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International Conference Call
Natura
4th Quarter 2013 Earnings Results
February 14th, 2014

Operator: Good morning ladies and gentlemen. At this time we would like to welcome everyone to Natura's 2013 Fourth 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 Natura's earning conference call for fiscal year of 2013.

I'd like to start highlighting that the results in the quarter were in line with what we have been saying since the middle of the year: with growth in Brazil accelerating and the international operations maintaining its strong growth.

In Brazil our revenue grew by 9.3% in the quarter supported by growth of 6% in consultant productivity, which is the result of our marketing investments, the new launches made in the year such as the *Sou* line, the very successful sales strategy for Christmas and the offering of the new payment options for consultants.

In parallel our international operations, which at the end of the year accounted for 17% of our consolidated revenue, reaching annual net revenues of more than R$1 billion continued to grow at strong rates with continued gains in brand preference and recognition and profitability gains, which went from negative Ebitda of R$12 million in 2012 to positive Ebitda of R$38 million in 2013.

These results confirm our believe that we are on the right path to consolidate our relevant business platform in the region.

Another highlight was the significant advances made in Mexico where in 2011 we implemented the sustainable relations network, which encourage entrepreneurship and promoted accelerated channel growth. And in January we reached a symbolic mark of 100,000 consultants in the country.

Our target market in Brazil grew by 8% in the first 10 months of 2013 based on data from SIPATESP. The recovery in our sales between July and October helped to reduce our market share loss in the year from 180 to 120 basis points in the period.

Although we do not have official data on market growth for the last two months of the year, given the fact that we grew by 9.3% in the 4Q we estimate that we maintained our market share stable in the closing months of the year.

Aesop, which we acquired in February 2013 and is important to our medium-term strategy to have more brands and categories, reported results in line with the business plan. During the year we opened 28 new stores, which included stores in three new countries and ended 2013 with 80 stores in 10 countries.

So we are very enthusiastic about the next steps to be taken by this brand in its current markets and in the future also in Latin America.

2013 was also marked by the continued confirmation of our medium-term strategy. After the lessons learned from our pilot project for the Natura network in the cities of Campinas and São José dos Campos we are not prepared to expand this model to other regions of Brazil.

The network will be important for strengthening even further the relationship with our 1.5 million consultants and with our 100 million consumers while improving the quality of our service and the relationships.

I would also like to mention that in 2013 we met our commitment undertaken in 2007 to reduce our relative greenhouse gas emissions by 33% incorporating sustainability into our management system has leveraged initiatives that have helped us to meet these commitments, such as increasing the percentage of plant-based ingredients in our products, adopting packaging with lower environmental impact, substituting conventional for organic alcohol in our perfumes, changing the type of paper on which that Natura catalog is printed, as well as many other initiatives.

For this year we expect the market to continue growing at the rate seen in 2013 in Brazil. We plan to maintain the level of our marketing investments that we began in the second half of 2013. We have a stronger pipeline than last year and we are also intensifying our initiatives involving channel segmentation and management tools for the sales team.

We have also intensified the focus on our productivity and efficiency seeking to maintain historical levels of profitability while continuing to invest in preparing our business for the medium-term by extending the Natura network and developing new brands and categories.

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

Mr. Roberto Pedote: Thank you Alessandro. Good morning everyone. This quarter we recovered our revenue growth in Brazil, continued to invest in projects that will enable us to advance our medium-term strategy and had excellent results in our international operations.

In 2013 in Brazil various factors impacted our profitability: slower growth in the first half of the year and consequently the lower dilution of fixed costs, the increased promotional efforts to activate the channel, the depreciation in the Brazilian Real (which pressures gross margins), logistic inflation and the cost required to transfer the Cajamar distribution center to the new distribution center in São Paulo and, at the same time, we have continued to capture productivity gains in various processes of the company, such as administrative expenses and collections process.

For 2014 we expect better balance profitability in Brazil given factors such as: 5% increase in price to be fully implemented in March, the transfer of the distribution center in Cajamar to the new center in São Paulo (which will bring significant efficiency gains) and the intensification of efficiency programs in all of our processes, including a more cautious budget in terms of expenses since the start of the year.

In the international operations the very positive trend in margins will continue. As Alessandro has already mentioned, we expect to have this year similar profitability to historical levels.

2013 was a very important year for Capex investments and we have almost finalized the cycle investments in logistics and manufacturing facilities. We opened a new distribution center in São Paulo and in the coming months we will inaugurate a new plant in Cajamar and in Pará.

In 2014 we plan to invest R$500 million in Capex with a priority on investments in information technology, which are crucial to the execution of our medium-term strategy. The examples include the extension of the Natura network in 2014, in the investments in transaction systems in Latin America, operations to support our strong growth in those countries.

In 2013 our free cash flow was 57% lower than in 2012 due to the working capital needs of R$170 million and the 550 million invested in Capex. Despite the higher working capital needs in December, during the year we operated with an average monthly position similar to the one in 2012.

For 2014 we expect better results in free cash generation since in the area of working capital we will continue to reduce our inventory coverage, improve our recoverable taxes position and increase payments to suppliers, which will more than offset the investments made in payment means.

We ended the year with higher leverage ratios than in 2012, which was mainly due to the higher Capex investments and the Aesop acquisition. We believe that our current leverage level is consistent for the coming years with our projected level of profitability, working capital and Capex requirement.

And last, on the 12th of this month the Board of Directors approved the proposal for the payment of dividends and interest on equity for the results in fiscal 2013, which will now be submitted to the annual shareholders meeting. These amounts combined with those prepaid in August 2013 represent a payout of R$1,99 per share.

Those were the main points I wanted to cover today. Thank you very much we will now go on 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 Mr. Joseph Giordano, from JP Morgan.

Mr. Giordano: Hi, good morning everyone. Thank you for taking my question. I have actually a couple of questions here. The first one is on the competitive environment. Can you comment a little bit how your competitors are behaving, if they remain aggressive in marketing? That's my first question.

And the second is also in the same topic. Basically we saw an important improvement in consistent productivity in Brazil, which drove the sales growth in the quarter, but this was mainly relied on higher promotional activities, which pressured gross margin. So, can you provide us some color on how this balance between growth and margin should behave in Brazil going forward? Thank you.

Mr. Carlucci: Hi Joseph, it's Alessandro speaking. Regarding the competitive environment we've been seeing almost the same environment that is challenging because we have almost all the major brands and companies operating in Brazil in the last years and also indifferent channels, not only retail, but also in direct selling.

So even though nothing has really changed in the last month we keep doing business in a very challenging environment, so our most important thing to do is to be prepared to do business in a more and more competitive environment.

This is our vision, but to be honest nothing really relevant happened in the last months.

And regarding the productivity of our consultants we boosted the productivity because we raised investments in marketing, but also because good innovation, new products that we launched last year, and the last quarter and the last semester and also new payments ways to the consultants.

So it's not only promotional the effort, but it's helping the consultant to do better business in different arena, so the combination of those things and as we already mentioned that we are going to keep investing in marketing this year, 2014, and also we have a stronger innovation pipeline for this year compared with 2013.

Mr. Pedote: And related to profitability that you were asking, as Alessandro mentioned, we will maintain our investments to be competitive in the marketing mix, we will recover gross margin from current levels with our 5% price increase that will be fully implemented now in March and we will have space to optimize logistics costs with the full implementation of the new distribution center, with the use of the capacity that we built under our program and we are intensifying gains in all projects in our efficiency gains, in our internal productivity program and we are having a very cautious look in terms of expenses for the year.

Then we believe we will have a good balance of profitability for 2014 including, as Alessandro mentioned, to be very competitive in the marketing investments.

Mr. Giordano: Okay, great, thank you. Just a follow-up here on the price increases. We've been hearing from some apparel retailers that customers are not taking too much pricing, so how do you see this? Do you see like your customers are taking these price increases without affecting your volumes? Thank you.

Mr. Pedote: When we decided to give this price…there is all those two components: one is the cost and the cost pressure devaluation, but the main one is always looking product by product to what the competition is doing, what are our strengths in that sub-brand versus competition, then this price increase of 5% we believe that is in line with competition and it's in this similar level that we have done in previous year and will be accepted by the market.

Mr. Giordano: Right, thank you very much.

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

Ms. Serra: Hi good morning and thanks for the call. I wanted to ask a question about rep recruitment or rep activation.

You guys had a slowdown in that metric and in the second half of the year you put more effort in terms of getting the activity up and yet it still seems like it's hard. We didn't see a meaningful improvement in the second half of the year even though you were investing hard to do that.

And I wonder if you could help us understand kind of at the real world level what's going on, I mean, is it that there is a sort of set number of consultants and everybody's trying to recruit the same consultants and the consultants are just getting more, I don't know, distracted (I don't know if that's the right word)?

Is it... there is some specific competitors that are building a sales force, but maybe just trying to stabilize, I mean, could you help us understand why even though you are sort of focused on this and it's been harder than expected? Please.

Mr. Carlucci: Hi Lori, it's Alessandro speaking. Thank you for your question. First of all let me remind you that one year, one year in a half ago we decided to balance our growth focusing more than we used to at that time on productivity because at that time we had reached a very high level of penetration and also a consultant base of 1.3 million consultants in Brazil, so there was an asset to leveraged that was this number of consultants and also the preference of the brand.

So we decided to move towards productivity and to have a better balance in our growth between those two components: Channel growth and also the productivity of consultants. So then we started to develop new initiatives to boost the productivity.

Even though we know that some of the initiatives are going to push more productivity and some are given to push more the channel growth this is not a scientific correlation, so sometimes (and this is what happened in the last 4 to 6 months) the mix of initiatives they pushed more productivity even though some of them were more directed to increase the sales growth, the number of consultants.

But by saying that I would like to explain something to you: That what we're trying to increase is not the recruitment, because the recruitment is in a good level. So we didn't change so much the number of new consultants.

What happened (and we are trying to increase) is the frequency or (what we call here internally) the activity, the level of consultants that are in the system that needs to approve the order, but the level of recruitment is good. Nothing changed on that.

And, again, as I mentioned, the mix of initiatives in the last six months even though some of them were directly to increase the activity, they increased productivity. So there is nothing really specific happening in the competitive landscape to explain why we are not growing.

And again, what we are recruiting in a good level. What we are going to do is, again, try to balance for this year the marketing mix initiative to have roughly speaking half of our growth coming from the channel growth and half from better productivity.

But again, this is not really scientific, so maybe you were going to see some small variations between those two pillars to increase the top line of the company.

Ms. Serra: Okay, that's understood. And then just a follow-up. I just wanted to make sure I understood your comments about the market growth will be more aligned with last year's level. It looks like the data was 8% on its way to something that could be below eight for the full year, so your expectation is it that the rate of growth in the market this year (which likely means that the environment remains pretty tough)?

Is there anything that you see changing that could make it less tough, but if the market decelerates that much in competitions tight that's just challenging, right? So are you seeing anything differently than that?

Mr. Carlucci: Well, first of all we believe that even though those rates are below the historical ones if our markets keep growing around 10%, we believe that this is the still attractive for us even though everybody (and of course us) will be prepared for lower growth rates.

Saying that we don't have yet the final numbers of 2013, so we have the last two months to receive, we don't have the numbers and personally I believe that maybe it's going to be a little better than the average of the year, but if it's not eight, it could be nine, maybe 10% of growth.

And our expectation regarding 2014 is that the growth of the market should be similar to 2013. So, you know, around/between 8 to 10%, something like that. So this is our expectation and we did our budget and our plan taking this into consideration.

Ms. Serra: Okay, that's helpful. And then just quickly on international. I was interested in your comments that the margins would keep expanding and that seemed a little bit counterintuitive to me because you just had a big devaluation or a relatively big devaluation in Argentina, which is your largest market and you are investing in Mexico, which seems like it's the right thing to do and then your margins are already very high in the markets in consolidation, you know, when you look at the gross margin level, let's say, versus Brazil.

So I guess one question is just how is this recent movement and the Argentine currency going to affect the near-term results and then where are you seeing the continuation of the margin expansion internationally for this year, please?

Mr. Pedote: Hi Lori. We are still taking the benefit of growing more than 30% per year and diluting fixed costs. This effect will continue to happen and especially when you see the Mexico and Colombia we are still in the beginning of the profitability cycle.

Despite we are investing more there in want to build the brand, but this level of growth always allows us to increase profitability even like we have some fixed costs in the total internationally area as we have our head-office and some costs of projects in Buenos Aires and all of this has been diluting.

The Argentina situation by itself is something that we are looking carefully. The current devaluation that has happened there is something that is quite manageable, but as the institutional environment is more difficult we are looking carefully especially if we… any company can have some problems in terms of suppliers.

Argentina is always something that we need to see with cautious for the year, but excluding if something very different happened in Argentina we can continue with this dynamic in the total region.

Ms. Serra: Okay, thank you very much.

Mr. Pedote: Thank you.

Operator: Excuse me, as a reminder, to pose a question, please, press start one.

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: Thank you for participating in today's conference call. I would like to emphasize that the results in the quarter provide further confirmation that we are moving into the right direction despite the more challenging competitive environment.

We remain focused on the challenge of gradually improve the productivity of our consultants and investing in projects that are fundamental to our medium-term strategy. We also reaffirm our enthusiasm and confidence in our international operations, which already represent 17% of our sales.

I would also like to invite everyone to the opening of Ecoparque in March 12; our new *Sou* plant in Pará that was built with sustainable pillars, such as: filter gardens, reuse of rainwater, natural ventilation, geothermal cooling source, mobility using electric cars and bicycles and several things very very interesting in an industrial symbiosis of the company and sustainable assets to social biodiversity ingredients and, last but not least, also provides lower production costs.

So thank you again for participating in our conference call and I look forward to talking to you again in April when we will discuss the results for the first quarter of 2014. Good day everyone and have a nice weekend.

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