

# Natura

February 12, 2015

## 4Q14 Results: Disappointing sales and profitability

Natura's 4Q14 figures were disappointing. Sales in Brazil fell 3.3% YoY, to BRL 2.37 bn. It was the first quarter since the IPO in which the company recorded a retraction in Gross Revenue on the national market. Despite an increase of 2.2% YoY in the consultant base, to 1.3 mn, their productivity dropped 6.2% YoY. The slowdown in the company's performance resulted in market share loss in both Cosmetics & Fragrances categories (-0.5 p.p., to 30.5%) and Toiletries categories (-1.6 p.p., to 9.8%), during 10M14, according to ABHIPEC. The positive highlight remains in the international operations' performance, where sales grew by 22.3% in 4Q14, in comparison to the previous year, and the consultant base expanded 15.8%, to 422.5 thousand.

**Profitability.** Consolidated Gross Margin was also a positive highlight of the company's result. It increased 0.8 p.p. YoY, to 69.2%, due to price adjustments occurred in 2014. Consolidated EBITDA margin, on the other hand, fell 2.4 p.p. YoY, to 22.5%. Although international operations have shown an improvement of 3.2 p.p. YoY in EBITDA margin (to 12.1%), in the national market it fell by 2.9 p.p. YoY (to 25.2%). Investments completed at the end of 2014 in logistics, technology and production infrastructure, as well as an administrative restructuring, generated notable efficiency gains; however, they were not sufficient to compensate the high levels of marketing and innovation expenses and sales below expected.

Net income decreased 23.4% YoY, to BRL 225.2 mn, as a result of mark-to-market adjustments and higher debt level. The company policy is to hedge all of its foreign-denominated debt, which causes temporary noncash impacts. Excluding this effect, the net income would have decreased 8.7% YoY. As for the company's indebtedness, Gross Debt reached BRL 3.37 bn (+32.6% YoY) and the Net Debt/EBITDA ratio was 0.77x in December, 2013, but increased to 1.08x in December, 2014.

**Cash Flow.** The free cash generation increased by 15.3% YoY in 4Q14, to BRL 243.3 mn, but was not enough to improve the performance in the year. Thus, in 2014 as a whole, the free cash flow was BRL 210.0 mn, 28.8% less than 2013, driven by a 13% YoY reduction in net income and a deterioration in working capital (due to higher inventory coverage).

**Analyst opinion.** Natura's management considered that the company's performance during 2014 fell below their expectations and capacity. They believe their strategy remains powerful and sustainable and "must be adapted to the reality of the business environment". The priority now is to recover growth in Brazil, by getting closer to its consultants and diversifying sales channels, especially Rede Natura. The Stock Market reaction to the company's result was negative. NATU3 fell 6.9% while Ibovespa rose 2.7%.

Despite the weak result, we maintain our target price for NATU3 in BRL 47.20 to December, 2015. Although expectations that the economic outlook will be challenging in 2015, the cosmetic market, where the company operates, has presented a double-digit growth in Brazil for the last five years at least.

From 2010 to 2014, Natura invested BRL 2 bn in logistic, technological and production infrastructure. The benefits of this investment cycle have still not been fully captured and, on that basis, we expect profitability gains in 1H15. For 2015, Capex will be reduced to BRL 385 mn (-24% YoY), what is going to benefit the company's cash flow. Capex will focus on improving the commercial model and on expanding information technology. In 1S15, SAP system should be working, which will improve inventory management both in Brazil and international market.

Income Statement (BRL million)	4Q13	4Q14	YoY	2013	2014	YoY
<b>Gross Revenue</b>	<b>2,909.6</b>	<b>2,931.0</b>	<b>0.7%</b>	<b>9,451.7</b>	<b>9,950.3</b>	<b>5.3%</b>
Brazil Gross Revenue	2,454.2	2,373.9	-3.3%	8,040.3	8,185.6	1.8%
International Gross Revenue	455.4	557.1	22.3%	1,411.4	1,764.7	25.0%
<b>Net Revenue</b>	<b>2,165.6</b>	<b>2,182.3</b>	<b>0.8%</b>	<b>7,010.3</b>	<b>7,408.4</b>	<b>5.7%</b>
<b>Gross Profit</b>	<b>1,482.2</b>	<b>1,510.5</b>	<b>1.9%</b>	<b>4,899.2</b>	<b>5,158.3</b>	<b>5.3%</b>
Gross Margin (%)	68.4%	69.2%	0.8 p.p.	69.9%	69.6%	-0.3 p.p.
<b>EBITDA</b>	<b>538.7</b>	<b>491.4</b>	<b>-8.8%</b>	<b>1,609.0</b>	<b>1,554.5</b>	<b>-3.4%</b>
EBITDA Margin (%)	24.9%	22.5%	-2.4 p.p.	23.0%	21.0%	-2.0 p.p.
<b>Net Income</b>	<b>294.1</b>	<b>225.2</b>	<b>-23.4%</b>	<b>842.6</b>	<b>732.8</b>	<b>-13.0%</b>
Net Margin (%)	13.6%	10.3%	-3.3 p.p.	12.0%	9.9%	-2.1 p.p.

Source: Natura and BB Investimentos.

### Retail & Consumer Goods

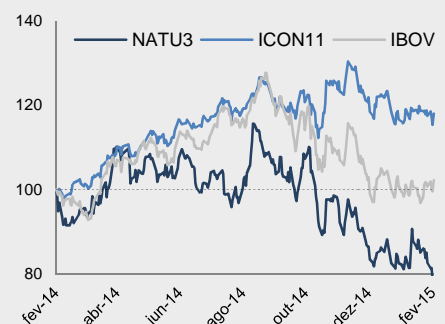
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NATU3	Market perform
Last Price 02/12/2015 (BRL)	27.00
Target Price 12/2015 (BRL)	47.20
Upside	74.8%
Market Cap (BRL million)	11,643
1 Month Change	-13.9%
LTM Change	-26.8%
YTD Change	-15.2%
52w Low (BRL)	27.00
52w High (BRL)	42.64

Valuation	BRL Million
Firm Value 2015E	22,587
Net Debt 2015E	(2,236)
Equity Value 2015E	20,350
# Shares Outstanding	431
WACC	11.6%
Growth in Perpetuity (g)	3.5%

Multiples	2015E	2016E	2017E
EV/EBITDA	12.0	10.3	8.8
P/E	24.4	20.0	17.4
EPS (BRL)	2.15	2.62	3.01



Source: Bloomberg and BB Investimentos

In addition, we see some positive changes in the company's strategy. In an attempt to approach Natura's products to final consumers, the company has tried to establish a direct communication through (i) targeted advertisements; (ii) new mall kiosks launches, where people can experience their cosmetics and (c) greater support to consultants that provide prompt delivery. The possibility of opening stores has also been analyzed by management. Besides that, Rede Natura's roll out has been accelerated. We know that it will take some time until all those initiatives bring effective returns, but they introduce a positive outlook for the company's performance in medium-term.

#### Announced versus Estimated

Income Statement (BRL million)	2014 A	2014 E	A/E	YoY
<b>Gross Revenue</b>	<b>9,950.3</b>	<b>10,308.8</b>	<b>-3.5%</b>	<b>5.3%</b>
<i>Brazil Gross Revenue</i>	8,185.6	8,428.2	-2.9%	1.8%
<i>International Gross Revenue</i>	1,764.7	1,879.3	-6.1%	25.0%
<b>Net Revenue</b>	<b>7,408.4</b>	<b>7,646.0</b>	<b>-3.1%</b>	<b>5.7%</b>
<b>Gross Profit</b>	<b>5,158.3</b>	<b>5,314.0</b>	<b>-2.9%</b>	<b>5.3%</b>
Gross Margin (%)	69.6%	69.5%	0.1 p.p.	-0.3 p.p.
<b>EBITDA</b>	<b>1,554.5</b>	<b>1,661.2</b>	<b>-6.4%</b>	<b>-3.4%</b>
EBITDA Margin (%)	21.0%	21.7%	-0.7 p.p.	-2.0 p.p.
<b>Net Income</b>	<b>732.8</b>	<b>778.9</b>	<b>-5.9%</b>	<b>-13.0%</b>
Net Margin (%)	9.9%	10.2%	-0.3 p.p.	-2.1 p.p.

Source: Natura and BB Investimentos.

**Announced versus Estimated.** Considering Natura's performance in the entire year, it came below our expectations, especially Gross Revenues (-3,5% YoY A/E). We expected stronger Sales, both in national and international operations. Regarding profitability, EBITDA margin was the highlight. It came 0.7 p.p. bellow our projections.

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