International Conference Call
Natura
1st Quarter 2014 Earnings Results
April 25th, 2014

Operator: Good morning ladies and gentlemen. At this time we would like to welcome everyone to Natura's 2014 First quarter conference call. Today with us we have: Alessandro Carlucci, the CEO, Roberto Pedote, the CFO and Fabio Cefaly, the Investor Relations.

We would like to inform you that this event is being recorded and all participants will be in listen-only mode during the Company's presentation. After Natura's remarks 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 *0 to reach the operator.

We have simultaneous webcast that may be accessed through Natura's IR website: 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 after the end of the event.

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 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 begin the conference.

Mr. Carlucci: Good morning everyone and welcome to our earnings conference call for the first quarter of 2014.

Natura's consolidated net revenue grew by 15% with the Brazil operation growing by 9% and international operations including Latin America and Aesop growing by 53%.

Our consolidated Ebitda grew by 8% year-over-year while net income fell by 6%. Our revenue growth in Brazil was driven by solid growth of around 8% in consultant productivity, which reaffirms the strength of our value proposition and brand preference. And it's also a positive sign of the investments in marketing, product innovation and management tools for our sales team that we've been making since mid-2013.

Our international operations in Latin America maintained a robust growth pace while also becoming more profitable. We decided to intensify our investments in brand building in the operations and implementation in order to take advantage of the good moment that these operations are enjoying, especially with the sustainable relations network model in Mexico.

Aesop, which today has 82 concept stores in 10 countries, has been registering very strong results in terms of revenues and profitability. At the same time that we are making the investments needed to make us more competitive in the short term in Brazil and to transform Natura through advances in its commercial model with the Natura network and the development of new brands and categories we also continue to make adjustments in our company to make it more efficient and that frees up resources that will be used to finance these initiatives while still keeping our profitability in line with historical levels.

I would like to take this opportunity to comment on some of these opportunities that combined with the significant improvement in our profitability in the international operations represent important sources of funds for reinvesting back into the company.

In our logistic operations we further diluted the fixed cost of the network we built over the last few years, for example; the new distribution center in São Paulo, which has a more efficient process with more technology and lower labor needs will support an increased in the volume of orders.

As a result of our continues focus on productivity and efficiency we identified optimization opportunities in our organization structure and most of them we already implemented during this 1Q, and as a result of our continues focus on capturing productivity and efficiency gains we identified opportunities to collect in our collecting trade bills process even though late payments are low and in line with our historical levels we are improving the collection process especially for bills that have already been written off.

We intensified our efforts in this area during the second half of last year and this quarter, in addition to the benefits captured, we had to make a one-off adjustment that Pedote will explain in details a bit later.

It should also confirm that we are going to rebalance our profitability along the year remembering always that our business decision accompany our launches in marketing actions with the calendar changing from cycle to cycle, month to month generating variation in our quarterly profitability, but not in our annual profitability.

In terms of our market share in Brazil, for the ninth straight years, we maintain our leadership in the overall CFT market with market share of 12.4%, which represents a reduction of 70 basis points from 2012. As we already mentioned in the earnings conference call for the fourth quarter of 2013, the contraction in our market share was concentrated in the first half of last year in the perfumery and cosmetic categories.

In the countries where we have operations in Latin America, excluding Brazil, our market share ranking improved from the eighth place to seventh. In the operation in consolidation we expanded our market share by 70 basis points to 5.1% and we are already a relevant player and in the operations in implementation our market share expanded by 20 basis points.

I should mention here that in March we inaugurated our industrial complex in Benevides, in the states of Pará, which will handle the entire manufacturing process for our soaps. *Ecoparque*, as we named it, is an important platform for generating sustainable business and for reducing production costs due its proximity to the supply chain.

Lastly, before handling the call over to Pedote, I would like to share with you that after one year of the Natura network pilot program in two important cities in the state of São Paulo the results obtained were very positive and we are planning to start expanding this model in the second half of this year.

So those were the points I wanted to cover. I would now ask Roberto Pedote to give us some details on the results.

Mr. Roberto Pedote: Thank you, good morning everyone. Since Alessandro has already commented on the factors that have supported consistent revenue growth in Brazil, I would like to take a look at other factors that impacted our results.

Despite the improvement in our profitability in the international operations our consolidated Ebitda margin was pressured by those lower Ebitda margin in Brazil caused mainly back our lower gross margin, the higher investments in marketing actions and the nonrecurring impacts from severance costs related to the optimization of our organization structure and also by the adjustments in our criteria for recognizing the recovery in the renegotiated trade bills, as Alessandro mentioned earlier.

Consolidated gross margin remained practically stable in the quarter due to the combination of a margin expansion in the international operations and margin compression in Brazil, which is explained by the increased use of promotions and the higher-than-expected local currency depreciation.

In Brazil we expect gross margin to recover over the course of the year since the positive impact from the price increase implemented in March and also from the second round of increases planned for August will be felt mainly in the second half of the year rebalance our gross margin in the total year of 2014 compared to the total year of 2013.

To give you more details on our receivables since last year we've been improving our collection process in order to make the process to recover trade bills past-due over 180 days more robust. In recent months we saw that these renegotiated trade bills present a different delinquency profile that calls for more conservative provisioning criteria.

For this reason we decided to make a one-off adjustment to the provisioning criteria that had been applied to the renegotiated trade bills last year, which generated a nonrecurring cost for this quarter. Even with these adjustments we achieved consistent improvement with repeal gains in our collection process.

In the quarter the fixed (0:11:02 inaudible – mic away) in net income was due to three main reasons: The higher depreciation expenses resulting from the Capex investments made last year, second was the planned increase in our net debt as well is the higher interest rate in the Brazilian economy that increased our financial expenses, and last is the temporary impact from adopting the straight line method for our income tax rate, which in 2013 stay at around 31.5% in the first nine months of the year and only in the 4Q was adjusted to reflect the average effect rate of 32.5 in the whole 2013 year.

For 2014 we've been applying since the first quarter the same 32.5% income tax rate.

In the whole of the year since depreciation in the financial results are independent from our revenue in Ebitda the divergence between the revenue growth and net income growth will be lower since the first quarter naturally present less favorable seasonality for revenue in Ebitda and at the end of the year the difference in the income tax rate will be neutral.

Free cash generation was impacted this quarter by the distribution of Capex, which this year will be evenly distributed over the four quarters. We have already invested R$135 million this year out of a total of 500 million planned for the period while in the first quarter of last year we invested only R$61 million out of the total of R$550 million invested in 2013.

Those are the main points I wanted to cover today. Thanks and let's go now to the question-and-answer session.

Q&A Session

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

Our first question comes from Ms. Melissa O'Connor, with Bernstein.

Ms. O'Connor: I'd love to learn a little bit more about that promotional intensity that happened in Brazil this quarter that, you know, as you mentioned, impacted those margins and market share.

Can you give us a little bit of color around what were the major drivers of that and, you know, why you think that is going to improve going forward? Thank you.

Mr. Carlucci: Hi Melissa, this is Alessandro speaking. Well, just to recap, since the second half of 2013 we raised the investments in marketing and we want to keep the same level in 2014.

What typically happens – but that's not something that is particularly to this year – is the fact that in the first quarter of every year we used to invest a little bit more because is a seasonal moment of the year in sales; it's summer vacation and people are not in the city, so we used to invest more in marketing when compared with the other quarters of the year, special on promotions.

So excluding this fact our plan is to keep the same level of investment in marketing that we had on the second half of 2013 for the whole year of 2014.

Ms. O'Connor: Understood. And so from your competitors are you seeing a greater response than you have before or is the competitive environment relatively consistent with how it's been?

Mr. Carlucci: Well, we keep seeing a very competitive environment with all the major competitors investing as we saw last year, so there isn't a change even though it is still very competitive.

Ms. O'Connor: Okay, great, thank you so much.

Mr. Carlucci: Thank you for your question.

Operator: Excuse me, our next question comes from Lori Serra from Morgan Stanley.

Ms. Serra: Hi, good morning (or good afternoon, I guess). I guess I wanted to ask a little bit about the pricing, you know, an year is passed I think most years you've taken one price increase and so I think you did one time, you did a second one because of taxation or something, but I don't remember this being a typical cycle of two price increases in one year. So could you give me a sense of why you see that opportunity this year?

I mean, I understand the FX rate is, you know, you're trying to cover the FX rate, but sort of from a market perspective why is that something you think is kind of the right thing to do?

Mr. Pedote: Hi Lori. I think that last year we did two price increases, but the key for us this year is that what we planned this first price increase in March the cost situation for Brazil related to the exchange rate was in a better situation than today. And then the second price increase is much related to a higher cost pressure that impacts everybody here in Brazil related to the exchange rates and inflation.

This is why we believe that there is this opportunity and we are going to do this now in August this second price increase.

Ms. Serra: Okay, and for sure you think about the two together is what you sort of put into pricing or is it one on certain products and the other on other products?

Mr. Pedote: No, normally any price increase that we give we always look category by category and even in the same category product by product to see you where are the opportunities in comparison to our competitors.

Then, generally speaking, there is a cost pressure, there is more the exchange rate is worse than previous years, but the price increase is not equal to everybody and it's always taken into consideration opportunities, specific opportunities and specific challenges that we have with some products.

Ms. Serra: Okay, great. And just if I could ask a little bit about the Aesop. I mean, it seems like you've been growing that more rapidly then I guess I understood in the past year.

Can you give us an update on, you know, kind of where you see that… I mean, I guess what you said is that you going to build stores in Brazil to help the effort

I guess you put on the e-commerce platform, but internationally, any updates in terms of what you see for that asset?

Mr. Carlucci: Hi Lori, it's Alessandro speaking. Well, you are right; as you said, the real business of Aesop is better than the business plan that they presented to us when we bought 65% of the company.

So the business is doing very well and I'm not including the efforts of opening in Brazil because this is something that we added to their plan after we acquired the company and also, as you said, we are planning to open two stores – Aesop stores – here in Brazil, so this is also going to speed up the growth and the expansion of the company and they have in their business plan there is this still a lot of space to growth in other markets regarding Aesop and this is going to happen not only this year, but also in the next two years in new countries because Aesop is nowadays in 10 countries and we believe that this brand can really be a global brand.

Ms. Serra: Okay, thank you very much.

Mr. Carlucci: Thank you for your question.

Operator: Our next question comes from Mr. Alex Robarts, with Citigroup.

Mr. Robarts: Thanks, hi everybody. I guess, you know, one of the things that would benefit from in this particular press release is that we get kind of a full picture for the year in terms of the industry growth rate, you know, the sell in according to SIPATESP for the market side we see the number posted at 10.6% growth last year and I'm just wondering how do you think about the industry growth for this year? It's quite a particular year there is a lot of moving parts, a political year as well.

If you could comment on the growth rate you think that the market can have this year and particularly do you think that toiletry continue to outpace the cosmetic and fragrance segment as we saw last year?

And then, finally, it looks like, you know, *Sou* did a good job helping you to stabilize that toiletries market share for the year. Do you think it makes sense to or do you plan on doing some small white space type of rollout in fragrance or cosmetics but that might stem any more further loss of share in that segment? That would be very helpful, thanks very much.

Mr. Carlucci: Hi Alex, it's Alessandro speaking. We project (and of course this is only a projection) that this year because of all the facts that you mentioned the CFT growth should be between 10 and 8%. So this is our expectation today even though we don't believe that the World Cup or the other things that will happen are a problem for our industry, we know that are not going to help, so because of that the growth should be similar maybe a little bit lower than last year.

Regarding the cosmetic and fragrance market share, Natura's market share, we believe, yes, that we can grow market share in this area – even though we lost last year – mainly because we have a good innovation pipeline on this two categories for the next two years and during this period we believe that we could grow market share and there are yet some white spaces in the market where we can occupy with our brand.

They are not as big as it was in the *Sou* launch, but there are some white spaces and we are working on that to guarantee that we can really be present in the different segments of the market where our customers want to buy.

Mr. Robarts: Thanks very much. That's all.

Operator: Ladies and gentlemen, as a reminder, if you would like to pose a question, please, press the star key followed by the one key on your touchtone phone now.

Our next question comes from Ms. Lori Serra, with Morgan Stanley.

Ms. Serra: Hi, thanks for taking another question. I want to ask you about the rep pace and, you know, I know we talked a bunch about this, but you know, you've been trying I guess the last three or four quarters to get rep base growing and it seems to be sort of stuck and stubborn and I'm getting to think and I'm getting the impression (I could be wrong, but) some of the new entrance to direct selling maybe aren't having as much of an impact now as they were let's say 12 or 18 months ago.

So if you think about this effort to recruit reps, is it just getting more difficult because, I don't know, (0:24:39 unintelligible) in Brazil or, you know, there is a finite number here on your reaching as an industry and therefore is it really the big issue is introducing the new reps to the online model because they are new and then the demographic reach cohort in this?

So I guess what I'm asking is in the direct sales model is the sort of rep base now really just kind of where he can be?

Mr. Carlucci: Hi Lori, let me see if I understood your question please let me know if I missed something. Well, first of all, as you know, our strategy changed in the last year because in the last five years we were focused to increase penetration mainly by growing the number of consultants and we realized last year that marginally speaking this strategy will give less result then historically speaking.

So we decided to leverage the asset of the number of consultants and the preference of the brand and the penetration that we already have to change the strategy from growing the number of consultants to growing their productivity because also, as you know, we have low-frequency on the consumer purchase, so that's where the opportunity is.

And by doing that we changed all of our motivation program, our marketing incentives and all the marketing strategy to promote more productivity. And since half of last year we started to have gains on the consultant productivity and we saw the same this quarter.

And this is the strategy. This does not mean that we are not going to grow anymore the number of consultants, but it means that we are going to grow lower than we used to in the past years.

Saying that, there is something important to share with you in this 1Q that typically January and February (that are summer vacations) are very low activity periods where our consultants they travel, they are not here. So historically speaking, the growth of the channel or the number of consultants is a lower in this period when you compare with other quarters.

When you are growing 10%, let's say, or 50% the number of consultants, if you lose two or three points of growth it's not a problem, or he does not call your attention. When you are growing in this new strategy we were growing 2 or 3% and you lose those 2 or 3% you don't have a growth; that's what happened this quarter.

So this is the only difference that I would like to call your attention to that explains why in this quarter we didn't see a growth in the number of consultants. But from the next ones you are going to see again a growth. Not as big as it used to be, but some growth in the number of consultants.

Talking about the industry or, maybe, before that talking about the strength of our recruiting process it's still very good, so we are still having a relevant amount of people that want to join.

What we've been doing since this change in the strategy with me more… how can I say… more selective to include new consultants trying to see which one are really going to keep because I work strategies retention.

So this is what changed, but the level of people that want to join is still higher. So we don't see a problem in the business model and in the industry, but what we see is a change in our strategy as we already shared with you.

Ms. Serra: Thank you, that's very helpful. Thank you.

Mr. Carlucci: Just to add something that he asked me. Of course that the Natura network is going to be a new way to recruit a new profile of consultants because we are offering a new way to do the activity and because of that we already learned – in the pilot – that we can start to attract a younger one and a more educated consultant when we compare with the average of our consultants.

Ms. Serra: That's very helpful, thank you.

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

Mr. Carlucci: Well, thanks for your participation in today's conference call. I'd like to close today by reaffirming that we are confident in our plants of 2014 with the highlights of the performance of the international operations that maintained a robust growth pace while also becoming more profitable, the initiatives that we continue to improve consultant productivity in Brazil and actions to obtain the productivity gains that will finance our investments including those important for our growth in the medium term.

I look forward to talking to you in July 25 when we will discuss the results for the second quarter of 2014. Thank you once again and have a good day.

Operator: That does conclude Natura's audio conference for today. Thank you very much for your participation. Have a good day.