Q1 2016 Earnings Call

Company Participants

- Jose Roberto Lettiere, CFO
- Roberto Lima, CEO
- Unidentified Speaker, Analyst

Other Participants

- Alex Robarts, Analyst
- Andrea Teixeira, Analyst
- Franco Abelardo, Analyst
- Guilherme Assis, Analyst
- Gustavo Oliveira, Analyst
- Irma Sgarz, Analyst
- Robert Ford, Analyst
- Thiago Macruz, Analyst
- Tobias Stingelin, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Thank you for waiting. Welcome to Natura's First Quarter 2016 conference call. Today with us we have Mr. Roberto Lima, CEO; Jose Roberto Lettiere, CFO; and Fabio Cefaly, IR Manager.

This event is being recorded and all participants will be connected in listen-only mode during the Company's remarks. After that we will begin a Q&A session when further instructions will be given.

This audio conference is being simultaneously translated into English and questions will be answered by those connected abroad as well. (Operator Instructions) This event is also being webcast at the following URL www.natura.net/investor. The slide deck can also be found at the same address and will be available after the event as well.

Before moving on, I'd like to mention that forward-looking statements made during this call concerning the Company's business outlook, operating targets and projections are based on assumptions and beliefs of the Company's management and also on information currently available. Forward-looking statements are no guarantee of future performance. They involve risks and uncertainties because they refer to future events which may or may not materialize.

Investors should have in mind that general economic conditions, industry conditions. And other operating factors might affect the Company's future performance and lead to results that will differ materially from those expressed in these forward-looking statements.

I'd now like to turn the conference over to Mr. Lima, Natura's CEO. Mr. Lima, you have the floor.

Roberto Lima {BIO 6848983 <GO>}

Thank you. Good morning, everyone. I'd like to start by thanking you and welcoming you to our conference call to discuss the results for the First Quarter 2016. As you will have observed in the release, we presented a strong contrast between the international operations and the domestic operations.

Abroad, we saw a growth of 42% and those operations now account for 33.6% of our net revenue. Operation in Latin America grew 31.8%, 29% in local currency in the respective countries, the five countries where we operate, a strong growth in the number of consultants. The Aesop, our Australian operation (inaudible) grew 26% in reais, 52% in Australian dollars, which was the result of the opening of 42 new stores in the past (inaudible) and a growth of 20% [ph] in that chain. In Brazil on top of the worsening of the macroeconomic scenario, our revenues were impacted by an increase of 3.4percentage points in tax burdens on our gross revenues and also because of the seasonality of certain dates such as Mother's Day. Today consolidate [ph] our investments in April. We continued to try to gain efficiency and cut cost in Brazil in nominal terms.

Our sales and administrative expenses remained stable with a slight growth of 1% when compared to a 10% inflation. In this spirit, the consolidated EBITDA dropped 24% due to a drop in net revenue, just as -- I have just mentioned. Later our CFO Mr. Lettiere will go into detail -- details about those numbers and also mentioned a non-recurring FX, which also affected already which will add to a BRL69 million loss in the quarter.

I'd like to talk about our strategic plan which was approved by the Board last year, which has to do with structural aspects of our business and makes us confident in terms of recovering our market share and our profitability levels in Brazil.

The plan has the following focus, emphasis on sales channel, innovation, rationalization of the portfolio, a better positioning of the brand, new channels. And international expansion. Speaking of the rebirth of our sales channel, we have several initiatives in place such as the digitalization of our channels. As I've mentioned before, we are making several tools and apps available for smartphones to increase our efficiency among consultants. As for innovation we have presented new products and have resulted to new technologies that help us leverage our business in Brazil. This is a new strategic access which will be consistently followed by Natura. As an example in 2016 we have re-launched the Chronos line which tabs on those technologies that I've mentioned.

Now we see the rationalization of our portfolio. (inaudible) are already underway towards reducing the number of SKUs. At the same time, we have selected strong brands which will be the focus of our innovative projects and marketing brand in the short one, for example, the Core Biery [ph] products.

Number four, the positioning of the Company's strategy. In March we have communication campaign out to strengthen our brand Viva sua beleza which strengthens fundamental pillars of the Company in sync with our main values, beauty, pleasure. And sustainability at the same time. As concerns new channels, we have important news in March, we started expanding our SOU line which was revamped in the second half of last year. We have now 27 drug stores of SOU line in the country of Sao Paulo. Now we have been working with the (inaudible) chain. We have also opened our first store at the Morumbi mall in Sao Paulo and have launched the e-commerce platform for the final consumer.

As for international expansion, still focus is on rapid growth in Latin America. Last year, as Roberto [ph] has mentioned, we have won market share in other countries in where we operate. Aesop is an important driver of that movement and we'll try and keep that fast pace in terms of opening new stores.

In France, our small operation went through a couple of changes. Our store moved from 250 meters in Saint-Germain to Mahe [ph] with the largest store. We gained cost and efficiency while increasing the revenues and at the same time, we're developing new online operation, which on top of servicing France is also able to service clients from other countries. In Brazil in 360 will be a year for us to focus on structural processes so that when the country recovers its growth we'll be well-positioned to complete at a good level.

At this point, I'd like to turn the conference over to Lettiere so that he can break-down the numbers for you. Lettiere, you have the floor.

Jose Roberto Lettiere {BIO 16358413 <GO>}

Good morning, everyone. Our conference call for the First Quarter 2016 will start with the financial numbers. I'll start by saying that we remain confident in our financial strategy very much in line with our growth strategy, a strategy we have been focusing on and which will surely lead us to a recovery, especially when we look at the initiatives relative to the recovery of margin, working capital and competitiveness and of course, we also (inaudible) mention the cash generation front, something we have been working on very consistently.

Given a very challenging First Quarter, when compare -- when talking about the top line, I'm talking about slides number 3, consolidated net revenue. The first highlight of the slide is that our international operations account for a significant share of our revenue and that has been growing gradually year over year.

A price increase and volume increase in Brazil will be dealt with later in the presentation. But if you're talking about the consolidated net revenue, a highlight is our growth from

2.9% in the quarter and our international operations again account for 33.6% of the total net revenue when compared to 24.3% which was filed last year -- in the First Quarter of last year.

Moving on to the next slide, net revenue for Brazil alone, I'll be making some comments about the impact we are feeling with the tax burden which we saw an increase of 3.4percentage points in the tax burden when compared to the First Quarter of 2015. We had also a price increase year on year, an increase of 9% in the First Quarter. We also saw a deleveraging when compared to our market performance which is quite different from what we had before.

As you well know, we have also seen a slowdown of the market. So we had a drop in sales volume of 11%. But at the same time, we have some good indicators. For example, our channel which grew 4.5%, that's very important. That channel needs to continue growing. Another important element I'd like to mention and which was also important for us in the First Quarter is that we had when compared to the First Quarter of last year the Mother's Day campaign, which is quite important for our operations. This year, we concentrated our activities in the month of April. So we transferred revenue from March through April which was not the case last year. So that's another important element which also impacted our revenues for Brazil in the First Quarter.

In the next slide, still about Brazil, according to Euromonitor data, you see a sequence of figures of our -- concerning our market share and in this First Quarter, the First Quarter of 2016, we saw a negative variation of points three. But as we can see this has been slowing down and with our plans in place, we're going to have to be working closely with that. But that's an important piece of data. We can now really see some indication of change even though the market is a bit more restrictive. But the trend is positive in terms of market share.

For Latin America in the next slide, Latin America has been performing well overall, has been showing good growth at 31.8% in all operations, in all countries where we operate, if we exclude the currency impact, we have grown in local currency at 28% with the member of consultants growing 18% and with a very significant level of productivity when we compare that to the First Quarter of last year, a growth of 11.4%. So Latin America as a whole has been providing strong growth at a very important challenging moment for the Company and has also been contributing significantly to our results.

If we move on to the next slide, we still see some market share data. The source again is Euromonitor. We can see a gain in market share when compared to 2014. We can see 2015, 2014 in the historical basis. So a big (inaudible) by region. Latin America went from 3.5% to 4.1% and we saw a growth in all countries which also makes us very confident that we are following in the right path in terms of growth in Latin America as a whole.

Still about international operations on the next slide, we have net revenue for Aesop. Aesop has been performing quite well in terms of top line. We saw a growth of 96.5% in the First Quarter when we exclude the currency impact between the real and the Australian dollar, still the growth level was extremely relevant at 52%. Another highlight is that Aesop stores posted or a same store sales growth of 20% when compared to the First Quarter which shows the strength of the brand Aesop in Australia.

Moving on to profitability or EBITDA generation on the next slide, we can see the consolidated EBITDA on the next slide. And we can see that we have suffered with a drop in the First Quarter 2016 and consequently, we have also suffered -- our margins have also suffered. Another important point, the tax burden as I've mentioned before when I talked about Brazil's net revenue, tax burden increased 3.4%. That's an increase when compared to 2015. Another factor is the currency exchange or the foreign exchange.

When we compare those figures to the First Quarter 2015, we see a strong impact even with the mitigation because our contracts controls our net exposure. But still we had an important impact in terms of currency devaluation which led to a negative impact on our margins. Another important factor is the operating deleveraging as I mentioned before when I talked about Brazil. We saw a drop in volume and we managed to offset that with higher productivity. But obviously it was not enough when faced with that significant drop in volume.

So that's a summary of some of the important impacts on our margin. Now the growth in our operating international operations were also important. But at a lower margin when compared to Brazil. So when we have -- when we make a weighted average of those numbers, the numbers are still negative. But our international operations remain growing well and they account as was said before for 30% of our EBITDA generation. Something else important to highlight is that our cost controller OpEx remains very much under control and it has also helped us -- it also helped us partially offset and mitigate those negative impact I have just mentioned.

On the next slide, net income. In this quarter we have had a few extraordinary adjustments, the business adjustments I mentioned when I talked about EBITDA generation. Those adjustments brought about in terms of income a contribution of BRL105 million. I'd like to explain some of those extraordinary effects, non-cash effects such as the mark-to-market factor when we see our derivative operations when we have -- when we talk about the older contract, we need to use BRL60 million mark-to-market adjustment and another important impact has to do with our Aesop operation.

Operationally, Aesop has been growing significantly. But based on IFRS, we need to include the impact of the valuation of Aesop and that impact in this quarter because of the business leverage level and also because of the foreign exchange valuation, the impact was at BRL62 million non-cash impact on the net income which was subtracted from our net income. In terms of debt service, financial expenses will also have an important impact because of the increase in interest rates we have in Brazil.

The foreign exchange variation and derivative hedge and some injunctions, some legal issues which also cost several significant impact on the business. And lastly we also had the income tax impact. The income tax is calculated independently country by country and we had positive results both in Latin America and in Australia. So we had a consolidated impact which was still negative. So our net income in the end was minus BRL69 million.

That's the first net income that we have calculated in the Company's history. But those extraordinary effects are contributing strongly to that result. They were important drivers to that negative number on the right.

On the next slide, we talk about the CapEx, consolidated CapEx. We have approved our CapEx for BRL350 million for 2016 when compared to BRL383 million for 2015 and that includes the Company's investment level at a new level. So far 2015 and 2016, we are already going towards a new direction concentrating on sales, IT, new channels slightly different from what we had before when our investment focused on infrastructure expansion, manufacturing, services, to ensure we could recover our growth levels.

So in the First Quarter, we had maintained a very controlled CapEx level and we spent around BRL48 million. A highlight here for -- once again for the international operations were the account BRL40 million of those BRL48 million.

In terms of free cash flow, our working capital in 2015 saw a strong drop when compared to our track record. When we compare March this year with March 2015, we saw a drop of BRL891 million to BRL611 million at the end of March. Once again in 2015, we had a very strong performance, a very high demand to decrease our inventory. But in the beginning of the years due to seasonality of our business especially in Latin America, we have managed to resume investment and inventory special in Latin America and because of that our working capital when compared to December 2015 where we were set at BRL489 million, we saw an increase in our inventory.

But our managerial procedures remained focused on controlling inventory. So our average working capital for March 2015 was 10.7% and in March 2016 we are talking about 7.5% so that's the highlight for the working capital which remains an important driver for free cash flow generation.

In terms of net debt, we had an increase when compared to the First Quarter 2015 mainly due to the reduction of the consolidated EBITDA over the last 12 months. We went from 3.3 times, a very normal stable level. And we are now paying very close attention to that and trying to manage our flows the best way as we can with a strong control.

If we continue to talk about our chief bottom line, we talk about now sustainability, we have our main indicators here highlighting a few of them, the material recycle post consumption comparing both quarter, in the First Quarter 2016, we closed at 3.7 in terms of water consumption 0.5 to 0.45 and the Crer para Ver penetration of our social project. We have a very important portfolio in this First Quarter several new innovations which have helped this project move along and remain important.

Basically those are the main drivers, the main financial numbers. I will now give the floor back to Roberto and we'll then move on to the Q&A and investors and shareholders. You have the floor.

Roberto Lima {BIO 6848983 <GO>}

I think we can move on to the Q&A session.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the Q&A session. (Operator Instructions) Robert Ford, Merrill Lynch.

Q - Robert Ford {BIO 1499021 <GO>}

You were saying that sales dropped in April, could you elaborate what's the rationale behind it? How do you compare the sales cycles vis-a-vis last year's sales cycle?

A - Unidentified Speaker

Actually that's a calendar effect. This year we had a change in important dates Mardi Gras and Easter and we used those dates and we postponed the launch of the Mother's Day's campaign. So impact in sales in March. Part of that impact are going to be carried over to April. That's based on the calendar, that's a civil calendar that -- these are moving holidays. The second part of the question was about the performance of the Mother's Day sales cycle. We're still within the Mother Day's sales cycle, it's a very important time for us. We still have one or two weeks in the month of May so we cannot anticipate results campaigning results will be announced in Q2.

Q - Robert Ford {BIO 1499021 <GO>}

Can you talk about price a little bit more? What about the demand and what's the competitors' take? How are they reacting?

A - Unidentified Speaker

Actually last year we had some strong impact in our cost structure. An increase in tax burden and devaluation of local currency that of course impacts imported goods and those that are priced in dollars and on top of that we had a local inflation of about 10%, we had to transfer that impact to prices. There were no (inaudible) about it and we did that in Q1. That has reduced volumes. But we could not take any chances of having margins deteriorate dramatically, we would be difficult to recover that in the future.

At the same time, we're working hard to reduce our promotions so that we can have additional resources to invest in marketing communication and to activate our sales channel.

Q - Robert Ford {BIO 1499021 <GO>}

Roberto, what's your take on the competition? Are they increasing their prices too at the same level?

A - Roberto Lima {BIO 6848983 <GO>}

We have little information. Survey institutes do not provide an information, these are just market data and I couldn't elaborate on what they're doing exactly. We are concentrated on our operations today. Our focus is to stop that market share loss we've had in recent years. But we are producing margin, we're not interested in something that is not healthy of course.

Q - Robert Ford {BIO 1499021 <GO>}

Thank you very much.

Operator

Thiago Macruz, Itau BBA.

Q - Thiago Macruz {BIO 16404924 <GO>}

If I'm not mistaking you've created a few clusters for consultants in Brazil. My question is can you determine those who are suffering the most in the past 18 months? What types of consultants have had less productivity in Brazil?

A - Unidentified Speaker

It's true. We've been trying to segment our channels so that we can have different sales offers. But we don't see major differences in more or less productivity within the segment. It happens overall. It happens across the board in Brazil maybe because of price. We've increased prices and minimum orders and we have more productivity in terms of ticket price. But we have fewer orders. But there are major differences within the segments.

Q - Thiago Macruz {BIO 16404924 <GO>}

Let me just ask another question. You've been talking about revitalizing the direct sales channel, retail maybe a good opportunity. Are you in any way considering creating new brands so that you can stop market share loss in direct sales by using your own brand, is that a possibility?

A - Roberto Lima {BIO 6848983 <GO>}

Yes. It is a possibility. We are considering it, we are studying it. We have designated teams to study. I cannot make any announcements. We are at a very early stage, if we are going to introduce a brand for even segment or any type of service offer. But you are correct, we of course have to look into any opportunity to innovate by using by resorting to another brand.

Q - Thiago Macruz {BIO 16404924 <GO>}

Thank you very much.

A - Roberto Lima {BIO 6848983 <GO>}

Thank you. Thank you, Thiago.

Operator

Guilherme Assis, Brasil Plural.

Q - Guilherme Assis {BIO 16143141 <GO>}

Let me just try to explore two things actually. First, my question is about the dynamics between margins and price. What we see is that the current scenario is not favorable and it should remain -- will remain -- so from when you think about income and employment rate and consumers' confidence. But at the same time we see that you have a better margin in the First Quarter based on what I was expecting actually. So here's my question. Do you think you may have to increase prices even more to recover the margin in the near future and do you think it can happen? What's the thirst of consumers so that you can increase sales volumes too?

So let me just ask the second question about this SOU rollout in drugstores that you just mentioned, you have expanded somewhat and pretty soon you have more than a 1,000 stores, maybe all of the stores of the Raia Drogasil drugstore network. So here's my question. I have noticed that Raia is also considering other categories. They're selling other cosmetics products. Aren't you willing to enter that segment or have you studied expanding to other product categories through drugstores?

A - Roberto Lima {BIO 6848983 <GO>}

The first one is about price, I understand. Despite the fact that I have showed you an average number of price increases, this is not an across the board increase, not for all products, not at the same rate. We've had selective price increases for some products and some categories and of course there are some products that haven't suffered any price increase. But most of them have in Q1. As to the impact in volumes I understand your frustration. We are frustrated as well.

But despite the fact that we do not talk about plans, we are within -- the results we've got are within our expectations. That's not too far from what we hoped, we expected.

There would be sales volume impacts. But in the previous quarter when we had the call for Q4 2015 I remember saying that clearly the pricing because of the inflation, tax burden. And the foreign exchange devaluation and a recession that worsened in Q4 I mentioned that pricing would be one of the most delicate issues because we had to deal with it. The decision we made seems to be correct. We couldn't afford to delay for too much and then find out later on that price increases would have to be much greater to recover margins.

We have a price to pay in volumes. But we've noticed that we manage to capture most of that now. As to the SOU project at the drugstore, we are very pleased with that project. Couple of months ago we introduced the project in the countryside of the state in Sao Paulo. Initial results were very encouraging and then we moved to 700 drugstores and now in the first semester we are going to reach 1,200 drugstores and results are very good. That will be -- don't -- we don't know whether it's going to increase sales overall. But all the SOU brand with the growth we can achieve with this new channel can be very representative for the brand and that brand will be well known, that's one of our objectives. And the channel has responded positively based on our initial expectations.

As to other categories, your question was whether we dis-considered or disregarded that? No. That's not the case, the fact is we cannot do everything at the same time. An entire operation would be very cumbersome. We had to find out whether we could do it, we could pull it off. And now we are currently studying whether this is feasible or not to have other categories within the same channel.

Q - Guilherme Assis {BIO 16143141 <GO>}

Roberto, let me just go back to the first question about the price dynamics. When you look at your average price there's an impact of effective sales price increase and in the mix in the quarter was 12.5% and you said that the average price was BRL9.1 and you highlighted that these are price increases by category. When you look at BRL9.1, that's the average price increase in products or is that the average for all price increases of all products?

A - Roberto Lima {BIO 6848983 <GO>}

I'm not sure I understand your question.

Q - Guilherme Assis {BIO 16143141 <GO>}

Quarter over quarter, no, what I meant to say is have you quantified the price increase that was BRL9.1, right? You did not increase prices for all products, right? So this BRL9.1 was just for the products you increased the price or is that the overall price increase?

A - Roberto Lima {BIO 6848983 <GO>}

No. That was the total increase in the past 12 months. That BRL9.1 represents the weighted increase for all categories for all brands in the past 12 months ending March 31st.

Q - Guilherme Assis {BIO 16143141 <GO>}

I got it. So these price increases are dynamic, right, are dynamic? So they will keep on happening based on the category for every cycle, is that correct?

A - Roberto Lima {BIO 6848983 <GO>}

Yes. It is based on the calendar. We may have some more price increases in some categories, especially those brands that haven't had their prices increased.

Q - Guilherme Assis {BIO 16143141 <GO>}

When you talk about that in Q4 and you talked about a price increase in February there was one of 1.7% and now a 2% increase. How does that relate to what you said in Q4, are there any elements you can quantify based on data from that call up until today?

A - Roberto Lima {BIO 6848983 <GO>}

Yes. We had the call in February and we had price increases in March, yes, that is correct. The average was 6.5%, 6.6% if I'm not mistaken back in March and then you add that BRL9.1.

Q - Guilherme Assis {BIO 16143141 <GO>}

Now it's clear. Thank you.

Operator

Franco Abelardo, Morgan Stanley.

Q - Franco Abelardo {BIO 17416219 <GO>}

Let me go back to the price issue. When you look at your gross margin in Q1 there was a more relevant drop in Brazil more than what happened in Q4 despite that price increase. Looking at the rest of the year, do you think that the March increases will help stop the loss of gross margin in Brazil or are there any other things, FX or inflation in costs, are there any other negative impacts on the way?

A - Jose Roberto Lettiere {BIO 16358413 <GO>}

Gross margin suffered a lot because of the 3.4% tax burden increase, the real devaluation was also important. These are the two major negative factors for impacting the gross margin. This year based on the political scenario we may not see further devaluation of the real. So the exchange rate won't be a problem.

As to the tax burden, we do hope there aren't any increases. But these are decisions made on a state-by-state basis, they may change sales tax individually. But if we are led to increase prices to offset tax burden increases, volumes drop. And once that happens, that impacts employment demand and so on and so forth. We hope we do not have any further increases in the tax burden.

Let me just follow up to that question. So taxes, foreign exchange and to offset these two negative factors, we had price increases and you've reduced promotions. That's the equation. That makes up the gross margin for Brazil. Of course the operational deleveraging, I've already mentioned when I first spoke that also impacted.

Q - Franco Abelardo {BIO 17416219 <GO>}

Was there any additional tax increase in Q1? But the impact has already happened in Q4, I did not understand why the gross margin drop was bigger now.

A - Jose Roberto Lettiere {BIO 16358413 <GO>}

Yes. But there's something, there's something else. We had increase of MVA, some states. When we compare to Q1 in 2015, we did not have that. When you compare industry tax IPI in Brazil, excise tax has increased in some categories. That was implemented last year in May. When you compared 2016, the entire year, we do not have the same impact in Q1 for 2015. So the comparison are two quarters. But the tax burden was different. 2016 is bigger for these two reasons.

The tax burden, if you were to separate taxes last year for example, when there was a new law implemented to extended excise tax all the way to distribution, we questioned that and that shows up in our accounts. But it had sales tax, two effects in reais and the rate in First Quarter of 2016, 14 Brazilian states increased their sales tax rates. That will impact our operation. So the Q1 -- yes, there was a tax increase in Q1 2016.

Q - Franco Abelardo {BIO 17416219 <GO>}

That's very clear, thank you. The second question about nonrecurring expenses, if I'm not mistaken with reducing the number of employees, what was the impact in Q1 and what about Q2? Are you going to level that off in Q2?

A - Unidentified Speaker

No. Those are additional expenses to reduce personnel, the severance payments we have to make in the First Quarter. If I may, when you compare that to the First Quarter 2015, we had BRL8 million in severance pay when compared -- 2015, 2016 and compared to 2015 and we expect further impact throughout the year.

Q - Franco Abelardo {BIO 17416219 <GO>}

Negative impact, you mean?

A - Unidentified Speaker

No, no, we should not feel impact coming from the cost reduction. We have to let some employees go so there's an initial cost relative to those severance payments. But moving forward, our payroll should drop. But that's what I can say for now.

Q - Franco Abelardo {BIO 17416219 <GO>}

Okay. Thank you.

Operator

Andrea Teixeira, JPMorgan.

Q - Andrea Teixeira {BIO 1941397 <GO>}

I'd like to go back to a previous question concerning March, January through March. I understand the movement towards Mother's Day. But if you could give us some more color about the decrease in revenue and also the drop in productivity, what can we expect in those fronts for the remaining of the year? And a second question about fixed costs, I understand that you have made some savings. But how can you forecast that margin?

I understand the effect of the US dollar of raw materials. But I can't understand since you've already paid out BRL8 million in severance pay how much more are you going to be able to save? In other words, what's the percentage of the fixed cost that you have both for SG&A which remains slightly high, I mean it's flat year over year. But in percentage point, it has grown because of the operating leveraging. So if you could give us some color in terms of doing the math, in terms of the operating deleveraging?

A - Roberto Lima {BIO 6848983 <GO>}

Okay, concerning the 10% drop, you're talking about the 8.9% drop in gross revenue.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Yes. That's right.

A - Roberto Lima {BIO 6848983 <GO>}

I mean net revenue.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Yes, net revenue.

A - Roberto Lima {BIO 6848983 <GO>}

Then 5% drop in gross revenue. That shows a strong impact coming from the tax burden. And you also referred to the productivity level of our consultants. What we see today is that because of the price increase, we have to change our association between the number of points per minimum order. So the amount of the minimum order has grown. So we have an effect coming from higher activity and not from a higher productivity, we have fewer orders. But larger orders. So more activity and that's now being addressed when specific measures depending on the different geographies.

As concerns fixed cost, we did two things. The impacts will be felt. You have observed that from one year to another in Brazil, we saw a drop similar to that of an inflation in nominal terms. In consolidated terms, the fact that we are growing in Latin America also reflects in Brazil and they're also affected by the real devaluation and that's of course offset by an increasing revenues in those countries.

To say how our prices will behave going forward given the fact that if you have measures to implement, I'd say I'd be -- it would be precipitated to forecast fixed cost for the remainder of the year. I could help a little bit, Andrea, if we look back and take expenses as a basis for this information, variable expenses, I'd say also concerning fixed expenses, if you consider the expenses for the First Quarter of 2014 and compare that figure with the First Quarter of 2016, we see a drop in nominal figures, in terms of expenses of about 5% again in nominal figures. So we are enjoying better synergies and we are focused on reducing expenses and especially in Brazil.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Okay. And that figure 5% as Roberto said might increase, right, given that there are other initiatives to be implemented or would you say that inflation will be a barrier for that. I'd like to understand what kind of opportunity you have ahead of us. And I'd like to thank you for that observation as well.

A - Roberto Lima {BIO 6848983 <GO>}

We have implemented cost reductions. But we need to remember that even though our situation in Brazil is a bit more difficult, we grow strongly in Latin America. So we have to consider the whole of the operations and not Brazil isolatedly. So we spent significantly in marketing which is quite complex in terms of logistics in Latin America. So there is a limit in terms of cost reduction.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Roberto, sorry to interrupt. But we have the figures of Brazil. For example, for SG&A is broken down, I'd like to understand what happens in Brazil. I understand, I can feel what happened in the other countries in Latin America and it's basically good news. I'd like to understand what happens in Brazil a little better if you could.

A - Roberto Lima {BIO 6848983 <GO>}

Well I was saying that we have structures in Brazil that serve us, the business throughout the continent. So the overhead in Brazil cannot be simply reduced thinking only on Brazil because they work, they provide services to Latin America as a whole. So what we are doing here is trying to renegotiate some contracts, trying to phase out processes that we do not use anymore, trying to renegotiate when suppliers, suppliers who are very understanding of our need to adjust margins, that's what we have been working on.

And Andrea, I'd like to emphasize that expense reduction in Brazil when we see an inflation of 70.5%, we manage to reduce cost by 5% when we of course continue our efforts to optimize our cost anyway we can.

Q - Andrea Teixeira {BIO 1941397 <GO>}

No. I understand. I understand. I understand it's ever more difficult to do that with the inflation levels we have right now. But I have another question going back to the gross revenue when to drop by 5% in Brazil. So in Brazil which was minus 10% and January and February was flat, is that how we should see the trend in the First Quarter or January and February were special difficult in nominal terms. How do we see this quarter as a whole?

A - Roberto Lima {BIO 6848983 <GO>}

Well in March we had a major impact coming from the tax burden as I mentioned before. 14 states increased their rates throughout the quarter mainly towards the end of the quarter. Maybe Lettiere can add something to that.

A - Jose Roberto Lettiere {BIO 16358413 <GO>}

Yes. When we look at the calendar an important element which we mentioned was the seasonality of the Mother's Day campaign. If we exclude that effect on the Mother's Days' investments and we compare first -- Q1 2016 with last year instead of 8.8% we'd have a 6.8% drop.

Q - Andrea Teixeira {BIO 1941397 <GO>}

But that's excluding only the calendar effect, right?

A - Jose Roberto Lettiere {BIO 16358413 <GO>}

Right.

Q - Andrea Teixeira {BIO 1941397 <GO>}

You're not excluding the tax burden effect, right? Okay. But if we were talking about gross revenue that might be easier out of those 5% from what I understand of course you have no impact in the gross revenue. You'd have an impact of the sales tax, right?

A - Roberto Lima {BIO 6848983 <GO>}

Just a second I'm looking for the data here. Hang on a second, please. Just a second. We are trying to access the percentage points on a monthly basis. But they are not available right now. We have only on a quarterly basis. But we could forward that to you later. But we will get back to you on that.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Okay. Thank you, Roberto. Thank you.

Operator

Tobias Stingelin, Credit Suisse.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Roberto, that strategic plan you are implementing is being deployed at the expected speed. You also said that results are not far from what you imagined. So the question is were you expecting such a difficult year, such a difficult quarter so that you can have a better idea of the trends as compared to your expectations before?

A - Roberto Lima {BIO 6848983 <GO>}

As concerns the plan, I think it's being deployed at the pace we expected. Of course we are talking about five elements. Internationalization is one where the pillars are different. We have operations which are already in place, others which are not and so the other focuses are revitalization of our business in Brazil and the multi-channel front. The other strategic access are being developed, communication, innovation, that's why the results are not complete clear. But multi-channel management is of course a priority.

So our initiatives happen on a weekly basis. New apps, which are adopted by the consultants immediately, we have a significant number of downloads for those apps, we are now trying to increase the use of those apps. Also electronic payment through debit cards, all of that is taking place right now and it's going at the expected speed, expected pace.

When I said I expected a very tough First Quarter, we postponed the budget because we could not really see what was going to happen after the Fourth Quarter. Then I took some time to assess all the impacts. But we anticipated that the First Quarter could be very tough for a series of reasons. We are very confident in what we are doing to recover margins and mainly recover sales volumes. This might not happen immediately given the scenario we are now facing. But we do expect that consumers' confidence levels also increases a long way the confidence on the part of the industry so that we can all move ahead.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Just a follow-up then, just thinking about what you just said, when you made your first remarks, you said this year we are getting things in order. We are sort of waiting for what's going to happen or something like that. So this year clearly you're working through a transition. So it's going to be difficult for us to come -- quickly perceive an impact of those initiatives and then obviously maybe next year you'd be able to reap out those benefits. Is that how we can expect to move ahead so with a transition year in short?

A - Roberto Lima {BIO 6848983 <GO>}

If we look at our three-year plan, 2016 has many challenges, structural challenges, a higher level of digitalization of our direct channels, the revitalization I've just mentioned, the implementation of best practices for those digital platforms that could provide as with a more prompt impact. We've been surprised by some of those initiatives such as the implementation of the electronic payment devices.

So we have good news as well. But we cannot lose focus of what we still have ahead of us. We need to improve the positioning of the brand. We need to recover the strength of sub-brands such as Chronos and Echo. And for that we need to make a very strong communication effort which is being financed by the decrease in investment in promotion. So we are focused on what needs to be done, our budget is quite challenging.

Now we know that's going to be a very difficult first half of 2016. But if the economic scenario picks up we might have a year which will not only be a transition year. But better than that. We expect to be able to benefit from a higher sales volume still this year and the SOU drugstore project is an example. It was clear to us that we had to scale that up. So we are now closer to 100 stores and that could have a positive double-digit growth still this year for the SOU plan. So we have several initiatives such as those and we will see the results of those this year. Results of course can be stronger. In the reactivation of the RACK [ph] sales which is our core business.

Q - Tobias Stingelin {BIO 18290133 <GO>}

so one final question, in the release you said you've launched an e-commerce platform for final consumers and my question is how does that relate to your digital strategy? Was there a consultancy company helping you out?

A - Roberto Lima {BIO 6848983 <GO>}

No, actually we have maintained our platform with our consultants. We have thousands of active consultants now. We have over 700,000 clients who regularly buy through e-commerce. Our best buyers are those who are brought in the system by our consultants. But we have of course eventual not so regular clients who come to us without the help of a consultant. So it's rather a question of convenience than anything else.

So we are trying to bring all our platforms to mobile and this will affect the speed of the purchase, the experience of the purchase we want to make clients' life easier. But the hedging Natura with the consultants adds considerable value to the brand because they give good guidance to the clients, many of them have told us that things they could no longer do on a person-to-person basis because of geographical distances, now they can though chat platform and other communication means. So we strongly believe in our digital network which is activated by our consultants.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Are the conditions the same in terms of pricing and freight, shipping and handling price conditions are the same?

A - Roberto Lima {BIO 6848983 <GO>}

Products are shipped to consumers' homes. When I say homes, I mean the client's home even if they bought through a consultant, they receive that at home. So the logistics conditions are being adapted to the different cases.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Okay. Thank you. Thank you.

Operator

Irma Sgarz, Goldman Sachs.

Q - Irma Sgarz {BIO 15190838 <GO>}

I have two quick questions. You talked about the rationalization of the SKUs portfolio and also the focus on the core beauty concept. Could you give us some more color on what categories are included in the core beauty category and where we should see the highest cuts of SKUs?

And also along the lines of that strategy of renewing the channel and see the debit card machines and everything, of course that has helped consultants. But I also believe that consultants might perceive that you are gradually starting a plan of opening your own stores, you are selling at drugstores, you are launching an e-commerce platform. Is there any concern on the part of the consultants because of that?

And at the same time prices are increasing, you are increasing minimum orders. What kind of reaction are you seeing on the part of consultants in terms of volumes and engagement. Are you at all concerned that competition that you've faced from other brands will backlash for the Company and feel along those lines if you could perhaps give us more detail about the different age brackets? In terms of direct sales of course you have younger consumers who of course -- who have already downloaded the app and will quickly get onboard.

But unless I'm wrong, there is an important group of consultants who are in age brackets who are not that much used to downloading an app for example and they might feel excluded from the process. How do you see the positioning of those let's say older consultants?

A - Roberto Lima {BIO 6848983 <GO>}

Well accepting the digital world has less to do with age or geographic reason, what I can say for sure 61% of our consultants do have a smartphone and they are used to downloading apps. That number grows by 30% a year. And that will depend on -- I remember saying that we are working hard to expanding digitalization through education removing barriers, guiding. And being true partners of our representatives.

Of course it will be more and more exposed to the digital world. As to a negative impact of course that is part of our daily concerns. Fortunately, they expressed themselves through social media and that is very positive. We can open that channel, that dialogue. And we can of course adjust our plans to mitigate that backlash you refer to. The goal to have our own stores and go to the drugstore and I go back to the test we had in drugstores for a couple of months. In the region we tested, one of the variables we wanted to see was whether there would be a reduction in sales in that category. That did not happen. There was no increase in direct sales. But there was no reduction whatsoever.

We believe there will be synergy customers that purchase from a drugstore, they can purchase online, they can purchase through a consultant, we want to be closer to customers because they want more convenience and we believe that this effect will indeed happen. Our stores will not be that many in the time-frame we're expecting in order to reduce sales through consultants. We had consultants at the opening of the stores and they all agree that that's necessary. Natura must show its products, the quality is fantastic, that make a difference in the market because we must show and display our products so that customers can try our products.

We believe the effect will be positive in sales through consultants. We have to make that very clear through our communication channels. But we believe results can be just like in other activities that were created in e-commerce on end of digital world and now have physical stores, we believe that direct sales can move on to the digital world and through the stores and there will be synergy the way we see it.

Well that's it. I don't think I have addressed all your questions.

Yes. There's one as to the rationalization of the portfolio. We're trying to detect brands or categories based on the ingredients that were used and they were not the best ingredients for that particular use for hair, we had a very broad line. But just a few ingredients have very good results. So we are rationalizing, in other words we are reducing the number of SKUs available in the marketplace. And very often results are positive. Maybe just one shampoo and one conditioner, we have a product that sells better than the four previous products just like in the Eco shampoo and conditioner have better results.

Q - Irma Sgarz {BIO 15190838 <GO>}

Thank you, Roberto. If I understood you correctly, by rationalizing the catalogue has more to do with the debt in some categories where you realize you don't need that many SKUs in that category. It's not a matter of cutting some categories to highlight other categories. That's what you are trying to do, right?

A - Roberto Lima {BIO 6848983 <GO>}

No. We're not discontinuing any categories. When we say we have core categories, we believe that they can perform very well, not to the core body. In fragrances, we are leaders and those that are side core are going to receive communications marketing. But that does not mean that we are going to overlook the other ones. The digital world allows us to display our products very effectively at much lower costs. So our marketing metrics is more comprehensive and we can sort categories and we know that they are core to our brand.

Q - Irma Sgarz {BIO 15190838 <GO>}

Thank you.

Operator

Alex Robarts, Citigroup.

Q - Alex Robarts {BIO 1499637 <GO>}

I would like to start by asking a question about the industry. In the press release, you said that you had stable market share last year. Could you please break that down into categories, fragrance, personal hygiene, toiletries? Can you describe the industry growth since last year and along those lines, thinking ahead, I believe that the industry this year will not perform as well as it did last year. Are you trying to protect your market share? Are you comfortable with losing some market share because of price increases? What's your outlook -- what's the outlook for the market in 2016? That's my first question.

A - Roberto Lima {BIO 6848983 <GO>}

Let me talk about the industry first. For the first time in 2015, there was a negative growth above 8%. 8.8% reduction in the Brazilian market size after 23 years of continuous growth.

For 2016, we don't see any major growth in our radar. But we believe markets is performing not as well as last year. We may not see growth rates as like in the past. Last year, we managed to reduce our market share loss. We lost less than we were losing before.

And this year, we want to have a stabilized market share. And it's more difficult when you increase your prices. Yes. It is. We raised our bets. We were going to increase our prices. We would reduce our promotions. But we would increase investments in marketing and we would invest in activating the channel. So that's within our expectations so far. So we believe we have made the right decisions.

As to the question to break-down categories that grew, it did not grow whether we increased market share. I don't think we are in a position to announce that data. I think you have consolidated figures for the country and for our international operations.

Q - Alex Robarts {BIO 1499637 <GO>}

Let me try to understand. You said that CFT reduced 8.8%, right? Is that what you're saying?

A - Roberto Lima {BIO 6848983 <GO>}

Yes. That is correct. That's the market information we have. After 23 years of growth for the first time, the market retracted.

Q - Alex Robarts {BIO 1499637 <GO>}

The second semester was worse, was weaker than 8.8%, right? I did not understand what you said about this year. Do you expect any growth for the industry this year?

A - Roberto Lima {BIO 6848983 <GO>}

I think it's early. Our scenario is not clearly defined. I don't know whether political decisions will affect consumer confidence, business people confidence, any predictions right now are too far out. Volumes may drop, companies may offset that because of cost increase to the tax burden, inflation. And they will be readjusting their prices. These are not increases. It's just a recovery of losses through inflation. But it's too soon to determine whether the market will grow or not.

Q - Alex Robarts {BIO 1499637 <GO>}

I understand. I have a second question about the Natura stores. Congratulations for this week. I was at one of the openings. I actually understood after the meeting, maybe 5 to 10 stores would be enough. What are your plans by year's end? What are the metrics that you are looking into for these key stores to determine whether the project was successful or not? Is 200 stores a feasible short-term objective, three, four years? To have a better understanding of whether the initiative is positive or not

A - Roberto Lima {BIO 6848983 <GO>}

Thank you, Alex, for your question and thank you praising our store. We are at an initial phase. Everything that we conduct at the store, tests, we have to confirm that in the real world we must be certain that the portfolio that was chosen is the right one. It may vary on a region-by-region basis. But we have a core portfolio and we have to fully test all the services we want to render.

It's not just off-shelf with products. We want to relive the Natura commitment, the experience consumers have with our representatives at the store. We have many things to test and concepts. We have learned a lot with Aesop because they have very strong proposal as to the customer experience at the store. And we are right now at a stage that pretty soon we may open five stores to test these things in several -- in different areas.

But initially we must confirm that the model is right, it will meet our expectations to better serve end-users and of course test that the model is economically viable. These are not concept stores. These are stores that have to have a positive P&L statement. And at the second stage, we are going to expand at that phase with our own capital and maybe at a third step, we may resort to franchising. We haven't made any decisions yet.

But once we have a very fine-tuned model, well-defined concepts and we believe that there won't be any setbacks or any negative results for that matter once we scale we will have a CapEx decision to make to find out what the best model is through our own stores or whether we'll open up to franchises. Right now, we want to establish the Natura store. Its proposal, its concept will be measured by sales and also through our customer satisfaction index.

Q - Alex Robarts {BIO 1499637 <GO>}

I understand. Thank you.

A - Roberto Lima {BIO 6848983 <GO>}

Thank you for your question, Alex.

Operator

Gustavo Oliveira, UBS.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Thank you, Roberto. My first question has to do with your gross margin. You have new products. You're rationalizing your portfolio considering that you had price increase in March. Shouldn't we be seeing better gross margins now once compared to Q1 results? Yes or no? If not, is SOU bringing a negative or positive result in your gross margin because SOU sales and drugstores is one of the few brands that has major growth. I want to understand the better -- I want to better understand the dynamics of your gross margin.

A - Roberto Lima {BIO 6848983 <GO>}

Well let me address the SOU product line. It has a positive margin, yes, that's true. And in the gross margin, it ends up helping the brand. It absorbs some of the costs and of course it does help the drugstore channel. But the dimension is smaller, it's an important brand. But over BRL100 million, that sales. And the growth is the growth of the brands, it helps overall of course. There are no questions about it. But to determine the gross margin for next quarter, we cannot do. That depends on variables we cannot control such as tax burden, taxes rates may change any time so that would be premature to speculate and specially to state what Q2 margins would be. But of course Gustavo, we are controlling, we're working into it every day.

We're monitoring on a daily basis to recover our margins. That was one of the first things I mentioned in my presentation. It's a dynamic scenario. You look at the short-term what you cannot control. But of course looking ahead into the future with the strategy. And down the road, we may of course -- we are considering recovering margins of course. Understand, the only thing that's not clear is the contribution of SOU. Does it have a gross margin that is below the average for the Company? It's a personal care category. The gross margin and attributed margin that is smaller than that's up the average of fragrances for example.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Thank you. My second question is about the portfolio rationalization. What stage are you at? Are you starting, are you concluding it so that I can better understand the type of impact you may have in your sales? You are saying that sales impacts for Q1 have some macro impacts. The moving of Mother's Days further down the calendar are there any effects attributed to the portfolio rationalization to? Excuse me?

A - Roberto Lima {BIO 6848983 <GO>}

Wait a minute. We'll be back shortly. Thank you. Yes. We are back.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

I'm not sure you listened to my question.

A - Roberto Lima {BIO 6848983 <GO>}

Just a second Gustavo, we are still reconnecting. Just a few more seconds. Could you repeat the question please?

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Yes. I'd like to understand where do you stand in the portfolio rationalization, are you beginning, are you finishing and has that affected your First Quarter sales?

A - Roberto Lima {BIO 6848983 <GO>}

Okay. We are far from over. We are in the first stages of the rationalization process of the portfolio, we have some launches and re-launches ahead. But where we think we can interrupt marketing, we know we have replacement products. We would hardly lose any sales volume because of that rationalization process.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

So in the worst case scenario would be a neutral effect?

A - Roberto Lima {BIO 6848983 <GO>}

Yes. Yes, neutral.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Okay, I understand. In what concerns the revitalization of direct sales, you talked about digital platforms and all. But could you give us an update on that process you used to have of the small outlets, small stores, you had about 100 stores when we started, has that moved ahead or not? I believe those stores have a high productivity level, it's like by now over a 1,000 points of sale we could be addressing. Where does that stand?

A - Roberto Lima {BIO 6848983 <GO>}

Yes. The improvement project addressed at those sales points with the new visual aspect (inaudible) plans, that's in place, that has been very successful, we already see that we can increase our market share increase of 4% of sales, increase of something close to 8% a very successful project. First, we concentrate on Sao Paulo and Rio. But when we talk about revitalizing direct sales, we see a clear need to focus on regions, we need to value to appreciate the local regions, the all different regions where we operate. We need to have a higher specificity in terms of offerings to all those regions so we can have the chance to work with different pricing and that flexibility will allow us to be much more successful in addressing that small store projects.

We have higher royalty level from the consultants, we have higher market shares, we have higher sales volumes. So it is a successful project. We need it to create structures to put that in place we have consultants who help out, those who are consultants/entrepreneurs who help introduce the products, we are very satisfied with the results. Other segmentation projects are in place, we have to identify those consultants who are more capable of working as consultants per se for those stores. So we are increasingly more focused in identifying a consumer segment and the best ways to tap on those segments.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Okay. One last question. With all those negatives in place you should see a drop in your active consultant-base. You are reallocating budget. So you were changing the business. Should we expect a drop in the active base of consultants in Brazil for 2016?

A - Roberto Lima {BIO 6848983 <GO>}

I said in the First Quarter we had a drop in activity especially because of the fact that the minimum order increased. But we'd seen a very reactive power on the part of consultants. We can now make individual offers to our consultants, those who use smartphones, for example, as they open the app they already have an offer right there and then for a specific category with a different type of pricing and 15% of those consultants end up accepting that offer.

So because of the price increases at the point of sale leads to a drop in activity that does not mean we are passively observing that. We have immediate reactions to that and we have different tools today in place to help us identify where we can help consultants become more active. We saw our channel grow this year overall in the number of consultants. So the effort now is to increase training and the royalty level of those consultants.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Okay. Thank you.

A - Roberto Lima {BIO 6848983 <GO>}

And thank you for the question too.

Operator

(Operator Instructions)

A - Roberto Lima {BIO 6848983 <GO>}

If there are no more questions, we can perhaps close or move on to our final remarks. Okay. Once again I'd like to thank you all for participating in our call and thank you very much for the excellent quality of the questions, they're inspiring. And to say that even facing a very challenging context, we are confident that we are building a linear organization, more efficient, less costly, much more in line with current times. We do believe we have a midterm plan which is quite strong which was thoroughly approved by our Board, a Board which is made up of professionals who are knowledgeable about our industry. Roberto Marki [ph] and Ricardi Zubera [ph] have just joined and are very knowledgeable in the industry. So the initiatives we are putting in place already show positive initial results which makes us confident that we are moving in the right way.

We now need to pay attention to speed, pace. But we are confident that we are treading the right way towards higher competitiveness and towards recovering growth of course hoping that the Brazilian economy will recover sooner than later. At the same time, we will keep close attention to continued growth in our international operations, both in Latin America and as for Aesop. And we hope that all our initiatives and also counting on the dedication of all our associate, on the dedication on the part of our consultants, we hope to be able to put Natura where the Company belongs in a leadership role, not only committed to investors. But also committed to the improvement of the community where it operates. We never miss focus of our mission, of our cause. Difficult as the situation may be, we will not abandon the pillars that made for the success of the Company, not only in Brazil but also abroad.

Once again, thank you all for participating, thank you for the questions. And I hope to see you again at the end of the Second Quarter where we will discuss our results in June. Thank you. And have a nice day and a nice weekend.

Operator

Natura's conference call is now over. Thank you, all for participating. Have a nice day.