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Natuzzi S.p.A.

First Quarter 2023 Financial Results Conference Call

June 5, 2023

C O R P O R A T E P A R T I C I P A N T S

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Pasquale Natuzzi, *Founder & Executive Chairman*

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C O N F E R E N C E C A L L P A R T I C I P A N T S

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P R E S E N T A T I O N

Operator

Welcome to the Natuzzi 2023 First Quarter Financial Results Conference Call.

As a reminder, you can join this conference live via telephone by dialing into the following number +1-412-717-9633, then passcode 39252103#, in addition to the link already provided to join via video. (Operator Instructions)

Joining us on today's call are Mr. Antonio Achille, Natuzzi's Chief Executive Officer, Mr. Carlo Silvestri, Chief Financial Officer of the Natuzzi Group, Mr. Pasquale Natuzzi, Founder and Executive Chairman, then Mr. Jason Camp, President of Natuzzi Americas, and Piero Direnzo, Investor Relations.

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

I'd now like to turn the conference call over to Piero. Please go ahead.

Piero Direnzo

Thank you, Kevin, and good day to everyone. Thank you for joining the Natuzzi's conference call for the first quarter 2023 financial results. 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, and good morning, good afternoon to our respectable investors and analysts. Before we get started, let me also introduce our Treasury Director, Marilena Scaramuzzo, today joining us, together with Piero and Carlo to handle potential questions or the financial side of our analyst presentation.

As we published in our press release, the first quarter sales were clearly below our ambition and below significantly 2022 first quarter. I do remind you that 2022 first quarter was one of the strongest that we ever recorded, but that is not enough to describe the situation. The situation is a situation which continues to be characterized by a very challenging business environment. Globally, real estate, which is one primary source of new demand for our business is very much frozen, given the high interest rates.

In general, consumers have turned away from durables, privileging more instant pleasures, so holidays and dining out. And this unfortunately is a contest we continue to see, even though we know the industry is cyclical, so we deeply believe that there will be a return to normality in due course.

Beyond what we experimented globally, we clearly have two geographies that deserve further reading. If we look at our performances, 75% of the absolute number, negative delta, is driven by two regions, North America and China. North America is accounting for a delta negative of 11.7 million versus the first quarter of 2022.

If we read carefully on the North American business, most of the, let's say, decrease comes from the wholesale business, especially the unbranded part of the business. The unbranded part of the business, which is still present, even though it's a minority for our business, in 2019, in North America first quarter accounted for 8.3 million, in the first quarter of 2022 for 6.5 million, and in the first quarter of the current year accounted for 1.8 million. So, it's roughly one-fourth what used to be three years ago before the pandemic. This is because we are not intending to divest for this market.

On the contrary, we are opening outsourcing and operations in Vietnam to be more effective. But we do want to do it in a way which is value accruity. So, we want to do it in a way where we don't serve client situations which don't give us adequate marginality, those brought us to be selective.

These are the first explanations for the branded part of the business.

For the branded part of the business for sales, as we anticipated, we are going through significant restructuring of our team. In a sense, we are powering up our team. We hired a senior executive, Scott Kruger, which comes from more than 30 years' experience in the sector. We are also expanding our geographical coverage mostly through multiline agents in order to be cost effective, but to have a more capital coverage of the country.

We believe that this will give us, and we already see from last day point, a positive momentum, even though it will take time because still we're experimenting that with large retailer; they are still in a destocking phase. That's for North America. We have here Jason that I'm sure will provide more explanation. So, North America has been dragged down mostly by the wholesale business, whereas retail is up versus 2019 and is in general performing in line with our expectation.

China is the other geography that deserves a further discussion. China is at 10 million below last year. I've been spending, with a core team of executives, in the last 10 days in China. I was there with the Chief

Brand Officer for Natuzzi Italia, Pasquale Junior Natuzzi and the Chief Brand Officer for Natuzzi Edition business, Cosimo Bardi. Beyond visiting stores and meeting dealers, we have been having a serious meeting with our JV counterparts.

I do remind you that we are in a minority JV, where we own 49%, where 51% is owned by our partner, Kuka. And we use this time with the JV to critically review the business and especially to identify what are the short term and mid term actions to regain growth. In China, we have 382 stores, mostly franchisees. Of those 103 are with Natuzzi Italian brand, the remaining with Natuzzi Edition.

It's quite evident that the Natuzzi Italia business is the one which is below our expectation in terms of fresh orders. Here, we clearly highlighted two, let's say, reasons. The first one is the outstanding inventory during 2022. Both our JV and our dealers in China placed a significant order of Natuzzi Italia inventory because the momentum was very good in terms of new orders. And from a supply chain, there was not yet a normalization of the supply chain.

JV and dealers, in order not to miss sales, they stock quite significantly. And this is now a buffer that we need to absorb. This allowed the JV to be relatively better than what we see at the selling level, which is our, let's say, sales to the JV as a manufacturer.

The second topic, which has been openly addressed, where we have a clear action plan is that in the new context of, let's say, more selective Chinese consumer, we need to create a better retail execution in China. Regardless, this is happening in our U.S. and in our franchisee. So, we agreed to have a more systematic integration of systems, IT system and practices both for our, let's say, U.S., the 14 U.S. Natuzzi Italia DOS and the franchisee so that when we deal with the franchisee, we don't provide only goods, but we provide methodologies in terms of merchandising or methodology in terms of running effectively a store.

These, of course, are actions that will be implemented in the next few weeks and months, and we hope to see a rebound of sales in the Natuzzi Italia part of business in China. What else, Natuzzi Edition business is still growing versus 2022, in our internal expectation.

This is, I would say, again, for a very high perspective of what's happening in terms of top line and by the main geography.

If we then have more reading of the quarterly sales. We are—despite all the difficulties—going in the direction of our long-term plan. That, as you remember, was around focusing on core markets and growing through retail and brand. The retail business on total sales moved from 41% in 2019 to 61.7% in 2023. So, we added 20 percentage points of retail on the total weight of business. As a reminder that for retail, we mean both directly operated stores and franchisee.

As a reminder, this was a strategic decision because to manage the brand is essential to manage also the retail operation. And hence, especially for Natuzzi Italia, this was actively thought as a direction. And in fact, if we look at the weight of retail on total Natuzzi Italia sales, the percentage goes up to 85% which is a typical percentage of a vertically integrated company.

The other elements, which is important to flash out is the percentage of total branded sales, which is now 92.3% on total sales versus 76% in 2019. So again, here, we are executing on the idea of becoming a branded company. As I said before, we don't want to neglect opportunity in the unbranded business, which was, if you want the history of the Company, as long as that it doesn't become a distortion of our journey and it comes with adequate margin.

Talking about margin. You have seen that in the context of declining sales, we were still able to expand the margin, the gross margin. Gross margin for the quarter was 35.6% versus 30% in 2019. So, we added almost 6 points of margin. The margin would have been almost 37% not considering EUR0.9 million of accrual we did for rightsizing our workforce. So, even in a context where it is easy to become very aggressive in terms of pricing and discounting, we try to be very disciplined.

We're doing regular benchmarking to make sure we are not off, and we are not off, but we still want to protect our marginality. And it's worth noticing that those margin improvements have been achieved in the first quarter, not applying any further price increases. I'm sure you remember that both in 2022 and 2021 due to the high inflation, we were forced to do price adjustments.

In the first quarter of 2023, we didn't do any price adjustments. Those margin enhancements happened despite the fact that, as I mentioned before, Natuzzi Italia, which is typically the highest margin part of our business, decreased more than the rest of the business. So, I think that margin increase to me, it happens really deliberately because we are trying really to focus on margin production.

Just talking about margin, then when we look at our fixed cost structure, this is an area where work has been done, but most of the work still need to be done because, of course, we were acting during the quarter in response of the slow demand, but the nature of those fixed costs require time for materializing those savings. But this is an area where with Carlo and with our HR, we are looking not only at incremental savings, but really to do significant alternative ways to look at our organization, both at the center and at the region.

In closing, since typically something I've been asked for, I'll give you a sense of what's happening to our cost base. The underlying costs are mostly having positive dynamics. Transportation is really decreasing significantly, especially from China and Vietnam to North America, is also decreasing even those to a lesser extent from Italy to North America, and of course, that will be benefiting our marginality going forward.

In terms of raw material cost, in general, it is a good picture. Wet blue, the leather, is decreasing. The same, even though to a lesser extent, is true for motion to mechanics and to wooden frame. Polyurethane instead still slightly increasing. In general, our cost base of raw material is improving. You don't see that reflected still in the first quarter because we work mostly with inventory. So, the cost of material that we are currently embedding in our production is the one of the previous quarters.

That is again—we don't do guidance, but it's clear that it should be playing in our favor in terms of expanding marginality. Strategically, we're kind of playing a double game here, dual game. The main focus where every one of us is kind of very, very, very focused is regaining growth. We are really questioning all the dimensions of our business organization and business model to make sure we can get any potential gain in every geography, in every channel.

The other element, of course, is cost control, especially fixed cost. We are very cautious with investment. Investment is still prioritizing, where we can, the strategic direction. The retail expansion is continuing. In the first quarter, we opened two U.S.—Miami, which was a kind of buyback and San Diego in the U.S. We opened one JV DOS in the U.S. and one in China, and additional five franchising stores, of which three in China, one U.S. and one in Australia. So especially, of course, for the U.S., because of franchising, we don't make direct investments. We are trying to protect those investments.

The other—in closing, the other dimension, which is clearly something which keeps us very focused and I believe we have really a state-of-the-art approach in monitoring the one-year rolling cash need, is our short-term financial position, where currently all the different stress tests confirm the solidity of our group. As you know, we have zero debt, and in term of cash management, we're very, let's say, strict and stringent in managing it.

That, I would say, is an overall view of the quarter. In term of what we expect. We expect yet, let's say, a market which will not release these negative conditions very soon. So, we are kind of equipping ourselves for up and during, or during a challenging situation. Even though, for instance, the May results in retail

U.S. were encouraging, we start seeing some initial positive elements in some of our geographies, especially retail.

Let me stop here for any high-level question, then Carlo will provide a more accurate reading of our business by geography and channel. But, if you have any immediate questions to me, I can take it or I can take it after Carlo, Piero, Marilena will go through the detailed reading of our business.

Operator

(Operator Instructions)

Good day, David. Your line is now live.

David Kanen

Good morning. Thanks for taking my questions. I was surprised, given the decline in revenue that if I add back the restructuring charge, it looked like on an operating basis, you were actually breakeven, which is kind of a testament to the improvements that you've taken in terms of margin and it's encouraging for the future. Now, that being said, have you seen any improvement in written orders specifically in North America and China recently? Is this the trough? Is this the bottom in terms of written orders, or are things still very challenging and is there a potential for revenues to continue to decline from this level?

Antonio Achille

So, I think Jason can spend more on North America specifically. The situation remains challenging. In terms of written orders, if we compare that versus last year, the last 8, 10 weeks were clearly much better also because last year had a very strong start in the first part and then softening. So, if we look at our delta versus last year, it was more negative in the first weeks that is in the current trading.

The situation remains anyhow very challenging in the sense that we have to conquer every single sale, it’s not that we are getting high volume of traffic. And, I would say that's true for the industry, unfortunately, because it would be an encouraging sign, in a way, if it was just for us. I think the industry overall is quite cold in terms of traffic. In terms of trend versus last year's factually, last weeks are improving, but also because last year, by April, the wind kind of changed, so we're comparing it versus the second part of last year, which was softer.

In terms of North America, I might let Jason describe on China. They have favored the new year (audio interference), but the result on Natuzzi Edition they are very, very encouraging, the current trading. Natuzzi Italia, as I mentioned before, requires some fine-tuning of our merchandising and fine-tuning of our retail operation before it gets better. But Natuzzi Edition, the order flow is above last year.

Please, Jason, on North America, you might want to comment.

Jason Camp

Good morning, Dave. So, listen, I would say that from a written order standpoint, Q1 of '22 was our retail peak. In fact, uniquely, it was almost 10% above any quarter we had ever had in our history from a retail perspective in North America. Of course, what we're most focused on today is, we report revenues to you and in North America those revenues on a retail basis often come four to five months after the orders are written because we import almost all of our sales from Italy or China.

I would say, in general, that our start to the year on a written basis has been healthier and stronger than how we finished '22. So, the quarters that followed, let's say, the back half of '22, our business year-to-date is healthier and stronger than what we wrote in the back half of '22. Then lastly, I'll say is, if I'm looking at our—the health of our retail business against, even 2019, kind of pre-pandemic on a like-for-like or comp basis, we're comfortably running almost 30% above 2019, and in totality, that retail business, although still relatively small, will probably be in the range of doubling 2019 at a total level. I hope that helps.

David Kanen

Okay. That's very helpful. Then from my standpoint, critical to the success of the Company and value creation for shareholders is the continued expansion of branded, your branded presence in North America and like markets in Western Europe. Can you talk about—you said you opened three stores, I believe, in Q1. Is the plan on track for the balance of the year and then also 2024? In the past, we spoke about 8 to 10 stores, DOS stores per year or a combination. Is that still the case, and will you potentially accelerate that or fund it from sales of non-core assets, meaning real estate? Thank you.

Antonio Achille

Jason, as you commented, can I answer, yes for 2023? But I'll let Jason comment on a more elaborated way and then—if you agree, Jason, I will briefly comment with Carlo on the sales on the strategic asset.

Jason, do you want to comment on the pace for 2023 and color on where we're opening next?

Jason Camp

Our opening count is on plan for 2023 for the year. I think, in general, we're spending time aligning on 2024. So, I think simply said, we're on target to achieve that for 2023 and we're spending time getting aligned for 2024.

Antonio Achille

Dave and other investors and analysts, in terms of direction of our plan, which, by the way, was approved by our Board, it was a kind of formal, let's say, commitment everyone is taking towards the Board, nothing has changed. Brand retail and core market is a priority in the U.S., is in that frame, the largest priority. So, there's not been a redirection of the plan.

In terms of sales of non-strategic assets, equally, that is a priority. We are continuing a dialogue especially for our largest asset High Point where we are in dialogue with a potential buyer. And hopefully, we will be able to report back a more precise outcome. Also on the sales side, as you can imagine, with this interest rate, the loan-to-value for a potential buyer is reduced.

So, we will not accept, let's say, very sub-optimal offer. But if there is a change of fair valuation of the asset, we are very much with the Chairman—inside shareholder, we are very much aligned that it is a good moment for pursuing those opportunities.

David Kanen

Okay. Well, again, just to recap, although revenues were disappointing, what was encouraging is the fact that we were more or less breakeven on an operating basis. When we do return back to EUR100 million plus in revenue, it seems as though we're positioned to generate meaningful operating profit. So, I commend you on that and continue the good work of improving margins holding the line on expenses and expanding our North American footprint. Thank you.

Antonio Achille

Thank you, Dave. I think, of course, is a bitter satisfaction, if you want. But if you were simulating, we're doing this even today, what will have been the EBIT running at EUR100 million, which is nothing particularly exciting to write home about because our plan clearly at a higher target for this year, but will be a significant margin and EBIT with the current EBIT conversion that we're operating.

Okay. If there are no further questions, I suggest maybe Carlo drive or a comment from our colleagues or the Chairman, I suggest that Carlo drives through the more, let's say, detailed and technical aspect of this press release.

Carlo Silvestri

Good day, ladies and gentlemen. I will go through the data that we did report for the first quarter 2023, and then, I will have some information regarding what Antonio mentioned about the quality of our sales and other P&L assets.

At the first quarter 2023, the Natuzzi Group reported revenues for EUR86.1 million with a gross profit of EUR30.6 million and an operating loss of EUR900,000 with financial costs of EUR3.4 million, and the share of profit of our investments in the JV channel, EUR1.1 million. We closed with a loss before tax of EUR3.2 million and after tax of EUR3.3 million. In short, we had revenues for EUR86.1 million and a loss of EUR3.2 million before taxes.

In order, as Antonio did correctly mention, to give not as a justification of our performances, but to give you a better perspective of our performances, we will refer to not only the first quarter 2022 but also to the first quarter 2029, given the fact that the 2022 was under the spotlight as the last quarter of 18 months expansionary phase starting immediately after COVID. So, if we analyze the data, starting from an overall perspective, our sales, excluding the “other revenues”, so focusing on our core business, we did land at EUR84 million that represents a decrease of 26.2% versus 2022 and 16.9% versus 2019. Two-thousand-twenty-nine was at EUR101.1 million and 2022 at EUR113.8 million.

If we focus again on our branded delivery sales that includes Natuzzi Italia and Natuzzi Edition, we were flat at EUR77.5 million, the same as in 2019, while we were decreasing at 21.6% versus 2022. Between the two brands, we did see the sales of Natuzzi Edition surging and compensated by the decrease of Natuzzi Italia. So, based on our EUR84 million business, if we refer only on the branded quality, our business branded is now at 92.3% versus 86.8% in 2022 and 76.7% in 2019.

If we then go and analyze our sales giving a specific information related to our retail strategy, we see versus 2019, an increase of 23.9% in terms of sales, even as we mentioned, in overall decrease in performances. This is, again, an underlying—the message is, as Antonio mentioned, that the Company is still focusing on the retail strategy.

While for the wholesale business, we are not exiting the business, but we are pursuing a different strategy, protecting our marginality for our unbranded business. So, it means that we are focusing on selected distributor that will bring results on a later stage, while for our branded strategy, as Antonio mentioned, we have a new agile structure in the U.S. that just started its activities. So, this is to say and to give you a quick recap that based on the EUR84 million, at retail level, we are at 61.7% versus 54.8% in 2022 and 41.4% in 2019.

Just a few comments on, as Antonio was mentioning in China and on the U.S. market, specifically about China. So, anticipating a one-off, the information you would find in our profit and loss. China is still facing a challenged situation, but the Company is still profitable and is focusing on the destocking. The combined action from our JV team has brought out a positive effect of EUR1.1 million in our performances that I repeat is shown with the equity method within our P&L. So, we do not consolidate. We just show the performance with the equity method. So, China has a benefit in our performance of EUR1.1 million.

Talking about marginality, and we are today at 36.6% (net of the 0.9 million euros of accrual accounted for to streamline the workforce), with 2022 at 34.3% and 2019 about 30.1%. The combined effect is about sales mix and channel mix and decreasing tariff in raw materials. This is, of course, given the fact that we have seen some inflationary phenomenon that stopped with a decrease of raw materials and utilities and also, given the fact that our purchase process would reflect the full results of the decrease in the tariff in the next 60 days, this margin is still incorporating some purchases and inflationary processes started in the last quarter of 2022.

Talking about our overall performances in terms of operating expenses, I would like to talk about the percentage impact that our overall cost as on our sales. In 2022, we were at 33%, while now we stand at 36.6%. As Antonio did mention, it is, of course, where we don't want to be in terms of impact. We are aware of this. We are working on this. So, in a different direction, we are reviewing our organization in order to see and to find further efficiencies, and we are trying also to work on different levers, including the optimization on the working capital and see how to focus on cost control, specifically on discretionary expenses.

For what we said above and for the fact also that we do include in our results a EUR900,000 to streamline our workforce, if we deduct from our loss of EUR900,000, that is the EUR900,000 we did invest to streamline, operating result would breakeven.

Specific attention needs the finance costs. We are all aware about the spike in interest rates. In our P&L, we have seen an average interest rate that increased 52% in the first quarter 2023 versus the first quarter 2022. And even, if we did try to decrease our average loan exposure, we are now facing a total financing cost of EUR2.1 million versus EUR1.8 million in 2022. These are the same as for the operating expenses, as it is a challenge for the Company, and we will further work on this because the internal target is to rebalance the situation and moving more towards self-financing of the sources.

Talking about the cash as the last point, the cash was EUR48.3 million, as a result of EUR5 million invested in working capital, EUR3 million in CapEx and EUR1 million paid to reduce our workforce.

So, these are all the comments related to our P&L. If there are any questions, please do let us know.

Operator

Thank you. (Operator Instructions)

I may turn it for any final remarks from Antonio and Carlo.

Antonio Achille

Thank you, Kevin, for moderating. As usual, very effective our conversation. I thank our supportive people who've been attending for the last 45 minutes our conversation. We've been—and we will continue being extremely transparent on our business. We do remain confident of the potential of this group. When we go around talking with our dealers, our partner, even our final customer, we really believe that what we set ourselves as a midterm goal is absolutely achievable and this Company deserves it.

At the same time, our, let's say, midterm plan, we need to recognize that we’re encountering a strong headwind and that this will—causing to be 18 months plus shift in terms of execution over time of our plan. But in term of direction and goal, we have not changed of one inch our conviction on the potential of this Company.

Thank you very much. And unless the Chairman or the colleagues want to have additional comments, I thank you for the time you dedicated to us today.

Pasquale Natuzzi

My comment is very simple. Business environment is complicated and no question about it. I mean, there are tensions between China and America, tensions between Russia, China against Europe, and certainly, all those tensions, they impact negatively, obviously, on the consumer confidence. We are a company with a very strong and clear direction. Today, the team is more united and strong and professionally prepared to face this kind of a situation and I'm totally confident about the future of the Company despite the environment, again.

Thank you very much everyone, for attending this call and we hope to give you better news in the next one. Thank you very much again.

Operator

Thank you. 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.

Pasquale Natuzzi

Thank you.

Antonio Achille

Thank you. Bye-bye.