Industrie Natuzzi S.p.A. and Subsidiaries Consolidated Financial Statements

At December 31, 1997 and 1996
and for each of the years in the
three-year period ended
December 31, 1997
(With Independent Auditors' Report)

Contents

Natuzzi

KPMG

Revisione e organizzazione contabile

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Independent auditors' report

To the Board of Directors
INDUSTRIE NATUZZI S.p.A.

We have audited the accompanying consolidated balance sheets of Industrie Natuzzi S.p.A. and subsidiaries (the "Natuzzi Group") as of December 31, 1997 and 1996 and the related consolidated statements of earnings, changes in shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 1997. These consolidated financial statements are the responsibility of the Natuzzi Group's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in the Republic of Italy and the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Natuzzi Group as of December 31, 1997 and 1996 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 1997, in conformity with established accounting principles in the Republic of Italy.

Established accounting principles in the Republic of Italy vary in certain significant respects from generally accepted accounting principles in the United States of America. Application of generally accepted accounting principles in the United States of America would have affected results of operations for each of the years in the three-year period ended December 31, 1997 and shareholders' equity as of December 31, 1997 and 1996 to the extent summarized in Note 24 to the consolidated financial statements.

Bari, Italy
March 30, 1998

KPMG SpA.

Consolidated Balance Sheets as of December 31, 1997 and 1996

(Expressed in millions of Italian lire, except as otherwise indicated)

Assets	1997	1996
Current assets:		
Cash and cash equivalents (note 4)	239,371	128,001
Marketable debt securities (note 5)	4,802	78,057
Trade receivables, net (note 6)	184,382	174,894
Other receivables (note 7)	64,858	53,278
Inventories (note 8)	114,724	90,450
Prepaid expenses and accrued income	1,151	4,658
Deferred income taxes (note 14)	3,483	2,434
Total current assets	**612,771**	**531,772**
Non current assets:		
Property, plant and equipment (note 9 and 16)	258,719	171,401
Less accumulated depreciation (note 9)	(70,464)	(58,683)
Net property, plant and equipment	**188,255**	**112,718**
Other assets (note 10)	10,912	16,094
Deferred income taxes (note 14)	372	37
Total assets	**812,310**	**660,621**

See accompanying notes to consolidated financial statements.

Liabilities and Shareholders' Equity	1997	1996
Current liabilities:		
Short-term borrowings (note 11)	1,796	3,867
Current portion of long-term debt (note 16)	3,191	3,159
Accounts payable-trade (note 12)	108,487	101,244
Accounts payable-other (note 13)	16,576	15,148
Allowance for unrealized foreign exchange losses (notes 22 and 23)	2,184	-
Income taxes (note 14)	19,362	20,413
Salaries, wages and related liabilities (note 15)	16,945	15,590
Total current liabilities	**168,541**	**159,421**
Long-term liabilities:		
Employees' termination indemnity (note 3 (k))	27,040	23,218
Long-term debt (note 16)	3,999	7,189
Deferred income taxes (note 14)	2,546	-
Other liabilities	3,417	2,916
Minority interest (note 17)	**1,349**	**2,129**
Shareholders' equity (note 18):		
Share capital	7,110	7,110
Reserves	62,241	14,508
Additional paid-in capital	9,238	9,238
Retained earnings	526,829	434,892
Total shareholders' equity	**605,418**	**465,748**
Commitments and contingent liabilities (notes 19 and 23)	-	-
Total liabilities and shareholders' equity	**812,310**	**660,621**

See accompanying notes to consolidated financial statements.

Consolidated Statements of Earnings for the years ended December 31, 1997, 1996 and 1995

(Expressed in millions of Italian lire, except per share data)

	1997	1996	1995
Net sales (note 20)	1,063,132	854,633	839,286
Cost of sales (note 21)	(716,235)	(576,792)	(555,007)
Gross profit	**346,897**	**277,841**	**284,279**
Selling expenses	(171,659)	(142,414)	(143,048)
General and administrative expenses	(39,053)	(35,022)	(32,755)
Operating income	**136,185**	**100,405**	**108,476**
Other income, net (note 22)	12,318	47,130	7,366
Earnings before taxes and minority interest	**148,503**	**147,535**	**115,842**
Income taxes (note 14)	(44,148)	(28,539)	(18,527)
Earnings before minority interest	**104,355**	**118,996**	**97,315**
Minority interest	(181)	(1,556)	(1,455)
Net earnings	**104,174**	**117,440**	**95,860**
Basic earnings per share (note 3 (q))	**1,832**	**2,073**	**1,701**
Diluted earnings per share (note 3 (q))	**1,817**	**2,056**	**1,680**

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 1997, 1996 and 1995

(Expressed in millions of Italian lire, except number of ordinary shares)

	Share capital					
	Number of ordinary shares	Amount	Reserves	Additional paid-in capital	Retained earnings	Total
Balances at December 31, 1994	**56,364,500**	**7,046**	**12,829**	**3,832**	**234,158**	**257,865**
Dividends distributed	-	-	-	-	(4,030)	(4,030)
Exchange differences on translation of financial statements	-	-	-	-	(173)	(173)
Grants received	-	-	3,297	-	-	3,297
Taxes due on grants received	-	-	(768)	-	-	(768)
Net earnings	-	-	-	-	95,860	95,860
Balances at December 31, 1995	**56,364,500**	**7,046**	**15,358**	**3,832**	**325,815**	**352,051**
Transfer of reserves to parent company	-	-	(553)	-	553	-
Other transfers	-	-	(297)	-	297	-
Exercise of stock options	514,300	64	-	5,406	-	5,470
Dividends distributed	-	-	-	-	(9,018)	(9,018)
Exchange difference on translation of financial statements	-	-	-	-	(195)	(195)
Net earnings	-	-	-	-	117,440	117,440
Balances at December 31, 1996	**56,878,800**	**7,110**	**14,508**	**9,238**	**434,892**	**465,748**
Dividends distributed	-	-	-	-	(14,788)	(14,788)
Exchange differences on translation of financial statements	-	-	-	-	2,551	2,551
Grants received	-	-	53,005	-	-	53,005
Taxes due on grants received	-	-	(5,272)	-	-	(5,272)
Net earnings	-	-	-	-	104,174	104,174
Balances at December 31, 1997	**56,878,800**	**7,110**	**62,241**	**9,238**	**526,829**	**605,418**

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows for the years ended December 31, 1997, 1996 and 1995

(Expressed in millions of Italian lire)

	1997	1996	1995
Cash flows from operating activities:			
Net earnings	104,174	117,440	95,860
Adjustments to reconcile net earnings to net cash provided by operating activities:			
• Depreciation and amortization	21,954	18,827	15,673
• Employees' termination indemnity	8,094	6,918	6,612
• Deferred income taxes	(4,121)	(505)	1,147
• Minority interest	181	1,556	1,455
• Provision for unrealized losses on marketable debt securities	66	(318)	(944)
• (Gain) loss on disposal of assets	(1,640)	(350)	92
• Change in provision for unrealized foreign exchange losses	2,184	-	(3,254)
Change in assets and liabilities net of effects of acquired business:			
• Receivables	(14,845)	5,951	(22,307)
• Inventories	(24,274)	(8,644)	1,489
• Prepaid expenses and accrued income	3,507	302	(555)
• Other assets	(2,528)	(845)	(1,193)
• Accounts payable	523	(5,920)	18,913
• Income taxes	(1,051)	16,120	(5,790)
• Salaries, wages and related liabilities	1,355	4,011	(86)
• Other liabilities	501	1,468	690
• Employees' termination indemnity	(4,272)	(6,448)	(1,694)
Total adjustments	**(14,366)**	**32,123**	**10,248**
Net cash provided by operating activities	**89,808**	**149,563**	**106,108**

See accompanying notes to consolidated financial statements.

	1997	1996	1995
Cash flows from investing activities:			
Property, plant and equipment:			
• Additions	(81,084)	(36,338)	(23,206)
• Disposals	1,245	970	879
Government grants received	46,876	-	2,924
Marketable debt securities:			
• Purchases	(102)	(71,793)	(53,287)
• Proceeds from maturities	4,579	64,720	24,436
• Proceeds from sales	70,585	8,866	4,529
Purchase of business, net of cash acquired	-	-	(1,551)
Purchase of minority interest	(288)	(18,833)	(3,389)
Net cash provided by (used in) investing activities	**41,811**	**(52,408)**	**(48,665)**
Cash flows from financing activities:			
Long-term debt:			
• Proceeds	-	2,000	-
• Repayments	(3,158)	(2,878)	(2,767)
Short-term borrowings	(2,071)	(6,331)	(38,957)
Exercise of stock options	-	5,470	-
Dividends paid	(14,788)	(9,018)	(4,030)
Dividends paid to minority shareholders	(1,018)	(1,124)	(2,831)
Net cash used in financing activities	**(21,035)**	**(11,881)**	**(48,585)**
Effect of translation adjustments on cash	786	(95)	(100)
Increase in cash and cash equivalents	111,370	85,179	8,758
Cash and cash equivalents, beginning of the year	128,001	42,822	34,064
Cash and cash equivalents, end of the year	239,371	128,001	42,822
Supplemental disclosure of cash flow information:			
Cash paid during the year for interest	840	1,345	3,262
Cash paid during the year for income taxes	36,199	799	10,413

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

(Expressed in millions of Italian lire, except as otherwise indicated)

1 Description of business and Group composition

The consolidated financial statements include the accounts of Industrie Natuzzi S.p.A. ('Natuzzi' or the 'Company') and of its subsidiaries (together with the Company, the 'Group'). The Group's primary activity is the design, manufacture and marketing of contemporary and traditional leather and fabric-upholstered furniture.

The subsidiaries included in the consolidation at December 31, 1997, together with the related percentages of ownership, are as follows:

Name	Percent of ownership	Share Capital	Registered office	Activity
Softaly S.r.l.	98.24	Lit. 190	Bari, Italy	(1)
Divani e Poltrone Italia S.r.l.	99.98	Lit. 3,700	Bari, Italy	(1)
Soft Cover Italia S.r.l.	100	Lit. 5,000	Bari, Italy	(1)
Spagnesi International S.r.l.	100	Lit. 800	Bari, Italy	(1)
Spagnesi S.p.A.	99.95	Lit. 1,000	Quarrata, Italy	(1)
Creazioni Ellelle S.p.A.	99	Lit. 2,500	Altamura, Italy	(1)
D.L.S. S.r.l.	100	Lit. 90	Bari, Italy	(2)
Natco S.p.A.	99.99	Lit. 8,500	Bari, Italy	(3)
I.M.P.E. S.p.A.	90.83	Lit. 1,500	Qualiano,Italy	(4)
Natex S.r.l.	98	Lit. 90	Bari, Italy	(5)
Natuzzi Trade Service S.r.l.	100	Lit. 3,500	Bari, Italy	(6)
Natuzzi Americas Inc.	100	US$ 50,000	High Point, NC, USA	(6)
Nagest S.r.l.	100	Lit. 90	Bari, Italy	(7)
Finat Ltd	100	Lit. 1,000	Dublin, Ireland	(8)
Masternat S.r.l.	100	Lit. 500	Bari, Italy	(9)
Italiana de Sofa Franquiciados S.L.	100	Pta 40,000,000	Madrid, Spain	(9)
Natuzzi Pacific Ltd	100	AUD 50,000	Sidney , Australia	(9)
Tecnolevante S.r.l.	100	Lit. 60	Modugno, Italy	(9)
Expan Italia S.r.l.	99	Lit. 90	Bari, Italy	(10)
Natuzzi Argentina	99	US$ 12,000	Buenos Aires , Argentina	(10)

(1) Manufacture and distribution
(2) Cutting, sewing and product assembly
(3) Intragroup leather dyeing and finishing
(4) Production and distribution of polyurethane foam
(5) Intragroup production of fibrefill down cushion and polyurethane shaping
(6) Distribution
(7) Intragroup accounting services
(8) Intragroup cash management and treasury operations
(9) In liquidation
(10) Non operative

In July 1997, the Company set up a subsidiary in Dublin (Ireland), known as Finat Ltd, which is engaged in the provision of intragroup cash management and treasury operations. The interest of the Group in this subsidiary is 100% for consideration of 140,000, of which 1,000 was recorded as share capital and remaining 139,000 as additional contributed capital. In addition, this subsidiary has received a certificate from the Minister for Finance of Ireland which confirms that all qualifying income derived from financial services activities is subject to corporation tax at a reduced rate of 10%.

During 1997, the Company acquired all of the minority interest of Italiana de Sofa Franquiciados S.L. and Tecnolevante S.r.l. for an aggregate consideration of 288 in cash. Goodwill arising from that acquisition amounted to 360.

In 1996, the Company acquired substantially all of the minority interest of Spagnesi S.p.A. and Creazioni Ellelle S.p.A. for an aggregate consideration of 18,951 in cash. The acquisition was accounted for using the purchase method. Accordingly, the purchase price has been allocated to the fair value of net assets acquired, including trademarks of 4,655 for Spagnesi S.p.A. and goodwill of 1,648 for Creazioni Ellelle S.p.A.

In July 1996, the Company established a joint venture in Madrid, Spain. The joint venture, known as Italiana de Sofa Franquiciados S.L., manages in Spain the Group's specialized retail furniture chain 'Divani & Divani', in addition to selling leather and fabric-upholstered furniture directly to customers. The initial interest of the Group in this joint venture was 51%, for consideration of 124. The financial statements of this joint venture have been consolidated creating a minority interest of 118.

During 1996, the Company liquidated Natuzzi United Kingdom Ltd.

On January 23 and May 18, 1995 the Company acquired 40% and 20%, respectively, of a leather and fabric-upholstered furniture manufacturing business, Creazioni Ellelle S.p.A., for 4,800 in cash. The acquisition was accounted for using the purchase method. The Group consolidated Creazioni Ellelle's net earnings commencing the date of acquisition, while revenues and expenses were included in the consolidated statement of earnings for the full year 1995.

In 1995, the Company acquired all of the minority interest of D.L.S. S.r.l. and Masternat S.r.l. for an aggregate consideration of 3,389 in cash. Goodwill arising from that acquisition amounted to 2,401.

2 Basis of preparation and principles of consolidation

The financial statements utilized for the consolidation are the statutory financial statements of each Group company at December 31, 1997, 1996 and 1995. The 1996 and 1995 financial statements have been approved by the respective shareholders of the relevant companies. The 1997 financial statements have been approved only by the directors of the relevant companies.

The financial statements of subsidiaries are adjusted, where necessary, to conform to Natuzzi's accounting principles, which are consistent with Italian legal requirements governing financial statements considered in conjunction with established accounting principles promulgated by the Italian Accounting Profession and, in their absence, by the International Accounting Standards Committee. The consolidated financial statements are classified in accordance with the presentations generally used in international practice.

The consolidated financial statements include all affiliates and companies that Natuzzi directly or indirectly controls, either through majority ownership or otherwise. Control is presumed to exist where more than one-half of a subsidiary's voting power is controlled by the Company or the Company is able to govern the financial and operating policies of a subsidiary or control the removal or appointment of a majority of a subsidiary's board of directors. Where an entity either began or ceased to be controlled during the year, the net results are included only from the date control commenced or up to the date control ceased.

The assets and liabilities of subsidiaries are consolidated on a line-by-line basis and the carrying value of intercompany investments held is eliminated against the related shareholder's equity accounts. The minority interests of consolidated subsidiaries are separately classified in the consolidated balance sheets and statements of earnings for all years presented. All intercompany balances and transactions have been eliminated in consolidation.

3 Summary of established accounting policies

The established accounting policies followed in the preparation of the consolidated financial statements are outlined below.

a *Foreign currency*

Foreign currency transactions are recorded at the exchange rates applicable at the transaction dates. Assets and liabilities denominated in foreign currency are remeasured at year-end exchange rates, except for certain accounts receivable and payables as discussed below. Foreign exchange gains and losses resulting from the remeasurement of these assets and liabilities are included in other income, net, in the statement of earnings.

Receivables being hedged by forward exchange contracts are remeasured using the related forward exchange rate. Foreign exchange gains and losses resulting from the remeasurement of hedged receivables are recognized in other income, net, in the statements of earnings. Foreign exchange gains and losses on receivables and payables not hedged are aggregated with the unrealized gains and losses on forward exchange contracts not used to hedge any on or off balance sheet items to determine recognition. If a net foreign exchange loss results from this aggregation, such loss is recognized in other income, net, in the statement of earnings. A net foreign exchange gains is not recognized until realized (refer to note 3 (i) for the accounting of foreign exchange contracts).

The financial statements of foreign subsidiaries for which the functional currency is not the Italian Lira are translated at (i) year-end exchange rate for assets and liabilities, (ii) historical exchange rates for share capital and reserves, and (iii) average exchange rates during the year for statements of earnings. The resulting exchange differences on translation are recorded as a direct adjustment to shareholders' equity.

b *Cash equivalents*

The Group considers highly liquid debt instruments with original maturities of three months or less to be cash equivalents.

c *Marketable debt securities*

Marketable debt securities are valued at the lower of cost or market value determined on an individual security basis. A valuation allowance is established and recorded as a charge to other income, net, for unrealized losses on securities. Unrealized gains are not recorded until realized. Recoveries in the value of securities are recorded as part of other income, net, but only to the extent of previously recognized unrealized losses.

Gains and losses realized on the sale of marketable debt securities were computed based on a weighted-average cost of the specific securities being sold.

Realized gains and losses are charged to other income, net.

d *Accounts receivable and payable*

Receivables are stated at nominal value net of an allowance for doubtful accounts. Payables are stated at face value.

e *Inventories*

Raw materials are stated at the lower of cost (determined under the specific cost method for leather hides and under the weighted-average method for other raw materials) or replacement cost. Goods in process and finish goods are valued at the lower of production cost or net realizable value.

f *Property, plant and equipment*

Property, plant and equipment is stated at historical cost, except for plant and certain motor vehicles which were revalued in 1983 and 1991 according to Italian revaluation laws. Maintenance and repairs are expensed; significant improvements are capitalized and depreciated over the useful life of the related assets. The cost or valuation of fixed assets is depreciated on the straight-line method over the estimated useful lives of the assets (refer to note 9).

g *Other assets*

Other assets in the consolidated financial statements primarily include trademarks and patents, goodwill and certain deferred costs. Other assets are stated at the lower of amortized cost or recoverable amount. The carrying amount of other assets are reviewed to determine if they are in excess of their recoverable amount, based on undiscounted cash flows, at consolidated balance sheet date. If the carrying amount exceeds the recoverable amount, the asset is written down to the recoverable amount.

Trademarks, patents and goodwill are amortized on straight-line basic over a period of five years.

h *Income taxes*

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss. Deferred tax assets are reduced by a valuation allowance to an amount that is more likely than not to be realized. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

i *Forward exchange contracts*

The Group enters into forward exchange contracts (known in Italian financial markets as domestic currency swaps) to manage its exposure to foreign currency risks. The accounting for forward exchange contracts depends on their use as follows:

n Forward exchange contracts used to hedge accounts receivable are considered when remeasuring the related balance sheet item at the contract rate. Foreign exchange gains and losses from the remeasurement of the accounts receivable at contract rate are recorded within other income, net, in the statements of earnings.

n Forward exchange contracts are used to hedge future sales if the sales are supported by sales orders and customer's indications of future purchases as of the balance sheet date which are confirmed by sales orders received within the earlier of four months after the year-end or the issuance of the consolidated financial statements. Unrealized gains and losses on these forward contracts are deferred.

n Unrealized gains and losses on forward exchange contracts not hedging any on or off balance sheet items are aggregated with the foreign currency gains and losses resulting from the remeasurement of unhedged accounts receivable and payable (refer to note 3 d).

j *Government grants*

Capital grants from government agencies are recorded when there is reasonable assurance that the grants will be received and that the Group will comply with conditions applying to them. Capital grants are recorded, net of tax, within reserves in shareholders' equity.

The capital grants are part of the Italian government's investment incentive program, under which the Group receives amounts generally equal to a percentage of the aggregate investment made by the Group in the construction of new manufacturing facilities, or in the improvement of existing facilities, in designated areas of the country.

Cost reimbursement grants relating to training and other personnel costs are credited to income when received from government agencies.

k *Employees' termination indemnities*

Termination indemnities represent amounts accrued for each Italian employee that are due and payable upon termination of employment determined in accordance with applicable labor laws and agreements. The Group accrues the full amount of employees' vested benefit obligation as determined by such laws and agreements for termination indemnities. The expense recorded for termination indemnities for the years ended December 31, 1997, 1996 and 1995 was 8,094, 6,918 and 6,612, respectively.

The number of workers employed by the Group totalled 3,465 and 3,052 at December 31, 1997 and 1996, respectively.

l *Sales of goods*

A sale is recorded when title passes to the customer, which is at the time of shipment.

m *Advertising costs*

Advertising costs are expensed in the periods incurred. Advertising expenses recorded for the years ended December 31, 1997, 1996 and 1995 were 17,956, 15,087 and 13,966, respectively.

n *Commission expense*

Commissions payable to sales representatives and the related expense are recorded at the time shipments are made by the Group to customers. Commission expense is not paid until payment for the related sale is remitted to the Group by the customer.

o *Contingencies*

Liabilities for loss contingencies are recorded when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated.

p *Use of estimates*

The preparation of financial statements in conformity with established accounting policies requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

q *Earnings per share*

Basic earnings per share is calculated by dividing net earnings attributable to ordinary shareholders by the weighted-average number of ordinary shares outstanding during the period. Diluted earnings per share include the effects of possible issuance of ordinary shares under share options in the determination of the weighted-average number of ordinary share outstanding during the period. The following table provides the amounts used in the calculation of earnings per share:

	1997	1996	1995
Net earnings attributable to ordinary shareholders	**104,174**	**117,440**	**95,860**
Weighted-average number of ordinary shares outstanding during the year	56,878,800	56,664,508	56,364,500
Increase resulting from assumed conversion of share options	458,711	443,920	698,173
Weighted-average number of ordinary shares and potential shares outstanding during the year	**57,337,511**	**57,108,428**	**57,062,673**

4 Cash and cash equivalents

Cash and cash equivalents are composed of the following items:

	1997	1996
Cash on hand	48	46
Time deposits	120,132	-
Domestic bank accounts	91,320	91,783
Foreign bank accounts	27,871	36,172
Total	**239,371**	**128,001**

Time deposits have various maturities extending through January 1998.

5 Marketable debt securities

Details regarding marketable debt securities are as follows:

	1997	1996
Financial institution bonds	11	73,095
Italian government bonds	4,867	5,515
Total	**4,878**	**78,610**
Valuation allowance for gross unrealized losses	(76)	(553)
Net book value	**4,802**	**78,057**

Further information regarding the Group's investments in marketable debt securities is as follows:

1997	Cost	Gross unrealized Gains	Gross unrealized Losses	Fair value
Financial institutions bonds	11	-	-	11
Italian government bonds	4,867	54	(76)	4,845
Total	**4,878**	**54**	**(76)**	**4,856**

1996	Cost	Gross unrealized Gains	Gross unrealized Losses	Fair value
Financial institutions bonds	73,095	2,885	(552)	75,428
Italian government bonds	5,515	128	(1)	5,642
Total	**78,610**	**3,013**	**(553)**	**81,070**

	1997	1996	1995
Proceeds from sales	70,585	8,866	4,529
Realized gains	2,252	66	11
Realized losses	(408)	-	(40)

The contractual maturity of the Group's marketable debt securities at December 31, 1997 is as follows:

	Cost	Fair value
Within 1 year	3,423	3,359
1 - 5 years	1,455	1,497
Total	**4,878**	**4,856**

At December 31, 1997 and 1996, securities held by banks as collateral for loans amounted to 600 and 900, respectively.

6 Trade receivables, net

Trade receivables are analyzed as follows:

	1997	1996
North American customers	58,951	70,069
Other foreign customers	78,733	66,472
Domestic customers	50,024	44,056
Trade bills receivable	5,028	2,813
Total	192,736	183,410
Allowance for doubtful accounts	(8,354)	(8,516)
Total trade receivables, net	**184,382**	**174,894**

Trade receivables are due primarily from major retailers selling directly to customers.

No account receivable from any customer at December 31, 1997 and 1996 exceeded 7,000. The Company estimates an allowance for doubtful accounts based on the credit worthiness of its customers as well as general economic conditions. Consequently, an adverse change in those factors could effect the Company's estimate of its bad debts.

The following table provides the movements in the allowance for doubtful accounts:

	1997	1996	1995
Balance, beginning of year	8,516	6,254	5,500
Balance of subsidiaries acquired	-	-	517
Charges-bad debt expense	1,634	3,266	3,266
Reductions-write off of uncollectible accounts	(1,796)	(1,004)	(3,029)
Balance, end of year	**8,354**	**8,516**	**6,254**

Trade receivables denominated in foreign currencies at December 31, 1997 and 1996 and, where applicable, translated at the rate of the related domestic currency swaps, totalled 116,259 (118,038 translated at year-end exchange rates) and 117,564 (115,196 translated at year-end exchange rates), respectively. These receivables consist of the following:

	1997	1996
U.S. dollars	60,650	68,687
Australian dollars	11,177	4,228
German marks	9,673	8,001
French francs	7,146	11,550
British pounds	5,737	6,406
Belgian francs	3,838	2,569
Canadian dollars	3,025	4,812
Dutch guilders	3,020	2,495
Spanish pesetas	2,976	2,154
Other currencies	9,017	6,662
Total	**116,259**	**117,564**

7 Other receivables

Other receivables are analyzed as follows:

	1997	1996
VAT	40,721	38,614
Securities bought under agreements to resell	6,795	2,798
Government grants	6,623	1,362
Advances to suppliers	4,021	5,166
Receivable from tax authorities	3,107	3,011
Other	3,591	2,327
Total	**64,858**	**53,278**

The VAT receivable includes value added taxes and interest thereon reimbursable to various companies of the Group. While currently due at the balance sheet date, the collection of the VAT receivable may generally extend over a maximum period of up to two years.

The receivable from tax authorities represents taxes paid in excess of the amounts due in Italy and interest thereon.

8 Inventories

Inventories are analyzed as follows:

	1997	1996
Leather	54,303	41,132
Other raw materials	21,062	18,195
Goods in process	20,867	16,184
Finished products	18,492	14,939
Total	**114,724**	**90,450**

9 Property, plant and equipment and accumulated depreciation

Fixed assets are listed below together with accumulated depreciation.

1997	Cost or valuation	Accumulated depreciation	Annual rate of depreciation
Land	7,682	-	-
Industrial buildings	104,743	14,505	3 - 10%
Machinery and equipment	89,898	36,835	11.5 - 25%
Office furniture and equipment	19,490	12,774	12 - 20%
Transportation equipment	5,437	3,747	20 - 25%
Leasehold improvements	3,746	2,603	10 - 20%
Construction in progress	26,627	-	-
Advances to suppliers	1,096	-	-
Total	**258,719**	**70,464**	

1996	Cost or valuation	Accumulated depreciation	Annual rate of depreciation
Land	7,367	-	-
Industrial buildings	63,193	11,826	3 - 10%
Machinery and equipment	62,224	30,420	11.5 - 25%
Office furniture and equipment	17,075	10,923	12 - 20%
Transportation equipment	5,163	3,616	20 - 25%
Leasehold improvements	3,845	1,898	10 - 20%
Construction in progress	12,367	-	-
Advances to suppliers	167	-	-
Total	**171,401**	**58,683**	

10 Other assets

Other assets consist of the following:

	1997	1996
Trademarks and patents	24,509	24,298
Goodwill	5,224	5,913
Others	6,624	4,834
Total, gross	36,357	35,045
Less accumulated amortization	(25,445)	(18,951)
Total, net	**10,912**	**16,094**

11 Short-term borrowings

Short-term borrowings consist of the following:

	1997	1996
Bank overdrafts	921	602
Export financing	875	3,265
Total	**1,796**	**3,867**

Export advances in foreign currencies at December 31, 1997 and 1996 have been translated at year-end exchange rates. The weighted average interest rates on the above-listed short-term borrowings are as follows:

	1997	1996
Bank overdrafts	9.5%	11.5%
Export financing	5.6%	8.1%

Credit facilities available to the Group, including amounts guaranteed under surety bonds, amounted to approximately 133,100 and 128,800 at December 31, 1997 and 1996, respectively. The unused portion of these facilities amounted to approximately 112,300 and 112,500 at December 31, 1997 and 1996, respectively.

12 Accounts payable-trade

Accounts payable-trade totalling 108,487 and 101,244 at December 31, 1997 and 1996, respectively, represents principally amounts payable for purchases of goods and services in Italy and abroad, including invoices to be received at year end, and includes 27,388 and 19,382 at December 31, 1997 and 1996, respectively, denominated in foreign currencies.

13 Accounts payable-other

Accounts payable-other is analyzed as follows:

	1997	1996
Withholding taxes on payroll	4,752	4,610
Withholding taxes on dividends and other	1,270	1,156
Cooperative advertising and quantity premium	4,182	2,850
Provision for returns and discounts	3,261	3,661
Payable to customers for returns and financial discounts	2,304	1,894
Other	807	977
Total	**16,576**	**15,148**

14 Taxes on income

Italian companies are subject to two income taxes:

	1997	1996	1995
IRPEG (corporate tax)	37.0%	37.0%	37.0%
ILOR (local tax)	16.2%	16.2%	16.2%

During December 1997, the Italian Government approved two legislative decrees which introduced two new income tax schemes, one denominated the 'IRAP' and the other the 'Dual Income Tax'. The general guidelines regulating the new taxes are the following:

(a) for fiscal years beginning on or after January 1, 1998 IRAP will replace ILOR, net equity tax and other minor taxes. For 1998 and 1999 fiscal years the tax rate will be 4.25%. Thereafter, each Italian Region will have the power to increase the rate by a maximum of 1%. In general, the taxable base will be a form of gross profit determined as the difference between gross revenues (excluding interest and dividend income) and direct production costs (excluding labour costs, interest expenses and other financial costs); and,
(b) for fiscal years beginning on or after January 1, 1997 the IRPEG was modified to introduce a dual income tax for the purpose of encouraging companies to use equity rather than debt finance. A first portion of the taxpayer's taxable income is calculated by applying an interest rate percentage (based on the return on government and private sector bonds) to the net increase in shareholders' equity of such taxpayer, subject to certain restrictions. This portion is subject to IRPEG at the reduced rate of 19%. The remaining profit will be subject to tax at the ordinary IRPEG tax rate (at present 37%). The combined application of IRPEG and the dual income tax cannot generate an overall tax charge lower than 27%. The application of the provisions of the modified IRPEG had no significant effect on the Group's income taxes.

Furthermore, on December 18, 1997, the Italian Government approved a legislative decree that effectively eliminated income taxes imposed on the remittance of dividends to a parent company. The legislative decree is effective for fiscal years beginning after December 31, 1997.

Under Italian investment incentive schemes for under-industrialized regions, certain of the Group's operating entities are currently entitled to enjoy a full exemption from IRPEG and ILOR for ten years. A very substantial portion of the Group's earnings in 1997, 1996 and 1995 is derived from companies entitled to some extent to the aforementioned exemptions, the most significant of which presently are not due to expire until 2002. See the table below for the effect of such exemptions on the Group's 1997, 1996 and 1995 income tax charge.

As a result of the new tax scheme (see above), the Group's operating entities currently entitled to enjoy a full exemption from ILOR and IRPEG will now be subject to taxes under IRAP.

During 1997, 1996 and 1995, domestic subsidiaries of the Company distributed previously unremitted earnings to the parent company in the form of a dividend generating taxable income.

Approximately 97.2%, 99.6% and 99.4% respectively, of the Group's earnings before taxes were generated by its domestic Italian operations during 1997, 1996 and 1995.

The effective income tax rates for the years ended December 31, 1997, 1996 and 1995 were 29.7%, 19.3% and 16.0%, respectively. The actual income tax expense differs from the 'expected' income tax expense (computed by applying the corporate and local tax rate of 53.2% to income before income taxes) as follows:

	1997	1996	1995
Expected income tax charge at full tax rates	79,004	78,489	61,628
Effects of:			
• Tax exempt income	(38,658)	(54,594)	(47,737)
• Aggregate effect of different tax rates in foreign jurisdictions	(823)	(208)	(194)
• Tax effect of unremitted earnings of domestic subsidiaries	433	944	3,066
• Effect of net change in valuation allowance established against deferred tax assets	(2,774)	2,058	38
• Tax effect of change in tax rates on deferred taxes	3,427	-	(68)
• Non-deductible expenses and others	3,539	1,850	1,794
Actual tax charge	**44,148**	**28,539**	**18,527**

Total taxes for the years ended December 31, 1997, 1996 and 1995 were allocated as follows:

	1997	1996	1995
Earnings from operations	44,148	28,539	18,527
Shareholders' equity, for deferred taxes on government grants (excluding minority interest)	5,283	-	768
	49,431	**28,539**	**19,295**

Income taxes on earnings, which primarily relate to Italian operations, are further analyzed as follows:

	1997	1996	1995
Current taxes	48,269	29,044	17,380
Deferred taxes	(4,121)	(505)	1,147
Total	**44,148**	**28,539**	**18,527**

Tax years for Italian companies are open from 1992 and subject to review pursuant to Italian tax laws.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 1997 and 1996 are presented below:

	1997	1996
Deferred tax assets:		
• Allowance for doubtful accounts	2,829	3,755
• Intercompany profit in assets	1,824	269
• Provision for returns and discounts	1,206	1,948
• Unrealized foreign exchange losses	1,053	-
• Tax loss carryforwards	920	1,901
• Provision for termination indemnities	896	1,020
• Provision for contingencies	370	532
• Trademarks	151	389
• Other temporary differences	624	683
Total gross deferred tax assets	9,873	10,497
• Less valuation allowance	(3,678)	(6,452)
Net deferred tax assets	6,195	4,045
Deferred tax liabilities:		
• Unremitted earnings of domestic subsidiaries	-	(944)
• Government grants related to capital expenditures	(4,886)	(630)
Total deferred tax liabilities	(4,886)	(1,574)
Net deferred tax assets	**1,309**	**2,471**

A valuation allowance has been established principally for the allowance for doubtful accounts, provision for termination indemnities and for tax loss carryforwards of certain subsidiaries where it is more likely than not the benefit will not be realized.

Net deferred income tax assets is included in the consolidated balance sheets as follows:

1997	Current	Non current	Total
Gross deferred tax assets	6,976	2,897	9,873
Valuation allowance	(2,412)	(1,266)	(3,678)
Net deferred tax assets	4,564	1,631	6,195
Deferred tax liabilities	(1,081)	(3,805)	(4,886)
Net deferred tax assets (liabilities)	3,483	(2,174)	1,309

1996	Current	Non current	Total
Gross deferred tax assets	8,347	2,150	10,497
Valuation allowance	(4,900)	(1,552)	(6,452)
Net deferred tax assets	3,447	598	4,045
Deferred tax liabilities	(1,013)	(561)	(1,574)
Net deferred tax assets	2,434	37	2,471

The tax loss carryforwards of the Group total 2,487 and expire as follows:

1998	42
1999	207
2000	388
2001	8
2002	1,842
Total	**2,487**

Losses may be carried forward for five years from the year of declaration for offset against IRPEG taxes only.

15 Salaries, wages and related liabilities

Salaries, wages and related liabilities are analyzed as follows:

	1997	1996
Salaries and wages	7,691	7,322
Social contribution	7,064	5,758
Vacation accrual	2,190	2,510
Total	**16,945**	**15,590**

16 Long-term debt

A significant portion of long-term debt is carried at reduced interest rates under Italian government investment incentive schemes for qualifying investments in southern Italy, and all long-term debt is secured by mortgages on the Group's properties for a total of 28,590.

Long-term debt is analyzed as follows:

	1997	1996
• 5.1% long-term debt payable in semi-annual installments with final payment due December 31, 1997	-	63
• 14.5% mortgage loan payable in semi-annual installments with final payment due June 30, 1998	45	125
• 5.5% long-term debt payable in semi-annual installments with final payment due September 16, 1998	444	889
• 5.1% long-term debt payable in semi-annual installments with final payment due December 31, 1998	262	511

	1997	1996
7% long-term debt payable in semi-annual installments with final payment due December 31, 1998	308	576
5.2% long-term debt payable in semi-annual installments with final payment due June 30, 1999	1,515	2,462
7.3% long-term debt payable in quarterly installments due January 18, 2001	1,529	2,000
4.8% long-term debt payable in semi-annual installments with final payment due June 30, 2001	479	601
5% long-term debt payable in semi-annual installments with final payment due June 30, 2001	995	1,248
3.7% long-term debt payable in semi-annual installments with final payment due June 30, 2003	1,613	1,873
	7,190	10,348
Less current portion	(3,191)	(3,159)
	3,999	**7,189**

Loan maturities after 1998 are summarized below:

1999	1,684
2000	1,197
2001	645
2002	312
2003	161
Total	**3,999**

17 Minority interest

Minority interest shown in the accompanying consolidated balance sheet at December 31, 1997 of 1,349 (2,129 at December 31, 1996) includes 103 pertaining to the majority shareholders of the Group (1,085 at December 31, 1996).

18 Shareholders' equity

Share capital through October 28, 1996 was composed of 28,439,400 ordinary shares of par value Lit. 250 each, fully paid. On such date the Company's shareholders' at an Extraordinary General Meeting approved a two-for-one stock split of the Ordinary Shares. As a result of the stock split, the capital stock was increased to 56,878,800 ordinary shares of par value Lit. 125 each, fully paid. Accordingly, all share information in these consolidated financial statements has been adjusted to reflect this stock split.

In February 1994 the Board of Directors of the Company adopted an employee stock option plan (the "Plan") pursuant to which managers and certain key employees of the Group may be granted options to purchase an aggregate of up to 1,680,000 ordinary shares from the Company at an exercise price per share equal to 95% of the May 1993 initial public offering price, or 10,637.5 per share. Employees receiving options may exercise such options over four years during exercise periods from May 15 to May 31, as follows: (i) with respect to 25% of the options, in the year in which they were granted; (ii) with respect to 35% of the options, in the second year thereafter; and (iii) with respect to the remaining 40% of the options, in the fourth year thereafter. Following each exercise period, the Company must seek shareholder approval to increase its capital and comply with certain requirements of Italian law, after which the ordinary shares may be delivered.

A summary of the status of the Plan as of December 31, 1997 and 1996, and changes during the years ended on those dates is presented below:

	1997		1996	
	Shares	**Exercise price**	**Shares**	**Exercise price**
Outstanding at the beginning of the year	620,000	10,637.5	1,093,500	10,637.5
Granted	-	-	168,800	10,637.5
Exercised	-	-	(514,300)	10,637.5
Forfeited	-	-	(128,000)	10,637.5
Outstanding at the end of the year	**620,000**	**10,637.5**	**620,000**	**10,637.5**
Options exercisable at year-end	-		-	
Weighted-average remaining contractual life	0.55 years		1.55 years	

The share capital is owned as follows:

	1997	1996
Mr. Pasquale Natuzzi	45.8%	45.9%
Miss Anna Maria Natuzzi	2.5%	2.9%
Mrs. Annunziata Natuzzi	2.5%	2.9%
Public investors	49.2%	48.3%
	100.0%	**100.0%**

An analysis of the reserves follows:

	1997	1996
Legal reserve	2,151	2,151
Monetary revaluation reserve	2,065	2,065
Grants	58,025	10,292
Total	**62,241**	**14,508**

These reserves are all distributable except for the legal reserve which may be utilized to cover losses. Italian law requires that 5% of net income of the parent company and each of its consolidated subsidiaries be retained as a legal reserve until this reserve is equal to one-fifth of the issued capital stock of each relevant company. The combined legal reserves totalled 6,415 and 6,243 at December 31, 1997 and 1996, respectively. During 1996, one of the Company's subsidiaries transferred distributable reserves of 553 in the form of a dividend to the Company. The Company has, accordingly, reclassified such amount from reserves to retained earnings in the consolidated financial statements.

As of December 31, 1997 taxes that would be due on distribution of the portion of stockholders' equity equal to capital grant reserves and unremitted earnings of foreign subsidiaries would approximate 7.000 The Group has not provided for such taxes as the likelihood of distribution is remote and such reserves and earnings are deemed to be permanently reinvested.

The cumulative translation adjustment included in stockholders' equity related to translation of the Group's foreign assets and liabilities at December 31, 1997 and 1996 was a credit of 3,032 and 481, respectively.

19 Commitments and contingent liabilities

Purchase commitments for raw materials at December 31, 1997 and 1996 amounted to 34,000 and 23,795, respectively.

The Group is involved in a number of claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters, after considering amounts accrued, will not have a material adverse effect on the Group's consolidated financial position or results of operations.

Several companies of the Group lease manufacturing facilities under non-cancellable lease agreements with expiration dates through 2006. Rental expense recorded for the years ended December 31, 1997, 1996 and 1995 was 2,688, 2,433 and 2,478, respectively. As of December 31, 1997, minimum annual rental commitments are as follows:

1998	1,807
1999	1,683
2000	1,268
2001	886
2002	685
Thereafter	413
Total	**6,742**

A bank has provided guarantees at December 31, 1997 to secure the payments to several suppliers of leather hides amounting to 15,386. These guarantees are unsecured and have various maturities extending through May 1998.

VAT reimbursed by tax authorities during 1997 and in prior years is secured by surety bonds for 135,662 (124,910 at December 31, 1996) from certain financial institutions. These surety bonds are unsecured and will expire after a maximum period of up to two years or when the tax authorities perform the final review of VAT claim requests.

On December, 1996, the Company and the ‘Contract Planning Service’ of the Italian Ministry of the Budget signed a ‘Program Agreement’ with respect to the ‘Natuzzi 2000 project’. In connection with this project, the Natuzzi Group has planned a multi-faceted program of industrial investments for the production of upholstered furniture. Investments are projected to total approximately 571,500. According to the agreement, the Italian government will contribute 281,600. Receipt of the Italian governments funds is based upon, among other things, the Group constructing facilities in accordance with certain specifications and maintaining a minimum number of employees.

During 1997 the Group has received under the aforementioned project capital grants for 52,549. Capital expenditures under the Natuzzi 2000 project amounted to approximately 113,000 at December 31, 1997. The capital grants are secured by surety bonds for 50,423 from a bank. These surety bonds are unsecured and will expire when the Italian Ministry of Budget releases the final approvals of all investments made.

Natuzzi Americas Inc. has entered into several construction contracts for a new showroom and office complex on a cost plus profit basis. At December 31, 1997, management estimates additional cost of approximately 11,960 will be incurred under these contracts before the project is complete in the spring of 1998.

During 1996, the Company developed a plan to deal with the Year 2000 problem and began converting its computer systems to be Year 2000 compliant. The plan provides for the conversion efforts to be completed by the end of 1999. The Year 2000 problem is the result of computer programs being written using two digits rather than four to define the applicable year. The total cost of the project is estimated to be 400 and is being funded through operating cash flows. The Company is expensing all costs associated with these systems changes as the costs are incurred. As of December 31, 1997, 100 had been expensed.

20 Segmental and geographical information

The Group operates predominantly in a single industry segment, that is, the design, manufacture and marketing of contemporary and traditional leather and fabric upholstered furniture. It offers a wide range of upholstered furniture for sale, manufactured in production facilities located in Italy. The Group's products fall into five broad categories: stationary furniture, sectional furniture, motion furniture, sofa beds and lounge chairs. Sales information by products is not available.

The Group also sells to a minor extent polyurethane foam and leather by products.

The following tables provide information about net sales of upholstered furniture and of long-lived assets by geographical location. Net sales are attributed to countries based on location of customers. Long-lived assets consist of property, plant and equipment, and other assets (intangible assets):

Sales of upholstered furniture	1997	1996	1995
United States	428,462	309,418	303,013
Italy	75,570	61,135	55,904
England	56,357	47,079	40,388
Germany	55,984	52,277	53,536
The Netherlands	42,106	35,862	31,533
France	35,534	48,219	58,258
Other countries (none greater than 5%)	283,446	228,527	225,684
	977,459	**782,517**	**768,316**

Long lived assets	1997	1996
Italy	171,072	117,665
United States	28,095	10,529
Other countries	-	618
	199,167	**128,812**

No single customer accounted for more than 5% of net sales in 1997, 1996 and 1995.

21 Cost of sales

Cost of sales is analyzed as follows:

	1997	1996	1995
Opening inventories	90,450	81,806	81,670
Purchases	506,666	395,568	389,111
Labor	135,944	108,662	90,304
Third party manufacturers	62,695	53,891	49,539
Other manufacturing costs	35,204	27,315	26,189
Closing inventories	(114,724)	(90,450)	(81,806)
Total	**716,235**	**576,792**	**555,007**

22 Other income, net

Other income, net is analyzed as follows:

	1997	1996	1995
Interest income	13,358	15,279	9,997
Interest expense and bank commisions	(2,060)	(2,528)	(4,169)
Interest income, net	11,298	12,751	5,828
Gains (losses) on foreign exchange, net	(1,201)	30,895	(3,682)
Provision for unrealized exchange losses on domestic currency swaps	(2,184)	-	-
Gains (losses) on foreign exchange	(3,385)	30,895	(3,682)
Gains (losses), net on securities	1,844	(39)	(29)
Unrealized gains (losses) on securities	(37)	369	944
Gains on securities	1,807	330	915
Put option premium expensed	-	-	(1,221)
Other income, net	2,598	3,154	5,526
Total	**12,318**	**47,130**	**7,366**

The gains (losses) on foreign exchange are related to the following:

	1997	1996	1995
Realized gains (losses) on domestic currency swaps	(8,087)	34,013	(6,959)
Realized gains (losses) on accounts receivable and payables	7,589	(5,572)	3,590
Provision for unrealized gains (losses) on accounts receivable and payable	(703)	2,454	(313)
Total	**(1,201)**	**30,895**	**(3,682)**

Other income, net consist of the following:

	1997	1996	1995
Refund of taxes	-	-	2,418
Refund of social contribution	-	-	1,685
Release of accrual for contingent liabilities	3,500	-	-
Employment incentives	370	2,860	-
Tax on net shareholders' equity	(3,058)	(2,051)	(974)
Other, net	1,786	2,345	2,397
Total	**2,598**	**3,154**	**5,526**

Employment incentives

The Company and certain subsidiaries, on the basis of regional laws, received from the regional agencies employment incentives in the form of grants for new permanent employees and subsidies of up to 100% of the cost of training courses for permanent and temporary employees. The incentives received were related to prior years. For the years ended December 31, 1997 and 1996 these incentives amounted to 370 and 2,860, respectively.

Tax on net shareholders' equity

Other income (expense), net includes a 0.75% tax applicable to the adjusted net shareholders' equity of all Italian companies. This tax resulted for the years ended December 31, 1997, 1996 and 1995 in a charge of 3,058, 2,051 and 974, respectively.

Refund of taxes

During 1995 certain subsidiaries formed in prior years obtained from the tax authorities approval to enjoy a full exemption from IRPEG and ILOR, effective the date that such subsidiaries were formed. As a result, these subsidiaries credited to income the amount of 2,418, which relates to the recovery of taxes paid through the years ended December 31, 1994.

Refund of social contribution

A subsidiary of the Company during 1995 was entitled by the Italian social contribution agency (INPS) to compute the social contribution due on the basis of a different rate. As a consequence, the subsidiary recorded to income the amount of 1,685, which relates to social contribution overpaid during prior years.

23 Financial instruments and risk management

A significant portion of the Group's net sales, but only approximately 30% of its costs, are denominated in currencies other than the lira, in particular the U.S. dollar. The remaining costs of the Group are denominated principally in lire. Consequently, a significant portion of the Group's net revenues are exposed to fluctuations in the exchange rates between the lira and such other currencies. The Group uses forward exchange contracts (known in Italy as domestic currency swaps) to reduce its exposure to the risks of short-term declines in the value of its foreign currency-denominated revenues. The Group uses such domestic currency swaps to protect the value of its foreign-currency denominated revenues, and not for speculative or trading purposes.

The Group is exposed to credit risk in the event that the counter-parties to the domestic currency swaps fail to perform according to the terms of the contracts. The contract amounts of the domestic currency swaps described below do not represent amounts exchanged by the parties and, thus, are not a measure of the exposure of the Group through its use of those financial instruments. The amounts exchanged are calculated on the basis of the contract amounts and the terms of the financial instruments, which relate primarily to exchange rates. The immediate credit risk of the Group's domestic currency swaps is represented by the unrealized gains on the contracts. Management of the Group enters into contracts with creditworthy counter-parties and believes that the risk of material loss from such credit risk to be remote. The table below summarizes in Italian lire equivalent the contractual amounts of domestic currency swaps used to hedge future cash flows from accounts receivable and sales orders at December 31, 1997 and 1996:

	1997	1996
U.S. dollars	253,971	152,538
British pounds	33,919	18,239
German marks	32,351	29,810
French francs	27,333	48,206
Canadian dollars	22,442	13,587
Belgian francs	20,694	17,167
Dutch guilders	17,552	-
Australian dollars	15,209	14,759
Japanese yen	14,844	16,760
Swiss francs	7,566	14,555
Total	**445,881**	**325,621**

At December 31, 1997, the domestic currency swaps had a net unrealized loss of 4,604 of which 1,779 relates to and was included as a reduction in accounts receivable, 803 has not been recorded as it relates to existing sales commitments and 2,184 had been accrued as a provision for unrealized foreign exchange losses in the balance sheet and charged to other income, net in the statement of earnings, as it did not relate to existing commitments at year-end.

At December 31, 1996, these domestic currency swaps had a net unrealized gain of 12,109, of which 2,368, relates to and is included as an increase in accounts receivable, 2,644 has not been recorded as it relates to existing sales commitments and 7,097 has been deferred and not charged to other income, net in the statement of earnings, as it did not relate to existing commitments at year-end.

The following table presents information regarding the contract amount in Italian lire equivalent amounts and the estimated fair value of all of the Group's domestic currency swaps. Contracts with unrealized gains are presented as 'assets' and contracts with unrealized losses are presented as 'liabilities'.

	1997		1996	
	Contract amount	Fair value	Contract amount	Fair value
Assets	161,186	5,141	269,807	14,241
Liabilities	284,695	(9,745)	55,814	(2,132)
	445,881	**(4,604)**	**325,621**	**12,109**

The following table summarizes the carrying value and the estimated fair value of the Group's on- and off-balance sheet financial instruments:

	1997		1996	
	Carrying value	Fair value	Carrying value	Fair value
Assets:				
• Cash and cash equivalents	239,371	239,371	128,001	128,001
• Marketable securities	4,802	4,856	78,057	81,070
• Trade receivables	184,382	184,382	174,894	174,894
• Other receivables	64,858	64,858	53,278	53,278
Liabilities:				
• Short-term borrowings	1,796	1,796	3,867	3,867
• Accounts payable	163,554	163,554	152,395	152,395
• Long-term debt	7,190	6,779	10,348	9,494
Off-balance sheet financial instruments:				
• Domestic currency swaps	(1,779)	(4,604)	2,368	12,109

Cash and cash equivalents, receivables, payables and short-term borrowings approximate fair value because of the short maturity of these instruments.

Market value for quoted marketable debt securities is represented by the securities exchange prices at year-end. Market value for unquoted securities is represented by the prices of comparable securities, taking into consideration interest rates, duration and credit standing of the issuer.

Fair value of the long-term debt is estimated based on cash flows discounted using current rates available to the Company for borrowings with similar maturities.

The carrying value of domestic currency swaps is determined based on the unrealized loss of such swaps recorded in the consolidated financial statements. Fair value of domestic currency swaps is determined by using exchange rates at year-end.

24 Application of generally accepted accounting principles in the United States of America

The established accounting policies followed in the preparation of the consolidated financial statements (Italian GAAP) vary in certain significant respects from those generally accepted in the United States of America (US GAAP).

Those differences which have had a material effect on net earnings and/or shareholders' equity are as follows:

(a) Certain property, plant and equipment has been revalued in accordance with Italian laws. The revalued amounts are depreciated for Italian GAAP purposes. US GAAP does not allow for such revaluations, and depreciation is based on historical costs. The revaluation primarily relates to industrial buildings.

(b) In the application of US GAAP, the Group has classified its investment portfolio as securities available for sale, which are those securities that may be sold prior to maturity as part of asset and liability management or in response to other factors but are not trading securities. Such securities are carried at fair value, and any changes in fair value are recorded in a separate component of shareholders' equity, net of applicable deferred taxes. Under Italian GAAP, all current asset investments are stated at the lower of cost or market value on an individual security basis.

(c) The Group generally recognizes net unrealized foreign exchange losses but defers net unrealized foreign exchange gains until realized. In connection with its hedging activities employing domestic currency swaps, net unrealized foreign exchange gains and losses are deferred as they relate to future sales for which commitments are received at the balance sheet date. The Company defines such commitments for Italian GAAP purposes as sales orders on hand and customers' indications of future purchases as of the balance sheet date which are confirmed by sales orders within a designated time period. Unrealized gains and losses on domestic currency swaps not designated to cover accounts receivable or future sales commitments are generally deferred in the case of net unrealized gains and recognized in earnings when results in a net unrealized losses. See notes 3 (d) and (i) for the Group's accounting policy.

Under US GAAP, generally both unrealized foreign exchange gains and losses from foreign currency transactions are recognized in the statement of earnings unless prescriptive hedging criteria are met. The Company's accounting policy for US GAAP purposes is that unrealized gains and losses on domestic currency swap contracts are deferred only for such contracts designated to cover firmly committed transactions supported by sales orders on hand. Accordingly, under US GAAP, unrealized gains and losses on domestic currency swap contracts designated to cover anticipated future sales which are not supported by sales orders on hand as of the balance sheet date are credited or charged to the statement of earnings.

(d) Government grants related to capital expenditures are recorded, net of tax, within reserves in shareholders' equity. For US GAAP purposes, such grants would be classified as a reduction of the cost of the related fixed asset or as a deferred credit and amortized to income over the estimated useful lives of the assets. The adjustments to net income represent the annual amortization of the capital grants based on the estimated useful life of the related fixed assets. The adjustments to shareholders' equity are to reverse the amounts of capital grants credited directly to equity for Italian GAAP purposes, net of the amounts of amortization of such grants for US GAAP purposes. In 1995 and 1997, the Group received certain grants relating to fixed assets acquired between 1989 and 1997 with various useful lives. For US GAAP purposes, the Group is amortizing such grants over the remaining useful lives of the assets to which the grants relate.

(e) The Company does not record the compensation cost resulting from the granting of share options. For US GAAP purposes, this intrinsic value (resulting from the excess of the market price of the underlyng shares at the date of grant over the excercise price) is being recognized as compensation cost in the consolidated statement of earnings over the vesting period of the options. For US GAAP purposes, in 1997, 1996 and 1995 the Company recorded a charge of 2,444, 4,018 and 4,964, respectively, while the remaining unrecognized compensation of 1,626 will be charged in declining amounts annually through 2000.

(f) On January 23, 1995 and May 18, 1995 the Company acquired 40% and 20%, respectively, of the shares of Creazioni Ellelle S.p.A. Even though net losses have been included since the acquisition date, Creazioni Ellelle's items of revenues and expenses for the entire year ended December 31, 1995 have been included as part of the Group's consolidated statement of earnings for such period. Creazioni Ellelle's preaquisition revenues of approximately 799 and expenses of 902 are included in the consolidated statement of earnings for the year ended December 31, 1995. Under US GAAP, the Group would consolidate Creazioni Ellelle's revenues and expenses commencing January 23, 1995, the date of acquisition.

As a result of the foregoing, consolidated sales, cost of sales, selling and general and administrative expenses for the year ended December 31, 1995 would be as follows:

Net sales	838,487
Cost of sales	(554,267)
Selling expenses	(142,949)
General and administrative expenses	(32,692)

The calculation of net earnings and shareholders' equity substantially in conformity with US GAAP is as follows:

Reconciliation of net earnings:

	1997	1996	1995
Net earnings under Italian GAAP	104,174	117,440	95,860
Adjustments to reported income:			
(a) Revaluation of property, plant and equipment	85	83	81
(b) Marketable debt securities	(477)	(574)	(1,451)
(c) Unrealized gains (losses) on foreign exchange	(7,213)	(2,032)	9,268
(d) Government grants	5,103	1,190	1,438
(e) Employee share option compensation	(2,444)	(4,018)	(4,964)
Effect of minority interests on US GAAP adjustments	(2)	128	(116)
Tax effect of US GAAP adjustments	2,872	900	(5,122)
Approximate net earnings in conformity with US GAAP	**102,098**	**113,117**	**94,994**
Basic earnings per share in conformity with US GAAP	**1,795**	**1,996**	**1,685**
Diluted earnings per share in conformity with US GAAP	**1,781**	**1,981**	**1,665**

Reconciliation of shareholders' equity:

	1997	1996
Shareholders' equity under Italian GAAP	605,418	465,748
(a) Revaluation of property, plant and equipment	(939)	(1,024)
(b) Marketable debt securities	54	3,013
(c) Unrealized gains (losses) on foreign exchange	(116)	7,097
(d) Government grants	(52,311)	(4,398)
Effect of minority interests on US GAAP adjustments	10	(5)
Tax effect of US GAAP adjustments	4,994	(4,290)
Approximate shareholders' equity in conformity with US GAAP	**557,110**	**466,141**

Impairment of long-lived assets and long-lived assets to the be disposed of

The Group adopted the provisions of SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of, on January 1, 1996. This statement requires that long-lived assets and certain identifiable intangibles be reviewed for impairment wherever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flow expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceed the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount of fair value less costs to sell. Adoption of this Statement did not have a material impact on the Group's financial position, results of operations, or liquidity.

Accounting for Stock-Based Compensation

Prior to January 1, 1996, the Company accounted for the Plan in accordance with the provision of Accounting Principles Board ('APB') Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. As such, compensation expense was recorded on the date of grant for the excess of the current market price of the underlying share over the exercise price. On January 1, 1996, the Company adopted SFAS No. 123, Accounting for Stock-Based Compensation, which permits entities to recognize as expense over the vesting period the fair value of all stock-based awards on the date of grants. Alternatively, SFAS No. 123 also allows entities to continue to apply the provisions of APB Opinion No. 25 and provide pro forma net income and pro forma earnings per share disclosures for employee share option grants made in 1995 and future years as if the fair-value-based method defined in SFAS No. 123 had been applied. The Company has elected to continue to apply the provisions of APB Opinion No. 25 and provide the pro forma disclosure provisions of SFAS No. 123.

The weighted-average fair value of each option granted by the Company during 1996 was estimated on the grant date at 62,500 using the Black-Scholes option pricing model with the following weighted-average assumption: dividend yield of 0.6%; expected volatility of 25%; risk-free interest rate of 7.29%; and expected lives of 2.55 years. Had compensation cost for the Company's Plan, for US GAAP purposes, been determined consistent with SFAS No. 123, the Company's US GAAP net earnings and earnings per share for the years ended December 31, 1997 and 1996 would approximate the actual amounts presented in the reconciliation.

New U.S. Accounting Standards:

SFAS No. 128, Earning Per Share, was issued in February 1997. This statement simplifies the standards for computing earnings per share previously found in APB Opinion No. 15, Earning per share, and makes them more comparable to international EPS standards. Statement 128 replaces the presentation of primary EPS with a presentation of basic EPS. In addition, the Statement requires dual presentation of basic and diluted EPS on the face of the income statement for all entities with complex capital structures and requires a reconciliation of the numerator and denominator of the basic EPS computation to the numerator and denominator of the diluted EPS computation. The Group adopted the provisions of Statement 128 in its computations of earnings per share under US GAAP for the year ended December 31, 1997, 1996 and 1995. Statement 128 had no effect on earning per share for prior years.

SFAS No. 130, Reporting Comprehensive Income was issued in June 1997 and is effective for fiscal years beginning after December 15, 1997. Reclassification of financial statements for earlier periods provided for comparative purposes is required. It requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. It also requires that an enterprise (a) classify items of other comprehensive income by their nature in a financial statement and (b) display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of a statement of financial position. Management is currently reviewing the likely impact on the classification of items included in consolidated shareholders' equity.

SFAS No. 131, Disclosure about Segment of an Enterprise and Related Information was issued in June 1997 and is effective for fiscal years beginning after December 15, 1997. In the initial year of application comparative information for earlier years is to be restated. It requires that companies disclose segment data based on how management makes decisions about allocating resources to segments and measuring their performance. It also requires entity-wide disclosures about the products and services an entity provides, the material countries in which it holds assets and reports revenues. The Group adopted the provision of SFAS 131 for its 1997 consolidated financial statements and restated prior years disclosure.

25 Supplemental cash flow information

Changes in operating assets and liabilities are net of acquisitions of businesses. The following is supplemental cash flow information with respect to the acquisition of Creazioni Ellelle S.p.A. in 1995:

Fair value of assets acquired	15,291
Liabilities assumed	(10,491)
Cash paid for net assets acquired	4,800
Less: cash	(3,249)
Cash flow on acquisition net of cash acquired	**1,551**

26 Subsequent events

In March 1998, the Chairman of the Board called an Ordinary and Extraordinary General Meeting of Shareholders to be held on April 29, 1998 (first call) and, if needed, on April 30, 1998 (second call), in order to discuss and vote on:

Ordinary General Meeting
Approval of the proposed distribution of dividends amounting to Lit. 1,600 per Ordinary Shares or American Depository Share (including a special distribution of Lit. 1,234 per share) amounting to 91,006;

Extraordinary General Meeting
The increase of capital stock for a maximum amount of 800,000 ordinary shares reserved for employees of the Company and its subsidiaries and related amendments to the by-laws.

Board of Directors

Pasquale Natuzzi	Chairman of the Board of Directors
Giuseppe Desantis	Vice Chairman of the Board of Directors
Jeff Baron	Director
Stelio Campanale	Director
Pietro Lascaro	Director
Giambattista Massaro	Director
Claudio Dematté	Outside Director
Pietro Gennaro	Outside Director
Cataldo Sferra	Outside Director
Enrico Vitali	Outside Director

Management

Pasquale Natuzzi	Chief Executive Officer
Giuseppe Desantis	Vice Chairman
Jeff Baron	General Sales and Marketing Manager
Giambattista Massaro	General Purchasing and Logistics Manager
Michele Bonerba	Human Resources Manager
Stelio Campanale	General Counsel
Gaetano Del Re	Production Engineering Manager
Michele D'Ercole	Purchasing Manager
Piergiorgio Giura Longo	Manager of Leather and Dyeing Operations
Pietro Lascaro	Production Manager
Nicola Lassandro	Manager of Management Information Systems
Cesare Laberinti	Manager of Polyurethane Foam Operations
Dino Lorusso	Sales Manager for the Far East and Africa
Nicola Masotina	Sales Manager for Divani & Divani
Bruno Mele	Product Manager
Tommaso Melodia	Corporate Affairs Manager
Giovanni Mercadante	Accounting and Controlling Manager
Anna Maria Natuzzi	Product Manager
Annunziata Natuzzi	Internal Relations Manager
Vittorio Notarpietro	Treasurer & Investor Relations Manager
Giuseppe Pellegrino	Sales Manager for Europe
Giuseppe Stano	Sales Administration Manager
Giovanni Trentadue	Quality Manager
Emanuele Valente	Logistics Manager
Ruth Harriet Williams	Executive Vice President for Natuzzi Americas

Board of Internal Auditors

Francesco Venturelli - President
Ferdinando Canaletti
Giuseppe Russo Corvace

Independent Auditors

KPMG S.p.A.

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