# Natuzzi S.p.A

# First Quarter 2019 Financial Results Conference Call

## May 28, 2019

## CORPORATE PARTICIPANTS

**Piero Direnzo,** *Investor Relations*

**Pasquale Natuzzi,** *Chief Executive Officer*

**Vittorio Notarpietro,** *Chief Financial Officer*

## CONFERENCE CALL PARTICIPANTS

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

**Giovani Danisi,** *Private Investor*

## PRESENTATION

**Operator:**

Good morning, ladies and gentlemen. Thank you for standing by. Welcome to the Natuzzi Conference Call for the First Quarter 2019 Financial Results. 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 up for questions.

Joining us on today's call are Natuzzi's Chief Executive Officer, Mr. Pasquale Natuzzi; the Chief Financial Officer, Mr. Vittorio Notapietro; Mr. Nazzario Pozzi, Chief Officer of the Natuzzi Division; Mr. Gianni Tucci, Chief Officer of Softaly Division; and Piero Direnzo, Investor Relations.

As a reminder, today's call is being recorded. I would now like to turn the conference over to Piero. Please go ahead.

**Piero Direnzo:**

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

Before proceeding, we would like to advise our listeners that our discussions 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 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:**

Good morning and thank you for joining us today.
I would like to talk about two important areas this morning.
First, where we are and second, where we are going and the specific steps we are taking to get there.
I would describe the first quarter of 2019 as a perfect storm.
Sales of upholstered furniture through traditional channels continued to decline and the imposition of US tariffs on Chinese goods added significant pressure on prices.
Natuzzi Group suffered an almost 9% decline in total revenues and showed an operating loss of Euro 3.0 million.
But within these results are some very strong signs of the impact of our efforts on a turn-around.
Our gross margin improved from 28.2% to 30.1%, despite the decline in sales of Euro 10.4 million.
This is the result of greater efficiencies in production and logistics coming from our new management team and the continued improvement in both our mix of business and in our DOS network.
Our branded sales grew to 76.7% of total, up from 75.1% in the same quarter in 2018.
We will continue to follow such direction.
While these are not the results we have in mind, I am encouraged by the very strong signs that we have taken the right strategy and that our efforts are finally bearing fruit.
Our customer base continues to shift into a price focus at the lower end and a total experience at the higher end.
The Natuzzi customer is one who seeks a high-end lifestyle combined with a high-end retail experience.
The results of our direct retail sales prove this observation.
As such, we will continue our efforts to build out both our Direct Operated Stores as well as a network of mono-brand franchises for both Natuzzi Italia and Natuzzi Editions.
These represent the best path to growth at the higher margins we desire.
At the same time, we will continue to eliminate unprofitable business in our private label activity in Softaly.
We will no longer make sales that are not profitable, and we will recover the working capital from this business to devote to the accelerated growth of our retail structure.
This is an effort that has been underway for the past several quarters, but I have decided that we will now accelerate this transition.
This will allow us to reconsider the structure and management of our entire organization as we shift from a wholesale business to a retail business.
We will seek efficiencies in the structure and cost of our company on a global basis as we go forward.
Lastly, let me comment briefly on tariffs.
The trade war between the US and China is a real issue for our industry.
Fortunately, we do not own our Chinese manufacturing plant and we are able to consider moving production closer to the markets we serve, notably the United States and Europe.
We will be considering new manufacturing options with a focus on efficiency and margin as we continue the transformation into a high-end branded lifestyle experience.
We remain dedicated to returning our company to strong profits and we will stay on our current course as the results say we are going in the right direction.

If there are questions, I would be very pleased to answer to all of you. Thank you.

**Vittorio Notarpietro:**

In the meantime, Mr. Natuzzi, let me go through some more details around...

**Pasquale Natuzzi:**

Okay.

**Vittorio Notarpietro:**

…our numbers. But let me go through some detail in order to check if something progressed in Q1. First quarter, as said, was negatively impacted, in large part by the uncertainty surrounding tariffs. As a result, the revenues declined in the quarter by roughly €10 million compared to last year. Even though mitigated by better mix and price increase, sofa sales expressed in terms of volumes, which are seats sold, went down by 16% in the quarter while we had a stable business with furnishings.

Brazilian and Romanian plants are okay with the capacity utilization. We have instead the redundant workers in Italy, but we are addressing that, as said in previous quarters, with a new scheme agreed with the Italian authorities that allow us to shift our first significant portion of the production to Romania. China plant has the impact of lower sales deriving from tariffs, but already reacted by lowering workforce variable and even some fixed costs. All the plants increased their productivity. That's the main reason for the improvement of gross margin.

The production efficiency is improving even in difficult times.

Thus, the directly operated stores chain has been under development, and until now has incurred a net loss. We have assumed control of several stores previously run by third parties and restructured their operations.

As these efforts have been largely completely, today our DOS looks like this.
In Q1, we had 65 point of sales, of which 39 are Natuzzi Italia DOS, 14 Divani&Divani by Natuzzi store, and 12 Natuzzi Italia Concessions. In Q1, the operating profit of the entire DOS chain was €0.7 million, or 4.1% of net sales. Spain, where we operate 11 stores, broke even. France, where we recently opened two stores to enter the market, showed there's more loss. U.K still lossmaking, UK I mean. We have, in Q1, closed down the concessions we had and started restructuring the stores business. In Switzerland we operate three stores, which almost broke even in Q1.

The full Natuzzi Italian DOS in Italy shows as more loss. Divani&Divani DOS in Italy, after difficult years, showed a very positive result thanks to the new format, new merchandising, and new management. Florida, six consolidated stores plus one just opened in Sarasota, is growing quite positively. Mexico, 3 stores plus 12 concessions, is improving. Both show profits.

Finally, United States of America DOS, which, as said by Mr. Natuzzi, is and will continue to be the most important market for Natuzzi. The DOS sales in United States of American showed in Q1 a dramatic improvement from last year's first quarter. The USA five DOS chain is finally profitable.

In addition, the 55 like-for-like stores shows a 7.6% increase in sales and a turnaround from loss to positive EBIT, so retail is improving too.

Rest of the year, our fiscal budget for 2019 includes the following areas of focus.
A significant improvement in the DOS chain; a better mix including some price increase; lowering raw material price, especially leather; a positive contribution by shifting production from Italy to Romania; a better performance of our plants; and reduce expenses resulting from the progressive phase out of unprofitable customers.

In Q1, we have done what we planned. However, the weak order flow of the last eight, nine weeks likely will affect our results in Q2 2019. But in these days, we have the spring Congress here in Santeramo and we are meeting all our clients worldwide. I'm sure Nazzario will elaborate on that. In spite of Q2 order flow difficulties, we will continue, as said by Mr. Natuzzi, to stay on the path.

Our JV with Kuka in China is progressing. They are doing the planned rollout for Natuzzi Editions and Natuzzi Italia stores. In Q1 2019, the contribution of JV to Natuzzi has been €0.4 million profit while last year in Q1 the full EBIT impact was €0.2 million. We believe we have chosen the right path in China and are encouraged.

The Company has €49.1 million cash by the end of the quarter and we're focusing on the working capital. The increasing focus on the more profitable branded business will reduce the overall complexity. The lower complexity will result in lower working capital needs. In doing that, we will continue to operate on the reduction of our fixed cost basis, SG&A included. Thank you so much.