Natuzzi S.p.A.

Third Quarter 2022 Financial Results Conference Call

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CORPORATE PARTICIPANTS

Piero Direnzo, *Head of Investor Relations*

Antonio Achille, *Chief Executive Officer*

Jason Camp, *President of Natuzzi Americas*

Pasquale Natuzzi, *Founder, Executive Chairman*

CONFERENCE CALL PARTICIPANTS

David Kanen*, Kanen Wealth Management*

PRESENTATION

Operator

Good day ladies and gentlemen. Welcome to the Natuzzi Third Quarter 2022 Financial Results Conference Call.

Following the introduction, we'll conduct a question-and-answer session.

Joining us today on the call are Mr. Antonio Achille, Natuzzi's Chief Executive Officer; 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 would 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 conference call for the third quarter 2022 financial results. After a brief introduction, we will give room for a Q&A session.

Before proceeding, I'd like to advise 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 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'd like to turn the call over to the Company's Chief Executive Officer. Please, Antonio.

Antonio Achille

Thank you, Piero and good afternoon, everyone.

Thank you for joining our third quarter 2022 conference call. Let me share a few highlights on the third quarter but also as we are pacing at the end of the nine months of 2022.

The third quarter closed with a positive tone in terms of revenue. We reported revenue of €116 million, which means an increase of almost 15% versus 2021, which was a strong year for us with an increase of 30% versus 2020 and an increase of 32% versus the year 2019, which can be considered the last year of normality before the pandemic.

I also would like to flash out the growth of the branded business. As you know, Natuzzi operates two main brands, Natuzzi Italia and Natuzzi Editions, and that revenue was €103 million with an increase, which is higher than the average increase of the total revenue, of 22.5% versus 2021 and 57.6% versus 2019. This means that the branded business is growing faster than the overall revenue, which is very consistent with the strategy that Pasquale Natuzzi, our Chairman, initiated a decade ago to transform the Company to a brand lifestyle company and a retail company.

One of the priorities we gave ourselves with my new mandate is working on marginality to extract more value to be reinvested in the business, but to extract more value also for the benefit of the investor, majority investor and every investor. When it comes to marginality, we closed the quarter with 37.7% gross margin which compared with 36.6% of 2021 and with 28.7% in 2019, so versus 2019 almost 10 additional percentage points of marginality, this in a year which is being still characterized by significant increasing costs in some of the materials and a true spike in energy costs.

As a result of those elements, let's say our continued growth and better marginality, we closed the third quarter with €4.1 million operating profit, which compares with a loss of €0.4 million of the third quarter last year and a loss of €8.7 million in 2019, so quite a significant improvement during the third quarter.

If we look at the nine months of 2022, the operating profit has been €6.7 million, which compares with a profit of €4.3 million in 2021's first nine months. It's important thus to remember that in 2021, Natuzzi, as all, let's say, major companies benefit for COVID-related measures, that in our case during the first nine months amounted to $4.2 million. So, if we want to compare the profit of the first nine months of 2022 versus 2021, the improvement after netting the one-off COVID-related measures has been very significant, clearly much more significant versus 2019 where the first nine months ended with an operating loss of €19.5 million.

When we look at the profit per American Depositary Receipt, or ADR, which is basically what every one of you own, that means that we closed with €0.50 of profit per ADR, per American depository receipt, which is to be compared with a loss of €0.35 available in 2021 and €1.05 in 2022 third quarter. From the very beginning, we discussed in our call that the priority for our business is to create value for our shareholders and for our employees and for our customers, and that this is somehow happening.

Cash-wise, we're close to a position which is very similar to what we had at the end of last year. Last year, we closed with €53.5 million cash. This quarter, we closed with €53 million, so almost exactly the same, this despite the fact that we are having some more inventory due to the slowing of the business.

In essence, I hope you appreciate our effort to manage the Company in a way to extract more value and to have a more tight cash management. Clearly it's very early days. We don't want to be celebrating any success, but I believe the numbers show that the work is paying some results.

I want also to highlight in a very candid manner that the trend that we already discussed in the last press release, which is the slowing down of the business since April, has not reversed. So both in our retail and the business with our clients, we see a pace of new orders which is below our expectations, which means our budget. We keep comparing notes with the remaining peers in the industry and we see this is quite a general trend, given whatever is happening around us, which I believe at this point is even redundant to repeat.

We don't take, of course, this as an excuse. We are working very hard. We're also taking some change in our organization, most notably in our sales team in the U.S. and also in our European and emerging market team to reinforce our team and to make sure we stay closer to our existing clients, and also to reinsert new clients selectively to strengthen our pipeline of business.

This is a bit of executive summary, so I will say a quarter which ended up on a positive note. Unfortunately we're experiencing quite strong headwinds which is not helping our turnaround. We are very committed to continue the growth journey, which is part of our five-year plan, but we need to acknowledge that this is happening in a market context which is not necessarily favorable. We know the industry is cyclical, so we definitely hope it's not going to be lasting forever. We're working so that despite these headwinds, we keep our business up and our factory busy.

Just providing an additional few highlights on our cost structure before opening to Q&A. When it comes to G&A, there's been a better absorption and also SG&A, given our business leverage. When it comes to raw materials, it's noticeable the spike in energy. As I mentioned before, we had an extra cost of €2.8 million for energy. Material is a bit a multi-faceted dynamic. Leather is improving the cost. Fabric and metallic parts are still on the rise because those industries themselves use a lot of energy in the production, and so they pass the additional costs to their clients, which in the circumstance are players like us.

The other point to note is transportation, which is normalizing, not yet at the levels of 2019, but especially from China to U.S. and Vietnam to U.S. has been steadily reducing and allowing us to be competitive again from those platforms.

This is a bit the executive summary I wanted to provide. Let me stop here for observations and questions as usual.

Operator

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

Our first question today is coming from David Kanen. Your line is now live.

David Kanen

Okay. First, congratulations. I know the quarter didn't turn out exactly as you would like and up to your long-term potential, but to earn €0.50 per ADR is certainly an accomplishment and demonstrates how undervalued the Company is, so congratulations. It's encouraging to see what the potential is long term.

A couple of questions. One your comments in the press releases, "In response to the tough market conditions, we've launched a set of actions to lower the cost of our G&A, tightly manage our working capital, and protect our cash position." So, could you speak specifically to what's going on in terms of lowering the cost of G&A?

Implicitly what it tells me is that there's more leverage in our financial model to the upside during periods of normalization, but if you could just quantify that for us and give us some specifics as to the areas that you're targeting.

Antonio Achille

Okay. Thank you for the positive note and encouragement, Dave. We know that you have been a long-term investor and that comes from a deep understanding of our business. I appreciate it.

When it comes to managing our costs, we went back to basics in the sense that in 2019, the Company also with the external support of McKinsey, put together a process to manage in a tight way the restructuring costs, looking at any individual dollar which has been spent across all categories, which included purchasing, transformation costs, industrial costs, G&A, so we have replicated that methodology internally.

I was part, of course, of the McKinsey team there, so a lot of people also here are already black belts on that methodology, so we have a weekly meeting and we have accounted around 13 responsible, which as you can imagine are the typical functionaries responsible, and we have put down a series of new initiatives to tightly manage the different costs and also the working capital.

I can give you a few examples. One is really around streamlining and accelerating the restructuring in the quarter, where we identified potential to accelerate the right-sizing over the quarter, also as a way to allow to bring in new capabilities. We are looking at all possible ways to reduce the impact of any additional energy costs on our factories, so we are reviewing the processes. When we come to working capital, we are applying a lot of scrutiny on the total different kind of working capital that we have in the Company, which means the raw materials that we have, which means also the finished product that we have in some of our geographies, we are adding really a tight management of those items to ensure that there is no cash trapped in those areas.

We are addressing also some more structural opportunity like the simplification of our offering, where we want to be very compelling and appealing to the consumer, but we also acknowledge that there is a lot that can be done to simplify the covering assortment, the way in which we make intermediate stock on that level. So, it's a kind of holistic approach managed with a tight methodology where every week, we appreciate progress, we intervene to change and resolve situations and we need to be accelerate.

David Kanen

Can you quantify what the cost savings are in terms of millions? Is it a low single-digit, mid-single-digit, or a high single-digit number when it's fully implemented?

Antonio Achille

I think if we just look at the third quarter, also to compensate a slowdown in the revenue, we're looking at, I would say a material potential impact on the order of €3 million or €4 million for a quarter, which doesn't mean that will increase the EBIT but it means that will also allow us to counterbalance the negative effect of the loss of revenue momentum. I believe this is a Company which is—we know that we've always been mentioning the opportunity around restructuring. This is a Company which has an opportunity to manage in a more tight way its business, and the opportunity *per se* of that can be quite substantial, quite substantial in early days. It can be quite substantial.

David Kanen

Okay, and then in the press release, you referred to the impairment of a trade receivable which increased SG&A. What was the dollar amount of that?

Antonio Achille

I will pass you over to Piero for that, hoping that he has the answer.

Piero Direnzo

Impairment of trade receivables? it was €0.1 million for the third quarter.

David Kanen

Okay, and then a quick question for Jason. In North American DOS like for like, how did we do?

Jason Camp

We're spending a lot of time looking at both kind of how we're comparing to '21 and to '19, and so when you look at year-to-date, we're trending down 8 to '21 and plus-50 to 2019 year-to-date.

David Kanen

Okay. Thank you.

Jason Camp

Like-for-like.

David Kanen

Okay, and then final question.

Antonio, you've referred in the past to your Factory 4.0 sequential rollout. Can you give us an update on that? In the past, you referred to a mid- to high single-digit improvement in gross margin. Once that's implemented, where are we, and when do you expect that to be fully rolled out?

Antonio Achille

I confirm that that is the range of the potential, *ceteris paribus*, which means that if the factories are adequately saturated, they operate with the right level of saturation, that in our business means 80%-plus, the application of that approach of working, which more than technology is a way of having a lean manufacturing way of organizing the flow, can produce that kind of result. The plan is to allow that in most of our Italian factories by next year, and as we're also considering a potential relocation of the factory in China, to make sure the new plant can be fitting this new approach of working, and then the next wave will be Romania and our Brazil operation, so that can be the benefit.

I need to be, again, candid here because before modeling the benefit in the margin, we need to acknowledge that the reduction in volume is also translating in a reduction of factory utilization, which being a fixed cost business, of course, has a direct impact on the cost per minute, so we are even working harder on the Factory 4.0 because we see it not only in the long term something we deeply believe-in as an opportunity to enhance margin but also as an opportunity short term to counter fight the potential negative impact on cost per minutes deriving from a lower capacity utilization of our factories.

David Kanen

Okay. Thank you. I appreciate the commentary. Good luck, and you guys have a nice holiday.

Antonio Achille

Well, we're definitely going to talk before the holiday. For us, holiday, we will do holiday after the plan is completed. In 2027, we do holidays.

Operator

Thank you.

If there are no further questions at this time, I'll turn the floor back over for any further or closing comments.

Antonio Achille

I feel I've spoken enough. I leave the floor open maybe also if Pasquale wants to comment, or Piero or Jason, then I will do a summary myself. I also want to leave the floor open for the Chairman and the rest of the team if they want to comment anything, and then I do my final remark.

Pasquale Natuzzi

You gave plenty clear explanation, Antonio, for what we are doing and what is happening, so probably what we missed to explain probably and rather to underline is that in order also to reduce G&A, we are reviewing the organization, consolidating some organization, like for example the Southwest Europe market together with Emerging market is under a single regional manager, and also aggregating and synergizing the customer care and other functions. So, reviewing the organization aggregation certainly will allow us to improve the service, improve administration and reduce the cost. This is something that we are following.

For the rest, you gave all the major explanation, Antonio. Okay?

Antonio Achille

Thank you, Pasquale. It's been a very appropriate comment on your side.

In closing, I want to restate how committed we are. We're really working as one team with just one strategy. The Chairman, myself, here you see Jason, our leader in North America, but also the remaining of our team, we're very cohesive, we're very committed on the long-term plan. We know that there are challenges ahead of us, but we are very equipped for those challenges. We have a good cash position, we ensure the Company is managed adequately on that front, and as I mentioned before, we're going to be stepping up in term of aggressiveness on cost reduction as due to this phase and as everyone you have seen is doing, also starting from the large digital company in U.S.

This is the, let's say, third quarter result. In term of strategy long term, nothing has changed. We're still committed to make Natuzzi the most successful high-end European brand globally. I believe that with the current strength of the brand, the current heritage of the brand, this is something is due and is also achievable.

Having said that, thank you so much for your attention. I wish you a great continuation of the day, and I hope to reconnect soon in our next press release.

Operator

Thank you. That does conclude today's conference and webcast. You may disconnect your line at this time, and have a wonderful day. We thank you for your participation today.