

## Q1 2019 Earnings Call

### Company Participants

- Dennis Herszkowicz, President
- Gilsomar Maia Sebastiao, Chief Financial Officer, Investor Relations Officer and Member of the Executive Officers Board

### Other Participants

- Fred Mendes, Analyst

### Presentation

#### Operator

Good morning and welcome to the TOTVS conference call to discuss the results of the first quarter of 2019. We have with us today Dennis Herszkowicz, the CEO; and Gilsomar Maia, the CFO. (Operator Instructions)

The audio is being simultaneously webcast at [ri.totvs.com.br](http://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 on 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. Dennis, who will begin the presentation. Mr. Dennis, please go ahead, sir.

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

Good morning to all. Thank you for participating in our conference call. First, I want to express my satisfaction with the results and to thank all TOTVERS for them. We will start our presentation on Slide 3, where we mention our positioning as a TECHFIN and why TECHFIN instead of fintech? Because we are a company that has and will continue to have technology and software in our DNA.

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We will not become a financial institution. For us, the debt of the long-term relationships already established with our clients is a key differential that enables us to expand our current scope of operations, advancing in the value chain or/and adding financial services. We are structuring ourselves to create innovative solutions that combine TOTVS' technologies with that of partners in order to simplify and expand clients' access to credit and financial services in general, while making them more affordable as well.

As an example of this, we hired Eduardo Neubern as Head of the fintech operation. Eduardo has vast experience in this market, having worked in companies such as Cielo, Mastercard, and American Express. The positioning as a TECHFIN, reinforces our strategy of creating new markets that will always be connected to the core business of software. That's the message we provide to our team: "Technology first, always." To successfully execute this strategy, focus is essential. That is why we decided to sell the hardware operation.

And yesterday, we signed a binding memorandum of understanding with ELGIN regarding the operations in Brazil.

I now hand over the presentation to Maia for his comments on the quarterly results, starting from Slide 4.

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

Thanks, Dennis. Good morning, everyone. This quarter was important to show the acceleration in the company's revenue growth. For the first time, we surpassed BRL 400 million in recurring revenue in our quarter, reaching BRL 416 million, which corresponded to 74% of total revenue. As the chart on the right shows, the year-on-year growth in recurring revenue reached double digits.

This was the key factor that led total software revenue to grow from 3.2% in Q1 '18 to 8.6% in this quarter. Note that this growth is purely organic and reflects among all the factors the competitiveness of solutions offered by TOTVS, which is evident from the net addition of the annualized recurring revenue shown in the chart on the left on Slide 5, which totaled BRL 33 million this quarter. Another factor that contributes to this recurring revenue performance is the loyalty of our customer base, as evidenced by the renewal rate shown on the chart on the right, which closed this quarter at 98.1%.

And considering that software is by nature a scalable business, the acceleration in software revenue growth combined with disciplined cost management led to 7.9% year-on-year growth in adjusted EBITDA, shown on Slide 6, which totaled BRL 104.4 million in the quarter. This EBITDA resulted in an adjusted margin of 18.5% despite the provision for bonuses of BRL 13.5 million higher than in Q1 '18. Note that the EBITDA and margin amounts do not include the positive impact of BRL 10.4 million from the adoption of IFRS 16. Including this impact, EBITDA totals BRL 114.8 million in EBITDA, margin comes to 20.4%.

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Moving to Slide 7, we see that adjusted net income grew 32% and 27% respectively, quarter-on-quarter and year-on-year. This performance mainly reflects the growth in adjusted EBITDA in addition to the reduction in net debt, which I will comment on Slide 8. This quarter, net debt decreased 47% from fourth quarter '18 and 90% from first quarter '18, remaining at 0.1x of last 12 month's adjusted EBITDA.

This reduction in debt, despite a 45% drop in free cash flow, resulted mainly from the increasing working capital on account of the increasing trade receivables, since sales and quarterly closing fell on a weekend in addition to the increasing prepaid expense at the start of the year, and also the increasing income tax and social contribution payments due to a tax rule that does not allow the offset of federal tax before complying with some ancillary obligations that will occur in the second quarter of 2019.

Moreover, we consider the impact of IFRS 16, which increased net debt by BRL 235 million. Net debt corresponded to 0.7x EBITDA in the last 12 months, which is lower than the 0.9x level presented in the same period of last year, that didn't have IFRS 16 placed.

I now turn the presentation back to Dennis for his closing remarks on Slide 9.

### **Dennis Herszkowicz** {BIO 17998338 <GO>}

Thank you, Maia. My closing message is a snapshot of the first quarter. We started 2019 with an acceleration of revenue growth based on double-digit growth in recurring revenues, total organic growth of over 8.5%. We expanded the scalability of business with an EBITDA that reached more than BRL 100 million and an adjusted EBITDA margin of 18.5%, even with the provisioning for bonus being BRL 13.5 million higher than 1Q '18, and the focus on software with the sale of the hardware operation. Finally, our positioning as TECHFIN so that we don't forget that TOTVS has technology in its DNA and will maintain its 100% focus on the software business.

We will now begin the questions-and-answer session. Thank you.

## **Questions And Answers**

### **Operator**

(Operator Instructions) Our first question comes from Mr. Fred Mendes, Bradesco.

### **Q - Fred Mendes** {BIO 17221617 <GO>}

Hello. Good. Good afternoon everyone, I have 2 questions here. I mean, the first one, in terms of the top line growth, just trying to get a better understanding, especially related to the recurring revenue growth that was way above what we had here. I mean, is this more related to acceleration of subscription sales and then already starting to see an impact from the, let's say, renegotiation or at least see some high pressure in the franchise that you started to do again in the beginning of the year or this is basically an improvement internal?

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I know that of course both helped, but just trying to understand what was the main one. So that'll be the first question. And then the second one related to the R&D expenses. Do you already have an idea about the profitability of each segment in order to analyze how you do the capital deployment on, let's say, on an individual basis of all of the 11 segments, I guess now 12 that you have?

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

Hi. Thank you for both questions. This is Dennis. Look, in terms of the recurring revenues, as you said, it is a combination of everything that you mentioned and a few more. But the most important aspect is the performance of the sales team. It's not only the franchisees, but our own team as well. So the performance in terms of sales of subscriptions which we start to charge immediately, this was strong across the board in terms geographies, in terms of segments, in terms of products.

So this was the main factor. And of course, churn is decreasing. So it's another boost that is immediate. So as long as we lose less, it is something that impacts the results immediately. Regarding the second question of R&D and the work that we are doing here in terms of understanding exactly what we have in terms of the segments, it is still a work in progress. We have not yet concluded the analysis. But we have advanced it. So today we have more visibility of what is what and where we are spending the money.

But more important than where we are spending the money is to understand how we are spending this money and the level of return that we are having on these investments. And in this front, it is still a work in progress. Right now, yesterday for example, I was meeting with Marcelo Eduardo, who is the Vice President responsible for the segment, and Apendino, who is the Vice President of Sales. And we are preparing, for example, a map of all the segments and subsegments in which we operate.

And we are doing a work -- we will do a work similar to the work that a portfolio manager does in terms of deciding where we are going to focus more. This is the beginning of the work for the budget of next year. Obviously, it is early, we are still in May. But we are already starting to work on where we are going to put our money and what kind of returns we expect from this. And obviously this kind of work will help us as well in terms of the M&A strategy. So you know that one of the pillars that we have is exactly to deepen our presence into the segments.

And this map of where we are and the capabilities that we have in each and every one of the segments and subsegments, not only in terms of offerings of products, but also in terms of the capabilities of the distribution platform, this will help us a lot in deciding not only the organic investments, but the future M&A as well.

**Q - Fred Mendes** {BIO 17221617 <GO>}

Perfect, very clear. Thank you.

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

Thank you.

## Operator

(Operator Instructions) Next question comes from Fred Mendes, Bradesco.

### Q - Fred Mendes {BIO 17221617 <GO>}

Okay, so if there's no more questions, if you just allow me a follow-up here. Just 2 more. I think the first one, especially on the fintech space, it looks like you're hiring new directors, of course, in order to explore new opportunities. So just wondering, as you, let's say, expand your team, should we expect an increase in G&A at least in the first -- in this initial period, let's put that way, in a more relevant way?

This will be my first question. And my second question related to the Material Fact that you published last week, confirming the possibility of raising procedures to complete the execution of a business plan. I'm not sure how much you can talk about and if you can talk about it. But in case you do, just any kind of visibility related to where you're thinking to focus the most, at least in a scenario where debt happens, where you see more opportunities to deploy this money? Of course, anything you can say would be great.

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

So regarding the first question related to Eduardo Neubern, and -- so we don't see them move as something that will change our cost structure. So it's really part of our organization here to bring people that can give us more capability to develop new markets. So we understand that we have conditions to absorb the restructure, not change the behavior of our costs here, okay, so far.

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

Fred, this is Dennis again. Look, regarding the Material Fact, there is not much that we can say in addition to what we put into the Material Fact. So as we have been saying from the beginning of my tenure here, M&A is back on the deck. So we have designed the strategy based on 4 pillars. And we are working to execute this. So the Material Fact simply states based on the news that got out at Brasil Jornal, simply states that, yes, the company has intention to have funds for the execution of the business plan. So that's the maximum information that we can give as of now. Of course, whenever we have more concrete facts, we will make them available to all of you.

## Operator

(Operator Instructions) This concludes the Q&A session. I would like to invite Mr. Dennis, for his closing remarks.

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

Well, I just want to thank you all for participating in the call. And to reinforce that we are working here very hard to keep the momentum and to try to accelerate even more the top line of the company. So again, thank you very much. Have a nice day.

## Operator

This concludes TOTVS conference call for today. You may disconnect your lines, have a nice day, and thank you for using Chorus Call.

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