International Conference Call
Natura – Q&A
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Ms. Lore Serra: Good morning. Thanks for those comments, that is very helpful. I wonder if we could just talk a little bit about the trend we have seen in the last few quarters - and I know it has been a challenging really 12 months at this point - but there has been a pretty much deceleration in your revenue growth if I look first quarter, second quarter, third quarter and I am wondering if you could talk about any specific issues associated with why the third quarter was quite as bad as it was and in this context of this sort of fixes that you are trying to do, that you - you explained well, but it is a medium-term thing - are there any short-term fixes to help? Because obviously the market share implications of the third quarter growth were not good. Thanks.

Mr. Carlucci: Hi Lore, is Alessandro speaking. How are you? Nice to hear you. Let's talk about the last quarters and I will refer to the initial comment because I think that there are two main factors to define why we are decreasing in our growth. The first one is that we are facing a higher competitive environment and I think that this is going to be our future. The Brazilian market is the third biggest market in the world, it is a market that is one of the biggest and is growing fast. We have stability in Brazil, so we believe that we are going to face in the future the same kind of aggressiveness in our competitors. So this is something that started to happen in the last two years and we are going to face for the next years and this is the first reason.

The second one - and maybe more important because if is something that we can act - is the fact that we are in this transition period, we ended a cycle of strong growth in the last four years and we are building a new cycle where we need to redefine some marketing efforts - what we are calling less is more - related with the innovation process where we would like to launch more breakthroughs and less quantity. We want to focus on projects more relevant, for example I mentioned some projects related to the evolution of the commercial model – as the CNO and the Casa Natura and the decentralization - and those efforts are going to be implemented in the next two years. So I think that we decreased our growth this year because of those two the effects: a more competitive environment and at the same time a construction, we are building a new cycle and new marketing efforts to start this new cycle of growth.

I think that we will have some signs of recovery in the next year, in 2008, because some of these actions are going to impact the short-term but the total impact of this plan we are going to see only in 2009 because, as you know, some of these implementations are going to finish at the end in 2009 so this is why we have the less results decreasing the growth and why we are enthusiastic with the starting of this new cycle that we believe that we are going to face some signs in 2008, but only in 2009 we are going to see all the impact of this plan.

Ms. Serra: That is helpful, but I guess if I could just ask ... your revenue growth in Brazil was around 5.5 in the third quarter and was around 16% in the first quarter. Should I read into that that the competitive environment has just gotten really bad over the first three quarters of 2007? Because actually it feels like - that is what am trying to understand - because it happened very fast, I mean the competitive environment changes, but I am not sure it changes as quickly as your momentum has changed...

Mr. Carlucci: Ok no, now I understood better your question. No, I did not face a huge difference in the competitive environment in the third quarter; I think that we are facing and we are going to face a huge competition for the next 10 years, so I did not see something different in this last quarter. What happened is probably that the efficiency of our marketing efforts was not so good as we would like to be in the last quarter, so I think that this is the explanation why we did not reach the growth that we would like to have.

Ms. Serra: Ok thank you very much.

Operator: Excuse me; our next question comes from Mr. Marcos Mundim of Templeton.

Mr. Marcos Mundim: Hi, I have a question regarding leverage. I see you increased your debt in the last quarter; my question is would you be willing to pay any extraordinary dividends or implement some buy-back program to increase the leverage of the company?

Mr. José David Uba: We intend to go on with our dividend policy, which is to distribute something around 75% of our net income or at least 100% of free cash flow; that might add a little bit more to the leverage of the company but not very much. We believe that we are now facing a transitory impact on our profitability and we would not like to reflect that in the dividend policy of the company and therefore we might see a slight increase in the leverage of the company in the coming years. Now we are not intending to buy back shares simply because we need to have a minimum of 25% of free float to be in the Novo Mercado – we are exactly at the 25% level right now. So that is not an option that we have.

Mr. Mundim: Ok. If I may, one more question. There were news on the press about a strike of chemical employees in the company; does that have any effect on your Christmas season preparation?

Mr. Carlucci: Hi Marcos, is Alessandro speaking. We do not have any impact in our Christmas production and we are dialoguing with the union and we are not on strike, so we do not have any impact on our production or in our sales for the last part of the year. Usually in October the unions start to negotiate, so it is his usual to receive some people here asking and start to dialogue with the unions, so we are working normally.

Mr. Mundim: Ok perfect, thank you very much.

Mr. Carlucci: You are welcome.

Operator: The next question comes from Jose Yordan of UBS.

Mr. Jose Yordan: Good morning everyone. My question has to do with the recent denial of any involvement in the transaction with you and Avon - you were denying that the company was for sale and all that - I just wanted to understand whether that denial came from the company management or whether it came from the controlling shareholders, who after all are the ones whose decision it is to even consider such a sale? Should we read into that the denial was from them as well or only from the management?
And then the second part of the question is I understand your answer about the recent increase in debt, whether what was the reason for and the use of proceeds?

Mr. Carlucci: Hello Jose, is Alessandro speaking. We deny this new about Avon from both the management and from the shareholders. We did not have any dialogue with Avon and the shareholders they do not have any intention to sell the company, so you can be sure that both management and shareholders deny that we have any dialogue with Avon. So you can be sure that nothing is going to happen because there are no intentions and there are no contacts with Avon.

Mr. Uba: Again, regarding the leverage of the company we had the main proceeds of the leveraging process were our adjustment policy and the dividend policy as well. We always had a policy of not building up cash in the company and we also have a tremendous advantage from a fiscal point of view of giving the money to the investors, to the stockholders than keeping it here in the company. Just to give you one simple example, any financial income has a 34% income tax in the company and a 15% income tax for the individuals here in Brazil. So there is no sense in building up cash in the company, that that would destroy value in the company and again, as I said before, we see this lower cash generation we saw in the company in the last year as something temporary and we would not like to reflect that in our dividend stream over the years, so we decided to keep on with our dividend policy with a high growth rate and therefore reaching a small leverage for the company - it is very low leverage at this point. Jose I do not know if I answered your question or if you have any specific ...

Mr. Yordan: So I guess your operating cash flow is a little bit less than it was, was just a re-leveraging to more optimal levels, it does not ... it is just to keep the dividend policy. I understand, thanks a lot.

Mr. Uba: Thank you.

Operator: Our next question comes from Lauren Lieberman with Lehman Brothers.

Ms. Lauren Lieberman: Thanks, good morning. I just wanted to know if you could talk a little bit about potential risk of disruption in the Brazilian market as you go further into this CNO model and I apologize for not knowing how far long you are in this process now, but has if had any impact on the productivity and behavior of the representatives in the third quarter?

Mr. Carlucci: Hi Lauren, is Alessandro speaking. The CNO has nothing ... we can not see any impact of the CNO negative in the results of the third quarter because now we are still on a pilot in a specific region in Brazil and even though we decided to roll out the CNO the first of region to be rolled out is going to start on March of 2008, so the results of the third quarter are not related with the implementation of the CNO.

Ms. Lieberman: Ok and then when you think about a way and even into 09, what do you think is the big risk around the implementation of this model and is it going to change how your existing representatives interact with the company? Because I know when Avon has gone through some changes when they for example went from single level to multilevel overtime there was definitely cost and disruption among their existing representatives base.

Mr. Carlucci: Hi Lauren, Alessandro again. I think that we managed the risks of the implementation of the CNO first of all because it is not a multilevel approach, even though it is another level - but is only one level more - so it is not so far from the model that we are operating now and the second reason that can help us to manage all the risks in the implementation is the fact that we tested the CNO model for almost four years in this region, so we learned a lot, we developed new things, so we are really confident that we can have the benefits of this model and the most important benefit is a better relation with the Natura consultants because nowadays our sales promoters they have around 600, 700 consultants; with the CNO model each CNO will take care of 130 so the relations are going to be better and this is very important in our strategy.
So we are confident and we are going to implement the CNO in two years, so we are not going to do a big bang, we are going to do gradually in other regions in Brazil, so it is another way to manage the risks. So we are really confident that we can have very good things with the implementation of this model.

Ms. Lieberman: Great thank you.

Mr. Carlucci: Thank you.

Operator: We have an additional question from Lore Serra of Morgan Stanley.

Ms. Serra: Thanks for taking the follow-up. I wanted to ask a question about margins, but I do not want to push you into 2008, a sort of making a 2008 estimate. What I want to ask you, you made it pretty clear that you want to shift your marketing mix more towards advertising and less promotion and obviously keep the focus, or tight the focus on innovation.

What I would like to understand is if you think about the competitive changes that have happened in the market that you have talked about and you look at 2007, which has been a sort of an uneven year right? And that has somehow reflected in your profitability. As you look at the medium term and you think about Brazil do you think that your 2007 model is a level that you think is sustainable over the medium term or do you think that even with the unevenness you had in 07 the market continues to get more adverse and we should think about possible margin pressure over the medium term from your current level in 07? Thanks.

Mr. Uba: Lore, this is David speaking. There is, yes, there is a good chance that we will see some margin pressure in the medium term. We will increase our investment in marketing and that is a decision to do it. In addition to changing the marketing mix we will give more emphasis on the marketing tools that emphasize the relationship and improve the relationship with our consultants: how we launch the new products, qualification, training of the consultant, etc.
So from that point of view, from that short-term strategy we will see some pressure, yes, and some pressure on the margin. We expect to compensate it with the less discounts probably - we hope we can do that - and also with some productivity improvements we are still working on and we have some very tough objectives for the next year. But the net impact might be some margin decrease in 2007.

Ms. Serra: From 2007's level?

Mr. Uba: I mean in 2008, yes, compared to 2007 we might see some further decrease in 2008 - decrease in the Ebitda margin as compared to 2007, although we still have to wait to little bit in order to have a better idea of what might happen in 2008; but at this point we are not rejecting this hypothesis of a slightly smaller Ebitda margin in 2008.

Ms. Serra: I got it, 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. We have a question coming from Robert Ford of Merrill Lynch.

Mr. Robert Ford: Good day everybody, thanks for taking my call. Alessandro I was curious if you could discuss a little about this union negotiation this year compared to other years; is it normal to have this kind of confrontation with the unions and I understand there was protest in front of your plant this week; I just want to understand if that is typical in October in your view?

Mr. Carlucci: Hi Bob, how are you? Nice to hear you. It is typical, is typical around this part of the year to start to dialogue with the union; in some years the dialogue is softer, in some years the dialogue is tougher - this year was a little bit tougher, but every year they have a different approach and not only with Natura, with all the companies in the chemical area. But we are operating regularly, so we do not have any reasons to be afraid or to be worried about the impact on our results in the third quarter.

Mr. Ford: It is great to hear and then if you could please, I understand that you are envisioning perhaps expanding the Casa Natura concept and I was not sure what the dimensions of that expansion might be; could you talk a little bit about how Casa Natura is functioning right now in Brazil, what kind of benefits you are seeing in terms of brand and getting closer to the consultants and your plans for rolling out more Casas Natura in Brazil and elsewhere?
And I was also curious to know more about the distribution infrastructure that you are adding. I know that you want to reduce the fulfillment cycle ... can you discuss your distribution plans and the improvements you generated this far?

Mr. Carlucci: Hi Bob. Let's talk a little bit more about Casa Natura. If I understood your question you want to know a little bit more how does it work, Casa Natura and how we are going to roll out in the next year. So Casa Natura is a place - is like a house - where we receive our consultants, it is almost the of Natura consultants' house, is a place where we can, we have the Natura environment with a product experience area; we have a training area; we have a coffee area; we have another area where the sales promoters receive the Natura consultants to talk about their job, their activity and new launches and so on; and a small area where people of Natura work - a small office, very small. So it is a place where we can share the values, we can share the new products, we can share knowledge and we can receive in a better way our consultants - it is a way to be near to these people.
Nowadays the have only one Casa Natura in Brazil, in Campinas, it is a city 50 miles from Sao Paulo and we intend to roll out those Casas Natura for the main cities in Brazil in the next two years; we are talking around probably 30, 40 Casas Natura - I do not have the precise number - but we want to have in every major city in Brazil places where we can receive in a better way our consultants. Today in the other cities to do some training, to launch products, we need to rent some rooms in hotels or in buffets or other places and we do not believe that those places represent in the best way the Natura expression; that is why we want to have this marketing tool - because this is a marketing tool - to be near of our sales force.

Mr. Uba: Hi Bob, this is David. I am going to explore a little bit this decentralization project and what is driving our decision to decentralize the distribution. The first reason for the decentralization is cost; we have now reached such a high volume of operation and volume of orders, of consultants, that it is necessary to have a couple or three more distribution centers in order to rationalize the distribution costs for the company. So it makes sense from a cost point of view to decentralize a little bit the physical distribution of our products.
Now what we are doing right now is running a pilot test in the Northeast of Brazil to see if a dramatic reduction in the delivery time has any impact on the consultants' productivity. If we can measure and verify a direct impact on our consultants' productivity as a result of a shorter delivery time we will probably invest more in the decentralization process and then instead of having 3 or 4 distribution centers we

might have 10 - but we are still conducting that pilot test and also in the same time seeing what kind of marketing mix we should combine with this shorter delivery time in order to get the maximum effect from this better service to the consultant. It is not only shortening the delivery time, but maybe also changing the length of all our promotional cycle, what kind of incentives and marketing tools we should put in place in order to combine with the shorter delivery time and have the consultant to sell more, to offer a better service to their final clients. So this decentralization project is still being defined to the degree of decentralization and we expect to have a final decision probably by the middle of next year.

Mr. Ford: So this is much more comprehensive that you are reviewing actually, you are changing the length of the cycle; this is almost as significant as moving to a two sheer direct sales model, no?

Mr. Uba: This is one possibility; it depends on how logistics can deal with a shorter length for the promotional cycle; the decentralization might help that, but that is one possibility that is one of the options we have to study and assess. As I said, we have to organize different marketing tools and shortening ... combined with the level of service to see what impact it might have in the consultants' productivity. But we still have to wait and see the impact in this pilot test we are running now in the Northeast of Brazil.

Mr. Ford: Thank you both very much, it is very useful.

Mr. Uba: Ok thank you Bob.

Operator: The next question is from Celso Sanchez from Citigroup.

Mr. Celso Sanchez: Hi good afternoon everyone. Just I was hoping you could share with us a little bit more on some of the reasons for your conviction that some of the changes you have made will improve not just the results but also the perspectives for the next growth cycle? I think obviously ... things early a couple of examples now and for not taking changes very lightly so it think my sense is that a lot of things you are talking about now represent an important evolution for the company, but I just wonder if you mind sharing with us because I think for some of us hard to figure on exactly why the confidence that you have in those changes? Why is there? I am sure you have information or examples internally but is there something you can share with us, illustrate or clear otherwise ... the level of conviction that you have?
For example I guess in a certain way to discuss distribution centers is interesting but the CNO program in terms of studies that you have done over the last few years, retention and improvement in recruitment over what timeframe? Is it six months after implementation that one would expect to see those benefits and to what degree would you expect to see them? Is there any way could help us with that as an example or anything else?

Mr. Carlucci: Hi Celso how are you? Alessandro speaking.

Mr. Sanchez: Hi.

Mr. Carlucci: I do not know if I can answer totally your question because I can not give you numbers of facts that allow us to prove that the plan is going to give us the results that we really believe, but I can share with you first we are the preferred brand in Brazil; second, we are going to focus two or three projects in the evolution of our commercial model - CNO, Casa Natura, the decentralization examples and we really believe that those three and other few things integrated are going to enhance strongly our commercial model and if we are the preferred brand in Brazil we are going to have our consultants in the right place to offer to the customer our value.

And on the other hand we are going to continue to invest in the innovation process with more focus on breakthroughs and this is a change - if I could say like this. In the last years we launched around 200, 180, something like this SKUs per year with some breakthroughs and we decided months ago that we want to focus on the most important breakthroughs and invest in the marketing tools to offer those breakthroughs to our consultants of course and then allow them to offer to their customers. So this is going to help us to integrate all these actions to reach the results.

Again, the preferred brand; with a better commercial model; with more breakthroughs; and a marketing effort based on those breakthroughs we really believe that we can start a new cycle of growth. Of course we are going to do other few things - and the details of those things I can not share with you - but our confidence comes from the fact that we really believe that we have the tools to implement a new cycle: we have a brand, we have a channel, we are going to implement those evolutions, so that is why we are confident. I can not give you a proof because it is really difficult to give you; I think that we must wait, we do not believe that all the effects of this plan are going to be seen in 2008, only in 2009 we are going to have all the effects of the implementation; but I think that we can follow the implementation of these plans and start to see some signs that we are implementing with discipline and with some results and building this new cycle of growth in Brazil.

Mr. Sanchez: Ok thanks. If I can ask a follow-up on the idea of the breakthroughs, the focus on those. Can you help us understand ... my understanding of the direct sales industry was only that one of the reasons for you to focus on innovation is to allow the consultant force more opportunities to speak with the clients with new catalogs and your products more currently and really get an opportunity to call up clients on a pretty regular basis. If you focus more now on breakthroughs - which are presumably fewer and far between ... further between - is that still consistent with the direct sales model, or is that a concern that you have or have you looked into that - and I imagine you have - and perhaps ... gives you comfort that that may help ... is that the way it was years ago and that is why you call forth this?

Mr. Carlucci: Celso, if I understood your question we are not going to stop launching new products, definitely each promotional campaign we are going to offer new products and innovation, but what we are going to do is focus on breakthroughs. I do not have the precise numbers but just as an example this year we are going to launch around 200 products. Probably next year we are going to launch 120 - so a lot of new products - but we are going to focus these 120 more on breakthroughs and invest in the marketing of those new products. And we have some ... in the last few months we had some examples of this: for example the zip lipstick for us is a breakthrough, even though it is a lower price product you can not find a lipstick with the same value because we have a mirror in the lipstick in this kind of price, with the quality of this lipstick this is the only, the best value proposition in the make up industry in Brazil - in my perception, that is why we sold a lot of lipsticks. Chronos Passiflora ... and we invest in the marketing of this product. Chronos Passiflora is another example, we launched the product this month and we invest a lot, we invest in events to our consultants showing the product, show in the technology, offering experimentation to the consultants, some things that we stopped to do in the last years. So what we are going to do is keep launching a little bit less, but focusing on breakthroughs and investing more in those breakthroughs.

Mr. Sanchez: probably ... you used to do ...

Mr. Carlucci: Yes, yes.

Mr. Sanchez: Thank you very much, very helpful.

Operator: Our next question is from Bill Schmitz of Deutsche Bank.

Mr. Bill Schmitz: My question has to do with first of all the overhead that has been trending the last several quarters and then also I do not know if you have the data handy but what percentage of your representatives, your consultants, sell competitor products? Thank you very much.

Mr. Carlucci: Hi Bill, is Alessandro speaking. Thank you for the question. First of all the turnover is still low, we did not see a change in the turnover - and this is a good new, this is very important to us because we invest in training, we invest in kits of material for the new consultants - so keeping the turnover low is very important in our strategy and the numbers are the same of the last quarters and as you know we have a very low turnover, around 25%, 30% per year when the industry has around 90, sometimes 100% of turnover. So the turnover is still the same and if I understood your question the percentage of our consultants that resell other products is around 30%, 35% of the total consultants and this is a little bit stable during the year.

Mr. Schmitz: Ok great, thank you very much, that is all I have.

Mr. Carlucci: Thank you.

Operator: Our next question is from Andrea Teixeira of J.P. Morgan.

Ms. Andrea Teixeira: Hello everyone, thanks for taking my next follow-up question from the Portuguese call, but just if you can extrapolate, elaborate a little bit more I think from Alessandro's and David's comments that you do not reject the possibility of a decline in Ebitda margin in 2008 in relation to 07. If you can just tell us, if you can break down in the margin effect, the gross margin effect in sales mix and the marketing effect, if that is going to come from each ... I mean, how you see those, that decline coming from? Thank you.

Mr. Uba: The decline will come mainly from higher investment in marketing, higher marketing expenses in 2008 - that is the main source of the decline in Ebitda margin. As I said before, we believe we can compensate part of that increase in marketing expenses by improving productivity in some of our operational processes and just to give another example - of course that will depend on how much we grow next year - but we are still, we keep our policy of keeping all the overhead expenses fixed for next year. We did it this year, the level of overhead we saw in the last quarter of last year is exactly the same we have this year and it will be kept, fixed for the coming year. So we also might see some leverage effect that would compensate partially for this increase in marketing expenses, but the main source is the increase in marketing...

Ms. Teixeira: Ok great that is clear. Thank you very much.

Mr. Uba: Thank you.

Operator: We have an additional question from Margaret Kalvar of Harding Loevner Management.

Ms. Margaret Kalvar: Yes hi, thanks for taking the question. I would like to draw a little bit deeper on the situation with the consultants because the relationship with the consultants was always one of your great strengths and now it seems there has been a decline in productivity and you are responding by focusing on rebuilding or reinforcing that relationship with more Casas Natura and a change in the structure of the sales force. Is this a function of the fact that your rep force just grew so fast or to what do you attribute what seems to be somewhat of a change in the quality of this relationship over the past 12 months?
That is my first question and then the second question has to do with just bringing a little bit more color on what you would define as a breakthrough? Would it be a new product category, would it be ... I would imagine it would be more than a product extension within the same category, but if you could give a little bit more of color on what directions your breakthroughs might take that would be very helpful.

Mr. Carlucci: Hi Margaret, is Alessandro speaking.

Ms. Kalvar: Hi.

Mr. Carlucci: First of all I think the facts that pushed the productivity down this year are the same facts that decreased our growth during the year and mainly I think that there are two reasons: the competitive environment that is getting tougher and tougher, and this is something that we are going to face in the next 20 years probably because the Brazilian market is a very good market, so I think all the companies are going to invest here; and the second part is that we need to increase the investments in marketing and probably during this year the investments were not enough to help the productivity of the consultants and the innovation - and as I said now we are starting, to be honest in the last four, five months we started to focus the innovation process more on breakthroughs and this is the second part of the question and supporting those launches with better marketing efforts and so these are the reasons, in my opinion, because we faced a decrease in the productivity and not because we are growing so fast. I think that this is not the main effect. Of course that when you grow fast in the number of consultants because of the productivity of the new ones are lower than the old ones you have a mix effect, but I think this is only the mathematics; the real facts are the competitive environment and the need to increase the marketing efforts and to do better a innovation process focusing on breakthroughs.

And talking about breakthroughs, first of all the breakthrough is defined by the market because sometimes we think we have a breakthrough and the market does not perceive, disagrees that this is a breakthrough. So during the time we can see which are the breakthroughs that we launched. But in a conceptual definition I think that breakthrough is a new product, a new concept that can stay online for more than two years; is a product that you do not need to promote a lot to sell - and I can give you some examples in our company: for example the Ekos line; the Ekos line is a huge breakthrough, probably one of the biggest that we had because it is not only a very good product line - is a line that builds the brand; that gives attributes to the brand. I think that we have other breakthroughs in the recent time; in my perception, the zip lipstick is a breakthrough in the make up category launching a lipstick of R$ 8 with a mirror; a white shape packaging; with a formula, a new formula; with only R$ 8 is a breakthrough. I think that we are going to sell a lot of this product and we are not going to need to promote so much.
So a breakthrough in my perception first of all is the market that is going to define which one is a breakthrough and is a product or line that is going to be online more than two or three years representing something new in the categories that we are already, maybe new ones, but offering something new that you do not have a market nowadays. Different from line expansions that of course help us to grow the revenues, but they are not going to stay more than one year, one year-and-a-half. So this is what we mean when we say breakthroughs.
And of course the breakthrough is not only related with the intrinsic of the product - is the way that you launch the product, that you market the product, so that is why it is important to us to define which ones we are going to select to put more effort and market better when we launch the products.

Ms. Kalvar: Ok thank you very much, that is helpful.

Mr. Carlucci: Thank you.

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

Mr. Carlucci: We are facing, as we said, a transition moment but we are very excited with our proposed plan and confident that we will have enough discipline to implement it. The results of our plan, as we mentioned before, will be fully reflected in 2009 and we are confident that we are in the right path of a new growth cycle.
We do appreciate your time and the relationship that you have been keeping with our company. Your questions, suggestions are really important to help us to implement and to go further. Thank you all and have a good day.

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