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# Natuzzi S.p.A.

## First Quarter 2022 Conference Call

May 31, 2022

## CORPORATE PARTICIPANTS

**Piero Direnzo,** *Investor Relations*

**Antonio Achille,** *Chief Executive Officer*

**Jason Camp,** *President, Natuzzi Americas*

**Pasquale Natuzzi,** *Executive Chairman*

## CONFERENCE CALL PARTICIPANTS

**David Kanen,** *Kanen Wealth Management*

## PRESENTATION

**Operator**

Welcome to the Natuzzi First Quarter 2022 Financial Results Conference Call.

At this time, all participants are in a listen-only mode.

Joining us today are Natuzzi's Chief Executive Officer, Mr. Antonio Achille, the Executive Chairman, Mr. Pasquale Natuzzi; then, Mr. Jason Camp, President of Natuzzi Americas, and Piero Direnzo, Investor Relations.

As a reminder, today's call is being recorded.

I would now like to turn the conference over to Piero. Please go ahead.

**Piero Direnzo**

Thank you, Kevin, and good day to everyone. Thank you for joining the Natuzzi First Quarter 2022 Financial Results Conference Call.

After a brief introduction, we will give room for a Q&A session. Before proceeding, we would like to advise our listeners that our discussion today could contain certain statements that constitute forward-looking statements under the United States Securities laws. Obviously, actual results might differ materially from those in the forward-looking statements because of risks and uncertainties that can affect our results of operations and financial condition. Please refer to our most recent Annual Report on Form 20-F, filed with the SEC, for a complete review of those risks. The Company assumes no obligation to update or revise any forward-looking matters discussed during this call.

Now, I would like to turn the call over to the Company's Chief Executive Officer. Please, Antonio.

**Antonio Achille**

Thank you, Piero. Good morning to the investors joining from this time, in U.S., and good afternoon for the European ones.

Just a quick point of view of where we ended in terms of first quarter 2022. We continue executing our strategy. As you'll know, we are outgrowing the market. Our revenue grew by 17% versus the first quarter 2021, and 43% versus 2020. We're continuously improving the mix towards branded products.

In terms of order flow, roughly 90% of order flow account for brands, which is 4% or 5% higher than both the respective period of 2021 and 2020. We continue also focusing on key geographies. All three geographic areas which our strategy is centered on have been growing double-digit. North America is growing 32% in revenue, West & South Europe 19%, and China, 14%.

We also continue our focus on retail. I believe (inaudible) particularly significant. We had 19 freestanding new stores opened in the quarter, all franchises, 16 of which are in China, where you know we are really at critical mass with 356 stores. Then, two are in U.S. and one in Italy, so we added 19 freestanding stores in the quarter.

Another data which I believe is significant is DOS, in North America, like-for-like is above 50% versus 2021, so again, a strong sign that our retail formula start working. Vis-à-vis, the weight of retail, directly operated store and franchising on total revenue grew to 52% compared to 49% in the same quarter of '21.

We continued investing to modernize our factory. The pilot we are running, based on the 4.0 technology, is delivering very solid results and will be the base for future investment in other factories. We also continue iterating our growth with partnership. We just signed a partnership for the development of rest of Asia-Pacific, with TTF, which is a Vietnamese listed company that joined our Singapore venture with 20% share with an investment of 5.4 US million.

Lastly, we continue strengthening our governance and trying to create a more committed team. As you have read from our press release, Gilles Bonan, which is a senior executive which covered several positions including the one of CEO in Roche Bobois, joined our Board as independent, and also the Board approved the stock option plan which should become effective in the next two months.

We'll say a quarter very in line with where we want to go, this despite, clearly, some headwinds which we are experimenting, as everyone in the industry, in terms of significant inflation in raw material and higher than usual transport cost. We wish this to be a phenomenon that stayed in the COVID, but clearly, this inflation is continuing beyond COVID. We are monitoring this cost and adjusting our pricing, but the deals in the quarter limited our ability to expand further the margin than what we achieved.

As you have seen, in total transparency, we also mentioned that in China, we are dealing with restrictions imposed by the local authority which are affecting our factory in the Shanghai area. It is an important factory. The first two months of the second quarter, so nothing that you will read in the first quarter, but the first two months of the second quarter, in terms of revenue generation has been affected by the partial ability to operate full speed our Shanghai factory.

This is, in an extreme synthesis, a reading of the quarter. I think it's always good when you see your Company going in the direction you were driving it, and the direction is the direction we want to go to create value for our shareholder. Clearly, we wish that COVID was the biggest challenge we had to face in this plan; we are now dealing also with another additional element, which is the continued inflation, the COVID restrictions in China, and clearly the war in the Eurozone.

Let me stop here. I tried to be as brief as possible to leave even more space than usual to question-and-answer.

**Operator**

Thank you.

Our first question today is coming from Dave Kanen from Kanen Wealth Management. Your line is now live.

**David Kanen**

Hi guys, thanks for taking my questions.

The first one is regarding the price list increases that you're taking. In the press release, you said that they'll start to take effect during Q2, so I'm looking past Q2 as an extraordinary event or temporary period, vis-à-vis the lockdowns in China and so forth. But looking to the second half of the year and beyond, given the price increases that you're passing, and then also you've alluded to modernization investments or capital expenditures at the factory level to improve efficiency. Should we expect higher gross margins, assuming no further increases and inflation in the back half of the year from that combination of price increases, as well as some of the investments in technology at the factory level?

**Antonio Achille**

Okay. Thank you very much for your question.

If I take literally your question, the short answer is yes, in the sense that if we are not to assume any further inflation pressure, the answer is yes. In reality, we keep reporting strong inflation. The European Union just reported today an inflation for the month of May of 8.1, which is the highest since the creation of the European Union, in 1999.

Let me maybe expand a bit on our work on pricing. Every year, at the beginning—at the end of the year, and we take decision at the beginning of the year, we look at what to expect the dynamics for raw material and cost of different form, plus transportation, and how we should reflect these into price increase. Then we act typically between the third and fourth week of January so that we start the New Year with a pricing scheme that should be along the target margin, given the certain dynamic in costing.

This normally should be a decision which is taken once in a year and should be protecting your marginality for the full year. What we've been dealing is a situation where we, in certain months of the year, reported an inflation which has been higher than what normally we report in one year. We also reported, for instance, when it comes to method like energy, given the war in Ukraine, a complete surge of cost overnight, of fuel and other energy costs. We keep reviewing the price-list, maybe not just one but multiple times during the year, to make sure that we can protect the marginality we want.

This of course cannot be done every day because dealing with partners and clients, you cannot change the condition every day, so we try to be discreet and doing it will be a couple of time in a year.

You also need to recognize that, given our model, whatever decision we take today, it will be effective in terms of revenue two, three months afterward, because the fulfillment time between the order taking and order recognition, the revenue recognition is three months. It's a delicate game where we want to protect margin. We carefully look at the dynamics of the material, and if inflation had to be reasonably stable, this should be more than enough to protect our marginality. In reality, these dynamics have been particularly crazy over the last few months.

A second…

**David Kanen**

Okay, and then… Yes, I'm sorry, I'm assuming you're going to touch on…

**Antonio Achille**

(Multiple speakers). I think it's good to use this discussion to provide full transparency on our operating model. A second element which came to my attention, and we are acting on, is the use of discounts. Given a certain price list, typically the industry invests in selling discounts, so specific privileged condition, you recognize to your historical partner and so allowed discount, which is basically the discount that you do at the retail level to your final customer. This historically is significant for the industry and has been very significant for Natuzzi, which is another way to protect marginality, of course, acting on this.

We are reviewing the types of discounts which are allowed, and we are getting a better control of those, because those also protect—is a way to protect marginality. Not only the listing price, but also the management of commercial discount and privileged condition. Sorry, Dave, you were further articulating your question.

**David Kanen**

Yes. The second part of it was the investments that you're making in the modernization of your factory for the purpose of getting some cost benefits and efficiencies. When would we start to realize those benefits?

**Antonio Achille**

While pricing is, as you can imagine, more an immediate decision, capturing the benefit require two elements: one, investment in the factories, and also training of our team to work in different way, of our workers to work in different way. We started this pilot called 4.0, basically in December 2021, so we are five months. It's progressing well. It's based on three concepts.

One is simplification of the assortment. Second is managing them through a lean process, so with a continuous flow of work. The third one is integration of the supplier, which are a way of working which are quite new to the industry. To this specific industry, while maybe they are standard for the automotive industry.

The pilot is progressing well, is delivering results above our internal expectation. This is becoming the new blueprint, the new standard for the new factory we'll develop, and for the investment we are doing to modernize the existing factories. Starting from the second part of this year, we'll start drafting it on our Italian factory where the cost of labor is higher and where the benefits of this new technology are expected to be higher. We expect this to be a way to contribute to better quality for our clients and to reduce, quite importantly, the cost of production.

**David Kanen**

Okay. Can you give us some sense as to what those improvements will be as it relates to margin, and what the ROI is on some of this—I'm assuming it's capital equipment that you'll be purchasing.

**Antonio Achille**

Yes. We're looking at potentially high single-digit margin improvement, in terms of cost of production. I would say significant. Of course, for an industry like us, it can be significant improvement. In terms of timing of investment, it would be between the second part of this year and next year, the bulk of the investment in Italian plants.

In terms of ROI, I would say we look at that. It is attractive compared to the use of capital we want to do, so it's higher than the current, let's say average return on capital. It should be a good way to invest the resource of the Company.

**David Kanen**

Okay. Then, could you just give us an update—maybe this is a question for Jason. In the past, you've talked about the expansion of your North American footprint, direct operated stores, with a goal of opening up approximately 10 per year. Is that still the plan? As an investor, that was one of the reasons why we liked the story, is because there would be that pivot to much higher margin branded product, North of 70%. It was critical to our investment thesis; haven't heard you speak about that at all. If you or Jason could touch upon that, if we are on track to open approximately 10 stores a year for the foreseeable future in North America? Then also, if there's an opportunity in Western Europe and elsewhere, if you can touch on that as well?

**Jason Camp**

Great, so I'll kick off with North America. You can see that we did open two stores in the first quarter, and we expect to be on-track to open approximately 10 stores this year by year-end. We are still committed to that growth target of approximately 10 stores in North America a year.

**David Kanen**

Great. Thank you.

Then Antonio, can you talk about Western Europe? Is there an opportunity to increase your DOS footprint there?

**Antonio Achille**

I will say there's definitely opportunity to increase DOS and FOS in the U.K., which is a market where we already have a good established operational base, in terms of store and brand awareness. There's clearly an opportunity in Spain, where we have a team and we have 11 stores and a good brand awareness. I was yesterday in France, and also here, we used to be quite significant in terms of distribution. We now are with one store, which by the way, we are renovating. Here, we are also exploring way to come back.

As you know, the Company is distributed in about one-hundred markets, so definitely there are opportunity beyond the West, beyond the U.K. and Spain, but we need to be very focused. My view is that, especially when it comes to retail, we need to be strong locally to be strong globally. What I don't suggest the Company, I will not lead the Company to do, to be captured and to be one store here and one store there, because then it's very difficult to manage them, to attract talent, to leverage on marketing. We look at individual geography, also in Europe, to do that.

Differently is for FOS, where we have opportunity we are capturing, we just opened a new fantastic store in Vienna, in the Center of Vienna is a franchising with a partner, which is willing to open 10, 15 in that area. Our model of franchising is very attractive. Beyond the DOS, we look at franchising for DOS brand is a way to accelerate our retail transformation.

On that front, I believe Europe and emerging markets are quite promising, because different from North America and Asia, there is still a significant amount of traditional mom-and-pop furniture store, and as the industry's modernizing, they can see in our franchising a perfect plug-and-play business to substitute their mom-and-pops, which with this inflation, with this supply chain, is very difficult to manage, and become part of our family with a predictable return and a predictable investment. I believe our franchising can be quite substantial, it can be a quite substantial opportunity in Europe and emerging markets.

**David Kanen**

Okay, that makes sense, I understand wanting to have density in certain markets so that you can make those investments and scale them.

The next question, and then I'm going to turn it over to anyone that is in queue, I don't want to totally monopolize, my apologies to everyone on the call. In the past, we've looked at the China JV as a "hidden asset". I'm estimating it as probably worth almost $10 per share or more, that plus the real estate, and yet our stock is not getting credit for it. The core business, to me, is trading for zero value.

Can you give us an update on your efforts, or any initiatives underway to unlock that value for shareholders on the China JV? You don't have to talk about Vietnam or Singapore, we're aware they're much smaller; we like it, but just specifically China.

**Antonio Achille**

Yes. The amount of discussion we're having with the Board on this kind of option to create more value for the JV and for its individual investor, Kuka, which is listed in Shanghai and Natuzzi, is increasingly board by board. This is becoming more central.

I can be partially specific, but we agreed already to do some actions in terms of cost reduction and distribution to the partner, and also further recognition of some form of value that Natuzzi is doing in terms of R&D investment for the JV. Those have been already agreed upon, but I cannot be specific in terms of individual amount of those, but that is an initial step in the direction.

Is that the full, let's say, potential of China for us? The answer is no. As I mentioned, there is an alternative that will incite the shareholder, that Pasquale Natuzzi, the Chairman, will discuss, which include potentially an IPO of the China operation. But on that, there's been initial discussion with the partner, but at the moment, it is very premature. It's not something will happen in the next few months, but also that option is on the table.

**Operator**

Thank you.

If there are no further questions, I can turn the floor back over to Management at this time for any further or closing comments. There are no further questions.

**Antonio Achille**

Ok, I mean, you have the press release. I mean, we are looking at a quarter which we believe is a good step in our direction of accomplishing our plan, which is around brand, is around retail, is around growing, is around being focused specific geography and modernizing our factory. We've been mentioning, quite explicitly, in our press release, the fact that China is down and this is affecting our factories. Good news is that just at the beginning of June, the authority confirmed that we can go back and adding 80% of total workforce operational in the factory, which is positive. As I mentioned, we also keep investing to make sure that we can maintain our top line expectation, in terms of retail and gross sale, in a situation where, as you can see, the market in general for retail see a more prudent consumer.

This is a bit of the summary, I hope to stay with you. We keep investing to make our press release more self-explanatory. We also added one section with the spread of revenue by geography and the relative growth. We will welcome you to pose additional questions offline to Piero if you have any.

I don't know if Pasquale or the Chairman want to do any final remark beyond what I just did.

**Pasquale Natuzzi**

You covered everything. You are fantastic.

**Antonio Achille**

Thank you, Mr. Chairman.

**Operator**

Thank you.

On that note, that does conclude today's teleconference and webcast. You may disconnect your line at this time and have a wonderful day. We thank you for your participation today.