# Y 2021 Earnings Call

## Company Participants

- Dennis Herszkowicz, Chief Executive Officer
- Gilsomar Maia Sebastiao, Chief Financial and Investor Relations Officer

## Other Participants

- Bernardo Guzman, Analyst
- Cristian Faria, Analyst
- Diego Aragao, Analyst
- Fred Mendes, Analyst
- Leonardo Olmos, Analyst
- Marcelo Peev dos Santos, Analyst
- Unidentified Participant

## Presentation

### Operator

Good morning and welcome to TOTVS Fourth Quarter of 2021 Earnings Video Conference Call. With us today are Mr. Dennis Herszkowicz, CEO; and Gilsomar Maia, CFO.

We would like to highlight the fact that this video conference is following all essential health and safety measures as stipulated in our legislation and health protocols required by the competent authorities. Let me remind you that all participants will be watching the video conference during the company's presentation that will be followed by a Q&A session for investors and analysts when further instructions will be provided. (Operator Instructions).

The audio and video can be seen on the Internet via the link available on the IR website ri.totvs.com. Before proceeding, we would like to clarify that forward-looking statements made during this conference call concerning TOTVS's business perspective, projections and operation and financial goals are beliefs and assumptions of the company's management as well as information currently available.

Forward-looking statements are not any guarantee of performance. They involve risks, uncertainties and assumptions since they refer to future events and therefore depend on circumstances that may or may not occur. Investors should understand that general economic conditions, industry conditions and other operational factors may affect TOTVS future performance and may lead to results that differ materially from those expressed in such forward-looking statements.

Now we would like to hand it over to Mr. Dennis, who will start the presentation starting on Slide 3. Mr. Dennis, you may start.

## Dennis Herszkowicz {BIO 17998338 <GO>}

Good morning, everyone. Another year has come to an end and the progress of the vaccination rate is enabling the gradual resumption of in-person activities without neglecting the necessary sanitary measures and always focused on which is our priority and our daily routine we have changed our work dynamic and are slowly pivoting toward a hybrid and flexible model as this period undoubtedly has been one of the most challenging in the world. I might start by expressing my gratitude to all the TOTVERs, their families and to our partners.

In 2021, we delivered another fantastic year full of achievements and evolutions breaking historical financial and operational records besides keeping ourselves always in motion and seeking innovative ways to generate and unlock value. A practical example was the creation of Dimensa partnership between TOTVS and B3 which now has dedicated resources, more focused on autonomy in order to become the main B2B technology option for the financial sector.

Another example, was setting a corporate venture capital as a service model, an investment mechanism gear towards start-ups with high growth and innovation potential which adopt a new Management concept relying on an external management that is independent. I also would like to highlight the follow-on carried out at the right moment and that together with our solid operational cash generation enhances our M&A execution capacity, putting us in a position to capture opportunities because of our discipline, we believe that is a matter of time before we see corrections of the listed values that are of longer duration be reflected on private assets, creating opportunities for our M&A movements. Our 3D business ecosystem is already a consolidated reality. Our clients are accelerating their digitalization journey by accessing our broad portfolio of solutions that go way beyond ERP which broadens our competitive differentiators, as well as our addressable market by more than 7x.

We are definitely changing the rules of the game in the enterprise management software market. Amongst the key financial operational results for 2021, I would like to highlight in the Management dimension recurring revenue, which accelerated throughout the entire year including the last quarter, we achieved an impressive 24% year-on-year organic growth in Q4 and 18% for the year. This is a result of our focus on SaaS, which grew 30% with a special contribution from cloud, which climbed 48% in 2021.

In Business Performance, we entered 2021 with a 45% organic growth in recurring revenue, which totaled BRL155 million. It is worth noting that RD Station standalone ended 2021 with a net revenue of BRL220 million, a growth of 40% over 2020 and 14% [ph] million above the year expectations when we have the acquisition. In Techfin, proving once again the soundness of our business model, we broke consecutive records in credit production, which totaled BRL9.8 billion in the year. This is a growth of 80% -- 48% over 2020 without neglecting the discipline and granting credit, which was reflected in the low levels of default registered throughout the entire year.

At the same time, our Sales Machine continued delivering record organic net addition to the ARR totaling BRL629 million in 2021, of which 60% came from volume that is, new signings from new customers plus cross and up-selling to existing customers. An impressive result also proving our pricing power in a period of high inflation. This commercial success is a result of a broad combination of factors:

Number one, the NPS, Net Promoter Score at record levels. Two, churn reductions; three, the refreshment of the TOTVS brand rejuvenation; four, expansion of the solutions portfolio; five, migration process to the cloud reducing the total cost of ownership for customers; and six, the evolution in the productivity and efficiency of the commercial structure, which concluded an important consolidation process of our franchises. A fundamental movement for new investors, more sophistication and structure for the journey of the 3-D strategy. All of these progress positions TOTVS in the new moment of strong acceleration in growth with a sound EBITDA margin, which resulted in an increase of 13 percentage points in the Rule of 40, reaching 48% in 2021.

On Slide 4. This new momentum is clear in the chart on the left of the slide where we jumped from revenues of BRL2.3 billion in 2019 to BRL3.2 billion in 2021. This is a growth of almost 40% with an EBITDA margin jumping from 20.6% in 2019 to 24.7% in 2021, a gain of 4.1 percentage points. On the chart at the center of the slide, you can see that this gain in revenue was driven by powerful new growth engines. Two of which, Techfin and Business Performance that have been less than three years on the road already represent more than 13% of the total revenue of 2021 showing their potential and contribution to sustaining the growth of the business.

When we combine the SaaS results of Management, these engines together account for more than 40% of the net revenue in 2021 and funding about 70% of year-over-year growth. As we can see on the chart on the right, this accelerated revenue of growth which expanded 11.1 percentage points versus 2020 and the 1.7 percentage points in EBITDA margins generate a combined unique balance in the Brazilian tech market, a characteristic, an ideal condition to face any kind of scenario, even the most challenging ones, such as the one we have seen in the recent years in Brazil.

I will now turn the presentation over to Maia to comment on the earnings results of the fourth quarter as on Slide 6. You have the floor, Maia.



## Gilsomar Maia Sebastiao {BIO 16400533 <GO>}

Thank you, Dennis. The progress made in the new growth engine is more evident when we look at the results of the quarter with Business Performance and Techfin together with SaaS Management, adding up to 42% of the total revenue and over 63% of the year-on-year growth. Net funding revenue for the quarter totaled BRL890 million. This is a growth of 31% vis-a-vis the same period of 2020, featured prominently in three dimensions. SaaS Revenue in Management with kept accelerating its growth year-on-year and reached 37% in the quarter compared to the 32% during the third quarter. In Business Performance, the dimensions revenue represented almost 8% of the company's revenue and with an emphasis on recurring revenue, which maintained strong year-on-year growth outperforming 38%, the fourth quarter of 2020 on a like-for-like basis. In Techfin, supplier's credit production grew 36% year-on-year, with a production level very close to that of the third quarter of 2021 record.

Turning now to Slide 7. Techfin and Business Performance together accounted for 60% of the quarter's contribution margin compared to 9.4% during Q4 2020. These two new dimensions have clear addressable market growth and expansion mandates and even though they are still in the beginning, both already present sound contribution margins.

The EBITA margin ended the quarter at 24.4%. These are 120 basis points above Q3. Mainly due to: One, the increase of 480 basis points increase in the percentage of Business Performance contribution margin now an increase of 170 basis points increase in the percentage of Techfin contribution margin due to more efficient capital utilization. When compared to Q4 2020 the maintenance of the EBITDA percentage was possible due to the increase in the Management contribution margin, especially due to the growth and recurring revenue as we can see on the chart to the right, the Rule of 40 reached its historical record of 55.8% during this quarter with an increase of 14.5% over Q4 2020. Where practically almost all came from revenue growth due to the acceleration of growth especially in recurring and transactional revenues.

Turning now to the result of the Management dimension on Slide 9. The recurring revenue grew organically by an impressive 24% year-on-year, surpassing the previous record of Q3, an important part of this performance was in SaaS management, which grew 37% year-on-year in Q4 as can be seen in the chart in the center of the slide. This acceleration resulted from yet another new all-time high in the organic net addition of ARR of BRL238.3 million, 3x higher than the net addition of Q4 of 2020 and 68% higher than that of Q3 that you can see on our slide.

With this, the ARR Management surpassed the BRL2.8 billion. This expressive growth in ARR was possible mainly due to the evolution of sales volume made up of new signings, which accounted for approximately 63% of the addition of the quarter and the remaining 37% was due to the price effect resulting from price adjustments and maintenance and low levels of churn. As you can see by the high renewal rate of over 98%, which have been constantly presented.

And now moving on to Slide 10. The contribution margin of management overcome the BRL400 million in Q4, whereas the contribution margin over the net revenue grew 130 points for the same period. And in the year, the contribution margin overcame BRL1.5 billion, reaching 220 points, as the percentage of net revenue. And this increase in efficiency which is translated into the advance in the contribution margin happened because of the recurring revenue and the gross margin, as well as the lower provision level for the expected loss.

And now moving onto Performance Business in Slide 11. As shown in the graph on the left side, the net revenue for the quarter grew 35% vis-a-vis Q4 2020, with the same comparison basis and that was led by the 38% increase in the recurring revenue, which was capped above 97%. Dimension ARR shown on the right side of the slide closed the quarter with BRL268 million, 43% above the fourth quarter of 2020 in the same comparison basis, with a net addition of ARR of BRL17 million below. So -- and that was motivated by typical seasoning factors.

And then in RD Station, the highlight was for CRM product which had its net revenue in the quarter grew 112% when compared to the fourth quarter of 2020 and has gained more traction and representativeness that combined to client retention, especially when combined to RD Station Premium. I highlight that CRM will be the first product -- the first RD product where we will have a pilot using the Sales Machine.

And then in Slide 12, the Contribution Margin of the quarter's dimension was 52%, 300 base points above the same period for the previous years, 480 points above the Q3. And this performance is due, especially to the scalability of the SaaS model and this has to do with the contribution margin of the dimension, which had an expansion. And then in Slide 13, as we can see in the graphs on the left side, the credit production of Supplier grew 36% year-on-year with similar levels to the record of change in Q3. The credit portfolio grew 39% year-on-year. And then in the graph above it, we can see the net Techfin revenue of funding of 48% year-on-year and 35% quarter-on-quarter and that reflects a combination of production growth and cash optimization in the Supplier operation for the quarter. The greater representativeness of the Supplier portfolio when compared to the overall was motivated by a decrease in the FIDC aiming at optimizing cash and Supplier floating reducing excess funding and its associated costs.

I highlight that the Supplier portfolio has the same credit portfolio that was given to FIDC. Now, the default rate, which is greater than 90 days of the Supplier as observed in the lower graph in the middle of the slide ended the quarter with 0.8% and 70% below the average in Brazil. Once again, showing discipline in granting credit and resilience of the business model.

In addition, Techfin products reached 926 clients and that is showing in the graph. Credit production of these products range BRL284 million, a growth of 40% when compared to Q3.

And then finally in Slide 14, a greater efficiency in the use of capital with a reduction of the average cash available and an increase in the credit portfolio in Supplier led the Techfin contribution margin on the Net Revenue of Funding to close the quarter at 66.4%, 170 basis points greater than Q3. And then normalizing the impact of the Selic increase in Funding Cost as we have done in previous quarters.The Contribution Margin grow 180 points in the same period, the provision for the expected loss represented 0.21% of the credit production in the quarter and that's within the Supplier historic.

I would like to reinforce that we continue evaluating alternative funding sources that may allow better efficiency to the operation in any scenario, despite the current structure, which is centered in FIDC having allowed a significant expansion of the return on ROE. And now, I will turn it over to Dennis, so he can talk about ESG in Slide 15.

## Dennis Herszkowicz {BIO 17998338 <GO>}

Well, thank you Maia. ESG is a premise of our business. We continue engaging our stakeholders and TOTVERs in it. And in this period, we had an important advance which was the renewal of the Business materiality in matrix defining ESG priorities for TOTVS for the next two years. We also highlight in -- I am sorry. This pillar, the comment of the debate on the expansion of the dissemination of data related to greenhouse emission gases as a next and important step complementing indicators and environmental practices that we have already informed in our annual integrated report.

In the S pillar, the care with human capital is our priority. Our Engagement Survey demonstrated that 94% of TOTVERs are happy with the autonomy and 95% believe in TOTVS's future. With high levels of our ENPs. And we have advanced in diversity and inclusion, mental health, and flexible work. In education, we continue investing in the training and generation of opportunities for youth.

And now in Slide 16, as a final message, I would like to highlight that we see TOTVS as a company with a unique capacity of transformation. We will continue managing with flexibility and balancing the different dimensions of the business in different moments and mandates giving a highlight to youth culture with ambitious and creative cultures. In the Management dimension, I highlight that this was the third consecutive year of two-digit growth with 30% of SaaS coming from new names even with the very important leadership in the European market, which reinforces that this is not a mature market and it is in expansion.

In Business Performance, we are convinced that this is a high potential dimension and we will continue investing in it. Our main objective is to revolutionize the offer of Financial Services becoming the financial platform for small and medium-sized companies, expanding our portfolio with personalized products, which are more competitive, facilitating access to the services by means of integrated solutions based on Big Data.

For 2022, we will remain focused in our growth journey. In our transformation journey, we have seen consistently that companies are going after new technologies or and want to expand and recover investments to accelerate digitalization processes. So, in looking for strong partners with a capacity to provide solutions to their main problems, which will enable them to keep a focus in the core business becomes even more relevant especially among small and medium-sized companies.

TOTVS, is a great beneficiary of this scenario. The future is interconnected, interdependent and we will continue investing to become the partner that our clients know they can count on. Our partners will deliver value proposals and we will help them improve their performance. In other words, we will become the trusted advisor of our clients. We know that it's not simple, it requires investments, structure, sophistication and M&A capacity, things that only TOTVS can offer. That's why we here to improve the results of companies; always believing in what Brazil does. We are now available for the Q&A session.

# Questions And Answers

## Operator

Ladies and gentlemen, we are now going to start our Q&A session for analysts and investors. (Operator Instructions) Our first question comes from Bernardo Guzman.

## Q - Bernardo Guzman {BIO 5788014 <GO>}

Good morning, everyone. Thank you for taking my question. Actually I have two questions. First, on the business -- on the core business which call attention for the first quarter. Because we have important volumes in addition to prices, I wanted to better understand the client profile to justify these new services. And then I have another question. You recently informed two smaller purchases and I wanted to better understand these opportunities that you can see in service software for the financial sector, we can see that this will move on later on and does it make any sense in regards to the market?

## A - Dennis Herszkowicz {BIO 17998338 <GO>}

Well, thank you for the question. Good morning. Regarding our growth in Management, our growth was diversified above all. Once again, it happened throughout the year, not only in the quarter, and this is very positive. There are different sectors different client profiles that have led us to this growth. I wanted to highlight a few aspects; number one in terms of client size, we have two dynamics going on at the same time here. On one side, we have more and more cloud migration and the total cost of ownership is going down. And this has to do with Cloudification, SaaS utilization of our actions which makes implementation costs more accessible with a larger number of companies. So we have that and that has a impact on that new names as we call them.

Their average ticket has gone down consistently and it only shows this capacity to reach a smaller client profile. But we remain with a good capacity to sell new projects, expansion, cross-sell, up-sell which is also a bit higher. In terms of profile, these are the main dynamics. In terms of the segment, we have a diversification as I mentioned. But I would like to highlight education, which had an important recovery in the end of the year and logistics sectors and also Agri business which remained strong throughout the year. So this is the answer to the first question. In the case of Dimensa, well I think that it's important to highlight that Dimensa's capital and its resources for investments, including M&A are separate from TOTVS. When we had our follow-on for last year, this is the resource where TOTVS can have its M&A strategy when B3 invested in Dimensa and became a shareholder of that BRL6 million.

The resources available to Dimensa and they are independent from TOTVS. And yes, Dimensa has evolved quickly. I can assure you that it's going faster actually than we had foreseen for this period, which is very positive of course and we do expect Dimensa to continue making other transactions, expanding its portfolio which is the main objective here. About the possibility of better results, larger clients, yes that's always a possibility that we evaluate. Dimensa's pipeline has large things, medium size possibilities and some smaller ones, but they add a lot of value to us as well.

## Q - Bernardo Guzman {BIO 5788014 <GO>}

Thank you, Dennis.

## Operator

Our next question from Marcelo Santos from J.P Morgan Bank.

## Q - Marcelo Peev dos Santos {BIO 20444938 <GO>}

Good morning to everyone. Good morning, Dennis, Maia, the IR team. I have two questions here; number one, could you comment on the Business-to-Business performance. It is strong, but there is a sequential acceleration during Q4. Is this regarding a different seasonality that came from last year or some type of integration. Could you elaborate on what to expect on this business on the upcoming periods, you had a lower marketing expense, lower than what you would expect during Q4. Is this because you have a better NPS and you have a stronger brand therefore, you will need lower marketing expenses from here on or was this something very specific all of your quarter?

## A - Dennis Herszkowicz {BIO 17998338 <GO>}

Okay. I am going to start and then Maia can elaborate a little bit more on this matter, if he feels it. Now, regarding our Business Performance, mathematically there was a slowdown in our year-over-year from Q3 to Q4. Nonetheless, this slowdown took place mainly in Tail. It wasn't in RD and Business Performance joins three different businesses. RD from one side that would be the main business of this dimension. We have Tail and we also have digital commerce that currently is made up by our JV with VTEX. So when we break out these three components, the slowdown was in Tail. And this is something that is normal and that is expected. Q4 presents certain seasonality in Tails results, and I believe that we will see a quick recovery in Tails figures. Therefore, we do not see any type of concerning trend within our -- within the Business Performance dimensions, especially when we see RD. Now, obviously we have to be a little bit careful because 2020 was a very a typical year in everything. So even, in a business that has a strong recurring present like that of RD, well, the first semester of 2020 presented sales, production and an addition of ARR in RD lower than average. So this was the peak of the beginning of the pandemic. The second semester was the other way around, there was a strong acceleration in ARR connected to -- something connected to the second semester and of course this was a recovery of what should have happened during the first semester. This is why the year-on-year comparison when we compare the first semester to 2021, the closest to the beginning of the year, the lower the rule of comparison and at the end of the year the greater the rule of comparison. Therefore, there is nothing that concerns us here and we also would like to say that RD ended the year with BRL220 million in revenue that was BRL14 million above, we had planned when we carried out the acquisition. Therefore there are no concerns regarding this point. Now regarding marketing, well, quarter -- when you annualize quarter-on-quarter and it's difficult to control how much you are going to allocate, but 2020 and 2021 presented a lower marketing expenses because we didn't have universe, that is an important event where we dedicate a lot of marketing investments. In 2022, Universe is plan to come back, something that will be extremely beneficial and positive, but yes, you are right when we see a record NPS level and it has been record quarter-on-quarter, when we analyze the positioning and the freshness of the TOTVS brand in the past years, all of this contributes towards a better assessment of our investments. Now, we have to be careful because we don't want to run the risk of investing less than what we should invest and we are being very careful regarding this point.

## Q - Marcelo Peev dos Santos {BIO 20444938 <GO>}

Thank you, Maia. Thank you, Dennis.

## Operator

Our next question from Christian Faria from Itau BBA.

## Q - Cristian Faria {BIO 21795660 <GO>}

Thank you for taking my question and congratulations for the results. I have two questions. Number one would be regarding the new products of Techfin or consigned products and I would like to understand how -- I would like to understand about this result and during Q3, there was a strong result is there product that outstands in terms of evolution or that has presented a more homogeneous evolution? My second question would be regarding the cash margin, if you have a prospect of activating the RD and how can we see this from here on?

## A - Dennis Herszkowicz {BIO 17998338 <GO>}

Well, thank you. I am going to answer the first question and then Maia will answer the second question regarding Techfin. And also -- and the limit and not considering Supplier, this was an additional quarter of strong acceleration quarter-on-quarter, year-on-year. So the pace of the products that are organically created in TOTVS consigned, Connect Pay, better terms, all of them have grown at an accelerated pace. Most of them are growing above three digits and when you see the comparison base, well it's slow because these are new products and the main highlight is Mais Negocios, the consigned product has been successful with -- and our Sales Machine has been excellent. The amount of lives that we have is excellent but the main highlight goes to Mais Negocios. It is a product that has a longer sales cycle. It is a more sophisticated product nonetheless, when it runs inside the customer it has an origination of credit and the customer that demands no type of additional effort from TOTVS. So it has grown at an exponential pace and it contributes with our revenue something that we have to consider within Techfin and TOTVS. Now, regarding our effective cash flow. Well, by and large, it has been impacted by the amortization of the intangibles and the acquisition of RD now from the cash position point of view that affects the current cash, not yet this only happens when you incorporate the entire company therefore, in our short-term view, we do not expect this. There are number of other past acquisitions that will have to undergo through one of these processes and there is a certain pace in order to see the tax effects. For the time being no, credit is preserved and it continues as it is and we will continue with other acquisitions and other acquisitions and in the future perhaps we can assess this point.

## Q - Cristian Faria {BIO 21795660 <GO>}

Okay, thank you. Maia. Dennis, just a follow-up to my first question regarding sales, could you elaborate On the development of your franchises?

## A - Dennis Herszkowicz {BIO 17998338 <GO>}

Yes, yes, I can. Well, this is an ongoing process at a very good pace. 2021, by and large was a year full of tests, lots of pilot projects, and we have strongly evolved the amount of people within our Sales Machine that are dedicated to Techfin is a significant amount of people and practically slightly less than 50% of these employees are already within the franchises. The performance here has been good and the consolidation throughout the -- throughout last year well, the consolidation of the franchises has helped us a lot because the investment and the sophistication when you manage a new dimension of franchises is benefited when you have a greater franchise with greater investment capacity therefore, this is positive Antecipa, Consignado, Mais Negocios has been very successful because we have our own teams, but I have no doubt, but in brief Mais Negocios will also present good results amongst franchises. Excellent. Thank you very much.

## Operator

The next question is from Leonardo.

## Q - Leonardo Olmos {BIO 21197412 <GO>}

Good morning, Dennis, Maia, TOTVS. I have a question on cash generation. This decrease and the fourth quarter, I think it's seasonal, but it is on receivables of BRL89 million in the Supplier area. When we think of 2022 and we are still getting used to Supplier's, because of the volatility of the situation and because of what happened during the pandemic. So how do we see cash generation, as a whole and also how do we see receivables and the credit portfolio? Thank you very much.

## A - Dennis Herszkowicz {BIO 17998338 <GO>}

It's important to mention that this more intense use of cash is related to two aspects. The first one is that we tried to reduce excess cash, especially in FIDC which is lower capital. And the Supplier has a positive cycle for cash conversion. We have receivables before we pay our partners and that generates a positive floating and with excess cash and FIDC, it ends up being very high. So, as you reduce cash, we can optimize a little bit more the use of floating and Supplier. So this perception of worsening is more related to cash optimization. It was already available in Supplier and as the operation grows, it grows together and we can use this positive floating and it plays in our favor. As we maintain this level of cash use at more efficient levels, this tends to normalize. But of course, in the kick-off, we have this impact because we are using the available cash but over time it will be normalized.

## Q - Leonardo Olmos {BIO 21197412 <GO>}

Okay. Very nice. So it will be at a higher level. Okay, thank you very much. I am not sure whether you have been asked this. You had a mild decrease in PDD, could you comment on it a little bit for example in 2022, we have a lot of things going on. So, what could we do in PDD if we have changes to other levels in 2022?

## A - Dennis Herszkowicz {BIO 17998338 <GO>}

Well, for the past few quarters, we have been indicated that it was running at much lower levels than where it used to. When we had the pandemic in 2020, provisions were reinforced because of the risk perception and the prevention or to default. So we capture this change in the scenario reinforcing the provisions and as quarters went by and these losses didn't happen, we reverted these provisions, especially for the second half of 2020 and the beginning of 2021. When it happened, when we had this reversion, it had an impact and B2B was reduced. But this is something that happened in the past. As this provision ends and as the Supplier becomes more flexible once again going back to the levels that we had established before the pandemic default goes back to levels that are close to the history, which operates in a range of 0.20% - 0.25% of our portfolio. So we had 0.21% for this quarter, which is actually very close to the lower limit of this range. I think that within this range, 0.20%, 0.25% this is a normal level when compared to our history and eventually PDD, what could lead PDD outside this range is if we have any abrupt change in the market. And as it happened in the pandemic and then we review limits, we are more careful, strict and then PDD will start running at lower levels. And that is kept within this range. This is how I see it.

## Q - Leonardo Olmos {BIO 21197412 <GO>}

Okay, very clear. Thank you very much. Regards to all.

## Operator

Our next question is by Fred Mendes Bank of America.

## Q - Fred Mendes {BIO 22302086 <GO>}

Good morning. I have two questions. The first one is on the BBL [ph]close to BRL40 million. It's more got to do with the understanding unless inflation rates go down significantly and then we have an increase and the recurring revenue or if the churn increases, the recurring revenue should be accelerating in the third quarter. And then regarding Techfin. We had an adjustment. This is macro data, But in the mid and long-term, when we look ahead and we see that credit will remain growing 40%. Do you think that the main bottleneck is the addition of new clients or is it funding eventually obtain funding and then if size is the same eventually, we could have improvement but I wanted to understand this in the long-term. Thank you very much.

## A - Dennis Herszkowicz {BIO 17998338 <GO>}

Thank you vert much. Fred, I hope you have a good day. Regarding ARR and the math accounts, it's like what you said, as inflation rates apparently are not going down. unfortunately, yes mathematically speaking there is a good possibility for this recurring revenue to accelerate even further. I remember that when we were closing the year, we had some events that took place and conferences and other meetings. I said that TOTVS's business model when we have this level of recurrence and when we report this ARR vision except for what you mentioned with eventual churning peaks, which are very rare from one quarter to the other, in the next quarter or even two or three quarters later they are basically already given So yes, the fact that we reached BRL230 million in ARR addition which was 3x higher than what we had in the fourth quarter of 2020. This is amazing and it is an excellent sign that 2022 is going to be a good year. Our expectation at least right now is very good. Regarding Techfin growth. Taking into account, the elements that you mentioned such as new clients, funding and so on and so forth. What I can tell you is the following: We are in the beginning of our Techfin work. Even though, it already represents a lot to us, especially because of those Mias purchase, which is growing fast. Our ambition is significantly higher than what Techfin delivers today, that's why we believe that we are in the beginning of our journey. And this means that it's very likely that we will need to have a series of other elements in addition to the elements that we already have today so that we can reach this ambition. These new elements involve new funding modalities that's something that we work with on a permanent basis. The product portfolio is growing. The use of data is extensive and deeper distribution channels. Also, we have a additional ones. Our ambition is significantly higher than what we already have today, which means that, yes, we will need to have other elements, but we have worked on a daily basis, so that we can materialize these new elements and so that we can include these results

## Q - Fred Mendes {BIO 22302086 <GO>}

Well, thank you very much. I have another question and Business Performance. It was according to what you had estimated when you mentioned the purchase, but I want to know where you are at right now? Are you going to leverage in TOTVS Sales Machine, are you obtaining good results, or is it in the very beginning, basically RD? So I want to know how this integration is going on, so that you can leverage it. Thank you very much.

## A - Dennis Herszkowicz {BIO 17998338 <GO>}

Well from a numeric point of view, this is all for the time being. The results you see in RD, they are BRL220 million in revenue. They are organic results and so, we do not have a single set coming from this synergism with the Sales Machine. But as we mentioned, we are preparing the first pilot, it's already running actually in our hotel verticals. But we have a larger scale CRM and this is beginning just now. Throughout 2022, I believe that we will start having the expected contribution. A growing contribution in terms of numbers in RD. So on one hand, it is zero. On the other hand, we are already very close to start having an impact in the numbers and in results.

## Q - Fred Mendes {BIO 22302086 <GO>}

Very clear. Dennis, and thank you very much.

## Operator

Our next question is from Diego Aragao from Goldman Sachs.

## Q - Diego Aragao {BIO 17889908 <GO>}

Good morning, Dennis and Maia. And everyone, thank you for taking my question. The first one is a follow-up regarding the new customer question, not only the impact on Q3 but throughout '21. What about the incremental margin of these customers in your base considering the different profiles. And what will the margin be throughout the time? This is my question.

## A - Dennis Herszkowicz {BIO 17998338 <GO>}

Good morning, Diego. And thank you. New customers -- software customers, by and large new or old especially new customers, they present good profitability. I always joke and say that the marginal cost of one additional BRL of recurrent margin in a company of like TOTVS doesn't come close to this. The margin acceleration throughout the year comes from the growth of our recurrent revenue. The gross margin of the recurrent revenue is of 80%. So these new customers present a margin throughout their lifespan that is extremely positive. The lifetime value of this customer is good as I mentioned. With the drop of the TCO, we have been working with a lower profile of customers, but with these customers, we still do not know what will be -- or how long this customer will remain with us. The rest of our base is a base that presents an average of permanence that is a decade and it's not greater because most of our customers have been our customers for less than a decade. So if the new customer, a slower cost -- a smaller customer if they remain the same time with us, there is no reason to believe that this customer will present a margin different from the other customers, which is excellent news. Now, if it is a customer and because it is small and if it remains a significantly different period of time which differs from the base, well here perhaps, we will see a difference in the margin that the customer delivers. This doesn't mean that it's not going to be positive but perhaps it will be lower if the customer remains with us for a short period of time. But nothing is showing us that this will be different from our general customers. For example, let us see the variation of types of customers. I believe that they have, if things have been very similar. And I believe that the second question.

## Q - Diego Aragao {BIO 17889908 <GO>}

And I would like to follow-up on last question, I would like to know what percentage of your customer base could have access to these new products. Let us say a scenario where they can press a button and contract certain products through their control panel, what percentage of your customers could have access to these products and if you could compare this to what happened like a year ago. How do you see the evolution of systems platforms?

## A - Dennis Herszkowicz {BIO 17998338 <GO>}

Well, Diego, today or currently after two years of working intensively, we believe that we will not only have one way of contracting Financial Services, this dashboard is an essential product for us or service for us. It will continue being the main gateway for customers to higher financial services, but it will not be the only gateway. I will give you a practical example, we have focus so HR -- we want HR to become a contract gateway for the consigned customers together with the companies that sign contracts with us. And there are other initiatives, we are creating a pilot for the data product. And here there is a button within the product, it's not a financial dashboard where the data customer can simulate. Certain financial products and they anticipate this as one of them. So we have broadened the amount of customers very rapidly more than 50% of our customer base is enabled and prepared to contract financial services and this will continue growing, especially because we have broadened the amount of contact gateways or possibilities so that our customers can have access to our products and the other important factor is the number of products, as I answered to Fred. We still believe that our portfolio is a relatively small portfolio. In a number of years, our expectation is to have a portfolio significantly bigger and each product may demand, may require a contract access gateway that is a difference.

## Q - Diego Aragao {BIO 17889908 <GO>}

Thank you, Dennis.

## Operator

Our next question from Mr. Marchin, Citibank.

## Q - Unidentified Participant

Good morning. I have two questions regard -- One, Supplier. I would like to understand what you expect in the long-term? Will you give preference to FIDC? And the second question, if you could update the M&A pipeline that you have, what can we expect? This would be my questions.

## A - Dennis Herszkowicz {BIO 17998338 <GO>}

I would just, your first question was, I couldn't understand the volume was low. You asked about the future prospects. If we will still focus on the FIDC. In the long-term is to give priorities to FIDC. Okay. I am going to answer the first question, then Maia can answer the M&A question. FIDC is still an important source for us. FIDC as any funding source is not perfect. So at given moments, during certain situations can create imperfections. For instance, when you are at a strong pace of growth and when you have a higher level of volatility, that is something that happened since the beginning of the pandemic, you have more in efficiencies in FIDC than what is standard, because you have to raise the resource before the resource is still just being remunerated and it takes some time to put it in production and to become a portfolio that eventually turns into revenues above with the exception to these moments or of higher volatility. FIDC is an excellent funding source. And this is so that Supplier has been using it for the past 20 years so FIDC will continue being important for us. It is no longer the only funding source that we have and probably and as FIDC is the main source, I believe that it will lose its relevance in the future, which doesn't mean that it will not continue being the main funding for us, today it has a 100% relevance and perhaps in the future, its relevance will be lower, but it will be something that will be constantly use in the credit model that we use at TOTVS.

## Q - Unidentified Participant

Perfect.

## A - Gilsomar Maia Sebastiao {BIO 16400533 <GO>}

Now, regarding your second question regarding the M&A pipeline, what I can say is that we have made progress in our pipeline. In all the final stages the mouth of the funnel has been broaden that would be -- the mouth of the funnel, it would be the new opportunities. We have focused on filtering, all of these opportunities to really focus on the ones that make sense. We have made progress in a number of opportunities and a few of them, we already have a memorandum of understanding signed. This is a positive signal from the M&A point of view because this according to our history when we reach this level, the conversion level is high. So this is what I can say for the time being. M&A is only materialized after you sign the contract, you cannot say anything until the last moment. So our focus is to make deals that strategically makes sense for us. Fortunately, we don't have a VAR in our M&A because if we would have this we would even have to wait more. So, we do not have the VAR.

## Q - Unidentified Participant

Thank you.

## Operator

Our next question is from Victor Credits [ph]

## Q - Unidentified Participant

Good afternoon. Dennis. Good afternoon, Maia. I have two questions. The first one is, we can see that volumes represent 2/3 of ARR addition. It's important to understand how it contributes to volume in terms of recurring revenue year-on-year, and also why it has a higher impact? Question number two, related to Techfins. The growth was higher than the volume growth, do you think that will remain like this or in the long-term, will these stabilize? Thank you very much.

## A - Dennis Herszkowicz {BIO 17998338 <GO>}

Well, thank you, Victor. Regarding ARR growth and ARR addition and its impact on our revenue and the difference between volume and price. In ROE, there is always some delay, because ARR addition and its transformation is not instantaneous. It's fast but it's not immediate. It's very similar. I do not have an accurate number here, but over time when you look at it, instead of looking at the quarter, if you look for at the whole year, it's basically the same. So you can consider that what we show in ARR addition is for a 12-month period in ROE, as well. Regarding Techfin revenue, you are right, we had an increase in the nominal SElic and then the revenue ends up being higher, even though the spread does not necessarily go up. It is more or less stable, but the total revenue does go up. If you think of it, some months ago, Selic was below 4%. I don't remember why, but it was, it was two, and it's crazy to think that churn now it's 2-digit, a huge increase and revenue follows that. The Suppliers rates are before and after. They have a CDI plus something when the loan is granted, of course, you block the nominal number but it follows this increase in Selic and as CDIs stops moving then of course this trends to be a little bit more moderate in terms of revenue growth. As your revenue goes up, if your spread does not necessarily follow it, which is normal, your margin is compressed a bit. The other way around happens when you preserve your spread and the revenue does not go up artificially because of an increase in Selic and then the margin tends to improve so all this have to take into account, these two different sides related to credit. When the rate is going up, you have a benefit in revenue but not necessarily the same benefit in margin. And when this goes down eventually, you have some impact on revenue. But that's compensated by a positive impact in the margin.

## Q - Unidentified Participant

Perfect. Dennis. Thank you very much.

## Operator

(Operator Instructions) We are now going to end the Q&A session. I now turn over to Mr. Herszkowicz for his final considerations. Please move on.

## A - Dennis Herszkowicz {BIO 17998338 <GO>}

Well, I wanted to thank you all for your participation in this call and I also wish you an excellent day and end of the week. I hope that 2022 is even better than 2021. Thank you very much.

## Operator

TOTVS Teleconference is now over. We thank you all for your participation and wish you a good day. Thank you for using Chorus Call.