Natuzzi SpA

Fourth Quarter and Full Year 2018 Financial Results Conference Call

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CORPORATE PARTICIPANTS

Piero Direnzo, *Investor Relations Manager*

Pasquale Natuzzi, *Chief Executive Officer*

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CONFERENCE CALL PARTICIPANTS

Garrett Larson, *Kanen Wealth Management*

Giovanni Danisi, *Seeking Alpha*

Michael Feder, *The Feder Group*

Nick Ghattas, *GT Capital*

PRESENTATION

Operator:

Good morning, ladies and gentlemen. Thank you for standing by. Welcome to the Natuzzi Fourth Quarter and Full Year 2018 Conference Call. At this time, all participants are in a listen-only mode. Following the introduction, we will conduct a question-and-answer session. Introductions will be provided at that time for you to queue up for questions.

Joining us on today's call from the Natuzzi store in Milan are Natuzzi's Chief Executive Officer, Mr. Pasquale Natuzzi, the Chief Financial Officer, Mr. Vittorio Notarpietro, Mr. Nazzario Pozzi, Chief Officer of the Natuzzi Division, Mr. Gianni Tucci, Chief Officer of the Softaly Division, and from the Natuzzi headquarters, 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:

Thank you, Arnam. 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's fourth quarter and full year 2018 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 discussion today could contain certain statements that constitute forward-looking statements under the United States security 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 20-F filed with the SEC for a complete review of those risks. The Company assumes no obligation to upgrade or revise any forward-looking matters discussed during this call.

Now, I would like to turn the call over to the CEO. Please, Mr. Natuzzi.

Pasquale Natuzzi:

Good morning, everyone, and thank you for participating in the Natuzzi conference call. As already communicated last November, the first nine months of 2018 were very difficult for us due to the important issues we faced in the supply chain. This explained most of the operating loss of €15.2 million we reported at that time.

We have reacted to that and reinforced some key management positions, particularly in the operation, with professional coming from primary industrial players. In particular, we had these new hirings, and they are, indeed, Mr. Aldo Amati, with an extensive experience in aerospace industry, as the Chief Process, Innovation and Product Development Officer.

The operation department is now led by Mr. Antonino Gambuzza, who has 25 years of experience in manufacturing and engineering industry, as the new Chief Operating Officer of the Group.

And we have Mr. Umberto Longobardo with a deep experience in the fashion industry, as the new Chief Quality and Customer Care Officer, and Mr. Paolo DiMaggio, from the automotive industry, as the new Global Procurement Director.

We immediately started working together, checking a list of KPIs on a daily basis, and the first improvement started to arrive almost immediately during the fourth quarter of 2018 and that was confirmed in the first months 2019. This has led to a better and efficient programming and quicker delivery of our products so we didn't have delays in the production and the invoicing process, as occurred in the past.

Furthermore, the strict collaboration among managers has also led to finding new solutions to further improve the overall supply chain process. The Senior Management is in place. I am extremely confident about the contributions that can be derived from the job and recovering efficiency.

We also hired a new Human Resource Director from primary industrial player in Italy. His name is Michele Onorato, which has made already great job with achieving the agreement with Italian government and National Unions that allow us to reduce the cost of labor in the Italian plants and starting from April 1, 2019 to shift the volumes of production from the Italian plants to the Romanian plants. That's related to Natuzzi Edition production because Natuzzi Italia product will be manufactured still in Italy, where we have higher margin, obviously, while the Natuzzi Edition, the margin we have doesn’t allow us to manufacture in Italy. So that's the reality.

As a result, the overall labor cost in the production plants will improve accordingly starting from the second quarter 2019, and it will improve the Company margin. This is by far the most important news for Natuzzi for this year and going forward.

At the same time, I would like to remind you that we transformed our group from a manufacture company into a lifestyle brand. This has required a huge investment over the years, which relates to the worldwide brand awareness that Natuzzi name has gained over time on a global scale. Such company transformation has been pursued also through huge investment on mono-brand stores. In fact, there are evidences of such transition.

If you give a look at today’s performance, we clearly see that the retail mono-brand store business, which represents almost 50% of the entire business, is growing, allow us to control the brand value and margin.

As a result, the learning curve we have done in the retailer business in recent years, we intend to increase the percentage of our controlled distribution going forward.

The wholesale, on the contrary, is characterized by strong competition on price, putting high pressure on margin. For this reason, we will sell the unbranded product only to selected customer with acceptable volumes and margins.

But what we just said, going forward, we intend to focus on the retail-based strategy that is on the development of a mono-brand store network, both directly and franchising operating. We are very well positioned for this and this will deliver an effective return of the investments made on the brand over the last few years, or many years I must say, and that journey has been done so far.

A lot is still to do, but now we have clear in mind the path to be followed and confident that for the reason I just explained, we will be capable to overcome the turnaround and create value for the Company and for shareholders.

Thank you very much. We are here available for any questions. Thank you.

Vittorio Notarpietro:

Thank you, Mr. Natuzzi. Let me give our listeners some more numbers about this year and the last quarter. Let's start explaining the impact on Natuzzi 2018 full year profit and loss deriving from the joint venture agreement signed last year in China.

On March last year, Natuzzi signed a joint venture and share purchase agreement with one of the leading players in the upholstered furniture in China, which is the KUKA Group. Such agreements aim to expand Natuzzi's retail network in China, Mainland, Hong Kong and Macau, providing for the contribution by Natuzzi of the exclusive distribution right to perpetually use the Natuzzi Italia, Natuzzi Editions trademarks into one of Natuzzi's Chinese subsidiaries, whose name is Natuzzi Trading Shanghai, and the total investment of €65 million to sustain the expansion of the Natuzzi retail network in Greater China by means of the acquisition of a stake in Natuzzi Trading Shanghai Limited. Following such agreements, finally executed on July 27, last year, Natuzzi has lost control of the former wholly-owned subsidiary Natuzzi Trading Shanghai, in which each of Natuzzi and KUKA Group now owns a 49% and a 51% stake, respectively.

In accordance with IFRS 10, at the date, when control over Natuzzi Trading Shanghai has been lost, which is July 27, 2018, Natuzzi has, 1) de-recognized assets and liabilities of Natuzzi trading as the carrying amount for total amount of net assets of €2.6 million; 2) recognized the fair value of the consideration received from KUKA for a total amount of €65 million, out of which €30 million represented the reconsideration received by Natuzzi for the transfer of the 23.5% stake in the subsidiary, while €35 million represented the subscription by KUKA Group of Natuzzi Trading Shanghai capital increase, resulting in KUKA acquiring an additional 27.4% stake and diluting Natuzzi's investment in the former subsidiary; 3) recognized the 49% retained interest in Natuzzi Trading Shanghai at its fair value estimated in €48 million.

So, in fact, in consolidated statements of our profit and loss of the transaction as described before has been the recognition of a gain of €75.4 million. Of course, the fair value of Natuzzi Trading Shanghai has been estimated to a third-party independent appraiser based on a discounted earnings method.

Now, let's get back to the ordinary operations of the Company. As said by Mr. Natuzzi, while commenting on the results of the first nine months 2018, we explained the main factors affecting results: one, a weak wholesale business; two, raw material price increase; three, inefficiencies in the Romanian and Italian production plant; four, some extra cost with the logistic processes; five, unfavorable exchange rates.

But at the same time, we clearly stated that the retail operations were improving already, raw material prices' upward trend was changing, and we were adopting measures to address the supply chain. So, the Company agenda for the fourth quarter 2018 has been organized on the basis of the items just mentioned, of course.

Let's analyze the Q4 2018 results. The consolidated gross margin was 27.4% from—lower than 28.9% in the previous fourth quarter because it included €5.6 million of restructuring costs pertaining to workforce reduction program at the Italian operations.

In other terms, the cost of sales, net of the above mentioned cost and also thanks to a favorable trend in raw material prices in Q4 last year, gross margin would have improved at 32% on revenues.

In the fourth quarter, we have also seen the first tangible results of the action implemented in the meantime in the supply chain. The favorable trend of raw material prices has been confirmed in Q4 2018. The direct retail business has continued to improve.

As of today, the DOS, directly operated points of sales are 66, of which 39 Natuzzi Italia, 15 Divani&Divani by Natuzzi, as well as 12 Natuzzi Italia concessions in Mexico, having just closed 8 loss-making concessions in U.K., House of Fraser, to be precise.

During the fourth quarter of 2018, net sales generated by the direct retail division were €16.8 million, up 4.4% over the same period of last year, with positive sales numbers in U.S.A., plus 46%, Italy, plus 19.5% and Switzerland, plus 22.2%.

Q4 2018 sales on a like-for-like basis were €12.9 million, up 10.6% from €11.6 million in the last quarter 2017. Thanks to the performance of our DOS located in U.S.A., Italy and Switzerland.

As a result, the Group reported again an operating loss of €8.9 million versus an operating loss of €6.3 million in 2017 fourth quarter. But, excluding the €6.9 million of the cost relating to the restructure of Italian operations for 2018 fourth quarter, the Group would have reported operating loss of €2 million, so improving from the previous nine months 2018.

On this basis, let's now have a look to 2019. The business environment and global economy are still quite difficult almost everywhere, uncertainty about tariffs between China and U.S.A. are still there and Brexit consequences are unpredictable. As said before by Mr. Natuzzi, we continue our strategy while we are changing the industrial footprint between Romania and Italian.

Now, along with the new production allocation between Italy and Romania explained by Mr. Natuzzi, which are the other main pillars of 2019, we do not expect a significant increase of business volume in 2019. We will focus on the quality of the business. Indeed, we have planned a further improvement in like-for-like performance in the retail chain where we have opened six stores in 2018.

We're planning a modest growth in the branded sales, whereas as far as private label is concerned, we will focus on a few selected primary customers delivering reasonable margins. As a consequence of Natuzzi's primary focus on branded sales, the mix is expected to be more favorable.

In addition to that, we also put in place some price increase. The raw material is going down as expected. And finally, the continuous job in the industrialization of the prototype R&D department is progressively improving the cost of quality and will contribute to improving the overall production efficiency.

Finally and differently from last year, exchange rates are more favorable this year versus 2018. Overall, together with the further rationalization of our operating cost structure, will contribute to the return to a positive EBITDA in 2019 which is the Management goal for this year.

Thank you.

Operator:

This concludes today's conference call. Ladies and gentlemen, thank you for your participation. You may now disconnect.