2000 Annual Report

Growth that creates value

Natuzzi®

Group Profile

At December 31, 2000

The Group

The Natuzzi Group, founded in 1959 by Pasquale Natuzzi, designs, produces, and sells residential upholstered furniture.
It is Italy's largest furniture manufacturer and the global leader in leather upholstery, with the leading market shares in North America and Europe.
The holding company, Industrie Natuzzi SpA, was listed on the New York Stock Exchange on May 13, 1993.
In February 1995, Industrie Natuzzi's Quality System received the prestigious ISO 9001 certification and, on December 18, 1997 this certification was extended to all units of the Natuzzi Group according to ISO 9000 standards.
At December 31, 2000 the Group employed 3,700 with an average age of 30.

Markets and Distribution

Natuzzi exports 90% of its production, serving some 2,400 customers in 123 markets on the five continents.
Its products are sold in some 13,000 locations through a sale network of 98 independent representatives supported by sales managers and regional managers. In Italy, Greece, Spain, Portugal, Venezuela, Taiwan it sells through the 138 stores of its franchised chain, Divani & Divani (a trademark owned by Natuzzi Group).
In addition to Divani & Divani, 6 new stores opened under the Natuzzi brand in China, Switzerland,
Cyprus, Slovenia.

Manufacturing

Production takes place just-in-time and only on receipt of orders, eliminating unsold stock.
The Group manufactures over 92% of its own raw materials, ensuring their prompt delivery and controlling quality and costs reducing inventories.
Natuzzi produces over 400 models of contemporary, traditional and classic furniture, at every price-point and of every type (sofas, armchairs, recliners, motion, sofabeds, sectionals) along with 380 different coverings, including leather, fabric and microfibre: the most complete range of upholstered furniture available on the world market.

Services

Sales and customer assistance are managed at the Group's headquarters in Santeramo (Bari - Italy) and by Natuzzi Americas in High Point, North Carolina (USA).
Services provided include delivery directly to the dealers' location anywhere in the world, transactions in local currencies, and complete before and after sales assistance.
The Group also conducts in-house product research, marketing and communications (through its on-premises advertising agency and state-of-the-art photo studio), and educates its personnel through the Natuzzi Training Center. It also designs and engineers its own new plants, develops software and manages its information network linking the Group's companies and representatives throughout the world with the headquarters, providing real-time data transmission.

Contents

Financial Highlights

Twelve months ended December 31

(Italian GAAP)

		2000		1999		Change %		2000	1999
		(billions of lire, except as otherwise indicated)						(millions of US $, except as otherwise indicated)	
Net sales		1.333,1	100.0%	1,091,7	100.0%	22.1%	(b)	635.6	600.6
Gross profit		507.7	38.1%	440.1	40.3%	15.4%	(b)	242.1	242.1
Operating profit		245.0	18.4%	231.8	21.2%	5.7%	(b)	116.8	127.5
Net income		153.3	11.5%	159.6	14.6%	-3.9%	(b)	73.1	87.8
Net income per ADS (a)	(Lit.)	2.685.0		2.776.5		-3.3%	($)(b)	1.28	1.53
Cash dividends per ADS (a)	(Lit.)	560.8		3.166.4 (d)		-82.3%	($)(b)	0.27	1.74
Long term debt, excluding current portion		0.5		1.1		-54.5%	(c)	0.2	0.6
Stockholders' equity		709.6		732.2		-3.1%	(c)	344.0	380.8
Shares outstanding	**(#)**	**57,087,391**		**57,468,888**		-0.7%		**57,087,391**	**57,468,888**

(a) Each Natuzzi American Depositary Share ("ADS") represents one Ordinary Share.

(b) Average Noon Buying Rate 2,097.4 1,817.60

(c) Noon Buying Rate. 2,062.5 1,922.81

(d) Includes ITL 2.610 special dividend 2,062.5 1,922.81

Net Sales
BILLIONS OF LIRE

Net Income
BILLIONS OF LIRE

Stockolders' Equity
BILLIONS OF LIRE

Quarterly Stock Price - Price per ADS (AMOUNTS IN US$)

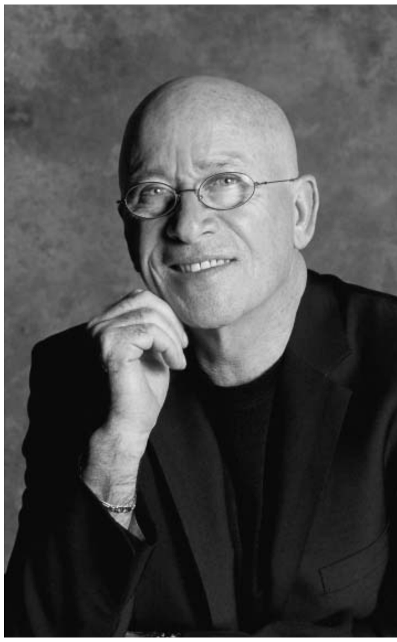
Information has been adjusted to reflect the Stock Split as from the first quarter 1996, while prior years reflect the price of ADSs before the Stock Split

	2000		1999		1998		1997		1996		1995	
	High	Low	High	Low	High	Low	High	Low	High	Low	High	Low
First	13	9 11/16	24 1/2	16 3/8	28 1/16	19	24 1/2	20 1/4	28	22 3/4	36 7/8	31 7/8
Second	12 13/16	9 7/8	19 7/8	16 5/8	29 1/4	24 7/8	26	21 7/8	27 1/4	23 3/4	38 1/4	30 5/8
Third	12	9 7/8	20 1/8	16 3/8	27 7/16	18	29 5/16	22 1/2	26	21 4/9	38 5/8	32 7/8
Fourth	13 1/16	11 3/8	20	12 1/2	25	14	23 3/4	18 1/4	24 3/4	21 3/8	46 5/8	33 1/4
Full Year	13 1/16	9 11/16	24 1/2	12 1/2	29 1/4	14	29 5/16	18 1/4	28	21 3/8	46 5/8	30 5/8

Letter from the Chairman

To our Shareholders,

2000 was another year of positive results. After two years of consolidating our position, we have strengthened our relations with Natuzzi's target customers, which this year resulted in a 26% increase in sales per customer and has once again set a pace of significant growth. Consolidated sales grew 22% during the year, reaching a record high of ITL 1,333 billion. Natuzzi's net income margin was in line with our historical target of 11%, a strong result relative to our sector, which experienced considerable further increases in key raw material prices such as leather (+13.7%), polyurethane (+8.1%), as well as transportation (+11.5%). The unfavorable trend in these key cost components were partially offset by effective cost-management at Natuzzi, and in any event had minimal impact on our selling prices, allowing us to increase market share.

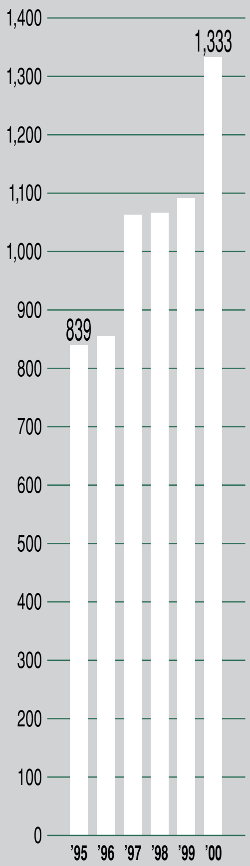


Pasquale Natuzzi,
Chairman of the Board and CEO

During the next few years, growth will be pursued by: a) Re-positioning the Natuzzi brand in the middle–to-high segment of the global furniture market; b) A more aggressive stance in the market's promotional segment. We will address the latter segment with Natuzzi's Italsofa branded furniture, which will be manufactured at several new plants abroad. During 2000, we began making significant capital investments in support of this strategy.

In Salvador di Bahia, Brazil, we have opened a school to train new employees who will work at a production facility that is currently under construction. This new plant is expected to be ready by the end of 2001. In Shanghai, China, a new plant with 180 employees is already operational, focusing on the production of Italsofa sofas and armchairs. And in Romania we began construction in 2001 of a new manufacturing facility that will transform wood into semi-finished products for our plants in Italy, as well as produce

Net Sales Billion Lire



living-room furniture. Expanding our global production capacity places Natuzzi closer to those markets that supply our key raw materials, as well as those markets in which we sell our products. From our new plant in Brazil, we will serve the east coast of the United States, while our facility in China will serve the west coast of the American continent. Once completed, the plant in Romania will allow us to easily reach most of Europe. The expected savings that will be derived from our overseas operations will enable us to produce furniture at much more competitive prices in order to capture additional market share in the promotional segment of upholstered furniture.

The increase in our production capacity abroad is proceeding hand in hand with manufacturing investments in Italy. In March 2001, a new production plant came on line in Ginosa (Province of Taranto). Once fully operational, this plant will produce 1,200 seats per day and employ approximately 400 employees. By the end of 2001, construction of another plant will be completed in Laterza (Province of Taranto). Products manufactured in Italy will be marketed under the Natuzzi label, which is being re-positioned in the middle-to-high price range of the furniture market. Consideration is also being given to including Natuzzi-branded products in our Decorator Concept offering.

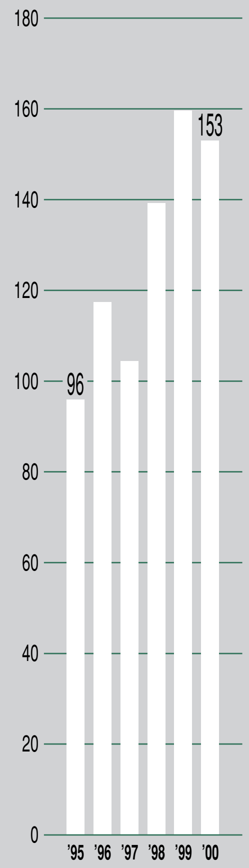
Our goal is to offer a complete line of living-room packages that will address consumers' varying tastes and lifestyles. At Natuzzi stores and galleries, our interior decorators will create coordinated living-room sets by matching various styles of sofas and armchairs with tables, lamps and rugs, all of which are created by our world-class furniture designers. The final product is a harmonious living room in which each individual object is perfectly matched with the other with balance and Italian taste. For the Decorator Concept to take root in the minds of consumers - a complete living-room solution with a high degree of aesthetic value - we must employ dedicated display areas that enhance the beauty and harmony of the design solutions proposed as well as give uniformity to brand's image. To this end, we worked assiduously during 2000 on the retailing front, adding 18 new stores to the 130 points of sale already in existence in Italy and abroad. Advertising campaigns will accompany the opening of our stores around the world to help build the Natuzzi brand name, our greatest challenge for the future.

A final thought should be devoted to something that, for us, is our company's key asset: the strength and determination of the people who work for Natuzzi. The Natuzzi of the third millennium is a global company that sells its market-leading products in 123 markets, manufacturing them on 3 continents. Its management is endowed with a global perspective, vigilantly monitoring and responding to the rapid economic, social and cultural developments that occur throughout the world. Natuzzi is a company that will continue to embrace globalization with skill and enthusiasm, while continuing to assert its identity and its vocation: growing and creating value for its shareholders, for its customers, and for the people who work for Natuzzi.

I thank you for the trust you place in this endeavor.

Pasquale Natuzzi
Chairman of the Board and CEO

Net Earnings Billion Lire



Year 2000 Revenues

Overview

Natuzzi's total net sales in 2000 (at current exchange rates) rose 22.1% to ITL 1,333 billion from ITL 1,092 billion in 1999. Of this amount, net upholstered furniture sales increased 20.1% to ITL 1,218 billion, while other sales (principally living-room accessories and raw materials produced by the Company) rose 49.1% to ITL 114.6 million. In volume terms, seat units sold increased 12.5% to 2,577,323 units. Driving upholstered furniture sales in 2000 was Natuzzi's Sofast product line, which has gained substantial recognition in the marketplace. Accentuating the strong price/value offering that is the hallmark of Natuzzi furniture is the speed with which Sofast is delivered to the customer from the time it is ordered. Looking at sales from a geographic perspective, the Americas continued to be Natuzzi's greatest source of revenue, representing 50.7% of net upholstered furniture sales in 2000. Europe was Natuzzi's second largest market, totaling 43.3% of sales, with the remaining 6.1% of net upholstered furniture revenues coming from outside these two major geographic markets.

The Americas

Sales to the Americas (North and South America) increased 29.6% over 1999 to ITL 617.4 billion. On a unit basis, seats sold in this market rose 17.2%. The robust revenue growth in the Americas stemmed primarily from the strong market acceptance of Natuzzi's Sofast program, which offers lower prices and faster delivery times in return for certain purchase conditions (a limited number of models, coverings and colors). In response to this growth, an entire factory has been dedicated to the production of Sofast models.

Europe

Natuzzi also experienced significant sales growth in Europe, where net upholstered furniture revenues increased 14.3% to ITL 393.4 billion, or an increase of 11.0% in unit terms. The following countries accounted for the strongest revenue growth in 2000: the United

Kingdom (+48.3%), Sweden (+44.9%) and France (+35.2%). In France, one of Europe's largest furniture markets, much of the sales growth was driven by Natuzzi's partnership with Roche Bobois, the country's dominant furniture retailer, which operates the popular Cuir Center chain of leather furniture stores.

In total, there are 73 of these specialized stores located throughout France. Sales in Spain also increased by a significant margin (+28.2%) in 2000, while Eastern Europe proved its enormous market potential, with sales in Russia rising 73.9% over 1999.

The Rest of the World

In the aggregate, net upholstered sales in the Pacific, Asia and Africa decreased 3.2% in 2000. This was primarily the result of declining sales in Australia (-20.4%), New Zealand (-6.9%) and Hong Kong (–76.1%). The revenue decrease in the first two markets was, in certain respects, by design. The Company made the strategic decision to position the Natuzzi brand in the middle/high price segment of the market in order to avoid dilution of the brand in the lower price points. Natuzzi is addressing the latter market with its new low-priced Italsofa brand (discussed later in this report). The immediate affect of re-positioning the Natuzzi brand in Australia and New Zealand was a short-term decline in sales. However, the Company expects to reach several important commercial pacts in line with this branding strategy during 2001, which should result in renewed and sustainable revenue growth

The net decline in sales in Hong Kong reflects the persistent economic crisis there, which is now in its third year. However, the results in Japan, another troubled market in recent years, were encouraging, with sales rising 9.4% versus 1999. Sales in Taiwan and China were excellent, increasing 55.0% and 76.3%, respectively. Singapore, where sales more than doubled (+127.3%), is now Natuzzi's second main reference market in Asia after Japan. Outside Asia, sales growth in Israel, another important Rest of World market, is also noteworthy, with revenues there increasing 16.9% over the prior year.

Sales by Styles, Coverings and Functions

Natuzzi achieved over the past few years a successful diversification in styles, coverings and functions. Sales of Classic and Modern styles totaled ITL 394.4 billion in 2000, representing 32.0% of total net upholstered furniture revenues versus 100% of revenues coming from Natuzzi Styles in 1992. This latter style represented 68.0% of sales in 2000.

Turning to revenues by covering, fabric and microfibre sales rose 40.6% to ITL 134.7 billion, accounting for 11.0% of total upholstered furniture revenues in 2000. Microfibre is an innovative synthetic suede fabric that has been gaining rapid market acceptance. Leather coverings made up the remaining 89.0% of coverings, increasing 17.9% over the prior year. Until 1995, Natuzzi used only leather in its upholstery production.

Looking at revenues based on functionality, sales of Natuzzi's Motion models (reclining armchairs, as well as sofas, sectionals and convertible settees with reclining mechanisms) rose 25.0% to ITL 182.1 billion, or 15% of total upholstered furniture revenues. The Company did not have this functionality until 1993.

Sales to Divani & Divani and Natuzzi Stores

Sales to Divani & Divani and Natuzzi stores, which are franchised by Natuzzi, totaled ITL 145.2 billion in 2000. During the year, 8 new Divani & Divani stores were opened in Italy, where the greatest number are franchises are located, bringing the total number of stores in this market to 109. Net sales to Divani & Divani stores in Italy totaled ITL 125.8 billion, a 13.3% increase over last year.

The expansion of Divani & Divani stores abroad continues, with 10 new stores opened in 2000, bringing the total to 40 stores. In addition, the first Natuzzi-branded stores were opened in Switzerland, Cyprus, Slovenia and China during the year. Total sales to overseas stores grew 25.7% in 2000 to ITL 19.4 billion.

Marketing

Addressing Specific Market Segments with Distinct Brands

A major shift in Natuzzi's corporate strategy has been the repositioning of the Natuzzi brand to address the medium-to-high price segment of the upholstered furniture market, while the new Italsofa brand will target the lower price segments. This strategy pursues two goals: revenue growth and the re-establishment of Natuzzi's leadership in leather upholstered furniture.

A great deal of care and attention has been devoted to planning and executing the re-positioning of the Natuzzi brand, which has achieved a high level of aesthetic value in the marketplace over the years. Similarly, Natuzzi's Decorator Concept, introduced in the fall of 1999, addresses the middle-to-high segment of the market. The Company continues to aggressively market this latest product offering, which received an enthusiastic reception at the Cologne and Milan furniture trade shows in 2000. The Decorator Concept offers consumers carefully coordinated sets of living-room furniture and accessories, such as coffee tables, rugs and lamps. In addition to the convenience offered by this complete, one-stop shopping solution, consumers can chose from a wide variety of furniture styles, coverings, colors, functions, as well as accessories.

In support of the harmony and aesthetic beauty of the innumerable living-room solutions offered by the Decorator Concept, the Company seeks to establish dedicated display spaces in which to house this product offering. Accordingly, Natuzzi-branded stores and galleries (shop within the shop) will be the exclusive points of distribution. Additionally, all Natuzzi-branded furniture will be sold only through Natuzzi Stores, which will gradually replace the Divani & Divani brand currently found in Italy, Greece, Portugal, Spain and Venezuela.

Marketing

To further support the Company's repositioning strategy, it has entrusted the creation of certain new Natuzzi models to world-renowned designers such as the architect Mario Bellini and the designer Massimo Iosaghini

Another major marketing initiative undertaken during 2000 was the launch of consumer advertising campaigns in support of new stores in Switzerland, China, Taiwan that bear the Natuzzi brand. The Company's advertising budget is scheduled to grow in the coming years with the aim of building brand awareness and driving revenues.

As regards the introduction of the Italsofa brand, a launch-preview took place at the High Point Furniture Fair in the U.S. last fall, and the new brand is now being promoted through by a massive retail campaign in major trade magazines.

From a competitive perspective, the Italsofa brand is designed to erode the competition's market share and re-establish Natuzzi's leadership in the low-end price segment of the global leather furniture market.

In support of this strategic initiative and to meet incremental demand, the Company is establishing additional manufacturing capacity in Brazil, China and, as announced in 2001, in Romania.

In addition to lower manufacturing costs, these strategic locations will place Natuzzi closer to suppliers of key raw materials like leather, as well as speed shipments to key international markets like the U.S. Concurrently, Natuzzi is expanding manufacturing capacity at home, where its world-renowned designers and highly skilled craftspeople are crucial to the development and production of products sold under the Natuzzi and Decorator Concept brands.

Product Research and Development

R&D continued to play a crucial strategic role in 2000, with the dual goals of enhancing the aesthetic value Natuzzi-branded products and the Decorator Concept product offering, and maintaining the Company's price competitiveness.

Over the years, Natuzzi's R&D activities have played an increasingly important role in the Company's growth.

Investments in R&D have made Natuzzi the undisputed global leader in the production of leather upholstered furniture and have allowed it to offer an unparalleled array of styles, coverings and functions.

Such investments have also resulted in the continuous improvement of operations and process efficiencies at all levels of the Company. In 1993, the year of Natuzzi's listing on the New York Stock Exchange, only a few dozen people were employed in the Company's R&D department.

Today, however, this department employs approximately 150 dedicated R&D personnel, who help introduce on average 80 new models annually, and invests approximately 2% of revenues in R&D.

In 2000, Natuzzi inaugurated the *Centro Stile Natuzzi*, a dedicated think tank made up of creative personnel, such as designers, interior decorators, and color experts, as well as product specialists like regional product managers, market analysts, and marketing managers.

Today, every new model in the Natuzzi collection is the product of this design center, where the cross fertilization of creative personnel and product specialists work to meet the ever-evolving needs of the global furniture market.

Among its diverse activities, the Centro Stile designs the almost limitless combinations of various furniture models and furnishing accessories that make up the Decorator Concept. During 2000, this design center produced 109 new models, 11 new leather products, 82 new colors, and 33 new living-room sets.

Substantial progress was also made from a technical perspective in 2000. During the year, the Company identified and patented various technical solutions to implement the ideas born by Natuzzi's designers.

For example, Natuzzi boosted R&D efforts in the area of new materials, with an emphasis on "importing" them from other industries, such as costume jewelry, clothing, automobiles, information technology, etc. Many of these imports have included the production processes themselves.

As a result of such efforts in recent years, as many as 15 different materials make up one of Natuzzi's upholstered chairs today, compared to the 5 basic materials used previously.

The use of new materials improves both the functional and aesthetic performance of Natuzzi's products without compromising the Company's price competitiveness.

With the aim of identifying new product technologies and improving process efficiencies, the Company also increased investments within its Industrial Product Department in 2000.

Production Investments

A program of domestic and international manufacturing investments launched in 2000 is aimed at achieving Natuzzi's growth objectives and supporting the Company's strategy to reposition the Natuzzi brand to address the middle/high price segments of the global furniture market as well as grow the Italsofa brand in low-priced segment.

Domestic Investments

To boost domestic production capacity, the construction of a new plant began in Ginosa, Italy in October 2000, and was completed in mid-March of 2001. In the space of five months, a state-of-the-art, 13,000 square meter production facility was completed. Once fully operational, this new pant will employ 400 new workers and will produce 1,200 seats per day.

A new 8,000 square meter productive plant is under construction in Laterza, Italy. It will be operational by the end of 2001 with a production capacity of 600 seats a day.

With the aim of improving leather quality and price competitiveness, substantial investments were made at Natuzzi's Natco tannery, located in Friuli, Italy. Among them, was a new 5,800 square meter tannery.

This new plant enables the Company to dry-process hides, eliminating the need to outsource this part of the tannery process.

The benefit is reduced production times and costs, as well as improved quality of leather, a crucial component of Natuzzi's products.

Overseas Investments

In October 2000 a professional training and educational institute was inaugurated in Salvador de Bahia, Brazil, to fully prepare the 100 employees who will initially operate a 4,000 square meter production facility, the construction of which began in February 2001. Italsofa furniture produced at this plant will be destined for the east coast of the United States.

The facility will eventually reach 16,000 square meters in size by February 2001, and will eventually employ 330 people who will produce approximately 600 seats per day. In December 2000, Natuzzi began opened a 14,000 square meter furniture plant in Shanghai, China.

This factory will initially employ a total of 180 employees, who will produce Italsofa furniture destined for the west coast of the United States. At present, production is already underway in an established plant, which is producing 350 seats per day.

In Europe, Natuzzi plans to build a 40,000 square meter factory in Baia Mare, Romania. The new factory will primarily produce semi-finished wood furniture frames to supply other Natuzzi plants, as well as manufacture sofas and armchairs that will be sold in Europe under the Italsofa brand.

Construction of the plant will commence in July 2001, and is expected to be fully operational by the end of 2002. When operating at full capacity, the new factory will employ approximately 600 people and will produce approximately 600 seats per day.


EL LISITSKIJ

2000 Compared to 1999

Net sales, which consists of sales of leather and fabric-upholstered furniture and other sales (principally of polyurethane foam and leather to third parties and accessories), increased 22.1% in 2000 to Lit. 1,333.1 billion compared to Lit. 1,091.7 billion in 1999.

Net sales of leather and fabric-upholstered furniture increased 20.1% to Lit. 1,218.5 billion in 2000, compared to Lit. 1,014.8 billion reported in 1999. The increase in net sales of upholstered furniture resulted principally from a 9.3% increase as a result of the devaluation of the lira against the U.S. dollar and other foreign currencies and a 12.5% increase in unit sales. These factors were partially offset by a 1.7% decrease in selling prices mainly due to a change in the mix of products sold.

In 2000, approximately 89% of the Group's net furniture sales were derived from exports. In 2000, net sales in Europe represented 43.3% of upholstered furniture net sales, compared to 45.6% in the previous year; the United States and the Americas represented 50.7%, up from 46.9%; and the rest of the world represented 6.1%, down from 7.6%. Net sales of leather-upholstered furniture increased to Lit. 1,083.8 billion, a 17.9% increase from Lit. 919.0 billion reported in 1999. Net sales of fabric-upholstered furniture were Lit. 134.7 billion, a 40.6% increase over the Lit. 95.8 billion reported in 1999.

In the United States and the Americas, net sales of leather and fabric-upholstered furniture increased 29.6% to Lit. 617.4 billion in 2000, compared to Lit. 476.3 billion in 1999; in Europe net sales increased 14.1% to Lit. 527.2 billion in 2000, compared to Lit. 462.1 billion in 1999; and in the rest of the world net sales decreased 3.2% to Lit. 73.9 billion, compared to Lit 76.4 billion in 1999. Net sales in the rest of the world were principally affected by a significant decrease in sales in Australia and in Hong Kong, where net sales registered a decrease of 20.4%

and of 76.1%, respectively. In Italy, net sales in 2000 increased from Lit. 117.9 billion to Lit. 133.7 billion due to the favorable results achieved by the Company's franchised Divani & Divani stores. Other net sales increased 49.1% to Lit. 114.6 billion in 2000, compared to Lit. 76.9 billion in 1999.

Unit sales of upholstered furniture increased 12.5%, from 2,290,492 seats in 1999 to 2,577,323 seats in 2000. The increase in unit sales included an increase of 11.2% to 1,188,989 seats in Europe, an increase of 17.2% to 1,229,159 seats in the United States and the Americas and a decrease of 7.8% to 159,175 seats in the rest of the world. Fabric-upholstered furniture unit sales for 2000 amounted to 360,801 seats, a 31.3% increase compared to 274,851 seats sold in 1999.

In 2000, the European markets showing the most significant increases in seats sold were the United Kingdom (+46.1%), Sweden (+32.7%), Spain (+27.9%), France (+25.3%) and Italy (+11.9%). Following continuous periods of decline in net sales, a significant increase was achieved in the French market principally as a result of our recent measures to restructure the French sales, marketing and distribution network. The German and Austrian markets, however, reported slight decreases due mainly to unfavorable market conditions.

The increase in unit sales in the United States and the Americas included an increase of 16.1% in the United States market and an increase of 45.7% in the Canadian market.

The decrease in seats sold in the rest of the world reflects mainly significant decreases in unit sales in Australia (-22.7%) and Hong Kong (-79.8%). These decreases were partially offset by increased unite sales achieved in certain Far East countries, principally Singapore, Taiwan, China and Japan.

Cost of sales as a percentage of net sales increased from 59.7% in 1999 to 61.9% in 2000, resulting in a decrease in gross profit as a percentage of net sales to 38.1% in 2000, compared to 40.3% in 1999. The increase in cost of sales as a percentage of net sales was principally due to an approximately 14% increase in the cost of raw leather, expressed in constant exchange rates, and to an increase in prices of other principal raw materials, such as polyurethane foam, polyester fibers and chemicals. The increase in the cost of raw leather was mainly due to diseases threatening the cattle industry, such as foot-and-mouth disease and mad cow disease, which have negatively impacted the supply of cattle hides, and to a strong demand for leather especially from the apparel industry.

Selling expenses as a percentage of net sales increased from 15.1% in 1999 to 15.8% in 2000. This increase was mainly due to higher marketing expenses and transportation costs, which in turn reflects principally a general increase in fuel prices.

General and administrative expenses as a percentage of net sales decreased slightly from 4.0% in 1999 to 3.9% in 2000.

The Company recorded under other income/(expense), net, net expenses of Lit. 42.3 billion in 2000 as compared to net expenses of Lit. 32.5 billion in 1999 (which included a Lit. 18.2 billion pre-tax extraordinary charge related to the settlement of prior years' tax claims). The increase in net expenses was mainly due to a significant increase in net realized losses on domestic currency swaps following a higher than expected devaluation of the lira against foreign currencies. In 2000, net interest income was Lit. 11.6 billion, as compared with Lit. 7.3 billion in 1999. Foreign exchange transactions resulted in a loss of Lit. 54.7 billion in 2000, as compared with a loss of Lit. 27.0 billion in 1999. See Item 11, "Quantitative and Qualitative

Disclosure about Market Risk". In 2000, the Company did not report losses on marketable debt securities, while in the previous year the Company recorded losses on its holdings of securities of Lit. 2.8 billion.

Furthermore, the Group recorded other income in 2000 of Lit. 0.8 billion, compared to other expenses of Lit. 12.8 billion in the previous year.

The Group's effective income tax rate was 24.3% in 2000, as compared to 19.8% in 1999. In 2000 the Group's effective income tax rate was negatively affected by the expiration of a tax exemption under the *Mezzogiorno* Program and by the lower gross profit reported by Group companies entitled to tax exemptions.

Net earnings decreased from Lit. 159.6 billion in 1999 to Lit. 153.3 billion in 2000 (on a per Ordinary Share or ADS basis from Lit. 2,776 in 1999 to Lit. 2,685 in 2000), while net earnings as a percentage of net sales decreased from 14.6% in 1999 to 11.5% in 2000.

Liquidity and Capital Resources

Cash plus marketable securities less short-term borrowings decreased from Lit. 311.8 billion at December 31, 1999 to Lit. 178.0 billion at December 31, 2000, principally due to the cash used to pay a special distribution to shareholders of Lit. 2,610 per Ordinary Share during 2000 and to Lit 45.0 billion used to repurchase ADRs under the share repurchase program approved by shareholders in July 2000. Under the program, the Company is authorized to buy back up to 4 million shares or Lit 100 billion. As of December 31, 2000, the Company had repurchased 1,782,700 ADRs.

Despite the decrease in the Company's net earnings and a significant increase in the cost of raw materials, cash flows from operations were Lit. 147.3 billion in 2000, compared to Lit. 139.2 billion in 1999. The increase reflects a number of factors, including an increase in income taxes payable at December 31, 2000 compared to December 31, 1999 (which increases operating cash flow) as compared to a decrease in income taxes payable at December 31, 1999 compared to December 31, 1998 (which decreases operating cash flow).

Cash used in investing activities in 2000 was Lit. 53.6 billion, compared to cash used in investing activities of Lit. 3.2 billion in 1999. The Lit. 50.4 billion increase in cash used in investing activities was principally due to higher net investments for the maintenance of property, plant and equipment, from Lit. 17.2 billion in 1999 to Lit. 53.1 billion in 2000. In addition, in 1999 the Company received net cash flows of Lit. 14.2 billion from the sale of marketable debt securities.

In 2000, the Company used Lit. 223.2 billion in financing activities, as compared to Lit. 96.7 billion in 1999. The Lit. 126.5 billion increase was mainly due to cash used during 2000 in connection with the payment of a special distribution to shareholders and the share repurchase program, as explained above.

The Group relies primarily on funds from operations to finance its working capital needs, including the financing of its inventories and receivables. At December 31, 2000, the excess of total current assets over total current liabilities of the Group was Lit. 465.0 billion, compared to Lit. 569.2 billion at December 31, 1999. The Group's trade receivables (net of allowance for doubtful accounts) were Lit. 271.5 billion at December 31, 2000, compared to Lit. 220.2 billion at December 31, 1999, and its inventories were Lit. 142.6 billion at December 31, 2000, as compared to Lit. 103.2 billion at December 31, 1999.

Management believes that the Group's working capital is sufficient for its present requirements. The Group had credit facilities available of Lit 362.0 billion at December 31, 2000, as compared to Lit. 281.0 billion at December 31, 1999. The unused portion of these facilities amounted to approximately Lit. 344.0 billion and Lit. 265.5 billion at December 31, 2000 and 1999, respectively. The Group's long-term debt at December 31, 2000 and 1999 represented less than 1% of shareholders' equity at those dates, respectively.

Capital expenditures were Lit. 53.9 billion and Lit. 18.5 billion in 2000 and 1999, respectively. Capital expenditures in 2000 were made principally to purchase and improve a new facility in Altamura (for leather cutting and sewing), purchase equipment for the leather dyeing and finishing plant in Udine and other facilities located in and around Santeramo in Colle, Altamura and Qualiano, and upgrade the Group's computerized information systems. Capital expenditures were also made to improve the capacity of the facility in Udine and to purchase a new Learjet airplane.

During 2000, the Group announced a series of investments in new manufacturing facilities in Ginosa and Laterza (Italy), Shangai (China), Salvador Bahia (Brazil) and Praia Mare (Romania). See Item 4, "Information on the Company — Manufacturing".

The company expects to make capital expenditures of approximately Lit. 120 billion in 2001 and Lit. 100 billion in 2002, principally in connection with the construction of these facilities. No assurance can be given that project construction costs will not be higher than expected. Fluctuations between the euro and the currencies of the countries in which we plan to open plants may adversely affect our construction costs. The Company expects to fund these projects with internally-generated cash flows.

In late 1996, the Italian Government entered into a “Program Agreement” with the Company in connection with the Natuzzi 2000 project, which was initiated in 1993 to plan for the future growth of the Group. The principal objectives were the consolidation and logistical improvement of the Group’s manufacturing structure (which consisted of 41 facilities scattered over a radius of about 25 miles), as well as the gradual increase of the Group’s production capacity to support its annual growth projections.

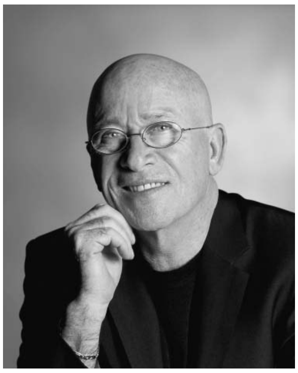
The plan provided for a total investment of up to Lit. 571.5 billion (of which Lit. 25.8 billion were targeted to be used for research), and for an Italian government contribution of up to Lit. 281.6 billion. The Company has reviewed the proposed future investments to be made under the program, and recently submitted a revised plan to the Italian Government for approval. The proposal contemplates total investments of Lit. 499 billion, reflecting the Group’s intentions to focus on quality and efficiency controls. No assurance may be given that the Italian Government will approve the Group’s proposal.

From the initiation of the project through December 31, 2000, about Lit.146.179 billion have been spent in constructing and equipping new plants, and capital grants of Lit. 52.6 billion were approved by the Italian Government in 1997 in relation to this project (the Company has to date received Lit. 46.9 billion in grants).

The Italian Government pays the amount of the grant in equal installments upon completion of each phase of the project, subject to satisfaction of certain conditions, including the completion of the facilities in accordance with certain specifications and maintenance of minimum numbers of employees. See Item 4, “Information on the Company — Italian Government’s Investment Incentive Program”.

Board of Directors

At June 30, 2001



Pasquale Natuzzi
Chairman of the Board of Directors

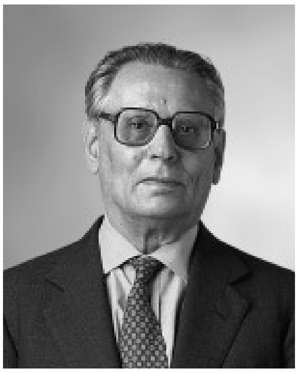
Giuseppe Desantis
Vice Chairman of the Board of Directors

Giambattista Massaro
Director

Gianluca Monteleone
Director

Stelio Campanale
Director

Claudio Dematté
Outside Director



Pietro Gennaro
Outside Director

Giuseppe Russo Corvace
Outside Director

Cataldo Sferra
Outside Director

Enrico Vitali
Outside Director

Armando Branchini
Outside Director

Financial Statement

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

At December 31, 2000 and 1999 and for each of the
years in the three-year period ended December 31, 2000
(With Independent Auditors' Report)

Contents

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KPMG S.p.A.
Via Abate Gimma 62/A
I-70121 BARI BA

Telephone +39 (080) 5243203
Telefax +39 (080) 5243425

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, 1999 and 1998 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, 1999. 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, which standards are substantially equivalent to generally accepted auditing standards in 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, 1999 and 1998 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 1999, 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, 1999 and shareholders' equity as of December 31, 1999 and 1998 to the extent summarized in Note 26 to the consolidated financial statements.

Bari, Italy
March 27, 2000

KPMG SpA

Consolidated Balance Sheets
December 31, 2000 and 1999

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

Assets	2000	1999
Current assets:		
Cash and cash equivalents (note 4)	183,174	312,648
Marketable debt securities (note 5)	51	50
Trade receivables, net (note 6)	271,525	220,190
Other receivables (note 7)	80,285	86,000
Inventories (note 8)	142,594	103,206
Unrealized foreign exchange gains (note 24)	4,069	-
Prepaid expenses and accrued income	555	705
Deferred income taxes (note 14)	3,532	7,751
Total current assets	**685,785**	**730,550**
Non current assets:		
Property plant and equipment (note 9 and 16)	352,254	295,858
Less accumulated depreciation (note 9)	(110,217)	(93,519)
Net property, plant and equipment	**242,037**	**202,339**
Treasury shares (note 19)	44,987	-
Other assets (note 10)	6,579	4,309
Deferred income taxes (note 14)	102	143
Total assets	**979,490**	**937,341**

See accompanying notes to consolidated financial statements.

Liabilities and Shareholders' Equity	2000	1999
Current liabilities:		
Short-term borrowings (note 11)	5,243	938
Current portion of long-term debt (note 16)	645	1,197
Accounts payable-trade (note 12)	163,407	116,611
Accounts payable-other (note 13)	22,513	20,495
Allowance for unrealized foreign exchange losses (note 24)	-	2,545
Income taxes (note 14)	7,349	2,774
Salaries, wages and related liabilities (note 15)	21,629	16,751
Total current liabilities	**220,786**	**161,311**
Long-term liabilities:		
Employees' termination indemnity (note 3 (l))	38,440	33,618
Long-term debt (note 16)	473	1,118
Deferred income taxes (note 14)	470	1,743
Other liabilities	8,227	5,821
Minority interest (note 17)	**1,543**	**1,557**
Shareholders' equity (note 19):		
Share capital	7,191	7,184
Reserves	108,191	62,029
Additional paid-in capital	16,037	15,441
Retained earnings	578,132	647,519
Total shareholders' equity	**709,551**	**732,173**
Commitments and contingent liabilities (notes 20 and 24)	-	-
Total liabilities and shareholders' equity	**979,490**	**937,341**

See accompanying notes to consolidated financial statements.

Consolidated Statements of Earnings
Years ended December 31, 2000, 1999 and 1998

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

	2000	1999	1998
Net sales (note 21)	1,333,084	1,091,689	1,066,173
Cost of sales (note 22)	(825,423)	(651,615)	(691,824)
Gross profit	**507,661**	**440,074**	**374,349**
Selling expenses	(211,016)	(164,467)	(171,345)
General and administrative expenses	(51,644)	(43,823)	(38,032)
Operating income	**245,001**	**231,784**	**164,972**
Other income, net (note 23)	(42,302)	(32,476)	20,810
Earnings before taxes and minority interest	**202,699**	**199,308**	**185,782**
Income taxes (note 14)	(49,344)	(39,441)	(46,335)
Earnings before minority interest	**153,355**	**159,867**	**139,447**
Minority interest	(90)	(305)	(148)
Net earnings	**153,265**	**159,562**	**139,299**
Basic earnings per share (note 3 (s))	**2,685**	**2,776**	**2,434**
Diluted earnings per share (note 3 (s))	**2,685**	**2,776**	**2,433**

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity
Years ended December 31, 2000, 1999 and 1998

(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, 1997	**56,878,800**	**7,110**	**62,241**	**9,238**	**526,829**	**605,418**
Dividends distributed	-	-	-	-	(91,006)	(91,006)
Exercise of stock options	590,088	74	-	6,203	-	6,277
Exchange differences on translation of financial statements	-	-	-	-	(2,860)	(2,860)
Net earnings	-	-	-	-	139,299	139,299
Balances at December 31, 1998	**57,468,888**	**7,184**	**62,241**	**15,441**	**572,262**	**657,128**
Dividends distributed	-	-	-	-	(91,950)	(91,950)
Transfers	-	-	(212)	-	212	-
Exchange differences on translation of financial statements	-	-	-	-	7,433	7,433
Net earnings	-	-	-	-	159,562	159,562
Balances at December 31, 1999	**57,468,888**	**7,184**	**62,029**	**15,441**	**647,519**	**732,173**
Dividends distributed	-	-	-	-	(181,946)	(181,946)
Exercise of stock options	56,640	7	-	596	-	603
Exchange difference on translation of financial statements	-	-	-	-	4,281	4,281
Treasury shares acquired	(1,782,700)	-	44,987	-	(44,987)	-
Grants received net of taxes	-	-	638	-	-	638
Revaluation of fixed assets net of taxes	-	-	537	-	-	537
Net earnings	-	-	-	-	153,265	153,265
Balances at December 31, 2000	**55,742,828**	**7,191**	**108,191**	**16,037**	**578,132**	**709,551**

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows
Years ended December 31, 2000, 1999 and 1998

(Expressed in millions of Italian lire)

	2000	1999	1998
Cash flows from operating activities:			
Net earnings	153,265	159,562	139,299
Adjustments to reconcile net income to net cash provided by operating activities:			
• Depreciation and amortization	20,094	18,430	23,848
• Employees' termination indemnity	10,372	9,234	8,582
• Deferred income taxes	2,812	(3,692)	(1,150)
• Minority interest	90	305	148
• (Gain) loss on disposal of assets	(239)	2,579	202
• Change in provision for unrealized foreign exchange losses	(6,614)	2,327	(1,966)
Change in assets and liabilities:			
• Receivables, net	(45,620)	(33,785)	(23,165)
• Inventories	(39,388)	3,340	8,178
• Prepaid expenses and accrued income	150	867	(421)
• Other assets	(2,862)	(993)	(1,342)
• Accounts payable	48,957	172	11,871
• Income taxes	4,575	(15,098)	(1,490)
• Salaries, wages and related liabilities	4,878	185	(379)
• Other liabilities	2,406	1,640	764
• Employees' termination indemnity	(5,550)	(5,876)	(5,362)
Total adjustments	**(5,939)**	**(20,365)**	**18,318**
Net cash provided by operating activities	**147,326**	**139,197**	**157,617**

See accompanying notes to consolidated financial statements.

	2000	1999	1998

Cash flows from investing activities:

Property, plant and equipment:			
• Additions	(53,919)	(18,496)	(26,199)
• Disposals	857	1,323	447
Government grants received	734	-	-
Marketable debt securities:			
• Purchases	(1)	(71,960)	(17,018)
• Proceeds from maturities	-	-	3,284
• Proceeds from sales	-	86,142	1,757
Purchase of business, net of cash acquired	(1,107)	-	-
Purchase of minority interest	(138)	(167)	-
Net cash used investing activities	**(53,574)**	**(3,158)**	**(37,729)**

Cash flows from financing activities:

Long-term debt repayments	(1,197)	(1,684)	(3,191)
Short-term borrowings	4,305	(2,952)	2,094
Exercise of stock options	603	-	6,277
Treasury shares	(44,987)	-	-
Dividends paid	(181,946)	(91,950)	(91,006)
Dividends paid to minority shareholders	-	(108)	(99)
Net cash used in financing activities	**(223,222)**	**(96,694)**	**(85,925)**
Effect of translation adjustments on cash	(4)	92	(123)
Increase (decrease) in cash and cash equivalents	(129,474)	39,437	33,840
Cash and cash equivalents, beginning of the year	312,648	273,211	239,371
Cash and cash equivalents, end of the year	183,174	312,648	273,211

Supplemental disclosure of cash flow information:

Cash paid during the year for interest	409	370	970
Cash paid during the year for income taxes	35,438	77,757	46,958

See accompanying 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, 2000, together with the related percentages of ownership, are as follows:

Name	Percent of ownership	Share Capital	Registered office	Activity
Divani e Poltrone Italia S.r.l.	99.98	Lit. 3,700	Bari, Italy	(1)
Soft Cover S.r.l.	100.00	Lit. 5,000	Bari, Italy	(1)
Spagnesi International S.r.l.	100.00	Lit. 800	Bari, Italy	(1)
Spagnesi S.p.A.	99.95	Lit. 1,000	Quarrata, Italy	(1)
Creazioni Ellelle S.p.A.	100.00	Lit. 2,500	Altamura, Italy	(1)
Style and Comfort S.r.l.	100.00	Lit. 5,000	Bari, Italy	(1)
Natuzzi Bahia Ltd	97.99	Rial$ 1.285.557	Bahia, Brazil	(1)
Italsofa Hong-Kong Ltd	80.00	US$ 1	Hong-Kong, China	(1)
Natco S.p.A.	99.99	Lit. 8,500	Bari, Italy	(2)
I.M.P.E. S.p.A.	90.83	Lit. 1,500	Qualiano,Italy	(3)
Expan Italia S.r.l.	99.00	Lit. 90	Bari, Italy	(3)
Natex S.r.l.	100.00	Lit. 90	Bari, Italy	(4)
Natuzzi Trade Service S.r.l.	100.00	Lit. 27,000	Bari, Italy	(5)
Natuzzi Americas Inc.	100.00	US$ 50,000	High Point, NC, USA	(5)
Nagest S.r.l.	100.00	Lit. 90	Bari, Italy	(6)
Softaly S.r.l.	100.00	Lit. 190	Bari, Italy	(7)
Finat Ltd	100.00	Lit. 1,000	Dublin, Ireland	(8)
Natuzzi Netherlands Holding	100.00	Euro 20.00	Amsterdam, Holland	(8)
Natuzzi Asia Limited	100.00	US$ 13	Hong-Kong, China	(8)
D.L.S. S.r.l.	100.00	Lit. 90	Bari, Italy	(9)
Natuzzi Argentina	99.00	US$ 12,000	Buenos Aires , Argentina	(10)

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

During 2000 the Company incorporated subsidiaries in Brazil and China. These subsidiaries will engage in the production of leather upholstery furniture that will be labelled “Italsofa”. The Company is building new production plants in these locations and these plants are expected to be in production by the end of December 2001.

In March 2000, the Company acquired 100% of a leather and fabric upholstered furniture manufacturing business, Style and Comfort S.r.l., for cash consideration of 1,107. The acquisition was accounted for using the purchase method. The acquisition resulted in a goodwill of 1,119, which represents the excess of purchase price over fair value of net assets. The fair value of assets acquired and liabilities assumed were as follows:

Current assets	292
Non-current assets, other than goodwill	293
Goodwill	1,119
Current liabilities	(380)
Non-current liabilities	(217)
Cash paid	**1,107**

In addition, during 2000, the Company acquired the remaining interest of 1% in Creazioni Elleelle S.p.A. for a consideration of 138 in cash.

During 1999, the Company acquired all of the minority interest of Natex S.r.l. for a consideration of 167 in cash. Goodwill arising from that acquisition amounted to 146.

From 1998 to 2000, the Company liquidated Masternat S.r.l., Natuzzi Pacific Ltd. , Tecnolevante S.r.l. and Italiana de Sofa Franquiciados S.L..

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, 2000, 1999 and 1998. The 1999 and 1998 financial statements have been approved by the respective shareholders of the relevant companies. The 2000 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.

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, 2000 and shareholders' equity as of December 31, 2000 and 1999 to the extent summarized in Note 26 to the consolidated financial statements.

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 results of operations 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 as discussed below. Foreign exchange gains and losses resulting from the remeasurement of these assets and liabilities are included in other income (expense), 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 (expense), net, in the statements of earnings.

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 *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:

- 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 consolidated statements of earnings.
- 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.
- Unrealized gains and losses on forward exchange contracts not hedging any on-or off-balance sheet items are recorded in other income (expense), net, in the consolidated statements of earnings.

c *Cash equivalents*

The Group considers time deposits to be cash equivalents.

d *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 (expense), net.

e *Accounts receivable and payable*

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

f *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.

g *Property, plant and equipment*

Property, plant and equipment is stated at historical cost, except for buildings which were revalued in 1983, 1991 and 2000 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).

h *Other assets*

Other assets in the consolidated financial statements primarily include trademarks and patents, goodwill and certain deferred costs. These 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 the consolidated balance sheet date. If the carrying amount exceeds the recoverable amount, the asset is written down to the recoverable amount.

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

i *Impairment of Long-lived Assets*

The Company reviews long-lived assets, including intangible assets, for impairment whenever 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 flows 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 exceeds the fair value of the assets. Estimated fair value is generally based on either appraised value or measured by discounted estimated future cash flows. Accordingly, actual results could vary significantly from such estimates.

j *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.

k *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 the 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.

l *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. The Group accrues the full amount of employees' vested benefit obligation as determined by such laws for termination indemnities.

The expense recorded for termination indemnities for the years ended December 31, 2000, 1999 and 1998 was 10,372, 9,234 and 8,582, respectively.

The number of workers employed by the Group totalled 3,700 and 3,492 at December 31, 2000 and 1999, respectively.

m *Net sales*

Revenue (or sales) is recognized when significant risks and rewards in respect of ownership are transferred to the customer: that is when title passes. Revenue is recognized when the following criteria are met: persuasive evidence of an arrangement exists; the price to the buyer is fixed and determinable; and collectibility of the sales price is reasonable assured.

Revenues are recorded net of returns and discounts. Sales returns are estimated and provided for in the year of sales. Such allowances are made based on historical trends. The Company has the ability to make a reasonable estimate of future returns due to large volume of homogeneous transactions and historical experience.

n *Shipping costs*

Shipping and handling costs incurred to transport products to customers are included in selling expenses.

o *Advertising costs*

Advertising costs are expensed in the periods incurred. Advertising expenses recorded for the years ended December 31, 2000, 1999 and 1998 were 34,203, 20,722 and 22,918, respectively.

p *Commission expense*

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

q *Contingencies*

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

r *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.

s *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:

	2000	1999	1998
Net earnings attributable to ordinary shareholders	**153,265**	**159,562**	**139,299**
Weighted-average number of ordinary shares outstanding during the year	57,087,391	57,468,888	57,223,018
Increase resulting from assumed conversion of share options	-	-	29,834
Weighted-average number of ordinary shares and potential shares outstanding during the year	**57,087,391**	**57,468,888**	**57,252,852**

4 Cash and cash equivalents

Cash and cash equivalents are composed of the following items:

	2000	1999
Cash on hand	95	33
Bank accounts in Italian lire	168,891	267,425
Bank accounts in foreign currency	14,188	28,949
Time deposits in Italian lire	-	16,241
Total	**183,174**	**312,648**

Time deposits have various maturities extending for 1999 through January 17, 2000.

5 Marketable debt securities

Details regarding marketable debt securities are as follows:

	2000	1999
Foreign corporate bonds	13	12
Italian government bonds	38	38
Total	**51**	**50**

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

2000	Cost	Gross unrealized Gains	Gross unrealized Losses	Fair value
Foreign corporate bonds	13	-	-	13
Italian government bonds	38	-	-	38
Total	**51**	**-**	**-**	**51**

1999	Cost	Gross unrealized Gains	Gross unrealized Losses	Fair value
Foreign corporate bonds	12	-	-	12
Italian government bonds	38	-	-	38
Total	**50**	**-**	**-**	**50**

	2000	1999	1998
Proceeds from sales	-	86,142	1,757
Realized gains	-	-	363
Realized losses	-	(2,804)	(114)

The contractual maturity of the Group's marketable debt securities at December 31, 2000 is between 1 – 5 years.

6 Trade receivables, net

Trade receivables are analyzed as follows:

	2000	1999
North American customers	131,961	102,082
Other foreign customers	81,094	75,150
Domestic customers	60,976	47,979
Trade bills receivable	6,111	5,260
Total	280,142	230,471
Allowance for doubtful accounts	(8,617)	(10,281)
Total trade receivables, net	**271,525**	**220,190**

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

No account receivable from any customer at December 31, 2000 and 1999 exceeded 20,000. The Company has insured its collection risk in respect of approximately 80% of accounts receivable outstanding balances and, estimates an allowance for doubtful accounts based on insurance in place, the credit worthiness of its customers as well as general economic conditions.

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

	2000	1999	1998
Balance, beginning of year	10,281	10,315	8,354
Charges-bad debt expense	739	478	4,278
Reductions-write off of uncollectible accounts	(2,403)	(512)	(2,317)
Balance, end of year	**8,617**	**10,281**	**10,315**

Trade receivables denominated in foreign currencies at December 31, 2000 and 1999 and, where applicable, translated at the rate of the related domestic currency swaps, totalled 196,017 (207,479 translated at year-end exchange rates) and 160,597 (174,827 translated at year-end exchange rates), respectively. These receivables consist of the following:

	2000	1999
U.S. dollars	126,693	100,818
British pounds	13,493	8,882
Canadian dollars	9,669	5,873
German marks	9,586	11,435
Australian dollars	8,117	9,290
French francs	5,753	4,030
Belgian francs	3,453	2,773
Spanish pesetas	3,189	2,498
Dutch guilders	3,367	2,233
Other currencies	12,697	12,765
Total	**196,017**	**160,597**

7 Other receivables

Other receivables are analyzed as follows:

	2000	1999
VAT	59,185	62,144
Government grants	6,583	6,441
Receivable from tax authorities	3,528	8,635
Advances to suppliers	4,798	4,207
Other	6,191	4,573
Total	**80,285**	**86,000**

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 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:

	2000	1999
Leather	58,055	36,574
Other raw materials	33,629	29,927
Goods in process	23,761	19,310
Finished products	27,149	17,395
Total	**142,594**	**103,206**

9 Property, plant and equipment and accumulated depreciation

Fixed assets are listed below together with accumulated depreciation.

2000	Cost or valuation	Accumulated depreciation	Annual rate of depreciation
Land	13,201	-	-
Industrial buildings	175,241	28,251	3 - 10%
Machinery and equipment	111,244	57,473	11.5 - 25%
Office furniture and equipment	26,169	18,858	12 - 20%
Transportation equipment	6,459	4,100	20 - 25%
Leasehold improvements	1,913	1,535	10 - 20%
Construction in progress	7,790	-	-
Advances to suppliers	10,237	-	-
Total	**352,254**	**110,217**	

1999	Cost or valuation	Accumulated depreciation	Annual rate of depreciation
Land	9,661	-	-
Industrial buildings	156,755	23,299	3 - 10%
Machinery and equipment	95,202	48,345	11.5 - 25%
Office furniture and equipment	23,810	16,425	12 - 20%
Transportation equipment	5,513	4,114	20 - 25%
Leasehold improvements	1,636	1,336	10 - 20%
Advances to suppliers	3,281	-	-
Total	**295,858**	**93,519**	

10 Other assets

Other assets consist of the following:

	2000	1999
Trademarks	20,464	21,811
Goodwill	2,767	2,770
Others	10,607	8,509
Total, gross	33,838	33,090
Less accumulated amortization	(27,259)	(28,781)
Total, net	**6,579**	**4,309**

11 Short-term borrowings

Short-term borrowings consist of the following:

	2000	1999
Bank overdrafts	5,243	938

The weighted average interest rates on the above-listed short-term borrowings are as follows:

	2000	1999
Bank overdrafts	5.2%	4.1%
Export financing	-	10.7%

Credit facilities available to the Group, including amounts guaranteed under surety bonds, amounted to approximately 362,000 and 281,000 at December 31, 2000 and 1999, respectively. The unused portion of these facilities amounted to approximately 344,000 and 265,500 at December 31, 2000 and 1999, respectively.

12 Accounts payable-trade

Accounts payable-trade totalling 163,407 and 116,611 at December 31, 2000 and 1999, respectively, represent principally amounts payable for purchases of goods and services in Italy and abroad, and includes 38,848 and 15,663 at December 31, 2000 and 1999, respectively, denominated in foreign currencies.

13 Accounts payable-other

Accounts payable-other are analyzed as follows:

	2000	1999
Withholding taxes on payroll	6,683	6,298
Withholding taxes other	205	129
Cooperative advertising and quantity discount	7,240	7,057
Provision for returns and other discounts	5,220	4,108
Payable to customers for returns and financial discounts	2,399	2,234
Other	766	669
Total	**22,513**	**20,495**

14 Taxes on income

Italian companies are subject to two income taxes:

	2000	1999	1998
IRPEG (state tax)	37.00%	37.00%	37.00%
IRAP (regional tax)	4.25%	4.25%	4.25%

The IRPEG tax is a state tax and it is calculated on the taxable income determined on the income before taxes modified to reflect all temporary and permanent differences regulated by the tax law. In 1997 dual income tax was introduced 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 19.00%. The remaining profit will be subject to tax at the ordinary IRPEG tax rate (at present 37.00%).

On December 23, 2000, the Italian Parliament approved law 388 which reduces IRPEG tax rate from 37.00% to 36.00% for fiscal years beginning on or after January 1, 2001, and from 36.00% to 35.00% for fiscal years beginning on or after January 1, 2003. As a result, the Company adjusted the effect of changes in IRPEG tax rates on net deferred tax assets during the year ended December 31, 2000. These changes in tax rates resulted in a decrease of net deferred tax assets by 156 as of December 31, 2000.

IRAP is a regional tax and each Italian Region has the power to increase the rate of 4.25% by a maximum of 1.00%. In general, the taxable base of IRAP is a form of gross profit determined as the difference between gross revenues (excluding interest and dividend income) and direct production costs (excluding labor costs, interest expenses and other financial costs).

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 a significant part of IRAP for ten years. A very significant portion of the Group's consolidated earnings before minority interest in 2000, 1999 and 1998 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 2000, 1999 and 1998 income tax charge.

Approximately 99.9%, 98.9% and 95.2% respectively, of the Group's consolidated earnings before taxes were generated by its domestic Italian operations during 2000, 1999 and 1998.

The effective income tax rates for the years ended December 31, 2000, 1999 and 1998 were 24.3%, 19.8% and 24.9%, respectively. The actual income tax expense differs from the 'expected' income tax expense (computed by applying the state tax of 37% to income before income taxes and minority interest) as follows:

	2000	1999	1998
Expected income tax charge at full tax rates	74,999	73,744	68,739
Effects of:			
• Tax exempt income	(42,157)	(48,261)	(32,613)
• Aggregate effect of different tax rates in foreign jurisdictions	(62)	(449)	(2,295)
• Tax effect of change in tax rates	(156)	-	-
• Effect of net change in valuation allowance established against deferred tax assets	(301)	226	878
• Non-deductible expenses and others	2,116	2,948	2,803
• Italian regional tax	14,905	11,233	8,823
Actual tax charge	**49,344**	**39,441**	**46,335**

Total taxes for the years ended December 31, 2000, 1999 and 1998 were allocated as follows:

	2000	1999	1998
Earnings from operations	49,344	39,441	46,335
Shareholders' equity, for deferred taxes on government grants (excluding minority interest)	175	-	-
	49,519	**39,441**	**46,335**

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

	2000	1999	1998
Current taxes	46,532	43,133	47,485
Deferred taxes	2,812	(3,692)	(1,150)
Total	**49,344**	**39,441**	**46,335**

Total income taxes for the years ended December 31, 2000, 1999 and 1998 were allocated as follows:

	2000	1999	1998
Italian State tax	34,192	27,746	36,770
Italian Regional tax	14,905	11,233	8,823
Tax of foreign subsidiaries	247	462	742
Total	**49,344**	**39,441**	**46,335**

Tax years for Italian companies are open from 1994 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, 2000 and 1999 are presented below:

	2000	1999
Deferred tax assets:		
• Provision for unrealized foreign exchange losses	-	4,678
• Allowance for doubtful accounts	2,905	3,553
• Provision for returns and discounts	2,057	1,656
• Provision for termination indemnities of sales representatives	1,788	1,741
• Provision for contingent liabilities	1,147	370
• Tax loss carryforwards	824	524
• Other temporary differences	1,856	2,064
Total gross deferred tax assets	10,577	14,586
• Less valuation allowance	(4,552)	(4,962)
Net deferred tax assets	6,025	9,624
Deferred tax liabilities:		
• Government grants related to capital expenditures	(2,631)	(3,286)
• Other temporary differences	(230)	(187)
Total deferred tax liabilities	(2,861)	(3,473)
Net deferred tax assets	**3,164**	**6,151**

Due to changes in Italian tax laws in 2000, provision for unrealized foreign exchange losses are tax deductible.

A valuation allowance has been established principally for the allowance for doubtful accounts, provision for termination indemnities of sales representatives and for contingencies of certain subsidiaries.

The valuation allowance for deferred tax assets as of December 31, 2000 and 1999 was 4,552 and 4,962, respectively. The net change in the total valuation allowance for the years ended December 31, 2000 and 1999 was a decrease of 410 and an increase of 406, respectively. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not than some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and the tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods during which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these deductible differences, net of the existing valuation allowances at December 31, 2000. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced.

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

2000	**Current**	**Non current**	**Total**
Gross deferred tax assets	6,755	3,822	10,577
Valuation allowance	(2,394)	(2,158)	(4,552)
Net deferred tax assets	4,361	1,664	6,025
Deferred tax liabilities	(829)	(2,032)	(2,861)
Net deferred tax assets (liabilities)	3,532	(368)	3,164

1999	**Current**	**Non current**	**Total**
Gross deferred tax assets	11,401	3,185	14,586
Valuation allowance	(2,851)	(2,111)	(4,962)
Net deferred tax assets	8,550	1,074	9,624
Deferred tax liabilities	(799)	(2,674)	(3,473)
Net deferred tax assets (liabilities)	7,751	(1,600)	6,151

The tax loss carryforwards of the Group total 2,288 and expire as follows:

2002	828
2003	439
2004	68
2005	953
Total	**2,288**

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

See note 23 for a description of the tax liability settlement effected in 1999, and note 26(f) for the difference between Italian GAAP and US GAAP in reporting such tax settlement.

15 Salaries, wages and related liabilities

Salaries, wages and related liabilities are analyzed as follows:

	2000	1999
Salaries and wages	10,678	9,747
Social contribution	8,555	6,673
Vacation accrual	2,396	331
Total	**21,629**	**16,751**

16 Long-term debt

Long-term debt is repayable in semi-annual installments with 645, 312 and 161 maturing in the years ended December 31, 2001, 2002 and 2003, respectively. Interest rates on long-term debt range from 3.7% to 7.3% at December 31, 2000 and 1999. All long-term debt is secured by mortgages on the Group's properties for a total of 8,000.

17 Minority interest

Minority interest shown in the accompanying consolidated balance sheet at December 31, 2000 of 1,543 (1,557 at December 31, 1999) includes 58 pertaining to the majority shareholders of the Group (53 at December 31, 1999).

18 Employee stock option plan

In February 1994 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 (U.S. dollars 5.11 at December 31, 2000 exchange rate). 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, of at least 50% plus one share of outstanding shares, to increase its capital and to comply with certain requirements of Italian law, after which the ordinary shares may be delivered. The shareholder approval is considered prefunctory as Mr. Natuzzi and his family own more than 50% of the outstanding shares.

A summary of the status of the Plan as of December 31, 2000, 1999 and 1998, and changes during the years ended on those dates is presented below:

	2000	
	Shares	**Exercise price**
Outstanding at the beginning of the year	56,640	10,637.5
Granted	-	10,637.5
Exercised	(56,640)	10,637.5
Forfeited	-	-
Outstanding at the end of the year	**-**	**10,637.5**
Options exercisable at year-end	-	
Weighted-average remaining contractual life	-	

1999

	Shares	Exercise price
Outstanding at the beginning of the year	56,640	10,637.5
Granted	-	-
Exercised	-	-
Forfeited	-	-
Outstanding at the end of the year	**56,640**	**10,637.5**
Options exercisable at year-end	-	
Weighted-average remaining contractual life	0.42 years	

1998

	Shares	Exercise price
Outstanding at the beginning of the year	636,240	10,637.5
Granted	19,240	10,637.5
Exercised	(590,088)	10,637.5
Forfeited	(8,752)	10,637.5
Outstanding at the end of the year	**56,640**	**10,637.5**
Options exercisable at year-end	-	
Weighted-average remaining contractual life	1.42 years	

The 590,088 Ordinary Shares with respect to which options were exercised in 1998 included 534,448 and 36,400 Ordinary Shares in respect of options granted to employees in 1994 and 1996, respectively, as well as 19,240 Ordinary Shares in respect of options received as a one-time bonus in 1998. In addition, options with respect to 56,640 ordinary shares were exercised in 2000 by employees who received options in 1996.

19 Shareholders' equity

The share capital is owned as follows:

	2000	1999
Mr. Pasquale Natuzzi	45.3%	45.4%
Miss Anna Maria Natuzzi	2.4%	2.4%
Mrs. Annunziata Natuzzi	2.4%	2.4%
Public investors	46.8%	49.8%
Treasury shares	3.1%	-
	100.0%	**100.0%**

An analysis of the reserves follows:

	2000	1999
Treasury shares reserve	44,987	-
Legal reserve	2,151	2,151
Monetary revaluation reserve	2,602	2,065
Governmental grants reserve	58,451	57,813
Total	**108,191**	**62,029**

In July 2000, the shareholders of the Company approved a share repurchase program to buy-back up to 4 million shares or 100,000. As of December 31, 2000, the Company had repurchased 1,782,700 shares at an average price of US$11.3 per share or 44,987. Under Italian GAAP, the purchase of shares was accounted for as a non-current assets and an amount equal to the cost of shares acquired was reclassified from retained earnings to an undistributed treasury shares reserve.

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 20% of the issued share capital of each relevant company. The legal reserve may be utilized to cover losses and the portion which exceeds 20% of the issued share capital is distributable as dividends. The combined legal reserves totalled 7,075 and 7,020 at December 31, 2000 and 1999, respectively.

As of December 31, 2000, taxes that would be due on distribution of the portion of shareholders' equity equal to unremitted earnings of foreign subsidiaries is approximately 400. The Group has not provided for such taxes as the likelihood of distribution is remote and such earnings are deemed to be permanently reinvested.

As of December 31, 2000, there are no taxes due on distribution of the portion of shareholders equity equal to retained earnings and governmental grants reserve.

The cumulative translation adjustment included in shareholders' equity related to translation of the Group's foreign assets and liabilities at December 31, 2000 and 1999 was a credit of 11,886 and 7,605, respectively.

20 Commitments and contingent liabilities

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, 2000, 1999 and 1998 was 1,996, 1,608 and 1,984, respectively. As of December 31, 2000, minimum annual rental commitments are as follows:

2001	1,624
2002	1,534
2003	1,215
2004	1,078
2005	1,037
Thereafter	366
Total	**6,854**

Some banks have provided guarantees at December 31, 2000 to secure the payments to several suppliers of leather and fabric hides amounting to 13,891 (14,927 at December 31, 1999). These guarantees are unsecured and have various maturities extending through December 31, 2001.

VAT reimbursed by tax authorities during 2000 and in prior years is secured by surety bonds for 12,031 (31,731 at December 31, 1999) 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.

In 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 received under the aforementioned project capital grants for 52,549. Capital expenditures under the Natuzzi 2000 project amounted to approximately

163,000 at December 31, 2000 (134,000 at December 31, 1999). 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.

The Italian tax authorities are currently auditing the corporate income tax returns and VAT declarations for the years ended December 31, 2000 and 1999 filed by two subsidiaries enjoying full exemption from IRPEG and IRAP for the aforementioned years.

The Group is also 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.

21 Segmental and geographical information

The Group operates 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 net sales of upholstered furniture analyzed by coverings are as follows:

	2000	1999	1998
Leather upholstered furniture	1,083,768	918,993	913,142
Fabric upholstered furniture	134,730	95,842	81,988
Total	**1,218,498**	**1,014,835**	**995,130**

Within leather and fabric upholstered furniture, the Company offers furniture in the following categories: stationary furniture, sectional furniture, motion furniture, sofa beds and lounge chairs.

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 the location of customers. Long-lived assets consist of property, plant and equipment

Sales of upholstered furniture	2000	1999	1998
United States	569,748	444,344	437,930
Italy	133,746	117,860	94,796
England	83,531	56,318	55,777
Germany	69,993	76,208	75,356
Belgium	42,033	41,378	39,288
Canada	41,596	25,313	21,900
The Netherlands	40,979	38,739	41,632
Australia	24,591	30,894	38,605
France	21,832	16,142	24,329
Other countries (none greater than 5%)	190,449	167,639	165,517
	1,218,498	**1,014,835**	**995,130**

Long lived assets	2000	1999
Italy	189,636	154,323
United States of America	51,060	48,016
Brazil	1,341	-
Total	**242,037**	**202,339**

In addition, the Group also sells minor amounts of excess polyurethane foam, leather by-products and miscellaneous furniture pieces (coffee table, lamps and rugs) which, for 2000, 1999 and 1998 totalled 114,586, 76,854 and 71,043, respectively.

No single customer accounted for more than 5% of net sales in 2000, 1999 or 1998.

22 Cost of sales

Cost of sales is analyzed as follows:

	2000	1999	1998
Opening inventories	103,206	106,546	114,724
Purchases	588,190	419,149	453,415
Labor	169,607	148,417	141,621
Third party manufacturers	69,574	47,557	53,184
Other manufacturing costs	37,440	33,152	35,426
Closing inventories	(142,594)	(103,206)	(106,546)
Total	**825,423**	**651,615**	**691,824**

23 Other income (expense), net

Other income (expense), net is analyzed as follows:

	2000	1999	1998
Interest income	12,750	11,335	14,041
Interest expense and bank commissions	(1,158)	(1,257)	(1,961)
Interest income, net	11,592	10,078	12,080
Gains (losses) on foreign exchange, net	(58,784)	(24,463)	4,445
Unrealized exchange gains (losses) on domestic currency swaps	4,069	(2,545)	(218)
Gains (losses) on foreign exchange	(54,715)	(27,008)	4,227
Gains (losses) on securities, net	-	(2,804)	249
Other, net	821	(12,742)	4,254
Total	**(42,302)**	**(32,476)**	**20,810**

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

	2000	1999	1998
Net realized gains (losses) on domestic currency swaps	(62,259)	(21,088)	418
Net realized gains on accounts receivable and payables	9,818	8,708	1,893
Net unrealized gains (losses) on accounts receivable and payables	(6,343)	(12,083)	2,134
Total	**(58,784)**	**(24,463)**	**4,445**

Other, net consists of the following:

	2000	1999	1998
Tax liabilities settlement	-	(18,190)	-
Employment incentive grants	-	1,457	1,128
Other	821	3,991	3,126
Total	**821**	**(12,742)**	**4,254**

Tax liabilities settlement

During 1998, the Italian tax authorities conducted an audit of the corporate income tax return and VAT declarations for the year ended December 31, 1992 – 1996, of a subsidiary enjoying full exemption from IRPEG and ILOR (regional tax until 1997 and replaced by IRAP effective January 1, 1998) for the aforementioned years. As a result of the audit, the tax authorities concluded that a portion of the taxable income generated by this subsidiary was not eligible for exemption from ILOR and assessed taxes in the amount of Lit 23,0 billion (excluding penalties and interest, estimated to be approximately Lit 14,0 billion). On May 24, 1999, the tax authorities raised additional tax claims on the basis of even more restrictive interpretations of fiscal rules related to such tax exemption. As a consequence, based on the advice of tax counsel, the Company decided to settle the claims, including assessed taxes and penalties, raised by the tax authorities for all open matters with respect to fiscal years 1992 – 1996 for a payment of 18,190. As a result of such settlement, a cost of 18,190 has been charged to consolidated statement of earnings for the year ended December 31, 1999, and was included in other income (expense), net. The table below gives a further breakdown of the tax liabilities settlement:

Income taxes (Ilor)	14,408
VAT	599
Penalties	3,183
Total	**18,190**

Employment incentive grants

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, 1999 and 1998 these incentives amounted 1,457 and 1,128, respectively.

24 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 forward exchange contracts used to hedge principally future cash flows from accounts receivable and sales orders at December 31, 2000 and 1999:

	2000	1999
U.S. dollars	318,271	283,375
British pounds	40,404	36,810
Canadian dollars	25,747	15,112
Australian dollars	18,010	22,385
Japanese yen	12,126	9,130
Swiss francs	3,747	3,437
Greek dracma	-	1,162
Total	**418,305**	**371,411**

At December 31, 2000, these forward exchange contracts had a net unrealized loss of 7,801, of which 11,462 related to accounts receivable, 408 related to existing sales commitments and (4,069) related to anticipated commitments at year-end. The Company recorded all those amounts, except for 408 relating to existing sales commitments.

At December 31, 1999, the forward exchange contracts had a net unrealized loss of 27,815, of which 14,230 related to accounts receivable, 11,040 related to existing sales commitments and 2,545 related to anticipated commitments at year - end. The Company recorded all these amounts, except for 11,040 relating to existing sales commitments.

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 forward exchange contracts. Contracts with unrealized gains are presented as 'assets' and contracts with unrealized losses are presented as 'liabilities'.

	2000		1999	
	Contract amount	**Fair value**	**Contract amount**	**Fair value**
Assets	163,944	6,341	10,971	48
Liabilities	254,361	(14,142)	360,440	(27,863)
	418,305	**(7,801)**	**371,411**	**(27,815)**

25 Fair value of financial instruments

The following table summarizes the carrying value and the estimated fair value of the Group's other financial instruments:

	2000		1999	
	Carrying value	**Fair value**	**Carrying value**	**Fair value**
Assets:				
• Marketable debts securities	51	51	50	50
Liabilities:				
• Long-term debt	1,118	1,070	2,315	2,248

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 forward exchange contracts is determined based on the unrealized loss and gain of such contracts recorded in the consolidated financial statements. Fair value of forward exchange contracts is determined by using exchange rates at year-end.

26 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 a material effect on net earnings and/or shareholders' equity are as follows:

(a) Certain property, plant and equipment have 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 Company in connection with its hedging activities employing forward exchange contracts defers net unrealized foreign exchange gains and losses related 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 forward exchange contracts not designated to cover accounts receivable or future sales commitments are recognized in earnings. See notes 3 (a) and (b) 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 consolidated 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 forward exchange 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 forward exchange 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 consolidated 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 2000, 1999 and 1998 the Company recorded a charge of 321, 307 and 1,322, respectively.

(f) Included in other income (expense), net in the consolidated statement of earnings for the year ended December 31, 1999 is the cost of a tax liability settlement (see note 23) as indicated below:

Income taxes (Ilor)	14,408
VAT	599
Penalties	3,183
Total	**18,190**

Under US GAAP, the cost of 14,408 would be classified as income taxes. As a consequence, "earnings before taxes and minority interest" and "income taxes" in the consolidated statement of earnings for the year ended December 31, 1999 would be 213,716 and 53,849, respectively.

(g) As indicated in note 19, during 2000 the Company repurchased its ordinary shares for a cash consideration of 44,987. Under Italian GAAP, the purchase of these shares was accounted for as non-current assets and under US GAAP, the cost of the acquired shares is reflected as a reduction from shareholders’ equity.

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

Reconciliation of net earnings:

	2000	1999	1998
Net earnings under Italian GAAP	153,265	159,562	139,299
Adjustments to reported income:			
(a) Revaluation of property, plant and equipment	103	78	77
(b) Marketable debt securities	-	-	(76)
(c) Unrealized gains (losses) on foreign exchange	4,268	(12,789)	8,398
(d) Government grants	2,993	2,917	3,782
(e) Employee share option compensation	(321)	(307)	(1,322)
Effect of minority interests on US GAAP adjustments	(2)	(2)	(2)
Tax effect of US GAAP adjustments	(2,034)	4,262	(3,776)
Approximate net earnings in conformity with US GAAP	**158,272**	**153,721**	**146,380**
Basic earnings per share in conformity with US GAAP	**2,772**	**2,675**	**2,558**
Diluted earnings per share in conformity with US GAAP	**2,772**	**2,675**	**2,557**

Reconciliation of shareholders' equity:

	2000	1999
Shareholders' equity under Italian GAAP	709,551	732,173
(a) Revaluation of property, plant and equipment	(1,541)	(784)
(c) Unrealized losses on foreign exchange	(239)	(4,507)
(d) Government grants	(43,432)	(45,612)
(g) Treasury shares	(44,987)	-
Effect of minority interests on US GAAP adjustments	4	6
Tax effect of US GAAP adjustments	3,936	5,472
Approximate shareholders' equity in conformity with US GAAP	**623,292**	**686,748**

Accounting for Stock-Based Compensation

The Company has elected to continue to apply the provisions of Accounting Principles Board ('APB') Opinion No. 25, Accounting for Stock Issued to Employees, and provide the pro forma disclosure provisions of SFAS No. 123, Accounting for Stock-Based Compensation. 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 assumptions: 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, 2000, 1999 and 1998 would approximate the actual amounts presented in the reconciliation.

Comprehensive Income

The Company has adopted SFAS No. 130, Reporting Comprehensive Income, which established standards for the reporting and presentation of comprehensive income and its components in a full set of financial statements. Comprehensive income/(loss) generally encompasses all changes in shareholders' equity (except those arising from transactions with owners). The Company's comprehensive income differs from net income only by the amount of the exchange differences on translation of financial statements charged to shareholders' equity for the period. Comprehensive income and accumulated other comprehensive income for the years ended December 31, 2000, 1999 and 1998 were as follows:

	Comprehensive income	Accumulated other comprehensive income
Beginning balance	**-**	**3,032**
Comprehensive income		
Net earnings under US GAAP	146,380	
Exchange difference on translation of financial statements	(2,860)	(2,860)
Total comprehensive income	**143,520**	
Balance at December 31, 1998		**172**
Comprehensive income		
Net earnings under US GAAP	153,721	
Exchange difference on translation of financial statements	7,433	7,433
Total comprehensive income	**161,154**	
Balance at December 31, 1999		**7,605**
Comprehensive income		
Net earnings under US GAAP	158,272	
Exchange difference on translation of financial statements	4,281	4,281
Total comprehensive income	**162,553**	
Balance at December 31, 2000		**11,886**

Accounting Standards Issued not yet adopted

SFAS No. 133:

Statement of Financial Accounting Standards (SFAS) No. 133 “Accounting for Derivative Instrument for Hedging Activities” as amended by SFAS No. 137, “Accounting for Derivative Instrument Hedging Activities-Deferral of Effective Date of FASB Statement No, 133” and SFAS No. 138, “Accounting for Certain Derivative Instrument and Certain Hedging Activities”, (together SFAS 133), is effective for the Company as of January 1, 2001.

SFAS 133 established comprehensive accounting and reporting standards for derivative instruments and hedging activities. SFAS 133 requires that an entity record all freestanding derivatives and certain embedded derivatives, as either assets or liabilities in the statement of financial position. This statement also defines and allows companies to apply hedge accounting to its designated derivatives under certain instances, provided an entity meets the strict documentation criteria of SFAS 133. It also requires that all derivatives be marked to market on an ongoing basis. Along with the derivatives, in the case of qualifying hedges, the underlying hedged items, are also to be marked to market. These market value adjustments are to be included either in the income statement or other comprehensive income, depending on the nature of the hedged transaction.

The Company will adopt SFAS 133 on January 1, 2001 and record its derivatives, on that date, at fair market value as a cumulative effect of a change in accounting principle in the year ending December 31, 2001. Based on managements review, the Company will not currently qualify for hedge criteria under SFAS 133. As a result, the Company will account for all its derivative financial instruments at their fair value with all prospective changes reported in the US GAAP net earnings.

Adoption of SFAS 133 will result in cumulative after tax expense of approximately 11,700 to the US GAAP net earnings. Adoption will also impact US GAAP shareholders' equity, and may have a material effect on future US GAAP net earnings.

SFAS No. 140:

In September 2000, the FASB issued SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, which replace SFAS No. 125. The Statement revised the standards of accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures. SFAS No. 140 is effective for recognition and reclassification of collateral for fiscal years ending after December 15, 2000, with restatement required for previous periods for comparative purposes. Disclosures about securitization and collateral accepted need not be reported for period ending on or before December 15, 2000, for which financial statements are presented for comparative purposes. SFAS No. 140 is effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after March 31, 2001. Application of this statement will not have a significant impact on the financial statements of the Company.

27 Subsequent event

Effective January 1, 2001, Natuzzi Americas, Inc., a 100% subsidiary of the Company located in North Carolina, USA, changed from operating as an exclusive sales and collection agent for the Company to becoming an exclusive distributor of the Company's products in USA. Consequently, revenues in 2001 for USA will be recognized at the time of shipment of Company's products from Natuzzi Americas, Inc.

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Giambattista Massaro	Director
Gianluca Monteleone	Director
Stelio Campanale	Director
Armando Branchini	Outside Director
Claudio Dematté	Outside Director
Pietro Gennaro	Outside Director
Giuseppe Russo Corvace	Outside Director
Cataldo Sferra	Outside Director
Enrico Vitali	Outside Director

Management *(At June 30, 2001)*

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Stelio Campanale	General Counsel
Giuseppe Catalano	Legal Affairs Manager
Giovanni Costantino	Vice President of Research & Development, Industrialization and Quality
Vito Dagostino	Purchasing Manager
Gaetano De Cataldo	Executive Vice President for Natuzzi Americas
Nicola Dell'Edera	Finance Manager
Gaetano Del Re	Production Engineering Manager
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Giuseppe Firrao	Communication Manager
Cesare Laberinti	Manager of Polyurethane Foam Operations IMPE Company
Valeria Lanzillotta	Sales Manager Asia Pacific
Nicola Lassandro	Manager of Management Information Systems
Stefano Lorizio	Production Manager
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Bruno Mele	Global Product Manager
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Vito Testini	Production Manager-Italsofa Bahia
Giuseppe Trevissoi	Logistics Manager
Emanuele Valente	Transportation Manager
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Board of Internal Auditors

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Independent Auditors

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