are, we created our private division, which leverages Totvs' capacity to retain our clients that gain bigger scale. It's important to mention that Totvs provides products and services for nearly 30% of companies listed on Bovespa.

In the range of the SMB, Totvs consolidated its leading position. The segment also has an estimated penetration of around 12% to 15% of ERP. At the base of the pyramid, which includes the micro-companies, we see a relevant opportunity to consolidate the fragmented and unexplored market. At the right side of this slide, it's important to note the share of software in the composition of IT spend in Brazil and in the main countries of Latin America, which is about 13%, whereas in more mature economies like the United States, the share is at 27%.

We understand that Totvs is better positioned to capture the high-growth potential of the Brazilian in Latin America European markets, so we can go to slide 14, where we analyze more details on our market share. On page 14, this leadership is confirmed by Gartner, which presents a 2.4percentage-point expansion in Totvs share in the Brazilian ERP markets, with a total participation of 53.1% in 2011.

However, our estimates indicate a market share of 50.9%. The comparability of the data provided by the research institute is impaired by the retroactive modification on informed revenues of Player A in the chart, the managers using the same criteria conducted for Latin America in the case of stable market share of 34.6% for Totvs.

On slide 15, we mention our recently launched advertisement campaign, which had a strong sales orientation and demonstrates the unique position that Totvs has in the Brazilian market. Here, we reinforce our ability to offer solutions for businesses of outsiders and in different segments of the economy in Brazil. We understand that this competitive position is very difficult to be replicated.

Finally, let's proceed to slide 16. Totvs management team has three strategic pillars in this agenda, growth, vitality, and margin. For growth, as previously announced, Brazil is and will be the cornerstone of our growth, combining organic and M&A initiatives. For the vitality pillar, we highlight the consolidation of our private and consulting divisions, Totvs brand recognition, our corporate social network, called By You, aiming to add a social layer to our offerings, the positioning of Totvs as an international company, reinforcing our position in Brazil in the mid-term.

Finally, our agenda also focus on margin expansion through efficiency gains, especially in services and development, the increasing adoption of scalable solutions and businesses, and the expected turnaround in the international markets.

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

Questions And Answers

Operator

Mr. Kim[ph] are you there? Sir? Our next question will come from Michael Moran from Morgan Stanley.

Q - Michael Moran {BIO 15909240 <GO>}

Yes, hi. Thanks for taking the question. So two things, can you hear me, Alex?

A - Alexandre Dinkelman {BIO 16100739 <GO>}

Yes. We are here.

Q - Michael Moran {BIO 15909240 <GO>}

Okay. I wasn't sure if we all got disconnected or something, but, anyway, so first of all, thank you for the added disclosure and for the added clarity on your international plans. I think that's very helpful. On that topic, I just wanted to know -- I think you're targeting 3% to 5% of revenues from international by 2016. Can you just remind us where that stands today?

A - Alexandre Dinkelman {BIO 16100739 <GO>}

First of all, I apologize for the technical problems. We are here also with difficulty to listen. Actually, we are round 1%, so it's 1.3% in terms of 2011.

Q - Michael Moran {BIO 15909240 <GO>}

So is it fair, then, to assume that to get to 3% to 5% by 2016 that you will more likely than not rely on some acquisitions, or do you think you can get there organically?

A - Alexandre Dinkelman {BIO 16100739 <GO>}

We believe that it's feasible to get there organically, that M&A part of the tools that we have to grow internationally. When we analyze M&A opportunities abroad, we think that the deal tends to be a niche deal, smaller deals than the one we did in the past in Brazil.

Q - Michael Moran {BIO 15909240 <GO>}

Then, secondly, I was just wondering if you can talk a little bit about what you're seeing on the ground with respect to your sales force, given that we've seen wage growth accelerate in Brazil and we know there's a very tight labor market. Are you experiencing any difficulty at retaining or even attracting additional sales people? And perhaps if you can mention just by how much your sales force has grown or has been growing, that would be helpful as well. Thank you.

A - Gilsomar Maia {BIO 16400533 <GO>}

Michael, this is Maia speaking. Good morning.

Q - Michael Moran {BIO 15909240 <GO>}

Hi, Maia.

A - Gilsomar Maia {BIO 16400533 <GO>}

In 2011 our selling expenses grew about 22%, so actually we ended 2011 with a very well-structured sales force, and for us it's naturally to have selling expenses growing less in this beginning of the year, so in terms of retention, we have not observed any significant change in terms of retention or attrition rate.

Q - Michael Moran {BIO 15909240 <GO>}

And is the sales force still expanding at this stage, or what is happening on that front?

A - Gilsomar Maia {BIO 16400533 <GO>}

In what sense?

Q - Michael Moran {BIO 15909240 <GO>}

You're still adding feet on the street? You're still growing the sales force this year, or are you focused more on trying to get more productivity out of your existing sales force?

A - Gilsomar Maia {BIO 16400533 <GO>}

For 2002 we are trying to get more efficiency.

Q - Michael Moran {BIO 15909240 <GO>}

Okay.

A - Alexandre Dinkelman {BIO 16100739 <GO>}

For 2012.

A - Gilsomar Maia {BIO 16400533 <GO>}

Oh, 2012, sorry.

Q - Michael Moran {BIO 15909240 <GO>}

Right, okay, all right. Thank you very much.

A - Gilsomar Maia {BIO 16400533 <GO>}

Okay.

Operator

(Operator Instructions) At this time we show no further questions. I would like to turn the floor back to Mr. Alexandre Dinkelman.

A - Alexandre Dinkelman {BIO 16100739 <GO>}

I would like to thank you, everyone's participation in the call. Again, I apologize for the technical problems, so please contact us if you have any further questions. We are available to address your questions, and I'd like also to thank Totvs' team and our partners and also to say that we are confident that this is the first step to a great year for the Company. Thank you.

Operator

Thank you. Totvs First Quarter Results Conference Call is over. Have a nice day.