

International Conference Call
Natura
2nd Quarter 2011 Earnings Release
July 22, 2010

Operator: Good morning ladies and gentlemen. At this time we would like to welcome everyone to Natura's 2011 2nd Quarter Conference Call. Today with us we have Mr. Alessandro Carlucci, the CEO; Roberto Pedote, the CFO and Helmut Bossert, 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 are completed 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 the conference.

Mr. Alessandro Carlucci: Good morning to all and welcome to the conference call on 2Q results. First of all I would like to reinforce the message that we gave in the previous quarter related to our growth. It was very much related to our decision to anticipate the price increase due to the possible approval of the provisional measure 497. The change in the tax burden expected in the measure actually did not happen, but there was an impact in our planning cycle.

I begin this consideration because at that time we had some signs of deceleration in the CF&T market; but as we have no official and final data we could not affirm that this was actually happening.

Well, now regarding the results of 2Q - that were below our expectations - we already have the industry data of the first four months of the year, which confirm the slowdown in our market, in which is the scenario we are going to see for the rest of this year. Nevertheless, we have gained market share in Brazil during this period and we had very positive results in international operations, which continue to show strength, growth and improvement in profitability.

In Brazil, as I said, our industry grew 9 over 13% year on year. At the same time, as the market grew less its level of competitiveness increased. In this new scenario for the industry growth for this year what are we going to do for the second half? We are adjusting our initiatives to keep growing in market share.

So we have a marketing plan which includes product launches and evolution in our marketing tools. We also have an even greater focus on efficiency and productivity gains in the second half of the year in order to adjust expenses, and in this scenario be able to reach at the end of this year a similar level of consolidated Ebitda margin of the last year.

We remain very confident about the future of the company and we have the expectation that these measures taken by the government in order to cool down consumption should have more impact this year, and in the next year the situation will be different and we will be able to see higher growth rates in our industry.

Above all we have high confidence in the fundamentals of our organization with a strong brand; a good leadership team; a channel that continues to grow at significant rates, as well as opportunities to fill in spaces where Natura, the preferred brand, is not at present in either category or price ranges.

It is important to tell you that we will keep investing in strategic products and in innovation because they ensure our long-term growth. I stress that we are very confident that even in this lower-growth scenario of the market we will continue to gain market share and achieve good levels of profitability.

Now I am going to pass on to Roberto Pedote to share with you some finance figures.

Mr. Roberto Pedote: Thank you Alessandro, good morning everyone. I would like to highlight some points that help us better understand Natura's performance in the quarter. As you have noticed gross margin increased as a result of the efforts we have made in our supply chain that practically have offset cost pressures.

Some expenses were affected because we were prepared for higher growth than what actually occurred. For example we had some spare capacity in our logistics as well as increase in inventories. Administrative expenses increased due to increased innovation investment and strategic projects that will enable future growth and productivity gains as we have been disclosing.

With regards to net cash flow in addition to the increase in inventories we have already mentioned, recoverable taxes also increased due to a PIS/Cofins credit on capital gains and ICMS on inventories. In the second half we are realigning our company to a more realistic growth level with the current market situation so as to avoid idleness of some processes.

We are also dealing with expenses from various areas and processes in order to anticipate productivity opportunities. These adjustments of the operation and expenses should be gradually reflected throughout the half.

To close I would like to highlight that the board of directors approved the payment of dividends and interest on equity for the first half of 2011 in the net amount of R\$ 0.76/share, 15% higher than last year, to be paid on August 12, 2011 to shareholders as of July 26.

The board also approved the buyback all 4 million shares at market price to cover options exercised for the following years and that will begin on August 1 and continue for a year. Those shares will be held in treasury.

Thank you very much, now we can move on to questions and answers.

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 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 all. I have two questions, the first one is you mentioned some adjustment that you will make in terms of expenditures given the lower market growth. Do you also plan to make adjustments in your capital expenditure plans in the sense that you reach R\$ 3000 million this year and probably the same amount next year? Specifically in terms of logistics that you are trying to open several distribution centers in-house.

Mr. Pedote: Hi Reinaldo. As we mentioned, the most important and strategic projects that we have that are related, as we mentioned, to include, to finalize our logistics plan, will continue in a very fast rate. We are not going to decelerate this program.

This program is very important for us in order to allow us to improve service level for our consultants and also it is a good basis for us for future innovation to reduce the cycle to the final consumer. There are several things related to this project that make it very important event for productivity gains - like it will be cheaper, when we finish all of this project also, we will have benefits also costs. Then we are not

going to change this and we maintain our R\$ 300 million guidance for Capex the year.

Mr. Santana: Right, and my second question: could you elaborate on how much you are spending in research and development as a percentage of sales and the level you intend to reach, let us say, in three years and whether you have changed it in the last six months due to the higher competitive environment?

Mr. Carlucci: Hi Reinaldo, this is Alessandro. We did not change our strategy that is gradually raising the investment in innovation. So we are around 2.7%, 3% of net sales and for the next 3 to 4 years we want to increase probably to 3.3, 3.5, something like this. So in other words we did not change the strategy. We strongly believe that this kind of investment is very important for the future of the company and there is no reason to change this.

The only thing, as we mentioned, that we are adjusting is in the short-term view some expenses of the company and also our initiative to guarantee that we can deliver a good profitability this year and also gain market share in a new environment that this year our market is going to grow; but it is going to grow a little bit less than we saw in the last years.

Operator: Excuse me. Our next question comes from Mr. Marcelo Nashiro from Merrill Lynch.

Mr. Marcelo Nashiro: This is actually Bob Ford again masquerading as Marcelo Nashiro from Merrill Lynch, but thanks for taking my call and on the earlier call there were a lot of questions with respect to competitive dynamics and a big part of that is because... the sell-in. I think Alessandro was very careful to say so and so in the earlier call.

The sell-in in the last quarter was 16.5% and (inaudible 12:52) expect to be... percentage and I was curious as to whether or not you are seeing comparable levels of sell-out in the products that may contribute with... a little bit more directly for those levels in particular.

Mr. Carlucci: Bob, it was very difficult...

Mr. Ford: ... if you even monitor them - I am not sure if you monitor them that carefully with Nielsen data or not.

Mr. Carlucci: Bob sorry, it was very difficult to hear you. We are having interruptions in your voice. Could you...

Mr. Ford: I will try this again and I was just curious with respect to... in earlier call there were some questions, some concern with respect to competition and I think it is because some of the multinationals are reporting such big numbers right now in sell-in, right? In the organized trade, and L'Oreal is indicating that their volumes in

Brazil sell-in were up 16.5% (I think in reais) and P&G is running at a rate of 20% or 30% right now in reais and I was curious if you are observing similar rates of sell-out or is it just a kind of initiation, they are building the channel and they may not be experiencing that rate of sell-out in the aftermarket.

Mr. Carlucci: Thank you Bob, now I understood. So first of all we do not have the final data to see if that is only a sale-in or if that... if we are seeing also a sell-out for those companies. What we saw for the first two months of the year in Nielsen was the same slowdown in the market. We saw that the market was growing less in sell-out than last year - but this was only in the beginning of the year, so maybe too early to say that this is a trend.

But my perception is that even if those two companies or maybe other ones are reaching good levels of growth the market is slowing down and again, those two companies are not as big as they use to be in other markets here in Brazil. So their growth is based on a lower size. So maybe they are growing, yes, and maybe they are sending out also their products; but to be honest I do not have yet good information to share with you.

But this does not change for me our perception that our market is slowing down a little bit and we... the most important thing - is that we must be prepared and that is what we are doing - to face the second half of the year with a lower growth of the market. So our adjustments are to put the company in the right track to... how can I say... to manage this new scenario.

Mr. Ford: Alessandro, when I listen to the innovation pipeline that is coming right now in the second half of the year it sounds as if you will also be supplementing that with greater share of voice in the second half. Is that fair? And if so will you be able to fund it with some of the sources of efficiency that Roberto has alluded to? Or can we expect a continued higher SG&A pressure in the second half as well?

Mr. Carlucci: We are also... you are right Bob we are also - but not only - also increasing the share of voice; but we are going also to improve some of our marketing tools and on the other hand we are going to finance this level of investment with efficiency gains and also allow the company in consolidated terms at the end of the year to reach similar levels of Ebitda margin of 2010.

Mr. Ford: That is very helpful, thank you very much.

Mr. Carlucci: thank you Bob.

Operator: Excuse me. Our next question comes from Ms. Margareth Kalvar from Harding Lovner.

Ms. Margareth Kalvar: Hi, I have a couple of questions, first on the competitive issues. To what extent are you feeling the impact of L'Oreal and Procter & Gamble and other players in the direct sales channel? My impression has been that they

are posting very strong in hair care. You do some hair care through direct channel, but that is also heavily a retail product as well. How much differentiation and inflation are you getting right now from your particular mix and from your door-to-door direct sales channel participation? That is the first question.

Mr. Carlucci: Margareth, first of all as you mentioned those competitors in the retail they are strong in categories where direct selling is not strong. So we are not feeling a direct impact from them - even though they are new competitors and they compete in the pocket share of the customer. But direct to us I do not feel direct competition because they are stronger in hair care as you mentioned, body care, deodorants, some other categories where the retail is stronger and not direct selling.

And regarding the direct selling you can see that our channel keeps growing in Brazil in a very good rate, above the market. So we do not see any structural change in the direct selling regarding those two or even other retail competitors in Brazil.

Ms. Kalvar: Ok and the other question I had related to pricing and also I guess some question to productivity with your sales force; but it looks like pricing might have been under pressure a bit in terms of revenues/units. What has your experience been?

And also the sales force productivity what do you see happening and what are your premises for the balance of the year that you better expected?

Mr. Carlucci: Ok thank you for the question. First of all the price is mostly impacted by our strategy in the short term. As you know half of our sales are under promotion, so that means that we define in a short term the mix of our products and the mix of our price because of the promotional planning. So this change is not because the market is changing or because the customers is buying cheaper products; it is only because we promoted during this period cheaper products than we used to do in the last year for example. So it is only because of our short-term promotional plan strategy.

The productivity of our consultants decreased mainly because even growing 16% the number of consultants in Brazil, as you saw our market grew 9% in the first four months and because of this our consultants they sold less than they sold last year. So it is the only reason why the productivity decreased.

And because we believe that we are going to keep seeing good levels of growth in this channel in the second half of the year I think that we are going to see some decrease also in productivity as we saw in the first half of the year. I do not know in which levels; but I think that it is good to share with you that we believe that we are going to see some decrease in productivity because the channel will keep growing at high rates in the second half of the year.

Ms. Kalvar: Do you expect to come to a point where the number of relatively new reps who have some seasoning, and therefore whose productivity maybe starts to rise, overcomes the rate of new rep recruitment? I mean, the brand-new reps generally have lower sales productivity, even adding at a rapid pace as you mentioned into a market whose growth has been decelerating. Is there a chance for a positive dynamics within the next 6 to 12 months of more season reps gaining a larger share of the base?

Mr. Carlucci: Margareth, the mix effect (I will call like this) of new reps with lower productivity decreasing the average productivity is also impacting what we saw in the first half and is going to have the same impact in the second half. This is important to share with you: the main reason of the decrease in productivity that we are facing... that we faced and we are going to keep facing this year is not because of this - even though it is adding to the fact that we are growing much more the channel than revenues.

Ms. Kalvar: Ok thank you.

Mr. Carlucci: Thank you.

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

Ms. Lori Serra: Hi good afternoon. I also wanted to ask a few questions. Let me first ask a little bit about your perspective on the market growth rate. I wonder if you could share with us if you think there is something different going on in the industry and I know that the economy is decelerating and I know that goods inflation is rising and I know interest rates have been rising; but none of those things you would expect to really hit a sector like yours, which is generally thought of as being a bit more resistant to those kind of factors.

So I wonder if you could give us some perspective on within your business are there certain sectors or segments that are weaker, whether you think that some of the weakness owes to less efficient innovation on yours and Avon's part or others.

I would love to understand... I know the economy between... is still a pretty good economy I think and some pretty strong deceleration in the industry and in yourselves.

Mr. Carlucci: Lori, let me share with you something in a high-level: we spoke with several economists in Brazil and to be honest nobody is understanding very well why those initiatives from the government are impacting in a different way different industries. So I cannot give you much better information of what we gave; and again, we are trying to understand the different impacts of those initiatives from the government and then if we know something more we can share with you.

Second it is important to say: look, we are facing a slowdown and for a company of our size the slowdown has relevant impact; but we are talking about 9% growth and this is a high rate of growth when you compare with other industries in Brazil and what we saw, the only thing that we saw - this is also in a high-level analysis - is that those measures of the government impacted much more the industry than the services categories. So products are more impacted than services.

This is the only thing that we saw in this beginning of the year and not only the cosmetics industry, also other industries. But again, I do not have much better information to share with you unfortunately.

Ms. Serra: Ok and then just sticking with that theme a bit, it does seem from looking at the industry data and comparing it to your data that the sales floated at the end of the quarter - and I know in the Portuguese call you said: do not read too much into a couple of months of data - but is it your view that industry growth is decelerating at a fast, a very fast pace or if that just some anomaly of the data?

Mr. Carlucci: I prefer to believe that this is more anomaly of data because two months are not enough to say that we are going to have a third bimester worse than the first two in the industry, but maybe this can happen. The only thing that I believe is very important to share with all of you is that we are prepared now, because we reset our expectation about the industry, to face a second half of the year with a market growing less - how much less I do not know.

I do not know if the market is going to grow in the same rate that we saw in the first four months or if we are going to see some deceleration. I do not know; but we reset our company to manage this new situation and we strongly believe that in 2012 we could see the market growing higher because we are going to have increase in the level of income especially for the lower income in Brazil and also lower inflation, and those two drivers are drivers important to our industry.

Ms. Serra: Ok and I wonder if you could give us a sense of the innovation counter for the second half of the year. I know you announced some things in your press release with Ekos, I know it is strategic information, you talked to start about filling in wide areas. Can you talk a little bit conceptually anyway about the number of important launches you think you have for the second half of the year?

Mr. Carlucci: Lore, I can share with you once it is already public and maybe there is another information regarding the public information that we already gave to the market that is the Ekos line. Ekos line is a total new line, not only a new package: a new formula, a new design, new benefits and this is going to happen gradually because Ekos line is a very big line.

So we started with hair care and then we are going to do this improvement and this innovation any other categories also adding new ingredients. So the Ekos, for example, is not only something that is going to happen in this first month; we are going to see in the next 3 to 4 months innovations.

And also, as we already shared, we are launching a new line, a new brand called VÔVÓ. That is a brand that developed products to put grandmothers and grandfathers closer to their grandchildren and we believe that this is not only a very strong concept that builds our brand, but also a good gift for Christmas, for Father's Day and other occasions.

So these are two examples that we are already informing, but we are going to have more, more initiatives - and not only products. We are going to also improve some of our marketing tools during the second half of this year - including advertising, but more than this.

Ms. Serra: Ok thank you.

Mr. Carlucci: Thank you.

Operator: Excuse me. Our next question comes from Mr. Celso Sanchez from Citi.

Mr. Celso Sanchez: Hi good afternoon. I just wanted to ask a little bit more about the consultant productivity issue. I was wondering if you might have some numbers you can share with us to give us a sense of if there is a difference in the regional productivity thinking about the impact of the CNO program.

I was wondering if perhaps the growth in the Northeast, in the lower GDP per capita in that part of the country might be helping to explain if the growth is coming more from there than the reps, and perhaps... the recent... the productivity there in general would be lower, if there is an explanation there; or is it possible that maybe the more reps you get as you grow aggressively perhaps a greater percentage are buying just for themselves or for a smaller base rather than for a broader clientele.

And I guess the third point related is is there any indication that a rep with X cycles of experience now is any more or less productive and if so how much than that same experience level of rep three years ago, before the CNO... for years before the CNO? Thanks.

Mr. Carlucci: Hi Celso, this is Alessandro speaking. Regarding productivity we did not see any region or any segment of consultants where the productivity loss was concentrated, and also I can add another information for you that when we think about our growth - not only productivity; I mean the revenue growth - we saw almost the same level of growth in the different regions in Brazil.

In other words our revenue frustration was similar in all the regions - so it is not a regional effect and also, as I mentioned before, it is not a segmented effect in some parts of the channel independent if they were CNO or if they are young or new. This is mainly impacted by the fact that the market grew less, we grew less, and the channel grew 16%. So this is a main reason why the productivity is lower.

Mr. Sanchez: Sorry, just to follow up: logically if the revenues are the same throughout the region and one region is growing reps faster than by definition the productivity associated to that region the reps will be lower, right? So whether that is a tenor issue in terms of experience or product mix in that region issue I am not sure; but revenue growing similarly in different regions does not necessarily mean that the productivity... that there is not a differentiation in productivity I would assume. Is that a correct way to think about it?

Mr. Carlucci: You are correct; but the productivity slowed down in the same rates in all the regions. So you are right to say that one thing is not directly related; but in this case, in this period of the year both things happened.

Mr. Sanchez: Ok very helpful, thank you.

Mr. Carlucci: Thank you Celso.

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: Once again I would like to thank you all for participating in our conference call and for your questions that always help us to reflect and grow. I want to reaffirm here that the company is absolutely prepared to face the current challenges as we have been assuring you, with a leadership team that is 100% committed and consistent in our long-term growth.

Results in a typical year... in an atypical year like this one when we have changes in the policy, in the economy apart of any company, and we are better prepared for the second half than we were for the first one.

We have a more effective marketing plan with important releases, advertising actions and support for the channel. We shall make the necessary adjustments without affecting investments for the future growth, but seeking more efficiency and productivity gains. We have strength in our business and solidity enough to continue to grow and gain market share in the medium and long term.

You can be sure that we will take advantage of this period to reinforce our foundations which are already solid, maintaining our track record of exceptional growth and expansion of our market share in the coming years. Thank you again and we will see you at our next earnings disclosure in October. Have a nice day.

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