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Natuzzi SpA

Third Quarter and First Nine Months 2019 Conference Call

December 2, 2019

CORPORATE PARTICIPANTS

Piero Direnzo, *Investor Relations Manager*

Pasquale Natuzzi, *Chief Executive Officer*

Vittorio Notarpietro, *Chief Financial Officer*

Italia Casalino, *Global Business Retail Channel*

CONFERENCE CALL PARTICIPANTS

David Kanen, *Kanen Wealth Management*

PRESENTATION

Operator:

Welcome to the Natuzzi Third Quarter and First Nine Months 2019 Conference Call. At this time, all participants are in a listen-only mode. Following the introduction, we will conduct a question-and-answer session. Instructions will be provided at that time for you to queue for questions.

Joining us today on the call are Natuzzi's Chief Executive Officer, Mr. Pasquale Natuzzi, the Chief Financial Officer, Mr. Vittorio Notarpietro, and Piero Direnzo, Investor Relations. As a reminder, today's call is being recorded.

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

Piero Direnzo:

Thank you, Kathy. Just a short notice, together with the Chief Financial Officer and the Chief Executive Officer, we also have today, Mrs. Italia Casalino who's in charge of the Retail channel, and then we have also Mr. Cosimo Bardi, who is in charge of the Wholesale Branded channel. Then, we have also Gianni Tucci, who is in charge of the Wholesale Unbranded channel.

Good morning to our listeners in the United States, and good afternoon to those of you connected from Europe and Asia. Welcome to the Natuzzi Third Quarter and First Nine Months 2019 Conference Call. After a brief introduction by the Chief Executive Officer and the Chief Financial Officer, we will give room for a Q&A session. Mr. Pasquale Natuzzi, together with a top Management team, will be glad to answer your questions.

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 Chief Executive Officer. Please, Mr. Natuzzi.

Pasquale Natuzzi:

Thank you. Good morning to everyone. Despite the unprecedented number that we generated during the first nine months of 2019, which disappoints everyone, but caused primarily by the trade war between the United States and China, and still without a solution. The Management has taken initiatives aimed to overcome this difficult situation. In fact, I would like to emphasize that the Retail division represented by direct operating store and franchising one, the percentage of volume has increased to 49% of the entire business, compared to 44% of last year.

Within the Retail business, the rollout of franchising store in China proceeds according to the plans. By the end of this year, we will have 240 stores in China, thanks to the 55 new Natuzzi store openings overall in 2019. We will continue to open stores in China with this intensity, and this will positively support our revenue in that region.

In the United Kingdom, we have recently reached an agreement with two historical partners for the aggressive development of the Retail business. Within end of this year, we plan to open five Natuzzi retail stores in the United Kingdom.

The Italian Divani & Divani by Natuzzi store network continues to deliver a positive sales performance and be profitable. In consideration of the ambitious program, we have, for the Retail development, recently hired a new Corporate Retail Manager, Ms. Italia Casalino, who will be responsible in supporting the Regional Manager for the achievement of their P&L early target and the execution of the Retail business model.

The Wholesale Branded channel, consisting mainly of Natuzzi galleries, represents 32% of the total business, the same percentage as last year. The strength of the Natuzzi brand has allowed us to limit volume and margin erosion in America caused by U.S. tariff. This distribution channel is now entrusted to Mr. Cosimo Bardi, who will support the Regional Manager in the development of such business. Eventually, Mr. Bardi and Ms. Casalino, they are available for any explanation, if needed.

The Wholesale Unbranded division, led by Gianni Tucci, represents 19% of the total business. It was at 24% one year ago. The performance of this division has reflected the imposition of such U.S. tariffs, because a final resolution is still unpredictable, unlikely.

In order to overcome the U.S. custom duties, we started the revision of the entire group industrial allocation to recover volume and margin, including outsourcing action in both Asia and Europe. The first step of such revisions started from China. In fact, our plant in China has become less competitive because of the above-mentioned tariff, so it must be downsized. Therefore, the current 88,000 square meter plant would be replaced in third quarter of 2020 by a smaller plant, 38,000 square meters, in order to satisfy the development plans only for China, and the rest of Asia-Pacific market, which—they are not impacted by duties.

We are now in an advanced stage of negotiations for an outsourcing production in Vietnam that will manufacture Unbranded product for the North American market. Production in Vietnam will start gradually from the first quarter 2020.

As for the production of Wholesale Branded for North America, our Brazilian plant, which has production capacity, will start serving the East Coast within the first half of 2020. That will improve the margin for this business channel. At the same time, we are progressing in negotiations with an external player to find additional outsourced production capacity in Mexico to serve the United States of the West Coast. We believe such outsourced production in Mexico could start in the second half of 2020.

To recap, North America market would be served from plants in low-cost countries outside China to avoid the U.S. tariff. The Unbranded production for mass market would be made in Vietnam. The Wholesale Branded production will be made part in Brazil, and part in Mexico.

To complete industrial review, we have almost completed the shift of certain low-margin production from Italy to Romania, as it was no longer sustainable here in Italy. We need further industrial capacity in Eastern Europe; that's why we are negotiating with third party production players located in Belarus, to get low-cost production capacity in outsourcing. To favour the Unbranded business in EMEA region, we believe the production in Belarus could start gradually in the second half of 2020.

The Romanian plant will continue to manufacture Wholesale Branded for the EMEA region. Nothing's changed for the high-end Natuzzi Italia production. That will remain based in Italy, regardless of the market to be served.

Lastly, we are progressing in the selling process of certain assets no longer consistent with our strategy. We have also decided to hire an advisor firm to support us in the sale, and if needed, in the financing of such sale process.

Now, I will pass the conference over to Vittorio, who will go through numbers in more detail. Then obviously, I'm available for any questions. The Management is here even in this meeting, and any questions, we will be very pleased to answer to you. Thank you.

Vittorio Notarpietro:

Thank you, Mr. Natuzzi, and good day to everyone. By the end of 2016, we all remember that the Company reached positive earnings before interest, taxes, depreciation and amortization. Then, we experienced a slowdown in sales for reasons already explained many times. We know the consequences in terms of profitability.

But, at least in the last three years, the Company has been capable to improve its direct Retail operations, to improve its Brazilian operating results, to reduce its workforce in Italy and lower its working capital needs. In fact, in spite of lowering sales for the first nine months of this year, earnings before interest, depreciation and amortization was positive at $0.8 million, little, but positive. Even with the poor sales of the third quarter 2019, EBITDA has been only a little negative.

Having said that, let me first address two questions we have received from investors during the weekend. First, our partnership in China is consolidated at equity, since we just own a minority stake of 49% in that company. The cash flow we display does not include any cash got by the JV legal entity, of course. We will start getting cash as soon as shareholders will be in the position, and the Company will be in the position to distribute dividends.

In the meantime, our partners in China continue to grow the business, the Natuzzi Retail business, and we have got €1.4 million as our share of net profit of the equity measured in the fee (phon).

Having said that, let me go through the cash flow in more detail. For the first nine months of 2019, net loss has been €26.8 million. Then, we had €22.3 million of positive adjustments for non-monetary costs, mainly for depreciation and amortization, plus the profit of the JV in China, for example, and others.

Then, we had a total of positive items for €17.1 million, mainly deriving—basically derived from a lower working capital need, and in particular, following the actions carried out to lower inventory and trade receivables. Notably, cash working capital reduction is proportionally higher when compared with the slowdown in sales.

Secondly, such positive total of €17.1 million includes already €4.6 million of cash-out for the reduction of workforce in Italy, since the restructuring costs are included into the operating results. Then, we used €6.3 million to pay back interest on financial debt and taxes. As a consequence, cash provided by operating activities, as displayed in our press release, was positive by €6.3 million. We have then paid €4 million for capital expenditures. This means, to address another question we have just received, that we had a small, but still positive, free cash flow of €2.3 million, which came out in third quarter this year.

Then, we had €36.1 million used as follows: €4.5 million reimbursed on long-term borrowings; €10.5 million used to pay back lease contracts related to our own stores; and €21.1 million to reimburse short-term debt, mainly related to lower sales of trade receivables through the securitization financing vehicle in line with lower sales.

What we do expect for the next quarter; we will have sales a little higher than those in the third quarter 2019 just displayed, but still lower compared with the fourth quarter 2018. In spite of that, we should display an improvement of operating results when compared with that reported in the third quarter 2019.

Thanks, everybody.