International Conference Call
Natura
2nd Quarter 2010 Earnings Release
July 23, 2010

Operator: Good morning ladies and gentlemen. At this time we would like to welcome everyone to Natura's 2010 2nd Quarter Conference Call. Today with us we have Alessandro Carlucci, the CEO; Roberto Pedote, the CFO and Helmut Bossert, the Investor Relations.

We would like to inform you that this event is being recorded and all participants will be in listen-only mode during the Company's presentation. After Natura's remarks there will be a question and answer session. At that time further instructions will be given. Should any participant need assistance during this call, please press star zero (*0) to reach the operator.

We have simultaneous webcast that may be accessed through Natura's IR website at www.natura.net/investor. The slide presentation may be downloaded from this website. There will be a replay facility for this call on the website.

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Natura's Management and on information currently available to the Company. They involve risks, uncertainties and assumptions, because they relate to future events and therefore depend on circumstances that may or may not occur in the future.

Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Natura and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I will turn the conference over to Mr. Alessandro Carlucci, the CEO. Mr. Carlucci, you may now begin.

Mr. Alessandro Carlucci: Good morning everyone and welcome to our earnings conference call for 2Q10. Natura recorded solid results in the quarter. Consolidated net revenues increased 24% to R$ 1.3 billion, while Ebitda grew by 32.2% to R$ 332 million for an Ebitda margin around 26%. We believe these numbers show that we are on the right path in terms of our business strategies and our management of the company.

In our Brazilian operation net revenue increased 24% to R$ 1.2 billion on 2Q and 23% in the 1H of the year, achieving R$ 2.1 billion. According to the Brazilian CF&T Association, in the first two months of the year Natura's market share stood at 23.7%, expanding by 90 bps from 22.8% share in the same period last year. Data for the months of March and April have yet to be disclosed, but we will pass information to you as soon as we receive it. As you can see, the CF&T market in Brazil is growing steady and we expect to continue amplifying our market share.

Factors explaining Natura's revenue growth include new product launches, the sales strategy adopted for commemorative dates and the expansion of the channel. Natura's innovations remain high with the launch of important new products which allowed the innovation index to stand at 68% in the quarter, slightly up from 64% in the same period a year ago. In 2Q we launched 38 new products, which combined with the products launched in 1Q brings the total number of products launched in 1H of the year to 52.

Of the various products launched in the quarter I would like to mention a few: first the *Kaiak Pulso* fragrance, which set record sales in the launch cycle of almost 2 million units; the Chronos line (our skincare line), which was completely reformulated with new packaging, a new sales structure combining age and skin types to ensure a better understanding by our consultants; and lastly the *Tododia Inverno* line, which features a line of six bath and body products and offers a innovative moisturizing solutions for the winter.

I would also like that in line with our strategy to continually reduce the environmental impact of our packaging we are going to use a green plastic. We recently announced a partnership with Braskem to produce the first cosmetic product with the packaging made of green polyethylene (which is also called green plastic). Made from sugarcane, a renewable plant source, this innovation will help to reduce the level of greenhouse gases. The green polyethylene will be gradually rolled out starting at the end of the year beginning with the *Erva Doce* refill.

Our consolidated sales channel expended by 19.2% in the quarter to reach over 1.1 million consultants. In our international operations net revenue in the quarter grew by 40% in weighted local currency to reach R$ 93 million.

The operation in consolidation (Argentina, Chile and Peru) registered gains with Ebitda of R$ 5.3 million in 2Q and of R$ 1.8 million in the first six months of the year. As you may remember, in 1Q this year we had a non-recurrent effect in those three operations, especially the earthquake in Chile and FX effect in Argentina.

Meanwhile the operation in implementation (Mexico and Colombia) posted loss with an Ebitda loss of R$ 6.4 million in the quarter, which compares with the Ebitda loss of R$ 14 million in 2Q09.

As already disclosed, we are implementing a strategy to increase the level of customization in our Latin American operations with a focus on innovations, sales model, the operation and logistics model and our corporate behavior and we are doing this to accelerate the growth and to be profitable in the region.

The sales channel in the international operations continues to grow at strong rates. In the period from 2007 to 2009 weighted growth was 36%. In the first six months of 2010 we reached 178 thousand consultants in our Latin America operations excluding Brazil for a growth of 28%. The number of relationship managers in all countries has stabilized at around 830, which means that today we have 213 Natura consultants per manager for growth of 28% on the previous year.

After comparing these numbers with the Brazil operation, where we have 900 relationship managers and 1,050 consultants per manager, we can say that our international operations already have an installed base of relationship managers of sufficient size to support growth in the consultant base over the coming years and help fixed-cost dilution.

We want to implement the Natura super consultant model – the CNO – in the Latina America operations adapting the model to individual cultures of the countries in the region and we expect to implement the model between 2011 and 2012. In the area of operations and logistic in Latin America excluding Brazil we have determined that we will outsource locally the production of a portion of our portfolio and we estimate we will work with partners in three countries.

By the end of this year we expect to outsource in at least one country and in 2011 we plan to expand the share of local production and the number of lines produced. We are not planning to build our own manufacturing plants outside Brazil; as I mentioned we are going to use outsourcing, third-parties.

Our corporate behavior is demonstrated in the region by the higher penetration of our sales in the product line *Crer Para Ver*, which currently stands at 12% and by the 14% contribution from products refills to our revenue. The coordination and execution of this strategy in Latin America is supported by the strong efforts to develop leaders in each country, as well as by the corporate team 100% dedicated to the Latin America operations that works out of the head office established in Buenos Ayres. This team is formed by executives from Brazil and other countries who have long experience in the industry, extensive knowledge of Natura and markets.

Lastly I would like to reinforce that we are confident in the continuous expansion of our business and markets in Brazil and in the various countries in Latin America in which we have operations. Those are the points that I wanted to comment for this quarter. I am now handing the call over to Roberto, who will present details on our financial results.

Mr. Roberto Pedote: Good morning everyone. In 2Q we recorded solid (inaudible 11:07) in our operation in Brazil and in our international operations. Consolidated net revenue grew 24% to R$ 1.3 billion, while Ebitda margin was 25.9%. The net income in the quarter was 14% higher than a year earlier due to the normalization of the effective income tax rate given the end of the goodwill amortization as we have commented before. The 1.6 bps improvement in Ebitda margin was basically due to productivity gains resulting from our logistics process and dilution in sales and administrative expenses, despite higher investments in marketing.

Gross margin decreased by 200 bps in the quarter in relation to 2Q last year. This gross margin compression was due to inventory losses due to the higher share of Mother's Day and Valentine's Day in sales and the negative currency impact in the international operations.

Inventories have already returned to the same coverage level as in the middle of last year and we are optimistic on the path of margins in the international operation and in our promotional strategy in Brazil.

I would like also to comment on our successful debentures issue in May this year. Demand exceeded the issue by twofold and we raised 350 million with a term of three years. Note that Standard & Poor’s (inaudible 12:46) a AAA rating to both Natura Cosméticos and the debenture issue. The transaction was made to lengthen our debt profile and today two thirds of our debt is long-term.

Meanwhile free cash generation improved by 70% between the two six-month periods, mainly due to better management of working capital. Inventories, as mentioned earlier, declined in the number of coverage days returning to the same levels as in the end of 2009.

Regarding improvements in the quality of service provided for our consultants, we are working to continuously improve the services by implementing structural measures to reduce the delivery time of products to final consumers. On this front in the next few months we will inaugurate two new distribution centers, one located in Belem and the other one in Uberlândia.

Closing I would like to comment that the Board of Directors approved ad referendum the annual shareholders meeting to be held the next year the payment of dividends and interest on equity for the first six months of this year in the amount of R$ 0.66 per share and which will be paid on August 11 to shareholders of record on July 27.

That concludes the main points I wanted to cover today. Thank you very much, let us go now to the question and answer session.

<u>Q&A Session</u>

Operator: Thank you. Ladies and gentlemen, we will now begin the Question and Answer session. If you have a question please press the star key, followed by the one key (*1) on your touch-tone phone. If at any time you would like to remove yourself from the questioning queue, press star two (*2).

Our first question comes from Mr. Reinaldo Santana from Deutsche Bank.

Mr. Reinaldo Santana: Hi, good morning everyone. I have two questions, the first one we saw increases in cost as a percentage of sales in raw materials and packaging in the quarter. You explained higher inventories and also negative FX transaction effect in the international operations; but I would like to know if in addition to this you saw any specific pressures in raw materials and what is the outlook for the second half of the year in terms of cost inflation?

And the second, in the past years Natura's number of SKUs have slightly deceased; but it appears that the new launches have increased this year. Should we expect a reversal of that trend in terms of SKUs? Thank you.

Mr. Pedote: Hi Reinaldo. Just to mention about the cost pressures, we do not see any important cost pressure looking forward that was not contemplated by our price increase that we have already done in the beginning of the year. As we mentioned there were specific reasons to reduce the gross margin in the quarter, but they are not structural reasons and we do not see any important cost pressure looking forward.

Mr. Carlucci: And Reinaldo, regarding the number SKUs, depending on the quarter and the cycle; because sometimes you have a launch of makeup, for example, with a lot of SKUs that increase a little bit, sometimes you have a launch of a fragrance that is only one. You are going to see some variations, but this is not a change in the strategy. We want to keep the total number of SKUs around 650 and 750, so in other words this is the level of SKUs that we would like to manage. But this is … we can see variation between the quarters, so this is nothing … it is totally normal.

Mr. Santana: Thank you.

Mr. Carlucci: Thank you.

Operator: Excuse me. Our next question comes from Ms. Andrea Teixeira from J.P. Morgan.

Ms. Andrea Teixeira: Thanks for picking up my questions again from the local call. I just want to ask something different about the international operations and I know you are not giving guidance on that business yet, but we see from what we spoke before the movement that you are looking at is the CNO implementation and also in your comments you said like 2011 and 2012 and also having local production.

These two movements one is probably going to increase your expenses a bit (which is the CNO) and the other one will likely reduce your costs from producing locally by third parties; the combination of both forces and the other initiatives to do the regionalization of the management team and all of that will likely worsen the margins?

Or in other words it is going to get worse before it gets better or you are still going to see improvement in margins because the local production will reduce your costs dramatically?

And if you can talk about like what you expect in terms of penetration of the CNOs improving your sales, in other words you are going to accelerate, you expect to accelerate growth in sales in the international operations in 11 or we should see the same kind of pace of growth which has already been very strong? Thank you.

Mr. Carlucci: Hi Andrea. We expect that in the beginning, in the consolidation of operations you are going to see better and better margins because they have already enough scale and the right size of sales force and structure. So we should expect better margins for the future, so you are not going to see something worse and then something better.

In the implementation operations where we feel needs to invest in the sales force and also in the brand, maybe you are going to see some investments in the next two, three years, because we need yet to reach the same kind of scale that we have already reached in the other countries.

And regarding the CNO implementation in the region, of course we expect that the CNO can accelerate the channel growth. That is why we are implementing and also we believe that we can dilute some fixed costs in the sales force as we saw in Brazil.

But you must not forget that when you grow a lot and you need to compare with a bigger size, a bigger base, so in other words if we keep growing the same Cagr that we grew in the last year this is a huge effort because we are bigger than we used to be three, four years ago.

So in other words we want to implement the CNO to accelerate the expansion, but keeping in mind the size that we have already today in the region.

Ms. Teixeira: Ok wonderful Alessandro, thank you very much.

Mr. Carlucci: Thank you.

Operator: Excuse me. Our next question comes from Mr. Joaquin Ley from Santander.

Mr. Joaquin Ley: Hi good morning everybody and thank you for taking my question. I have two questions actually, the first one is regarding the negative impact that you had on your gross margin due to, I understand, inventory losses. Could you please elaborate a bit more on that? Which product line is that? Do you think you have been conservative enough by marking down already those products internally or we carry the risk of seeing a complete write-off going forward?

And the second question is when you talk about the expansion of Ebitda margin one of the positives is more efficient logistics; could you provide us with some example about that please?

Mr. Pedote: Hi Joaquin. Just related to inventory, what we are talking here is when we do a provision for losses we have a continuous process here that we always evaluate all the products that we have in stock and if there are plans to sell them.

As we increased a little bit the stocks in the end of last year and we increased the coverage and the promotions in the end of last year to guarantee a very good Christmas, we had some products that were not sold in some specific lines - we do not open which lines – but what I can say is that generally it is through the portfolio.

And then what we do is that we every month and every quarter we do the provision for losses for these products that we do not have yet a plan to do something with them and this is a moving number like … it is not like one moment it happened; what we have this quarter is that in comparison to the same quarter in the last year we have an important increase in this provision and we expect that this provision will decline with a better process, with a lower stock coverage than we have today. Then we believe that this amount will decline to comparable levels as the previous year and even to lower levels in the future because we are doing a lot of things to improve the quality of this process.

The second question was about what is happening in the logistics. Basically one part is the orders through internet that today we have already 84% of all the orders from our consultants through Internet; the second part is freight - we have been renegotiating in the beginning of this year and end of last year the freight with several suppliers and we have important benefits from that. I think that so far these are the two main reasons for our improvement.

Mr. Ley: Thank you.

Operator: Excuse me. Our next question comes from Ms. Lore Serra from Morgan Stanley.

Ms. Lore Serra: Yes good morning, I actually have a couple of questions, let me ask one at a time. In terms of the gross margin question you were just addressing I think you mentioned in the earlier call that some of that was from kits that were not sold in the 4Q; does that imply that if you have written those off that in future quarters we should see gross margin benefit if you sell them?

Mr. Pedote: There are two different impacts here Lore: the first is that what we sell is that we have not kits, but generally speaking some promotions and some products that we made a higher provision for losses because we did not sell all the promotion in that specific line from one product and this is why we do a provision. In the end if you have a good plan to sell this we revert the provision; but this is the way we work.

The second comment is that we had a very good Mother's Day and Valentine's Day and then we sell much more kits than we were expecting and we were able to sell them and the kits they have a lower gross margin than the regular products and this was the effect versus the same period of last year, like the kits increased, the kits sales increase was higher than the average. That means that we have a mix effect in the gross margin in the quarter. These are the two different effects that we have specifically …

Ms. Serra: I understand that; but does the first one imply that if you recover … that you will recover some of that in the future quarters or not? … that is implying that your provision level on existing inventories may be higher than they need to be; is that correct or they were where they should be?

Mr. Pedote: They are exactly where they should be; but what happens is that next quarter we are going to see what are the products that … what are the plans that we have to sell these products plus what are the new products that we still do not have plans to sell.

This is the way, it is a moving provision. We expect that the net of this provision will reduce, because as we mentioned we had a much higher stock coverage last year that produced a position that is higher than that. Every quarter we have a provision for losses; but especially in 2Q it was higher we expect it to be lower in the following quarters.

Ms. Serra: Ok thanks and you have had a very high margin in the first half of the year, 25% your goal was 23%. A lot of that sort of excess margin versus your goal would come from your SG&A line and it seems to be coming from some of the things mentioned before like freight, logistics that are arguably sustainable.

So should we think about this year as a year where your Ebitda margin will be a sort of higher than your long-term average or is it reasonable to think that investment levels will go up materially into the second half of the year to cause that margin to gravitate more to your guidance level?

Mr. Carlucci: Hi Lore. First of all we are keeping the guidance of a minimum of 23% of Ebitda margin. In other words that means that could be a little bit higher or could be 23% - so it is a minimum.

And second you must take care because when you look a quarter sometimes you have a phasing effect especially in marketing and sometimes in project expenses. So probably in the next quarters we are going to spend a little bit more in marketing, little bit more and projects and that is why we are keeping the guidance of a minimum 23% of Ebitda margin that, again, could change a little bit, could be a little bit higher.

But we keep the guidance because we do not have any structural change, even though, as you saw in the last years, we are growing top sails; we are working hard to have productivity gains in the logistics area and those two effects are affecting positively the margin.

But reinforcing what we have been saying to you and to all the investors and analysts, we want to keep pushing the company to grow. If we have any opportunity to invest to grow the company we are going to do this. So this is the answer, I hope that that can help you.

Ms. Serra: Thanks and just last question: you are now at the point numbers where you a sort of elapsed the roll out of the CNO project and I understand that you have the capacity to grow your consultants a lot with the existing CNO rep.

But I wonder if you can give us any color on how difficult or easy it is for the CNOs to recruit additional reps and the pace of reps growth has been pretty extraordinary in the past year, but now I am just trying to get a perspective here or more of this program. Is it getting harder to recruit reps or should we continue to see that kind of absolute level of rep growth quarterly that we have been seeing in the last year or so?

Mr. Carlucci: Hi Lore. First of all it is important to remind that in this quarter we can compare the last quarter that was fully implemented the CNO. So we have … how can I say … a better comparison this quarter because in 2Q09 we were already operating with the CNO model fully implemented. So it is a better quarter to compare the channel growth.

And in other words what I am saying is that you have in the first 3 to 6 months a higher impact in the implementation, even though we expect that the CNO is still pushing this channel growth. We do not expect to see a decrease, a relevant decrease in the sales especially in this channel growth in the next years. It is not going to be the same of the first 3 to 4 months of implementation, but it is going to be high.

And you must remember that even though we still have space to grow with the actual CNOs, with the 9,000 CNOs that we have, the model allows us to open new groups of CNOs. So there is still room to grow using the CNO model.

Ms. Serra: Thank you very much.

Mr. Carlucci: Thank you.

Operator: Excuse me. Ladies and gentlemen as a reminder, if you would like to pose a question please press star one (*1).

Our next question comes from Mr. Celso Sanchez from Citigroup.

Mr. Celso Sanchez: Hi good morning, good afternoon. Most of my questions actually have been answered. Just to go back to the inventory question in terms of thinking about the trend picture in the last few years. I know it is a little bit choppy within quarters or within the year, from one quarter to the next there might be more absolute levels of write-downs than others.

But in general as a percentage of sales is the idea that, is the way of looking at that that a successful progression is to lower the inventory write-downs as a percentage of sales - which is what I thought would be sensible a few years ago - or is the thought now that the benefits from that actually are outweighed by the opportunity to have fewer stock-outs?

So if you have more stock-outs than perhaps you did in the past you lose more sales and the value of that loss is greater than the cost of carrying inventories that you might be writing down.

Is that a way to think about it or really is a percentage of sales we should see write-downs go down because that still is more important than the incremental benefit of avoiding stock-outs?

Mr. Pedote: Hi Celso. You are right with the logic that if we need to choose in any moment between sales and stocks we will choose higher stocks to guarantee sales and this is exactly what we did in the second semester last year because the tool that was available for us was to increase stocks in order to avoid sales losses.

What we mentioned is that we have a much more structured plan now in our planning system and we are doing huge investments also thinking about our forecast system and the integration of information in the way that we operate with logistics, that what we want in the future the first thing is to increase the service level and to deliver faster, to have a shorter cycle from the consumer perspective. This is what drives our main objective.

At the same time we believe that we can operate with lower stock coverage, because the way that we are putting together all the pieces of this architecture of our logistics and our planning system allows us to expect a decrease in the stocks as a percentage of sales - a gradual decrease, not radical - but we are in the direction to have a lower stock coverage, gradually lower stock coverage and a better service level that will avoid us to lose any sales due to the stocks.

Mr. Sanchez: Ok thank you.

Operator: Our next question comes from Ms. Irma Sgarz from Goldman Sachs.

Ms. Irma Sgarz: Yes hi good afternoon, thanks for taking my second or my question on this call as well. You referred in your earlier comments to the number of relationship managers in the market outside of Brazil and you mentioned a number of 830 there and the relationship to number of sales reps is something around 213 at this point, now it is around 900 or around 1,000 actually in Brazil that same number.

Are these numbers comparable when you think about the two models or do you think because you will be implementing a localized version of the CNO model we should think differently about this relationship between numbers of managers to number of sales reps? Thanks.

Mr. Carlucci: Hi Irma. I think it is a very good question and even though we are going to adjust and to localize some of the CNO model for the needs of the Latin America operations, I think the numbers are comparable. In other words, if you compare Brazil with Latin America, the other countries in Latin America you can see the potential of fixed costs dilution in the sales force and also the potential for growth. So even though they are going not to be the same I think you can compare those two numbers.

Ms. Sgarz: Ok great, thanks.

Mr. Carlucci: Thank you for your question.

Operator: Thank you. This concludes today's question and answer session. I would like to invite Mr. Carlucci to proceed with his closing statements. Please sir, go ahead.

Mr. Carlucci: Before closing I would like to say once again that we remain confident in the evolution of our operations in Brazil as well as in our international operations. Competition remains strong in all countries where we have operations.

We respect a lot the competition, we look for their movement but our value proposal, our brands and our corporate behavior lead us to believe that we have all the conditions in place in order to maintain our position in the industry, launch more products, build a better value proposition and keep growing in high rates in those markets.

Once again I would like to thank you all for participating in this conference call and I look forward to our next meeting in October to discuss the results for 3Q. Thank you and have a good day.

Operator: That does conclude Natura’s audio conference call for today. Thank you very much for your participation and have a good day.