International Conference Call
Natura
2nd Quarter 2008 Earnings Results
July 25th, 2008

Q&A Session

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 (1) key on your touch-tone phone. If at any time you would like to remove yourself from the questioning queue, press star (*) two (2).

Excuse me. Our first question comes from Ms. Lore Serra from Morgan Stanley.

Ms. Lore Serra: Good morning. Could you give us just a bit more clarification on the marketing spending? I think in the press release it says you spent R$ 26 million in the first half of the year in marketing and another 33 million in other expenses, so if … as I understand the press release that R$ 60 million, which means you would be proportionally matching your 400 million program - which, I guess, would be that 120 million a year in marketing spending - is that the way when you think about, how you planned out the marketing spending for the year?

Mr. José David Uba: Good morning Lore, this is David speaking. There is some confusion here with the numbers. Let me try to clarify what we meant: actually the total excess, I would say, of marketing expenses, our increase in marketing expenses was R$ 26 million; those 33 means … that is the increase in all marketing tools except discounts.

So what we are saying here is that we actually increased R$ 33 million in several marketing tools, except for discounts; in the discounts we reduced by 6 million, so the net increase in market expenses was 26. So ... I am sorry, the decrease was 7 million in discounts. So 33 minus 7 is the net marketing increase of 26 million.

Ms. Serra: Ok, that is helpful. So what you are saying is that as we get into the third quarter we should see a larger effort in terms of the marketing spending?

Mr. Uba: Yes, that is correct. We probably will increase a little bit this excess in marketing expenses as the year advances, yes.

Ms. Serra: Ok and could you just give us a sense of how you are going to measure the effectiveness of that additional marketing spending?

Mr. Carlucci: Hi Lore, this is Alessandro speaking. As we are sharing with you, our marketing plan is made by an integration of a lot of efforts as David mentioned before. So we have some effects immediately and we have some effects in the medium term: for example, the training effort to our consultants we are going to have results, concrete results, probably in a medium term. We do not have immediate results. In the publicity and advertising we can see some short-term results.

So we are measuring this with the accelerating of the revenues, the growth, and we believe that we are going to see first signs in this second part of this year of this acceleration and mostly in 2009. So we are measuring with not only the increase in revenues but the activity, the quantity of consultants putting orders and these are important indicators to follow the effectiveness of these efforts. Not only the revenue.

Ms Serra: And could you ... I guess ultimately the issue that you are going to be targeting is your … consultants' productivity, correct?

Mr. Carlucci: Sorry, could you repeat Lore?

Ms. Serra: I guess ultimately where you will feel successful is if you could increase the productivity of your consultants, is that correct way of thinking? Is that the metric you are going to gage yourself on?

Mr. Carlucci: Lore, of course that we are looking for and we are working to see some gains in the consultants' productivity, but I believe that the first ... we are going to see three things happening, in this order: the first one an acceleration in the number of consultants and this we are going to have because of the implementation of the CNO that we are going to finish in the middle of 2009.

The second effect is the increase of the activity that is the number of consultants that put orders in each cycle; and the third effect - and this one I do not believe that we are going to see any change in this year and probably in 2009 we can see some evolution - is the productivity. So yes, the productivity is very important, but I do not believe that we are going to see an evolution in the productivity in the short term.

Ms. Serra: Ok and just one last question: once you have rolled out the CNO structure completely, what would you think should be the rate of growth in you rep base?

Mr. Carlucci: Sorry Lore, I think that I cannot share with you this information, but I can assure you that we are going to increase the speed of growth in the number of consultants. But sorry, this is strategic information and I cannot share with you.

Ms. Serra: Sure, I understand. Thank you very much.

Mr. Carlucci: Thank you.

Operator: Excuse me. Our next question comes from Ms. Margaret Kalvar from Harding Loevner.

Ms. Margaret Kalvar: Yes hi, good morning. I have two questions: first, could you comment on the market share issue in Brazil and to what you attribute your decline and whether you think this is easily obtainable in terms of getting it back?

And the second question concerns profitability expectations in the Argentina, Chile and Peru operations. When do you see that moving from break-even into definitely positive territory?

Mr. Carlucci: Hi Margaret, this is Alessandro. The reason why we lost 0.8% of market share is because mathematically we grew less than the market and it is important to say that during this period the plan that we are implementing now was in the beginning of the implementation and as we are mentioning we are going to see better results in terms of revenues and market share - the first signs - in the second part of this year and full impact of the plan in 2009.

So I think that we can imagine that from now on we will like to change this trend of losing market share. But in the first four months of the year we did not have the implementation concrete of the actions in marketing.

The first important launch this year was "Amor América" and this launch was at the end of March, in the beginning of April and then we had the “Chronos” as we mentioned and we had the “Ekos” and then we started to increase advertising and now we are increasing the training efforts. So we should expect, again, in the second part of this year and mostly in 2009 a recovery in our market share.

Ms. Kalvar: Ok. Do you see any structural change in terms of market growth rates away from the prior margin in your stronger area of cosmetics, fragrances into more the personal care, shampoo area or is that not a factor?

Mr. Carlucci: No, today I cannot see a different effect between the two categories. We only have the data from the first four months, so I think that we should keep an eye on your question, but I do not believe that we should have a different impact of growth in both categories for the year.

Ms. Kalvar: Ok.

Mr. Uba: Margaret, I am going to answer your second question - this is David speaking.

Ms. Kalvar: Ok, hi.

Mr. Uba: Hi, about the evolution of our three operations in Argentina, Chile and Peru. As you can see, we have attained now a break-even point in terms of Ebitda margin being around zero and for projecting the evolution of Ebitda and seeing high margins in the future we depend on our strategy of how much we want to expand the sales network in those countries.

If you look, for instance, to the first half of this year we can see that we still put a lot of emphasis on the expansion of the number of consultants, of reps, in those countries - they increased by 30% - and we also increased our sales expenses by 25%. So as we perceive that it is worthwhile to keep on investing in the expansion of the distribution network in those countries, Ebitda margin will not grow at very high rates.

We might, if we decided at this moment to stop this high investment in expanding the number of consultants, we could see very fast an improvement in the Ebitda margin, but we believe that we would lose the total value of those operations in the medium term.

So what we see now in the next two to three years is still a slow growth of the Ebitda margin because we still believe that there is space in those countries for going on expanding the number of consultants and probably after two to three years we would see a second wave of lower growth rate in the number of consultants and therefore a higher average productivity and therefore higher Ebitda margins. That is the dynamics that we expect to see for these three countries, let us say, in the next five years.

Ms. Kalvar: Do you see the period - this two to three years period you are discussing for these countries - do you also expect that to be the timeframe for Mexico or is that a longer-tail expansion because of being a larger market?

Mr. Uba: No, Mexico actually is going to be longer, mainly because we started much later our Mexican operations: now we are completing three years, three years in Mexico.

Our original plan expected from 4.5 to 5 years the break-even point in Mexico, so Mexico, as you said, is a much larger market: actually Mexico responds probably, represents 50% of all the CFT market in Hispanic Latin America - excluding Brazil - so probably a little longer time for reaching that level that we expect to reach in two to three years in the other three countries.

Ms. Kalvar: How confident are you that you can ramp Brazil back up again to levels which you could continue double-digit growth even with the expansion in Mexico and elsewhere?

Mr. Uba: Well, our plan in Brazil - those R$ 400 million for the next three years - the first results we are already seeing: this second quarter we are pretty close to this double digit in terms of gross sales, in net sales actually we already saw a growth rate more than 10%.

We are pretty confident given two elements: we expect the total CFT market growing in Brazil for the next five years at very high rates; general expectation places that rate at 5%, 6% in real terms and we do believe we still can expand our market share in Brazil for the coming years. The combination of our innovation, the strength of our brand and also the increase in investment in marketing should bring us back to an expanding market share in Brazil.

Ms. Kalvar: Ok, thank you very much.

Mr. Uba: 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. Robert Ford from Merrill Lynch.

Mr. Robert Ford: Good day everybody. Alessandro, I had a question with respect to the diminution of SKUs first and I was wondering if you could give us a sense of what you lost of sales from the elimination of SKUs this current quarter, your best estimates?

Mr. Carlucci: Hi Bob, good morning, how are you? You know that those SKUs that we do not have any more sales they are almost insignificant in revenue terms. When we selected the SKUs that we were going to take off of our catalog we selected based on revenues; we selected based on the brand building; and in the alternatives regarding the customer needs that we are offering and sometimes we have two products that can reach the same demand of the customer.

So based on these three elements we decided which SKUs we should take out of our catalog. So the impact on sales of those 51 are almost irrelevant in this period and the other ones are going to be the same.

Mr. Ford: Ok and then I cannot remember the actual term, but when you look at unproductive inventory, or inventory that has been eliminated from the catalog, what was the charge this last quarter compared to the same period last year? I mean, in terms of what you eliminated from catalog and is no longer a viable for sale?

Mr. Carlucci: Bob, our decision to decrease the SKU is based on a policy that we are not going to have stock losses on these products, so they are going to still on sale till we have stock, so the fact that we do not have any more those 51 SKUs does not mean that we increased the losses in stock.

Mr. Ford: Good to know, thank you and the other question I had, Alessandro, is when you look at the "consultora/orientadora" successes in the Midwest, can you share a little bit with respect to the benefits you have seen in your pilot programs, how this program is similar or different to the structure now being put at Avon?

And you touched on the immediate benefit of trying more consultants, but if there is anything else in addition to that, any eventual disruptions in the incubation period?

Mr. Carlucci: Hi Bob, I think that it will take some time to go into details about the difference of the CNO and other peer models that we have in our competitors, so I think that we could have a special time together to explore those changes, those differences.

But you asked me also about what are the effects that we expect with the implementation and I could say to you that the first impact - and we should see some of these impacts in this semester that we are starting now - is the increase of the number of consultants. This is almost an immediate effect of the implementation of the model.

A second effect is the activity rate increasing - what does it mean, activity rate? Is the number of the total consultants that put an order in one cycle, in a promotional cycle, and we saw in our pilot that we increased the number of orders. So both effects we should see in a short and medium term and those two are the main indicators to evaluate the progress of the program.

Mr. Ford: Ok, thank you and then lastly with respect to some of the original investments that you are making in logistics and Casa Natura, can you touch based on … in addition to some of the savings in shipping I understand there are some tax benefits as well; can you give us a sense of what the magnitude is when you look at the combination of logistics benefit as well as possibly taxes?

And also if you could touch on the time for replenishment, how quickly can you improve the fulfillment experience for your final user?

Mr. Uba: Bob, as I ... we do not give any detail on those savings, but I can give you some ideas. We, of course, by decentralizing the physical distribution we expect to have some savings in transportation costs by having more efficiency and carry the products from manufacturing plants here in Sao Paulo to those distribution centers instead of carrying those boxes with a very low efficiency in terms of truck occupation and then from those distribution centers to the areas around them we expect also to improve the utilization of the vehicles and therefore decreasing the transportation costs.

We still are working on that side, we still do not have the final results. We are developing a new distribution model right now based on these distribution centers and probably we will not have any final conclusion about the final impact before, I would say, the second half of next year.

From the tax point of view the main impact we had came from some changes in the tax structure in a couple of states here in Brazil. It did not come from the creation of new distribution centers - part came from that, but not the largest part - and we still have to wait until next year, because this new tax structure in these states are still are still being analyzed by both, the tax authorities in these states and the companies that had been affected by those changes. We expect to have a final structure only next year. So that is the situation on the tax front at this moment.

Mr. Ford: Thank you very much David and then just lastly I know there was a possibility of perhaps providing a little bit of additional funding to the consultants in Brazil in particular; however, your receivables are actually down 7% and I was curious as to whether or not that is just a way the cycles come or if there is something behind that reduction of receivables?

Mr. Uba: Well Bob, we had two changes in our credit principles with the consultants or the funding process with the consultants. As you know, last December we decided to expand the credit, to increase, to extend the payment terms for the consultants and the results in terms of sales increase were not encouraging, so we decided to go back to our old system, the system we had before.

Now in this second quarter, we had a small change: we did not extend the payment terms for sales for our Valentine's Day here in Brazil because we actually did not need to have that credit extension for that particular event.

So the big change we see from December to June is because we usually extend the payment terms in December. For the next December we should see the same increase we saw before 2007, so the same structure we had in 2006 and 2005. So the working capital should not grow at the end of this year at the same rate that it grew last year. I do not know if that was precisely your question?

Mr. Ford: It sure was David and thank you very much.

Operator: Excuse me. Our next question comes from Mr. Filippe Goossens from Credit Suisse.

Mr. Filippe Goossens: Yes, good morning Alessandro, David and Helmut, many thanks for taking my call and I do apologize if some of my questions may have already been asked by my colleague Marcel Moraes from our Sao Paulo office.

Alessandro, you spoke a little bit about the increase that you plan in the marketing spending in Brazil; I would put the focus a little bit on the advertising side if I may. Over the last couple of years, when Avon in part on its own turnaround program globally it decided to significantly increase advertising expense … 4% target of revenues is a kind of the number that they would like to achieve.

And secondly, particularly in Brazil we have seen them change from a more institutional-type advertising campaign - in other words, targeting the reps – towards targeting more the end user by incorporating soap opera stars in their commercials.

So my question to you, Alessandro, is: do you think that you should also increase your advertising expense more? I think in Brazil right now Avon is probably hitting about 7% of revenues.

And secondly, do you also think that maybe you need to rethink a little bit in terms of whether you do more institutional advertising versus reaching out to the actual end user?

Mr. Carlucci: Hi Filippe, how are you? This is Alessandro. As we mentioned before, Filippe, we decided to increase around 60% the total investment in advertising and this is a part of the increase of the total investments in marketing and I would like to share with you that in the Natura case - because we are targeting a mass-tige market, probably different in some cases of Avon, that is targeting more mass market - we need to invest in other kinds of marketing tools.

We want to have a value proposition based on differentiation, so we are investing in training; we are investing in events with the consultants; we are investing in samples; so the advertising is only a part of the total marketing mix that we are increasing for the next two, three years.

Regarding the advertising, as I mentioned we have increased 60% and we are not focusing on the institutional or in the product content; our value to position is to integrate all those things. We develop and we offer products that are based on our main values, our essence.

So what we are trying to do? We are trying to offer a product for the customer at the same time that we can share the values and why and how we did that product. So in other words, we do not have any doubt between institutional or product, we try to do both together and this is because we believe that we can add value to our brand mixing those two things.

Mr. Goossens: Ok, thank you. My second question, Alessandro, obviously as we cover here at Credit Suisse the HBC sector globally we are hearing more and more people talk about the negative impact of higher food inflation on the purchasing power of consumers. Can you make a kind of comment how you are seeing higher food inflation, higher interest rates in Brazil potentially impacting somewhat the purchasing power of your target customer base?

Mr. Carlucci: Filippe, it is a very good question and it is an attention point for us. Today we do not have ... still we do not have any information to support that we are going to face a decrease in the growth of CFT in Brazil because we only have data from the first four months and in those four months we have good growth. But I think that we must keep an eye on this fact because maybe we can have some impact in the second semester of this year.

Regarding Natura, even though slightly better our growth in the second quarter was higher than in the first quarter. So we are not facing, our company is not facing yet a problem. But I think it is something to keep in mind and soon we have more data from third ... the third bimester of the year we can maybe have better information regarding the growth of the CFT.

Mr. Goossens: Ok. My next question, Alessandro, our sources tell us that Avon reduced the minimum order size and that may have helped them basically to report an increase in the number of reps they have in Brazil. In order to enhance your competitive position, Alessandro, are you also considering perhaps lowering somewhat the minimum purchase orders size?

Mr. Carlucci: Filippe, yes, we are considering and more than this we did it one month ago - we decreased our minimal order in 20% from R$ 100 to R$ 80, but ... I am sorry, it is not reais, it is a kind of coin that we have here, it is a kind of indicator to measure... in reais, yes, 20% decrease from 100 points to 80 points.

But I do not have any information that Avon here in Brazil decreased the minimum order, so we did this not because of a reaction of an Avon action, but mostly because we want to help the activity and the frequency in the number of orders from our consultants.

Mr. Goossens: Ok and then just a related question, Alessandro, if I may: with the new launch that you are getting ready for next month in terms of your children's business, are you thinking also about increasing a little bit lower-price products in your portfolio?

In other words, are you trying to add a little bit more lower price point SKUs to the mix in order to, again, enhance your competitive position going forward?

Mr. Carlucci: This is not the main objective of this launch; we are launching a new line targeting children from 3 to 7 years in a replacement of the old line that we had. So the main objective is to have innovation, to have a better value proposition and not to decrease the average price, even though specifically in this case we are offering a very innovative line with less price; we are decreasing the price regarding the old ones. But this is only to add more value to the customer and not as a main objective to reach a kind of customer that wants to pay less for cosmetic products.

Mr. Goossens: Ok and then my final question, Alessandro, relates to your initiatives to enter potentially the North American market. I understand at this moment you have not made a decision yet in terms of how you might eventually enter the U.S. market, but is there any change in terms of your thinking about when you might enter the U.S. market particularly given all the dire reports that we are getting from the U.S. market in terms of the significant decrease in purchasing power of U.S. consumers as a result of the major challenges we are seeing both in the housing market and also in the banking market?

Mr. Carlucci: Filippe, as you said, even though we are working hard to have a good business plan for the U.S. - and we have a dedicated senior team working on this - we do not have yet the decision if we are going to start the operation and when are we going to do it. Of course that economical conditions and the marketing conditions in the U.S. are going to be part of the decision, but I think that they are not going to be so relevant because we are going to be small, a small company in the beginning.

So, of course, we are going to take into consideration the situation, the actual situation in the U.S. market; but we are going to take into consideration other aspects of the international strategy for Natura and I think that until the end of this year we are going to have a decision to share with you with all the details regarding the beginning of the operation or the postponement of the operation. But today, as I mentioned, we do not have a decision yet.

Mr. Goossens: Great, thank you very much gentlemen and have a great weekend.

Mr. Carlucci: Thank you, the same to you Filippe.

Operator: Excuse me. Our last question comes from Mr. Celso Sanchez from Citigroup.

Mr. Celso Sanchez: Hi, good afternoon. Just a little clarification on the minimum order size change. Can you remind us roughly – and I recorded in terms of discounts a reduction in terms of points – but can you remind us roughly on a monetary basis how the gap compares with Avon? Has it widened or narrowed as a result of this in your view? That is just one clarification.

Mr. Carlucci: Just one second, Celso. Celso, in monetary basis our minimum order was around R$ 280 and now is around R$ 220, so 20% less and the minimum order in Avon is around R$ 60, so three times less - the new one, the R$ 220 as Natura has now.

Mr. Sanchez: Thank you and then a second question, I guess, is just a little bit more detail - I think you answered part of this before - but one of the savings measures that you had discussed when I met you guys in March were the better planning for the discontinuation of products (inaudible 53.45) control.

Can you give us an idea of how that process is progressing? You talked about (inaudible 53.50) products that you eliminated; now that is fine, that you are already where you wanted to be in this process or is there still plenty more to come, is there opportunity to still deliver further savings? Just want an update on that please. Thanks.

Mr. Uba: Hi Celso, this is David speaking. Yes, we have some improvements in the first half of this year; not very much from what we saw last year, it is an improvement, but not at the degree that we would like to see. Last year, in the second half of last year, we had very high losses coming from discontinued products and we expect to see, therefore to see a larger difference or a more … bigger impact in the second half of this year.

This is a new process we put together in the company, we expect it to improve along this year and probably reach the ideal level next year. But probably we will see a larger impact in the second half of this year.

Mr. Sanchez: Ok that is helpful, thank you.

Mr. Uba: Ok, thank you Celso.

Operator: Excuse me. This concludes today's question and answer session, reminding that all questions from the web will be answered through e-mail afterwards. Now I would like to invite Mr. Carlucci to proceed with his closing statements. Please go ahead.

Mr. Carlucci: Once again I would like to thank you, all of you for participating in this conference call and I hope to see you all at our next meeting in October and we would like to reaffirm the confidence on the implementation of the plan and gradually we are going to see an acceleration in our revenue growth - that is the main target. So thank you for your time and see you in the next conference call.

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