Natuzzi SpA

Third Quarter and First Nine Months 2021 Financial Results Conference Call

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CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Welcome to the Natuzzi Third Quarter and First Nine Months 2021 Financial Results Conference Call.

Joining us today's call are Natuzzi's Chief Executive Officer, Mr. Antonio Achille; the Executive Chairman, Mr. Pasquale Natuzzi; the Chief Financial Officer, Mr. Vittorio Notarpietro; and 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 call over to Piero. Please go ahead.

Piero Direnzo

Thank you, Kevin.

Good day to everyone. Thank you for joining the Natuzzi's Third Quarter and First Nine Months 2021 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 conditions. 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 so much Piero for your introduction.

Good morning and good afternoon, depending on the time zone, to our analysts, investors and potential investors attending this call. I'm here today with, beyond Piero, other three people who are very relevant and will be involved in our conversation. The first person is clearly Pasquale Natuzzi, who is our Chairman beyond being the founder in the live history of the Company. I'm working very closely with him on any strategy and organizational matter, so I will definitely be involved in when the subject pops up. The other person is Jason Camp. I believe most of you already know him. He is an executive with 25 years' experience in the sector, who leads our North America and Central America operation. And the third one is Vittorio Notarpietro, our CFO, longstanding CFO.

Let me open the conversation along to the press release which has been just released to say that on one end we are very pleased to see the growth of our product continue. That has not always been the case in the past. We're now on a positive trajectory which lasts for few a sequential quarters, written orders are even stronger than invoiced sales. Invoiced sales were 20% above the third quarter 2020 and 15% above the pre-pandemic levels, so 2019. So the demand for our products continues to be strong across most geographies. And you should double-click which was interesting is that the branded products, so the products which are sold with our two brands, Natuzzi Italia and Natuzzi Editions, posted very relevant growth rate. They are 40% above 2019, and currently they represents nearly 90% of what we do.

The Company, which has been going through a different phase of history, now is clearly focusing on brand, increasing focusing on having a direct access to consumers, and this seems to be paying off in terms of growth. When it comes to fulfilling that demand, we've been experimenting, and of course, we have not been the only one, but today we should talk about Natuzzi, we are experimenting, especially in the third quarter, difficulties to keep up with the increasing demand. And this again is a matter of availability of product, availability of workforce in our plant and availability of third-party producers to keep the demand, which has been, again, posting a very positive momentum.

These basically bear two consequences, the spike in material has been really pressuring our P&L structure. I believe, here, the Company has done good work in mitigating that. In fact, if you see our gross margin has been actually increasing, arriving at 36% versus 32% in 2020 and 28.7% in 2019.

Despite the strong pressure in cost of materials, which often has been in the space of double-digit increase on our main materials, like leather, like wood, we've been able to contain, and actually the gross margin has been improving. And this has been systematically by optimizing our purchases, but also by reflecting some of those price increases in our retail and selling prices.

The other element in terms of cost which has not been so easy for us to fully reflect and pass over to clients has been shipping cost. Shipping costs, given the global nature of our supply chain are a relevant part of our cost structure.

To be a fair party to our partners, we've been able to pass these in terms of additional freight costs, but not always in a timely manner. And as a result of that, we absorbed, due to Canada one-off cost, in some of these one-off freight cost, an additional €5 million this quarter. So the net result includes that negative impact and could have been higher.

The second element which is a consequence of the disruption in the supply chain is that our backlog is increasing, which in a sense could be also positive, because you're going to start next year with already some meat in the freezer, and this has been increasing by €20 million, arriving to €110 million, I'm talking in euro terms here. So we have a significant backlog, which gives us a good kick-off for the next year. At the same time, we need to work carefully to make sure the level of service across geography remains consistent.

It is a bit what you can read in our numbers, so I would say, a good continuation of our trajectory to regain growth, regain quality growth. At the same time, this could have been even higher if we managed the supply chain in a way to fully catch this growth momentum. We are working very much not only to do this for the short term to kind of enhance the output of our supply chain, but also to sustain our mid-term goals, which clearly are very significant in terms of top-line growth.

What are we doing? Basically, we are working on three main areas.

One is secure material availability. So we are working to pre-book some of the materials, especially the one which have a longer cycle. We are also trying to near-shoring, so get supplier closer to our factories for some materials which have strategic relevance but they don't bear a major implication in terms of cost. So the first area is secure material availability.

The second area is increase factory output, and later I would invite Pasquale to comment on that. As you know, one of our potential advantage is to have a very articulated supply chain. We have production in Italy, we have production in China, we have production in Romania. In each of those plants we are very carefully working to increase output, each plant has history. In Romania we hired 60 additional people. In Italy we are piloting a factory, 4.0 Fabbrica Italia, which is an innovative way of producing, much integration with the supplier through information systems. And in China we continue adjusting the capacity to the output. This is the long-term perspective.

In the short term, as I mentioned before, we are facing a series of complexity factors linked to the level of uncertainties, which was higher than we predicted, due to COVID. You must also remember that in Italy our factory shuts down for two weeks during August, and this also affects the third quarter production capability.

The third area where we are working on is increasing the strategic outsourcing. The Company, as you must know if you've been following our story, has been always producing in-house everything. This will continue being the case for Natuzzi Italia, which we proudly produce in Italy, and for which the made in Italy is a dominant part of the value proposition.

For Natuzzi Edition, to recognize that we want to have a more agile supply chain model, we are building the production where it makes sense from a delivery standpoint. So we will have Romania and Europe for Europe, we will have our Shanghai and Vietnam for the Asia and for some part of our North America demand, and we will build up Mexico for North America. This is something you will not see happening in one quarter, but it's something that progressively we believe will be delivering significant advantage to our ability to fulfill demand.

This is a bit very transparent view on our quarter where we continue enjoying strong demand, which by the way continues as we speak. So you see in the press release the data for the 44 week of the year where the written orders are up 24% versus 2020 and 15% versus 2019. As we speak, we are entering week 47, the trend of written order keeps very, very robust. So we don't see any weakening in terms of written orders demand.

I've been, hopefully, and I wish to be more specific in the Q&A, very transparent as for the hard work we are doing to evolve, modernize and enhance our supply chain and production.

During these months we also did other intervention to solidify the fundamentals of our business. One is the organization. We believe it however will be a people-led transformation. So in close symphony with the Chairman and our HR responsible, we have been evolving our commercial organization.

In clearance with what I said at the opening, the Natuzzi is almost entirely a brand company. We made the strategic decision to create a two-brand division. So now we have a Chief Brand Officer for Natuzzi Italia and a Chief Brand Officer for Natuzzi Edition; each of them is in charge for setting up the strategy and for controlling the P&L of his own brand, clearly indirectly with the regional heads like Jason and the others. So, introducing a matrix where the regions have the full autonomy and P&L accountability to grow the brand in the regions and the Chief Brand Officer sets up the destiny and the strategy of those brands.

Beyond the organization, we'll continue working on increasing what I can call the “access to the C”, where the C is our final customer, the clients. So in that direction there have been a few enhancements in this quarter. The first one, which I'm quite proud of, is the launch of our new global digital platform. We had before 46 individual platforms representing Natuzzi in the different markets. Starting from last Thursday, we sunset all those platforms and we introduced just one global new digital premise. This will represent a window for both Natuzzi Italia and Natuzzi Editions. They will be fully transactional toward 2022. We started from having e-commerce fully transactional in the U.S. for Natuzzi Italia. So now the window in terms of displaying the product is operational in all the geographies. The e-commerce is fully operational in the U.S. and we start recording the first sales during their Black Friday.

And digital will be, of course, one of the major priorities for the development of the Company. In the new organization digital will be reporting to me, and I will be closely following this development. When I said I am particularly proud, that means I'm not proud for the end result, this will be continue evolving, it will be the result of an agile implementation approach. I'm proud because four months ago we set up the planned date for the new launch, which was last Thursday, it sounds a bit of a challenging task. And I'm proud to report that our team has exactly matched the data, so gave me a sense, a good sense of delivery on the task.

The other area where we are continuing expanding our “access to the C” is North America retailer. Jason will be providing more color about that; but we are significantly higher, I would say double-digit high depending how you count, sometimes almost triple-digits high versus 2019 and 2020 on our U.S. and North America. And this again will be a very important area of priority for investment for me going forward.

Starting from this press, we provide a bit more color on our JV in China, where we currently have more than 300 stores with 60 new opening also this year. The brand is positioned in a very strong way with Natuzzi Italia being really positioned as a luxury brand and Natuzzi Edition being more an aspirational furniture brand. So the combination of digital in North America and China in my view are a clear confirmation that we are a brand recognized by the consumer; the consumer is appreciating not only our brand, but the experience he/she can receive of the brand in our retail.

And this is again in full transparency to provide you with a visibility on what could be my agenda as CEO, but also the agenda the Company is working on. The other point we flesh out in this press release is a bit of a reflection on our trajectory. As you know, the Company has been going through a different phase, the phase we are in potentially started some 10 years ago when Pasquale had his very visionary view of moving a producer or manufacturer into our brand retailer. We are now accelerating the trajectory, and looking at the last four years, I think it's encouraging to see some of those indicators confirming the viability of that strategy.

Let me flesh out a few numbers. The revenue of the first nine months has been growing, as I mentioned, 36% versus 2020, interrupting a cycle of declining lasting for years and more. The branded sales on total sales are 86%, in 2018 they were 76%, so they are 10 percentage points more. Gross profit percentage moved from 28% in 2018 to 36%, so 8 percentage more. In absolute numbers, we were posting a loss of, let's say, €17 million in 2018, €19.5 million loss in 2019 and €13 million loss in 2020. We are now posting a profit of €4 million, operating profit. The retail, it was a new venture for the Company, even in U.S., which has been always one of the strongest market. It was posting negative results until this year where we are posting a positive operating result of €2.3 million.

The job in my view just started. There is a lot for us to do, but I want to share some indicators that in my view confirms that the direction is the right one. And of course, myself and my team are highly committed to confirm the accelerated trajectory.

Let me stop here. I might ask maybe Pasquale, since you've been named a few times in my summary, to comment with any, let's say, color on our strategy, on the work we're doing together before opening to the Q&A.

Pasquale Natuzzi

Good morning and good afternoon, everyone.

Antonio, you have been the best analyst that I've met in my life. So you have been able to analyze the Company, understand the strength of our Company, the strategy. And you are the best communicator. I mean, I believe I can just confirm what you said, that's it. Then I'm going to turn the floor to any question, obviously.

Antonio Achille

Thank you, Pasquale. And again, we don't want to sound too nice to each other before Christmas, but I can confirm that all the Management, and especially with the Chairman, we are really working in a close syntony on the strategic agenda, which I know it was a question coming from most of you guys.

Okay. Maybe let's stop us here and let's open for questions, unless again, Jason or Vittorio, you feel you want to comment anything on what I just said.

Jason Camp

Ready for questions, team.

Vittorio Notarpietro

Me too. Thank you.

Operator

Thank you. We'll now be conducting a question-and-answer session.

Our first question is coming from David Kanen. Please go ahead.

David Kanen

Good morning. It's Dave Kanen. Can you guys hear me?

Operator

Yes. Please go ahead.

David Kanen

Okay. So, first question is, I see that backlog was up $21 million sequentially from Q2 to Q3. Can you approximate or quantify how much of that backlog is high margin branded product?

Vittorio Notarpietro

(Multiple speakers). The branded business is growing, as said by Antonio before. So according to that, the backlog is—also the quality of the backlog is improving.

Antonio Achille

My estimate, David, is that roughly resemble—I mean, if I look at the vintage of that backlog is baked between second part of last year and this year. So during this period, the percentage of branded product has been from 80% to 85%. So my assumption, which need to be verified, but I will be surprised if that is not the case, that percentage applies also to the vintage, to the backlog. So expect the backlog to be significantly represented by the branded product.

Okay. And for you to know, if I look at the area of our business where we experimented most difficulties in fulfilling quantity in third quarter was Italy for Natuzzi Italia. As I mentioned, I don't know if you follow that, but most European countries, and Italy was one of those, made a compulsory to have the green pass to re-enter factory during August. So a good part of our workers were not ready to do so, and we experimented some 20%, 25% of absentees. And Natuzzi Italia Factory Chief reproduced Natuzzi Italia brand product, so on the new additional backlog, the €21 million, I'm pretty sure the percentage of Natuzzi Italia product is significant.

David Kanen

Okay. That makes sense. And then when I look at the quarter on the surface, it looks like revenues were down versus the second quarter, but then when I look at written orders, they actually accelerated from Q2 to Q3. And then the backlog had a huge jump by €21 million. So, my question is, how much revenue do you think was lost due to the two week shutdown for the factory during August? I guess the two issues would be supply chain and then the two week holiday in Europe, how much of that was supply chain? How much of it was two week holiday?

Antonio Achille

Before maybe passing to Vittorio, if he has specific data on that specific question, I think you're pointing out something very relevant for the framing of the discussion. In the sense that depending, the result of these two quarters can be a picture or can be a part of a movie. If you look at the picture, of course, we could have higher revenues, even those have been higher than both 2020 and 2019, because we could be fulfilling additional quantity order we already booked for this quarter. If you look at in a sequence, as a movie, it's clear that trajectory is moving north in my view. I mean, the data speak clearly.

I mean, backlog in a sense are postponed revenue, so are not lost revenue. So all the order we received will be delivered. So that is a bit more high level answer.

Vittorio, I know we did some of the analysis David is asking for. I don't know if you have the precise figure, what could have been the revenue. Yes.

Vittorio Notarpietro

It's not much more precise, but for sure, David mentioned the €21 million backlog increase. We didn't have any plan to increase that backlog, we did have the intention to lower the backlog we had at the beginning of the year. So the delivered sales in nine months, if we compare the nine months that we have lost of that previous plan is higher than €21 million, at least it's €30 million if not more, because we had about €105 million backlog by the beginning of this year. We had in mind to recover a portion of that by delivering more sales, by producing more sales during 2021, which was not supposed to be another pandemic year. And instead of lowering that €105 million, we are €110 million. So it's more than between €20 million and €30 million at least, the loss in terms of delivered sales.

David Kanen

Okay. So, I mean, I'm going to look at it in a simplistic way. I'm not sure where you're completely understanding what I'm saying. We lost in the quarter at least 14 production days from the shutdown in Europe for the holiday. If I look at your total revenue and I just divide it by the number of days in the quarter, it's about $20 million. However, to be fair, not all of your production is in Europe. So it's somewhere, and my guess is $10 million to $20 million for the 14 lost days of production. Is there a way that you could quantify that for me or give me a little more detail?

Pasquale Natuzzi

If I may, I mean, while we are a global company and while the pandemic is still there, is still in Brazil, is still certainly in Vietnam. It is still in Europe. As our CEO said, now despite the two weeks' vacation, okay, but the absentees in the last three, four months has reached in one of our biggest factory 25%, is just unbelievable. So we had, I mean, problem based on pandemic in Romania in our factory. In Brazil, we had production reduction in Brazil. In Vietnam there was lockdown for long, long time.

But then one of the main problems is the transportation. I mean, it's very difficult to find space on the vessel to ship the product, and the price is just unbelievable. Why we used to pay $3,000 from China to America or from Vietnam to America. Now, the shipping company they are asking $15,000, five times more expensive. So we cannot ship just easily because we should manage cost and the shipment.

But also because we import a lot of components from Asia, even the cost of transportation and the availability of the component and transportation from Asia to Brazil, from Asia to Romania, from Asia to Italy is very complicated, seems to be in a war. If we don't get the component, we are not way capable to move the production. I mean, there are so many, many really problems that we are managing. Okay? And I must say, we are managing it very well. So that's my personal feeling.

Vittorio Notarpietro

If I can comment a little bit. If we have to qualify the shortage in delivery and sales, we had problems everywhere for the reasons explained, but the first one has been in Vietnam where the lockdown has been concluded by the end of October. So most of that shortage comes from our Vietnam sub-contractor.

Pasquale Natuzzi

And we have a finished product, I mean, in the warehouse that we cannot ship because there are no space on the vessel available. So production is there. As soon as we find space on the vessel and at a reasonable price, we will ship and invoice, and consequently will help the total revenue.

David Kanen

Okay. Let me move on to my next question. Do you see starting in Q4 you guys working down backlog and revenues increasing? Assuming written orders remain at the same robust pace, are you going start working down that backlog and delivering product output at a faster pace in Q4 and in 2022?

Antonio Achille

Let me answer. First of all, we have a luxury problem in a sense that we are trying to empty the backlog, but demand is always accelerating. So first, it is important to put in that frame, of course, it is a problem, but it's better to be in the situation than having empty plant and no demand. So our demand for the fourth quarter, from what I'm seeing, there's no sign of weakness, rather the opposite.

First, we are not like other companies in the market saying we are working down the backlog because we are kind of cooling down demand. Our demand keeps to be very hot. Second point, in terms of capacity but also marginality will work so that given our business cycle the action we put in the beginning of quarter one—sorry, at the beginning quarter three will be fully impacting in quarter four, both in terms of marginality and in terms of some of the production announcements.

Then the broader transformation I mentioned before, so opening up Mexico, increasing our productivity in Italy with the 4.0 production, bringing additional capacity in Romania, those are typically actions which have impact for the mid-longer term. It’s something we don't tactically from one quarter, we do because our, let's say, mid-term objective at 2026 forecast a major growth across our brands. So some of the, let's say, more tactical action definitely has been designed to have impact in Q4.

Hopefully we will see a better situation in terms of our output capacity and definitely in terms of marginality announcement. The other directions I mentioned are more to enhance our operational machine to sustain the long-term objective growth.

David Kanen

Okay. And then, in terms of the strategy for growth in North America that you've articulated previously to open approximately 10 stores per year for branded product, which will positively affect overall margin, do you believe that with the changes and plans you put into effect in Q3 that you'll be able to meet that additional demand with output?

Antonio Achille

Jason, do you want me to comment, or I should comment?

Jason Camp

Yes, It sounds like a supply chain question more than a retail question.

Antonio Achille

Two points to your question. Absolutely North America is a top priority. I feel one of my, let's say, missions of my job, I don't have a complex job in a sense, but one of my key missions is to allocate investments and prioritize investments, and retail in North America are both high priority and across each other. So when you talk about retail in North America, it's top priority, especially for Natuzzi Italia. So we plan to accelerate that.

When it comes to timing for executing, it's less a supply chain issue constraint, it's more the fact of identifying the proper location. We are very, let's say, anxious to deliver on the new opening. At the same time, we are very careful, because opening a new store is a multi-year commitment, even those, of course, we don't buy but we rent. So we want to find a perfect location, which fit the target consumer we want, which presents good economic conditions.

I've been already twice to New York to look at a location for a potential additional store in New York. So it's something just to tell you how relevant is the decision which I go, myself with Jason, to visit the store, look at the economics, looking at the catchment area. So we definitely want to keep the target and we will do. At the same time we want each opening to be successful and we're very careful examining new locations.

And this, I mentioned in New York, but they've had been in Texas, again, with Jason looking at a potential location. So we defined a process where a new location would be considered a major decision for the

Company, not just because of its size, but because it's a very important decision and we want to be, all of us, involved in taking the decision.

David Kanen

Okay. My question is, with the changes that you've put into effect, let's say each store contributes approximately another €4 million in revenue, can you meet that demand right now?

Antonio Achille

Yes. I mean, again, when I talk about…

Pasquale Natuzzi

I mean, certainly we have production capacity. I mean, especially in Italy, we have production, we have a factory, we have the people, we have a production capacity. The issue, again, has been transportation, material shortage, and the high absenteeism in the last three, four months. And likely the pandemic is still there, I mean, it didn't disappear. But again, yes, if we open the store, we have a production capacity, we have well-skilled people here in Italy, we have a factory, we have everything ready to go.

David Kanen

Okay. And my last question…

Pasquale Natuzzi

That was your question, right?

David Kanen

Yes. In general, can you meet that capacity?

Antonio Achille

I confirm that. What I said is we're not going to be slowing anything because of production. If anything it's because we don't find the perfect location, but production is not an issue for our stores.

David Kanen

Okay. And then just last question and then I'll turn it over to any of the other callers. I don't want to monopolize. But your KUKA JV from your original monetization of that where you sold a little over 50% for €65 million, it's grown considerably. Could you give us an update on that. As a shareholder, I would love to see you monetize that and help unlock the value for Natuzzi shareholders. Can you give us an update on how it's doing and if you're open to exploring alternatives or if you've already engaged?

Antonio Achille

We are open, we are engaged. Tomorrow we have a board with our colleagues of the JV. Some of the points for discussion are really about how to collectively extract the maximum value for that. The company, the JV continues to be on a positive trajectory, both in terms of growth and in terms of cash accumulation in the JV.

And in terms of profit, which has been distributed to us, I pass it over to Vittorio to share the progression of that profit, but the short answer to your question is, it is absolutely in our agenda. And we are engaged, actively engaged. So we're not just considering, we are actually engaged with our partner; of course, we sit in a board, so it is a matter of discussing, considering alternatives and taking common choices. But we have actively engaged the partner on the topic.

David Kanen

Thank you.

Antonio Achille

Vittorio, may be you want to share some numbers of the progression of the profit which has been distributed by the JV.

Vittorio Notarpietro

Let me have a longer perspective of that. When we started the JV by the year-end 2018, they had the full-year revenues of about €27 million. By the end of 2021 they will triple their sales. When they started in 2018 the JV had a single-digit EBIT, now they are in the area of 12% EBIT and EBITDA is around 13%. In first of August 2018 they started with €25 million cash, and as of September they have already doubled their available cash. So the Company is well managed, it is growing, it is improving margins and cash.

Antonio has already said about the co-operation with them, and maybe in the future this part will be analyzed by the JV board in terms of new developments. Now, the discussion is about the better use of the available cash, and maybe Antonio will discuss about the DOS development over the next three years with the Board of Directors of KUKA. But the Company is running very well.

David Kanen

Thank you.

Vittorio Notarpietro

You are welcome.

Operator

Thank you. Our next question today is coming from George (Inaudible) from MK (phon). Your line is now live.

George

Good afternoon. Thank you for taking my question.

Two quick questions. One of them is, can you give us your progress on the Mexico plant and your plan to have production there? And then, the other one is for Jason, just an update on revenues and store developments in the third quarter. Thank you.

Antonio Achille

Let me take the one on Mexico. And again, maybe Pasquale can provide more color.

First, when we talk about Mexico, it's primarily Natuzzi Edition North America. Okay? Just to qualify what we're talking about. There are two options we are going to be implementing in parallel. One is a producer, which is a very established company, which is a listed company. We will be producing a specific number of products which are today making what we call quick program. So quick program is that are made to stock which are products for the consumers in our stores, and if they buy, are immediately delivered to them.

We identify the subset of those models to be produced. We have been costing them, we've been looking at all the aspects. And I believe that it can be from beginning of 2022. And this is for Made to Order program. This will be having the benefit of fast delivery and reducing our working capital in the U.S., and particularly sensitive on anything which is related to capital absorption of the Company. So our quick program is very successful commercially, and it requires some selective working capital inventory in North America. This production in Mexico will lower this requirement of working capital to fulfill the quick program.

The second partnership we are exploring is a production JV similar to what we have been successfully implementing in Vietnam, where with, let's say, an established North American manufacturer, which has operation in Mexico, we were going to be ramping up capacity for our special order production. Special order means that the customer for Natuzzi Editions can order any combination. For Natuzzi Edition consumers can order any product in any configuration. And this is special order, this of course being a JV, being I wouldn't call it greenfield but almost a greenfield operation, will require more time, but we are targeting again to start production in 2022.

We are taking this very seriously in the sense that our Director of Operation, Ottavio Milano, is now entirely focusing on Mexico, working very closely also with Jason because of course is of interest of the North American market, but he is entirely focused on that to the point to let Ottavio focusing on that opportunity. We are trying to understand how to reinforce his current position of Director of Operations, but he will be in charge primarily and almost solely of this opportunity to elevate our execution capability.

I don't know, Pasquale, I know you've followed even before I joined the discussion on Mexico. I don't know if you want to comment anything here.

Pasquale Natuzzi

Okay. So for last the two weeks we had—Ottavio Milano is one of our top managers. With another two managers, they spend two weeks' time in Mexico. In Mexico, the cost of material is two times more expensive than in China, because, let's make it clear, we are going to make—so far we manufacture Natuzzi Edition for the North American market in China.

Our strategy is to move the production in Mexico because we downsized the factory in China in order to meet the demand from domestic market for the next five years and for the rest of Asia, while we believe that we need to manufacture for North America the brand of Natuzzi Edition in Mexico.

The cost of material in Mexico so far is much, much, much more higher than in China. The result we got so far in the last two weeks is that the cost of final product in Mexico is the same as in China, including the duty that we pay, which impact about 12%, 13%.

But we have also today the transportation cost is just unbelievable, very, very, very, very high. Certainly, let's say that on total cost today Mexico seems to be convenient. We should have a meeting in the next few days with our Management to finalize and understand that if really is convenient and when we should move forward with our production to meet the special order business.

While, as Antonio said, our CEO, we believe that we should start the production of five top seller models that we warehouse in America for immediate delivery. I mean, Mexico is still in the process. But it seems that all the Americans are trying to move to Mexico from China because the transportation cost is just prohibitive. And probably the feeling between Americans and China is not the best one, it is just a matter of feeling, certainly.

George

Maybe just to summarize that, so the made to stock is definitely happening, and that should be roughly around the beginning of ’22. And the special orders you are working hard on that, trying to see whether to start the process.

Pasquale Natuzzi

Within two, three weeks we should have really much, much clear idea how to do it and what to do it.

Antonio Achille

On the special order, on the made to stock your summary is very correct. We are launching it in 2022.

Vittorio Notarpietro

The other question was for Jason.

Antonio Achille

Yes, in fact the other question, I think Jason you should take the one on retail, U.S. retail.

Jason Camp

You bet. Thank you.

The results we're seeing in Q3 and now that we're almost two full months into Q4 continue to be encouraging. We've been already saying that our best stores are performing at and around $4 million, which we're continuing to see, and that our network average is closer to $3 million.

I think it's also relevant to share that as we have been watching some U.S. retailers report written order results in the fall, some of those retailers are having a hard time comparing against their 2020 orders. And we're very pleased on the retail side to confirm that our results in Q3 and into Q4 are at a double-digit increase over what we saw in 2020 in Q3 and Q4. So we're quite pleased to feel that continued momentum.

I hope that answers your question, George.

George

Yes. It does. Thank you.

Operator

Thank you. The next question, your line is now live. Please proceed.

Robert Marcin

Hello, gentlemen. Robert Marcin from Penn Capital. Congratulations on navigating a very difficult period with COVID and this explosive recovery.

I'm looking at a lot of talent on the screen right now. And I'm looking at a great product with a phenomenal brand name. And yet the only thing that's consistent has been the lack of profitability of the business. It's been good times or bad, high rates or low rates, good economy or bad, the Company has been consistently unprofitable. So we hope things are going to change.

Could you potentially give us a set of revenue and margin targets for the intermediate term that Management would be held accountable for and that shareholders can use as a benchmark to set a price target on the business, should these be achieved? Thank you.

Antonio Achille

Thank you very much for the positive notes on our business, which I do appreciate. I completely understand and sympathize with your question. I mean the marginality is really our focus. In transparency, the Company, as many producers, has more an attitude to focus on growth and top line rather than margin and capital utilization. We have been now having a full set of KPI supported by SAP, which allow us to track for any micro sale of our business, the EBIT produced, and going forward also the cash flow produced for every micro sales, that is just part of the story.

There's also a bit of cultural change because, again, all the Company—you will see something right, which I appreciate, because it was very straight. In any time the Company did not have great margin, I mean last 10, 15 years, but also need to be recognized that also growth was not there. So I think the Company secures growth, hopefully in a substantial way. We are seeing double-digit growth or whatever you cut to the business.

I think now definitely it's time for margin, and a top priority for us is what to really look at in reading the business is really what's going to drive our decision of investment, it's what is going to be driving our decision of MBO and promotion of people, our implication for my compensation. So this is really central.

I understand your question. I must disappoint you in the sense we don't provide guidance. We have internal target breakdown by geography, by line of business, but we don't provide the external targets, not because we don't want to help investors, but I think because there are so many parts moving that we're going to be—we want to be cautious in the way we create expectation around our Company, we want to deliver first and then to meet expectation.

I can assure it is very central. I'm sorry to disappoint you, because we don't provide guidance on where the margin or the EBIT or the cash flow will be in one year or one year and a half, that is something we don't do.

Pasquale Natuzzi

I'm Pasquale. I have something else to say also, Antonio, that it's true that in the last three years the Company has been negatively performing, but please understand that 15 years ago Natuzzi was an Italian manufacturing company, an Italian leather upholstery manufacturing company.

Today Natuzzi is a lifestyle brand. And to create a lifestyle brand requires just investment, investment and investment. And then to create a retail model that should be profitable, again, it requires investment, investment, investment. I mean, so that's the way we should interpret the result, the balance sheet result over the last 10, 15 years. So I mean, we have done huge investment.

Today we are lifestyle brands, the wholesale business represents 15%, 85% is branded where we make better margin, and now we have also good Management to manage the retailer and the brand around the world. So that's something to be considered.

Robert Marcin

Thank you very much. I will interject, Antonio, that one quarter or one-year outlook is guidance, and many companies do not provide short-term guidance because of the moving parts, but they do on their website for the presentation with financial intermediate or longer-term financial targets. They are two very different things, sir.

Antonio Achille

I think it is a very fair comment. I appreciate you making that. I think here you have a combination of us being on movement internally and outside being on movement. But again, I appreciate your question.

We will reflect if at one point we are going to feel this is something we will do to give more sense of confidence to potential investors. I've always been in the camp of…

Robert Marcin

Pardon me. When the business is up and running well and humming, I think it would behoove the Board and Management to put something like that out.

Antonio Achille

Thank you. We heard you. Thank you so much.

Is there any other question?

Operator

Thank you. Our next question is coming from Greg Cohen with Rambleside. Mr. Cohen your line is now live.

Greg Cohen

Hi, guys. Can you hear me?

Antonio Achille

Yes.

Greg Cohen

Hi. My question is around e-commerce. It looks like it was recently launched. Can you guys give some color on how large that opportunity can be and what if anything we're doing to promote it? Thank you.

Antonio Achille

Thank you for your question. I might take this and, of course, I will say Jason but everybody else on our side is very welcome to provide color.

Now let's triangulate on a few sources (phon) can be the opportunity. If you look at other players in, let's say, the furniture and accessories, they do a significant part of business online. So if you take (Inaudible) percentage are significant. I mean, I think you have the data, but we're talking about 40%, 50%, 60%. Of course I think Kuda accessory, when you look at more just furniture, is still is very significant, maybe 20%, 30%. Those are players which are focused on geography where digital and e-commerce are predominant or very well accepted by North America and Anglo-Saxon market. So I think it will be on the high end of what we can give us as a target, but this just to say that for us is a significant opportunity.

Until last Thursday, we were doing zero, we recorded some sales already this weekend. So it's all an upside. On an upside also because in my view it will allow us to tap into a new segment of customers, also with partially a different demographic. Then the way in which we are doing it is to be in a sense channel neutrals. That means that we are setting incentive system for the customer and for our team not to make one channel prevailing on the others. So it will be always an environment where the customer can buy either online or search online and then buy in our store without any barriers. But we believe this can be one of our major upside opportunities together with retail.

In terms of driving traffic, as you know, you need to be beyond the organic growth, which I think we're going to be benefiting a lot, because our brand is very, very popular across geography. Beyond organic growth we want to boost traffic by working with the usual suspects in terms of buying traffic.

There's one source of financing for me, it will come also from the sector practice of doing sales and discounts across the year. I think we should be progressively understanding how to move some part of what I'll call investment in that area, so doing discount, which is double digit for the sector, to move it to acquiring traffic digitally, and that will be a significant buffer which is not going to be nothing radical, but progressively we're going to be exploring how to move part of that budget to acquiring traffic digitally.

Operator

Thank you. Ladies and gentlemen, that does conclude today's question-and-answer session, and that does conclude today's webinar. You may disconnect your lines at this time and have a wonderful day. We thank you for your participation today.