

Y 2020 Earnings Call

Company Participants

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

Other Participants

- Frederico Mendes
- Marcelo Peev dos Santos
- Maria Tereza Azevedo

Presentation

Operator

Good morning. Welcome to TOTVS's Earnings Conference Call for the Fourth Quarter of 2020. Today, we have Dennis Herszkowicz, CEO; and Gilsomar Maia, CFO. We would like to inform that all participants will be on listen-only mode during the company's presentation. Subsequently, we will have a Q&A session for investors and analysts when further instructions will be provided. (Operator Instructions) The audio is being presented simultaneously in the Internet at ri.totvs.com.br.

Before proceeding, we would like to clarify that forward-looking statements made during this conference call that pertain to TOTVS's business prospects, projections, operation -- operational financial goals, our beliefs and assumptions of the company's executive Board as well as information currently available. They involve risks, uncertainties and assumptions because they refer to future events and depend on circumstances that may or may not occur. Investors should understand that general economic conditions, industry conditions, and other operating factors may affect the future performance of TOTVS and mainly to results that differ materially from those expressed in such forward-looking statements.

Now, we would like to give the floor to Mr.Dennis, that will start the presentation as of Slide 3. Please, Mr.Dennis, you may proceed.

Dennis Herszkowicz {BIO 17998338 <GO>}

Good morning, everyone. Thank you for being with us for the fourth quarter of 2020 earnings conference call. Finally, 2020 is over. I've heard this from many; a year that will remain in the history of each one of us and in the world where everybody had to reinvent themselves, discover strengths that they thought they didn't have, find solutions to

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problems never thought of before, unfortunately, with a lot of suffering and uncertainty, but it was also a year for resetting and union.

In this initial message, first and foremost, I would like to thank from the bottom of my heart all the TOTVERs, their families, our partners, and all those who helped the company to face and overcome this epic challenge. And to wish that, in 2021, you have more serenity, health, and why not also more achievements. TOTVS had a very successful year. Its financial and operational performance was well above what we imagined when the pandemic started. Since March, we have been preparing for the worst for a devastating scenario that included customer bankruptcies, default, churn, inability to sell, to implement and to service.

In addition, the acquisition of Supplier brought a new, unknown challenges during a difficult time. However, as Maia will demonstrate as of Slide 4, the strengths that brought TOTVS to the undisputed leadership position in technology and software for enterprises are reflected in its campaign, the Brazil that makes it happen, makes it happen with TOTVS. And this has become more real and stronger than ever. Maia?

Gilsomar Maia Sebastiao {BIO 16400533 <GO>}

Thank you, Dennis. Good morning, everyone. I'll start with the technology results. Our perception is that our customers are more resilient than the average Brazilian enterprises, amongst other reasons, for investing in first-line management software and having a level of control, planning and superior management sophistication, which has been proven. Our churn did not rise above the historical average at any time.

Effective defaults were also very close to the historical average. Our customers continued using our solutions and operated in an organized fashion with full support of TOTVS. As a result, we've reached a year-on-year growth in net Technology revenue of 10% in the first quarter and 8% in 2020. Such growth was driven by the expansion of a recurring revenue, which was 13.7% in the fourth quarter and 13% in the year, having reached almost BRL2 billion in 2020, and already representing about 80% of the Technology revenue.

We can see on Slide 5 that this expansion of recurring revenue is increasingly based on the SaaS model, which increase 21% in 2020, and accounted for 65% of the new sales in the fourth quarter. This performance combined with a renewal rate of almost 99% throughout the year, guaranteed solidity and predictability to the company's model even in an environment of great uncertainty. Our sales machine, even working remotely, proved to be stronger than ever, which is evidenced in the ARR net additions which totaled BRL300 million and led our ARR to surpass BRL2.2 billion in 2020.

Within this context, cloud was one of the sales highlights in 2020 with a growth of 31% in the fourth quarter and 27% in the year, which we see as fundamental for TOTVS's growth plans since the customers who use our cloud solutions are those that are best prepared to take advantage of the innovations we develop swiftly and as well to maximize the use of big data. In addition, the diversification of our portfolio also proved to be very important in 2020.

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It allowed us to quickly reprioritize, and thereby, take advantage of numerous business opportunities, including e-commerce with VTEX and also develop new Techfin products, as you can see on Slide 6. In the chart on the left, we can see that we have multiplied the number of customers by more than 11 times in 2020 using Digital Commerce platform of our operations with VTEX with 28% of this universe already in production, which has already reached level of volumes, GMV, which can provide scale to the revenue of this modality.

In the chart on the right, another highlight was the strong growth in the number of customers who already use our Techfin solutions, Consignado, EduConnectPAY, Mais Prazo, TOTVS Antecipa and Painel Financeiro. We see the evolution of these numbers as sign of the success of these solutions and that we're on the right track towards building a new Techfin and Business Performance ecosystem.

As we can in Slide 7, the revenue achievements I mentioned, combined to a strong cost management discipline have allowed us to increase the EBITDA in 24.6% in the quarter and 19.2% in the year. It is also noteworthy that between 2018 and 2020, the EBITDA margin in Technology expanded 630 basis points, further demonstrating the company's operational leverage capacity in an extremely challenging year as 2020.

Plenty of challenges were also faced in the Credit business in 2020. As we can see in Slide 8, after a strong V recovery observed in the third quarter, Credit Production continued its growth pathway and reached its highest historical level close to BRL2 billion as demonstrated on the graph to the left. This also resulted in an expansion of our credit portfolio, which reached levels that were similar to those observed before the pandemic, close to BRL1.1 billion.

And to face this growth in Credit Production, FIDC performed new captures in December, as we can see in the cash position on the left in Slide 9. Also, the graphs to the right have demonstrated a careful attitude adopted by the Supplier in credit concession from the beginning of the pandemic, which allowed us to keep delinquency in slightly lower levels than those observed before the pandemic. This protects our most valuable assets preserving a healthy portfolio history. And the behavior of the portfolio loss rate was not different.

All of this, as we can see in Slide 10, led the Supplier to close the year with EBITDA revenue and margins in the fourth quarter, very close to the same levels in 2019. In addition to these results obtained in an extremely challenging year, the business model was changed from a traditional to a Fintech model where the need of our own capital is significantly lower. This change led to new challenges for the Supplier, but also enabled us to increase the ROE in -- 20.3% in 2019 to 37.4% in the period that ranged between May and December 2020.

Also, we continually advancing in business integration and this has been translated into leads generated by TOTVS, which represent 35% of new affiliates.

And now, I turn over to Dennis.

Dennis Herszkowicz {BIO 17998338 <GO>}

Thank you, Maia. The result of all of this, as shown in Slide 11, was a growth year-over-year of 20% in the total net revenue and also in recurring revenue, including the Supplier in the fourth quarter with an EBITDA margin of 24%. In the concepts developed by analysts and investors, this balanced combination of growth and profitability results in a combination of 40 percentage points and is rarely observed, especially in a company that has been around for 40 years.

This is proof that TOTVS is a fantastic company with a unique capacity of transformation and adjustments to market opportunities. It is also important to highlight that the EBITDA growth also leverage cash profit growth year-over-year of 37 -- I'm sorry, 35.7% in the fourth quarter. And this included the effect of the 34% valuation. This also led to an increase of the cash profit of, as we can see in Slide 12.

As a final message, I'd like to highlight on Slide 13, the different advances we had in 2020. First of all, the evolution of our operational and financial performance, which reflects this capacity of transformation and adjustments where we had advances of 21% in our SaaS revenue and 25.5% in the EBITDA. The ARR broke records and grew BRL300 million, reaching over BRL2.2 billion. Only this additional ARR in 2020 would be enough to place TOTVS among the largest software companies in the country.

We reached close to 90% of the implementations that were implemented remotely where TOTVS services have become more intelligent and more accessible, which reflects the accelerated cloudification of our software and makes life a lot easier and faster. This change in the profile of services is essential and reflects the effort to exponentialize the permanent investment in innovation and digitalization has allowed us to provide quality products and increase the NPS.

We also expanded to new markets, generating more value in the production chain of our clients. Being there is part of TOTVS history. The advances has strengthened us and helped us turn our brand and our results into more positive outcomes. Our employees are proud to work here and 96% believe in TOTVS's potential. This has led to higher turnover and an increase of 20 percentage point in our employee rates. This has proved that we determined a proper strategy, which is essential to maintain long-term sustainability.

We also had an advanced in the ESG Agenda strategy. We have reinforced our role as an important technology player in Brazil in the development of a more digital, prosperous, productive, inclusive, and sustainable ecosystem in 2020. In face of uncertainties and challenges brought in by COVID-19, we have remained solidary, and as usual, determined to support our stakeholders. We have had over 2,000 IOS students and have created our Diversity and Inclusion Program. All of these initiatives materialize our commitment with the development of a business agenda based on ESG integration and best practices, as shown in our Sustainability Policy.

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Finally, TOTVS, more than ever, believes in a Brazil that takes things forward. Our business is more present on the day-to-day of companies. We are transforming Brazil into a more productive, efficient and innovating country by means of technology. TOTVS, more than ever before, believes in and Brazil, in its entrepreneurs and in clients, who have dared, just as we did, and have overcome obstacles.

Many of us have gone through the same process. In 2020, we were certain that technology is the main response for any company to survive. As the largest Brazilian technology company, we believe that TOTVS has a brilliant present and future. The awards achieved throughout the year, the acceptance into Ibovespa in early 2020 and also the MSCI indices in December 2020, among others, acknowledge important achievements. Our greatest challenge in 2021 will be to keep the same change and transformation pace.

The keyword in all of our discussions was agility, exponentialize, digitalize, cloudify were also essential keywords and they indicate the pathway for us to follow. We are working so that we can keep and expand TOTVS's relevance to all of our clients, helping Brazilian companies of all sizes and segments to be efficient and productive.

We're now available for the Q&A session.

Questions And Answers

Operator

(Question And Answer)

(Operator Instructions) Our first question is from Freddy Mendes with Bradesco BBI. Please move on.

Q - Frederico Mendes {BIO 19832788 <GO>}

Good morning, everyone. I have two questions. The first one is just I want to understand a little bit more about ARI, and the amounts for the last quarter. So I want -- you mentioned that you had an 11-fold increase, but I would like to know whether there is any larger representation? I have a technical question. I want to understand a little bit more about the gross margin. Of course, it increases as the business grows, but when you remove clients from on-premise and place them in the cloud, the same client will have lower margins, at least initially. But it sounds like you're more efficient in terms of support and I don't know whether this is true or not. Could you tell us a little bit about this, so that I can better understand this? I would like to know whether you can have a larger margin in the cloud as well? Thank you very much.

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

Good morning, Fred. This is Maia. I will start with your last question regarding the gross margin. I understand the intuitive aspect in your question. It's important to note here that we had significant advances as you mentioned in the recurring revenue. It has to do with

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the SaaS model sales and the cloud as we mentioned. And somehow this is associated to the decrease in the representation of the implementation business. It actually has a lower gross margin. So when we combine everything and over time as we advance with a SaaS model and these non-recurring services regarding planning station lose their relevance and I expand my recurring revenue, I can really gain scale gradually.

So despite your logic being correct, we do have this variable of implementation services. It is a positive effect and contributes for the overall results, as client expand their use and this is a constant challenge for those who work in the cloud we gain efficiency. Sometimes clients don't even realize this, but our team works constantly to provide cloud solutions, so that we can become more efficient. We use different new technologies such as the containerization and techniques that allow us to have a good cost experience balance. So, yes, it has been a good experience for us, as we expand our recurring revenues, this will improve our margins as well.

Now speaking about our ARR expansion was driven by cloud solution sales. The digital commerce solution has strongly contributed to this as well and human resources solutions as well. In addition to this, as we already stated, we had a very stable churn, in the past when as we mentioned, they have diminished the grace periods. We are very close to the levels before the pandemic, and as time went by, grace periods are expiring and we have a positive effect that this becomes revenue, and during the fourth quarter, we can clearly see the benefit of the contract readjustment that this is a sum of a number of elements.

Q - Frederico Mendes {BIO 19832788 <GO>}

Thank you. Very clear. If I could follow up on the ARR, naturally everything is very constant, because you have a greater base and as you have less grace periods, we believe that you will increase your revenue and be more productive and of course you will have growth?

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

Now the effect of the grace period is reflected on the revenue as we sold and open the window of grace periods. This gradually is part of our baseline and of our recurring revenues. Thank you.

Operator

Our next question from Marcelo dos Santos. JP Morgan. Mr.Marcelo, you have the floor.

Q - Marcelo Peev dos Santos {BIO 17186991 <GO>}

Good morning. Thank you for taking my questions. One, you use the Pink Paid from suppliers. Could you elaborate a little bit more on what this project is about? How much access do you have to your customers' information, the progress that you made after the last Investors Day? What is the roadmap for Pink Pay? And my second question regarding the TechFin services could you tell us -- how are you dealing with your services? So now, we've had one year of these products in the park it, could you elaborate with the performance of these products has been?

A - Dennis Herszkowicz {BIO 17998338 <GO>}

Thank you, Marcelo. Can I ask you -- I really couldn't understand your question. You said something about supplier and you said supplier twice, but we really couldn't understand what you were saying.

Q - Marcelo Peev dos Santos {BIO 17186991 <GO>}

My first question is big data, big data. You were talking about big data together with supplier and during the last Investors Day you spoke about the telemetry that you're having with big data and I would like to know what your roadmap is regarding big data?

A - Dennis Herszkowicz {BIO 17998338 <GO>}

Okay. Now I could understand your question. Now regarding big data in supplier, yes, we are broadening the use of it and the performance of supplier during and the post peak of the pandemic shows us how powerful transactional information as, when we see the level of recovery, how swiftly this has been recovered and the quality of recovery that we've had this is directly connected to the depth and the quality of the information that supplier credit models offer us. So you cannot preserve a loss index of 0.2% in a situation of maximum stress, like during COVID.

If you do not have a level of quantity and the use extension of this transactional information like supplier has, if you ask me if it is already using big data from TOTVS. No, it isn't we still have not reached this level. We will, but we're still not there. What it has done is it has used TOTVS technologies to have a level of access to the information of the affiliates. So it has more access, but mainly it has used the technologies of TOTVS to carry out a quick on-boarding process together with these affiliates. So if in the past it would take many times like six months to -- to run an affiliate with the support of TOTVS, we are dropping this period to a task, which is already something extremely positive. And this provides us an acceleration potential to the business, which is great. So this is a very relevant point that has been deeply explored by us.

Now regarding, your second question regarding the product like Antecipa, Consignado, they're performing fine. This is why we insisted in the including them in this release and we gave more color to the evolution quarter-on-quarter, quarter with these customers, the division between final and the credit products. Just to show you, that we are in an acceleration route was -- which is very important. And right now, the greatest concern that we have is not necessarily in terms of volumes of origination or revenue.

Now, we're concerned in guaranteeing an experience in terms of product, we wanted to be the best possible and we have strongly invested and have done adjustments as our customers show us the best pathway. And we want to guarantee as well to have the greatest number of users for these products. So this is why we want to demonstrate the ever growing numbers in each one of these products, because more than the origination.

The origination is a consequence of the number of customers that we have in the products. As we reach hundreds of customers, and we do know that we have 40,000

customers with the acceleration we haven't reach 1% of the total amount of TOTVS using our TechFin products.

Now, our focus right now, is in the combination between these two elements, which is experience in Antecipa and Consignado and both of them have made great progress throughout the year. But also the number of customers that became users of all of these solutions. Thank you very much.

Operator

(Operator Instructions) Our next question from Maria Tereza Azevedo. Maria Tereza, you may proceed.

Q - Maria Tereza Azevedo {BIO 16178885 <GO>}

Thank you for the call. Could you elaborate on M&A strategies? Or possible targets in terms of business performance and market digital marketing? Is there any space to buy these type of assets? Is this part of your strategy? And how do you see e-commerce and OMS evolving in your JB's? This would be my first question.

A - Dennis Herszkowicz {BIO 17998338 <GO>}

Good morning, Maria Tereza. As you know, we cannot comment anything specific about our target, any targets. But yes, we have stayed at and I will reiterate here. Yes, we want to go into business performance and this is a dimension that we believe -- that we believe that there are opportunities and this can complement our company. So there is no doubt that this is one of our focuses in terms of M&A. I really cannot go into details, but it is interesting.

What we were going to say, that went to the press will the only comment that I could make is that this demonstrates that we do have an amount of opportunities and variety in terms of segments and profiles and also in terms of sizes. I do remember that, that at the end of last year, there were some matters regarding, if there were major deals within the company's deck. And I would say that, yes. In our pipeline, we have potential deals that are potentially big there are medium size one and small ones like tail. So the variety and the diversity of all of these M&A opportunities is greater than ever.

And you also asked about VTEX, OMS and e-commerce. Little things are in progress. You've seen that we insisted in providing this disclosure things have sped up. And just like in terms of TechFin, our greatest concern is to guarantee differentiated experience to our customer and the greater amount of customers. We do know that there is a side that where we gain know how, so that the customer can evolve in their journey of omni-channel and e-commerce, and this is not a process that happens from day to night.

So we want to guarantee on one side this journey in a very user-friendly way. But we also want to guarantee a greater amount of customer and we managed this like a funnel. So we the mouth is big and then it starts funneling until the end the customer is operating and managing a JNV. And this naturally becomes a capture -- value a capture of revenue

and a capture of greater profit for us. This is something that we believe. What we believe that we will have more significant results in the upcoming quarters. For the time being the results are the -- in the number of customers.

Q - Maria Tereza Azevedo {BIO 16178885 <GO>}

Okay, perfect. And thank you very much for the performance during the year.

A - Dennis Herszkowicz {BIO 17998338 <GO>}

Thank you, Maria Tereza.

Operator

(Operator Instructions) As we have no further questions. We are bringing our Q&A session to an end. Now, I would like to give the floor to Dennis for his final comments. Dennis, you may.

A - Dennis Herszkowicz {BIO 17998338 <GO>}

Well, I wanted to thank all of you for your participation in this teleconference. I have ask to Maia, and (inaudible) For us to have video in our next session. This would be innovation for us. I wish you have a wonderful day, a wonderful year with a lot of calm, health and success to all of you and all of us. I would also like to take this opportunity to invite you all for TOTVS Day. It will take place on February 20, at 2 P.M. Brasilia time. And so it is a pleasure to invite all of you. I think we're going to have very interesting materials to share. We're going to have in-depth discussions. So once again, I thank you all very much, and wish you a wonderful year.

Operator

TOTVS teleconference is now over. We wish you a wonderful day, and thank you for using Chorus Call. You may disconnect now.

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