

International Conference Call
Natura
3rd Quarter 2008 Earnings Results
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13:05

Q&A Session

Operator: 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 now. If at any time you would like to remove yourself from the questioning queue, press star (*) two (2).

Operator: Our first question comes from Ms. Margaret Kalvar with Harding Loevner.

Ms. Margaret Kalvar: Yes, good morning, hello. I was wondering if you could elaborate a little more about the new launches that you had and what percentage of the sales they represent? Are the new lines anything like the magnitude of the Ekos launch a few years ago?

And whether your plan to have a lot of products going forward from those, do they represent huge new initiatives or are they a kind of more additive?

Mr. Carlucci: Hello Margaret, how were you? This is this Alessandro speaking.

Ms. Kalvar: Fine, thank you.

Mr. Carlucci: I can start answering your question talking about the launches of this year and the first most important was "Amor América". "Amor América" is a new brand, a fragrance new brand.

The second important launch was a new product in an already existent brand Chronos. It was a new skin care product under the Chronos line - that is a 15-year old brand and very well succeeded; the name of this product is "Politensor de Soja": it is a new technology, skin-care; it is a new product under an existent sub brand.

A third important launch was "Natura Naturé": it is a new brand, a new line for products for children between three and seven years old and this was, again, a very important launch and this could be an important brand, even though this is a smaller market because only for children.

And the third important launch this year, the last one, was the re-launch of an existing sub brand called "Todo Dia" - translating it means every day - and it is the same brand but with new packaging, new products.

So in this year we had a mix between new sub brands and the remodelation of existing brands with new products or sometimes new packaging, like the case of Chronos or "Todo Dia" and it is difficult to say to you if they are going to have the same impact of Ekos, for example.

As you know, we do not split the relevance or the size of each sub brand, but I can share with you that for example "Todo Dia" is a very important brand for us - as important as Ekos - and "Amor América", for example, is a new one. This brand is doing very well, but it is only six months old so we need to wait. This is a brand that we are going to keep investing; next year certainly we are going to invest in "Amor América".

And Chronos is a very important brand also, because it is our most important sub brand in the skin-care area and the skin-care area is very important, because it gives confidence to the customer because it is a product that you put in your face.

So Chronos is another very important - as important as Ekos, as "Todo Dia" - of course with different size and different value proposal and this is a resume to you regarding the launches of this year and this explains why the innovation index is growing in the last months in this year from 44 ... 54 last year to almost 67.

Ms. Kalvar: Could you discuss a little bit also about the consultant productivity, which looked to be down a little bit?

Mr. Carlucci: In this quarter we had a small increase in the productivity, different from the previous quarter where we saw a diminishing of the productivity. But in this quarter, do the accelerate of sales, we can face a small increase: we had a 2% growth in the productivity in the consultants in Brazil.

And this reflects the efficiency of the implementation of the plan that we announced in the beginning of this year with more marketing investments in advertising, in training, in the launches of new products and this is a small reflex of the efficiency of the implementation of the plan.

Ms. Kalvar: So do you expect that for the year the productivity will be up since the trend has turned up in the second quarter?

Mr. Carlucci: It is hard to give you some guidance, because the productivity is an indicator that changes in the medium and long terms; it is difficult to see a variation in the short term. So it is too early to say to you that "yes, we have a trend that the productivity is going up." But definitely in this quarter this small increase is related with the efficiency of the launches, the marketing mix. I can say this to you, but it is

early to give you a guidance that if you can see the same effect in the next quarters.

Ms. Kalvar: Ok, thank you very much.

Mr. Carlucci: Thank you for the question.

Operator: Our next question comes from Mr. Bob Ford with Merrill Lynch.

Mr. Bob Ford: Hey, good morning everybody. Congratulations on the quarter and David, I am very sorry to hear the news of your plans to leave Natura.

Alessandro, I had a question with respect to the price elasticities of demand that you have across your range of products and I was wondering in the event of a more pronounced slowdown, where do you think the greatest vulnerability is in your portfolio or/and what are you doing in terms of price replenishments or other initiatives ... as well as what can you do in the future to offset those, perhaps?

Mr. Carlucci: Hi Bob, how are you? First of all, as you know if we see the numbers of our industry, our industry is a little bit stable - the growth is stable - when we compare the variation of the Brazilian GDP, so probably we are going to be less affected when we compare to other industries here in Brazil.

Second, it is probably too early to say what we should implement if we face a deceleration of the growth in our market and I think that the plan that we announced is a way to take care of the situation, because we are going to rise investments in marketing. So I think that we are prepared to face some deceleration.

Regarding the average price I think that Natura, today, has different price positionings in the main categories that we are operating, so I think that we are able to maybe see some change in the mix if we have a change in the behavior of the consumer changing products with a higher price to a lower price and we have different price positioning, so we can offer some good value proposition to the customer.

So I believe that resuming, we are not going to face a huge difference in the growth of our market in the short term and I think that we are prepared to face it if this happens. And of course today is today and we need to follow all these moments day-by-day - sometimes hour-by-hour - so we are looking and following the things that are happening. So this is my vision for today, I really believe that we are prepared to face - if we have some - deceleration in the market.

Mr. Ford: Thanks Alessandro. If I could, just a couple of other questions: I was curious if you could give us some color with respect to your strategy on the catalog in terms of the physical size - I know you produce (inaudible 23.42) year on year, I was wondering what the strategy is on the catalog in terms of the size, the pages,

the materials you use and the printing, the numbers of "exemplares" or issues you have every cycle and how that is contributing to some of the SG&A improvements?

And then if you could give us a sense as ... you started the holiday selling period two days ago; what is different this year with respect to that strategy in terms of the kits and the funding and other things versus last year?

I cannot remember if it was the last year or the year before, where you used a little ... you were a little bit more oriented toward dealing used products that did not work out too well last year ... my sense is that the additional funding was a little bit disappointing in terms of the sales that it seemed to generate and I was wondering how you plan to go into that period this time around?

Historically there was always a kind of a scarcity value in the kits and I was wondering if you go more aggressive with kits, more larger supply or you try to rekindle that scarcity of value of the holidays sales kits?

Mr. Carlucci: Hi Bob, starting with the catalog. What we did was we decreased the costs and environmental impact of each catalog; on the other hand, we have increased the total number of catalogs - so at the end printing more catalogs we have less cost and less environmental impact. So it is a way to offer more value to our customer with less cost and less environmental impact.

And we changed the kind of paper, we changed the way that the catalog is produced and the number of pages, remembering that we are decreasing the number of SKUs, so this is going to allow us to decrease the size of the catalog and the number of pages and with all those things together we reached this good position: more catalogs with less cost and less environmental impact.

Mr. Ford: How many more catalogs are you circulating today versus a year ago, for example?

Mr. Carlucci: 17% more ... last year and regarding the kits, what are the changes that we are promoting this year - and we started the Christmas sales, the first one, yesterday - and the news are that the kits in 2008 are more innovative.

We are using more new products - we call part of them virtual products - that means that you are ... you can only buy those products through the kits and this is a way to offer more value for the customer and we are not going to increase the credit, because as you know last year we tried to do this and we did not reach good results - or the results that the planned - so this year we are, again, in the average credit for the consultants.

But the most important new is that the quality of those kits are better and when I mean quality I mean the innovation behind each one is better than in the previous year. So we really believe that we can have good Christmas sales in 2008.

Mr. Ford: And Alessandro, what is the price points in the kits this year, if anything? Are they lower? Is there a wider range of price points?

Mr. Carlucci: It is almost the same in the average, Bob. We have a very different price position. If I am not wrong, the cheapest one is around R\$ 20 and the more expensive is R\$ 190. So we have different price positioning to allow for every kind of customer, every kind of gift to be used with the Natura kit and the average is relatively the same of last year.

Mr. Ford: Ok, that is very useful. Thank you and all the best.

Mr. Carlucci: Thank you Bob.

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

Ms. Lore Serra: Good morning and congrats as well on the results. I wonder - maybe this is a bit of a direct question - I wonder if, David, you could talk a little bit about what are some of the reasons why you are moving on and also if we could get a little bit of background on the coming CFO? That would be helpful.

Mr. José David Uba: Hello Lore. I am leaving because probably I am too old ...

Ms. Serra: I do not believe that

Mr. Uba: I am 56 and I have had this plan already for almost two years. As Alessandro mentioned, we were working on that succession already for one-and-a-half year and the reasons are strictly personal: I want to change life a little bit and I think this is a good time for doing it and I will pass to Alessandro and he can explore a little bit the profile of the next CFO - his name is Roberto (inaudible 29:58) – but Alessandro will speak a little bit about him. Thank you.

Ms. Serra: Thank you.

Mr. Carlucci: Lore, we are going to miss a lot David also.

Ms. Serra: Absolutely, absolutely.

Mr. Carlucci: He probably is going to have some good time and I am sure that we are going to be together as friends and he is going to still support us in some way.

And talking about our new CFO, his name is Roberto (inaudible 30:31). Roberto had been working for Unilever for 16 years in the financial area. In the last two he was the CFO of Nokia here in Brazil and he has a business administration bachelor and an M.B.A. in the Michigan University.

And Roberto has a lot of experience in the finance and legal area and, as I mentioned in the beginning, Roberto is going to be with David in the next two

months and then Roberto will assume fully the responsibility in the beginning of 2009 and so we are very confident that we can manage the finance area as good as David did. But of course, we are going to miss a lot David, because ... one of the reasons that we are now in a good position is because we have a very good team here and also because David did a very good job.

Ms. Serra: Thanks very much for the explanation and we will all miss you, David. Can I ask one more question? If we think about the environment that we are going into probably for next year in Brazil maybe it is going to resemble the environment a little bit in 02, in 03 that existed and I guess it was a very different market for you back then, because you were a much smaller, younger company and Ekos was new and a lot of other things.

But if you put yourself back in that market in 02, 03, what do you think are going to be the challenges you are going to face in 09 if you are in a similar kind of environment like that? I understand you are saying that you will be better than other sectors - that is pretty intuitive to me - but I still think it is going to be potentially a challenging environment ...

Mr. Carlucci: Lore, just a moment please ... hi Lore, as I mentioned to Margaret, we do not believe that we are going to face a huge deceleration or even a small deceleration in the CF&T area. The projections for the GDP to next year due to the crisis decreased 0.5%, so today we do not have any reason to believe that we are going to face a different environment next year.

And as I mentioned, Natura has different price points positioning in the main categories to face an eventual change in the behavior of the customer relating to the price points, or the price the customer wants to pay for a lipstick or for a soap or for shampoos. So I think that we are prepared to face some changes in the market, even though we do not believe that this is going to happen in 2009.

Ms. Serra: What kind of GDP are you using your budget for 2009?

Mr. Carlucci: Around 3%.

Ms. Serra: Ok, thank you.

Mr. Carlucci: You are welcome.

Operator: Excuse me. Ladies and gentlemen as a reminder, to pose a question please press star (*) one (1). Our next question comes from Mr. Celso Sanchez with Citigroup.

Mr. Celso Sanchez: Hi, good morning. Also I echo the fact ,David, that you will be missed, but good luck to you in your new phase.

I just wanted to ask a little bit about ... I know it sounds very short-term, but obviously things have been changing pretty dramatically day-to-day in the global markets. To the extent that people in Brazil are looking at headlines and maybe considering supplementing incomes and things like that, can you give us an update on how, what kind of trends - maybe you do not want to share numbers - but just trends generally, recruitment, since the end of the third quarter?

And more importantly, is there any reason to believe if recruitment, for whatever reason, accelerates and people start looking to do direct sales to help provide another source of income - and in the next few weeks you have a very busy holiday season - what is the turnaround time if someone walks into the front door and says " I want to be a rep" how quickly can they get their kit and get out selling and get orders? What kind of processing is involved – credit checks and so forth? Can you remind us of that please?

Mr. Carlucci: First of all, Celso, we still do not have any change regarding ... in recruitment regarding or related with the external environment. What we should see and we would like to see and probably we are going to see in the next months is some acceleration in our recruitment because of the implementation of the CNO.

But I understood your question and your question is related with the unemployment here and I do not think that this should change a lot, but if something changes it is going to be positive because, as you know, when you have some more employment people sometimes look for direct selling as a way to complement the earnings, so it could be a positive effect. But I do not believe that especially in Brazil we are going to face a change in the employment rate, so I do not believe that this is going to happen.

And regarding the second part of your question, the time between a customer wants to be a consultant and this person receives the kit and the credit is very short, probably a week. So if we have more people with the desire to be a Natura consultant we can recruit these people very fast. So the time is very, very small.

Mr. Sanchez: That is great enough thank you. And I guess a related question: obviously the CNO Program you have been talking to us about for a while it seems like we are starting to see some results and you seem very optimistic on it for 09. What responses are you seeing in the marketplace from your competitors? What made us a bit surprised earlier this year was the level of growth in consultants in Avon Brasil – at least in the early part of the year, year-over-year.

Is there any sense that they are trying to match their campaign and again if the economic environment does change at all, how do you feel your portfolio is positioned now relative to theirs?

I know in the past you talked about - generally speaking – about the lower price point, average price point for their portfolio versus yours. My sense is that gap presumably now in the recent years ... is that fair and if you had an estimate the

difference . . . what is the weighted average price if you could of your portfolio versus theirs?

Mr. Carlucci: Hi Celso, first of all regarding some reaction from the competitors related with the CNO implementation, Avon had finished the leadership implementation in Brazil, I think, in 2007, so they had already implemented this evolution in their channel and we did not see any movement in their channel approach because of the CNO now.

And regarding the price positioning, the comparison between Avon and Natura is the same when we compare last year, for example. And as I mentioned, now we have ... since 2005, 2006 we have different price positioning in some categories that allow us to offer different value proposals in the same category to the customer.

So I think that we can ... today we can reach a lower price point ... not as low as Avon, because in some cases Avon is in the mass market with their products and we are not, because we have a different quality, we have a different value proposal.

So we are not reaching the mass market, we are not the first offer when you think in price; but in the other hand we have a very good value proposal in our lowest price with a very high-quality, so we really believe that we are prepared to offer different kinds of products. So we are not planning to change something in this area for 2009.

Mr. Sanchez: Thank you very much.

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

Ms. Irma Sgarz: Hi, good afternoon. I just have one question regarding your balance sheet and I see in your detailed financial statements that you have taken on additional debt from one part in working capital and two smaller loans from the BNDES – I think you have done an increase there and also secured account.

I am just wondering if you could elaborate a little bit, I see a part of that is falling due pretty much right now in October, November and I was just wondering if you could elaborate a little bit on what your strategy is, whether you are going to roll this over? Is working capital being paid down from free cash flow generation during the holiday season? If you could just give some guidance on that, please. Thank you.

Mr. Uba: Hi Irma, this is David speaking and our policy here in terms of balance sheet is always to guarantee higher liquidity for the company and as you can see from our third quarter balance sheet with R\$ 350 million in cash and also a total debt of 520 million with an average term of 15 months.

So the idea has always been to provide the company with high liquidity and of course we try to fund the company, like any other company, with the lowest cost possible and BNDES is always a good source of financing with much lower interest rates than the market and we have an access to these funds because of our investment in Capex, increase in working capital.

So we are always working with those options in order to execute our strategy of guaranteeing the company with a high liquidity. We did not change the policy, the policy is exactly the same. Sometimes you can see a little bit higher cash because of some new loans taken before BNDES, but we did not have any change in our balance sheet policy or strategy recently.

For this year, for this Christmas season, we do not intend to extend the payment terms in the same proportion that we did last year. As you probably know, the experiment we did last year did not bring any big result in terms of sales, so we will go back to the same terms we used to have before, in 06 and 05, etc.

So we will not see any big increase in working capital by the end of this year, it should be more or less in line with the increases we had in 05 and in 06. So I hope I have answered your question.

Ms. Sgarz: Ok thank you and if I could just follow up with a second question with regards to your Capex plan - which you have not revised down for this year - does that mean that you are pushing some of that Capex into next year or is that actually a specific project that you may be now considering not taking any further?

And also could you give us an idea of what Capex is going to be in 2009? Thank you.

Mr. Uba: Well, the decrease in Capex this year is not a year transferred to the next year, it is a real reduction. We increased the outsourcing of our manufacturing process this year. Now we are reaching around 30% of outsourcing of our products - finished products - so the requirements for manufacturing capacity here were lower this year.

Another decision we took was to postpone investment in a new laboratory here near Sao Paulo that also we do not intend to start building this year or next year, so we are not transferring that to 09.

And as we do every year we give our guidance for Capex in the conference call that we have in the beginning of the year covering the results for the whole fiscal year. So in February or beginning of March we will be providing our goals of Capex for next year.

Ms. Sgarz: Ok, thank you.

Operator: Our next question comes from Mr. Steve Powers with Stanford Bernstien.

Mr. Steve Powers: Hi, good morning. I guess it has been my understanding that one of the growth drivers for consumer spending in Brazil generally has been the extension of credit to those consumers and by extension to consultants, I guess, for Natura.

I guess to the extent that ... the GDP forecasts that you are looking at are looking to decelerate only very slightly; what is the outlook for the extension of that consumer credit? Is that closing and what effect ... might that have an additional effect on some of the cosmetic and skin-care categories in Brazil?

Mr. Carlucci: Hi Steve, this is Alessandro speaking. As you know, the cosmetic industry specifically here in Brazil does not depend so much on the payment terms because it is a low-ticket product and what may and can happen is that our industry can be benefited by the effect that the other durable goods that need credit and payment terms can be affected and then the customer can decide to change the new mobile phones to a new lipstick. So our industry can be in a good way affected positively for this change in the finance area or in the credit area to the customer.

Mr. Powers: Ok, thank you and I guess just one second question related to your decelerated growth that you saw in Brazil in the September quarter. Do you have a feel for how much of that was acceleration in growth in the category versus your potential share gains relative to competitors?

Mr. Carlucci: My feeling is that the Natura acceleration is related with the implementation of our plan raising market investments and not because the market grew faster than in the other quarters – but this is my perception, because we still do not have the official numbers of the market.

Mr. Powers: Understood, thank you very much.

Mr. Carlucci: You are welcome.

Operator: Our next question comes from Mr. Luiz Cesta with BES.

Mr. Luiz Cesta: Good morning everyone. We saw since the beginning of 2008 a decrease in the level of sales tax – it was 28.9 in 2007 and it is now 26.3 in the third quarter. First, I would like to know the breakdown of the impact on sales tax reduction coming from the decentralized distribution and also from the tax replacement mechanism.

And second, can we still expect further reductions in sales tax coming from decentralized distribution? Thanks.

Mr. Uba: Hi Luiz. Could you please repeat your first question? We could not hear well.

Mr. Cesta: Ok. I would like to know the breakdown of the impact on sales tax reduction coming from the decentralized distribution and also from the tax replacement mechanism, this was first.

And second I would like to know if you still can expect further reductions of sales tax coming from decentralized distribution?

Mr. Uba: Ok. Let us talk a little bit about this tax burden, sales tax as a whole and what we expect to see next year. We had this year a decrease in the tax burden mainly coming from changes in the tax system here in the State of Sao Paulo and also in a couple of other states in Brazil.

That is still a working progress, we still do not have the final parameters for this new tax system. I mentioned before that we were still negotiating with the tax authorities here in the State of Sao Paulo. We are following what is going on in the market on tax collection and then if we need to have some adjustments in that new tax system here in the Sao Paulo State.

So we might see some changes next year. It is still too early to advance any changes and we expect to see a final decision in the first quarter of next year. That is for these broader changes in the sales tax system, which are state taxes, a good part comes from state and sales taxes.

Now for the decentralization, we do not expect any big change in the tax structure because of that move. We are taking our decisions based mainly on logistics advantages or logistics impacts and we want to decrease the delivery time to our consultants, we want to decrease transportation costs - so these are the main drivers of our decision to decentralize our distribution.

We might have here and there is some small tax effect coming from that process, but they should not be material or very important to the company's results, ok?

Mr. Cesta: Ok, thank you very much.

Mr. Uba: Thank you.

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

Ms. Margaret Kalvar: Yes hi, another question. Could you quantify at all the impact of declining raw materials costs or are you able to set any kind of basis point improvement in Ebitda that you feel has come from that and has that benefited your working capital and do you expect it continue to do so?

Mr. Uba: Hi Margaret. Yes, this year we had a good impact on our costs coming not from a decrease in raw material prices, but mainly from our negotiation with our main suppliers, better terms with our suppliers.

We also - as we decreased the number of finished goods in our portfolio - we are buying more from our existing suppliers, so we can negotiate better terms with them. All this together probably ... well not probably, had a net impact this quarter of about 100 basis points in our gross margin.

Now for the future we still have to wait a little bit, because most of the raw materials had their prices also tied to the U.S. dollar and Euro, so we have to see what is going to be the net impact from decreasing raw material prices in dollar and the devaluation of the real here in Brazil. We still do not know, we have to wait a little bit to see.

Ms. Kalvar: Ok, thank you very much.

Mr. Uba: Thank you.

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

Mr. Carlucci: Once again I would like to express to all of you the trust that we have in the secure evolution of our CF&T market and in the growth of Natura's market position. Thanks again to all of you for participating in this conference call and I hope to see you all at our next meeting, which will be held next year for the annual results. Have a good day everyone.

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