NATUZZI

2003 ANNUAL REPORT

FINANCIAL HIGHLIGHTS

twelve months ended December 31, 2003
(Italian GAAP)

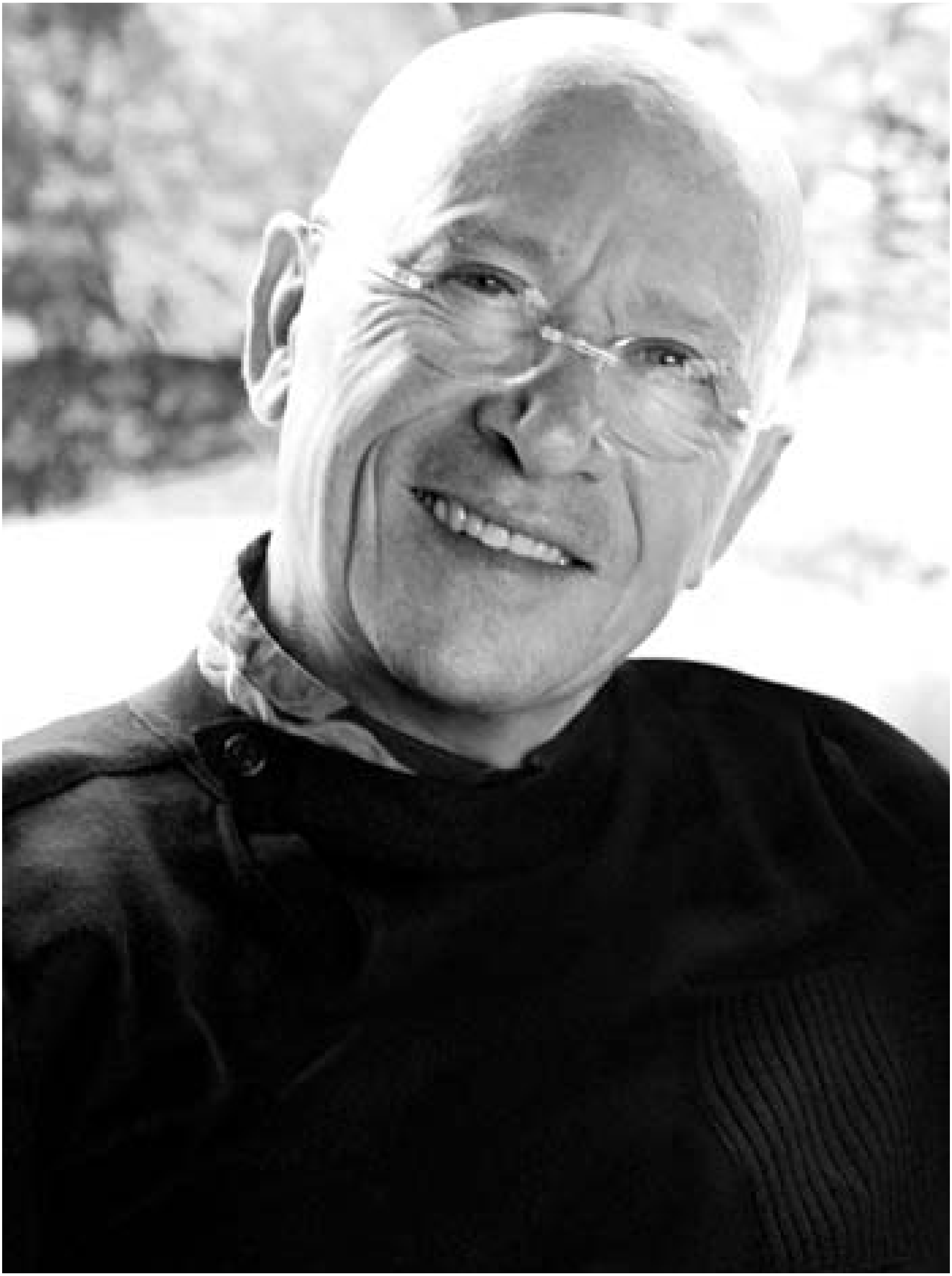
		2003		2002		Change %		2003		2002
		Euro millions (except as otherwise indicated)						USD millions (except as otherwise indicated)		
Net Sales		769,6	100,0%	805,1	100,0%	-4,4%	(b)	969,4		761,5
Gross Profit		260,8	33,9%	287,7	35,7%	-9,4%	(b)	328,5		272,1
Operating Income		42,3	5,5%	101,8	12,6%	-58,4%	(b)	53,2		96,3
Net Income		37,3	4,8%	91,4	11,4%	-59,2%	(b)	47,0		86,5
Net Income per ADS (a)	(€)	0,68		1,67		-59,3%	$ (b)	0,86		1,58
Cash Dividend per ADS (a)	(€)	0,14		0,33		-57,6%	$ (b)	0,17	$ (c)	0,35
Debt		10,3		5,2			(b)	13,0		5,5
Long-term Debt		4,2		3,6			(b)	5,3		3,7
Short-term Debt		6,1		1,6			(b)	7,7		1,7
Stockholders' Equity		515,1		495,8			(b)	648,9		519,8
Shares Outstanding		(#) 54,681,628		(#) 54,681,628						

(a) Each Natuzzi American Depositary Share (ADS) represents one Ordinary Share		
(b) Noon Buying Rate on December 31	1,2597	1,0485
(c) Noon Buying rate on the date dividends were paid		0,9904

Quarterly Stock Price - Price per ADS

(Amount in USD)

	2003		2002		2001	
	High	Low	High	Low	High	Low
First	10,05	7,24	15,70	13,91	14,05	12,13
Second	9,60	7,99	16,10	13,35	14,15	11,50
Third	10,39	7,82	15,04	10,92	14,00	10,15
Fourth	11,00	9,46	10,97	9,12	14,64	10,86
Full Year	11,00	7,24	16,10	9,12	14,64	10,15



LETTER FROM THE CHAIRMAN |

Chairman of the Board of Directors

Dear Shareholders,

As expected, 2003 was a difficult year for the worldwide economy. Consumer confidence was extremely low. The fall in demand has led to further price competitiveness from manufacturers located in countries where operating costs are lower. Extremely volatile exchange rates, along with a much stronger euro against the US dollar and primary currencies for our exports, have exacerbated these negative factors. In 2003 we reported consolidated revenues of 769.6 million euros, 4.4% less than the previous year. Net profits fell by 59.2% due to the business environment and larger investments in marketing, advertising and the opening of new Natuzzi sales points throughout the world.

Our strategy going forward is to strengthen the Natuzzi brand and increase our market share in the promotional segment through the Italsofa line. In 2003 our investments have been concentrated on three strategic assets: product, point of sale and brand communication. Product know-how is a strong point for our Group. Investments made in developing new models and the introduction of new materials and colours, have allowed us to assert our leadership and our style credentials in the market place. Our offer is increasingly characterised by the coordinated living room, designed and furnished entirely with Natuzzi products. This concept is developed in the Natuzzi Style Centres of Santeramo and Milan, the creative hub of our company. During 2003 investments in this area reached 10 million euros.

The development and management of the point of sale is a natural evolution of the work carried out by Research & Development. To reflect the brand values to the consumer, the product must be presented in the best possible setting. To this end, Group investments of 15 million euros in 2003 were aimed at qualifying the existing distribution network and at developing 39 more Natuzzi Stores and 256 Galleries worldwide. In 2003 the positive trend of sales per square metre in our new spaces dedicated to the Natuzzi brand name was confirmed. These positive results add more weight to the Gallery development programme, which will continue in 2004 with 100 new openings around the world. Moreover 40 new Natuzzi Stores will also be opened in strategic locations. The new Stores and Galleries give us the perfect opportunity *to continue investing in new Natuzzi international advertising campaigns focused on the consumer. In 2003 investment in advertising totalled 29 million euros.*

Special attention should be focused on Italsofa, the range of promotional sofas and armchairs introduced in late 2000 and produced in the Group's foreign factories in China, Brazil and Romania. In just three years of activity Italsofa has achieved a turnover of 141 million euros, with an increase of 12.5% in 2003. Sales in units are much higher with an increase of 30.5% over 2002, confirming the positive market reaction especially from American dealers. In order to sustain the growth of Italsofa, extension work, with the aim of increasing production capacity, continued at the plants in Salvador de Bahia (Brazil) and Baiamare (Romania) and work began on the construction of a new plant in Shanghai (China) that will be operational from the second half of 2004. 18 million euros have been invested in these projects.

The Company's 2003 initiatives, with investments totalling 72 million euros, are in line with the Natuzzi brand project and confirm our commitment to further expand and strengthen our presence in the international market in terms of sales and production, with the goal of consolidating our leadership and making sales and profits more stable over time. Our Group's competitive challenge lies in innovation, internationalization, the creation of Natuzzi brand value, lower costs and greater efficiency at all levels. I am convinced that the correct application of this strategy requires a deep awareness and a huge sense of responsibility within each Natuzzi employee. Today, more than ever, in order to successfully operate in the global market, it is important to rely on competent and efficient personnel who share the same values and believe in the Company's mission. With this in mind, we have developed our Group's code of ethics, which continues to recognise our values, our integrity and our respect for customers, employees and shareholders, the foundations upon which our Company is based. In this development your faith in us is a key factor and a vital requirement in supporting our company programmes and continuing to develop brand values. While I am aware of the difficulties that we may encounter in the new competitive scenario, I am confident that investments underway, the financial strengths of our Group and the experience acquired within international markets in 45 years of intensive work will allow us to continue our mission and make design, quality and luxury easily accessible to all.

Pasquale Natuzzi
Chairman of the Board of Directors

KPMG

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Report of Independent Public Accounting Firm

To the Shareholders of
Natuzzi S.p.A.

We have audited the accompanying consolidated balance sheets of Natuzzi S.p.A. and subsidiaries (the 'Natuzzi Group') as of December 31, 2003 and 2002 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, 2003. These consolidated financial statements are the responsibility of the management of Natuzzi S.p.A.. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the Republic of Italy and in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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, 2003 and 2002 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2003, 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. Information relating to the nature and effect of such differences is presented in note 26 to the consolidated financial statements.

KPMG S.p.A

Bari, Italy
March 26, 2004

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2003 AND 2002

Expressed in thousands of euros

ASSETS	December, 31 2003	December, 31 2002
Current assets:		
Cash and cash equivalents (note 4)	63,565	96,695
Marketable debt securities (note 5)	5	26
Trade receivables, net (note 6)	154,501	158,398
Other receivables (note 7)	58,157	58,337
Inventories (note 8)	97,518	84,081
Unrealized foreign exchange gains (note 24)	6,276	2,021
Prepaid expenses and accrued income	2,143	1,240
Deferred income taxes (note 14)	955	1,822
Total current assets	383,120	402,620
Non current assets:		
Property plant and equipment (note 9 and 21)	360,846	310,253
Less accumulated depreciation (note 9 and 21)	(106,653)	(81,361)
Net property, plant and equipment	254,193	228,892
Treasury shares (note 19)	37,828	37,828
Other assets (note 10)	17,087	5,052
Deferred income taxes (note 14)	166	93
Total assets	692,394	674,485

See accompanying notes to the consolidated financial statements

LIABILITIES AND SHAREHOLDERS' EQUITY	December, 31 2003	December, 31 2002
Current liabilities:		
Short-term borrowings (note 11)	4,770	162
Current portion of long-term debt (note 16)	1,291	1,437
Accounts payable-trade (note 12)	80,913	87,551
Accounts payable-other (note 13)	17,858	15,658
Income taxes (note 14)	4,258	9,195
Salaries, wages and related liabilities (note 15)	16,091	14,708
Total current liabilities	125,181	128,711
Long-term liabilities:		
Employees' leaving entitlement (note 3 (n))	27,587	25,577
Long-term debt (note 16)	4,218	3,574
Deferred income taxes (note 14)	376	371
Deferred income for capital grants (note3 (m))	13,359	14,229
Other liabilities (note 17)	5,716	5,716
Minority interest (note 18)	894	499
Shareholders' equity (note 19):		
Share capital	57,526	57,526
Reserves	80,236	73,071
Additional paid-in capital	8,282	8,282
Retained earnings	369,019	356,929
Total shareholders' equity	515,063	495,808
Commitments and contingent liabilities (notes 20 and 24)	-	-
Total liabilities and shareholders' equity	692,394	674,485

See accompanying notes to the consolidated financial statements

CONSOLIDATED STATEMENTS OF EARNINGS YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001

Expressed in thousands of
euros except per share data

	2003	2002	2001
Net sales (note 21)	769,579	805,143	786,148
Cost of sales (note 22)	(508,764)	(517,423)	(520,089)
Gross profit	260,815	287,720	266,059
Selling expenses	(179,282)	(145,378)	(134,840)
General and administrative expenses	(39,205)	(40,532)	(33,456)
Operating income	42,328	101,810	97,763
Other income (expense), net (note 23)	3,631	14,551	(225)
Earnings before taxes and minority interest	45,959	116,361	97,538
Income taxes (note 14)	(8,501)	(24,997)	(21,901)
Earnings before minority interest	37,458	91,364	75,637
Minority interest	(158)	74	20
Net earnings	37,300	91,438	75,657
Basic and diluted earnings per share (note 3(u))	0.68	1.67	1.37

See accompanying notes to the consolidated financial statements

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001

Expressed in thousands of
euros except number of ordinary shares

	Share capital					
	Nunber of ordinary shares	Amount	Reserves	Additional paid-in capital	Retained earnings	Total
Balances at December 31, 2000	55,742,828	3,714	55,876	8,282	298,580	366,452
Dividends distributed	-	-	-	-	(15,894)	(15,894)
Exchange difference on translation of financial statements	-	-	-	-	2,247	2,247
Treasury shares acquired (note 19)	(1,061,200)	-	14,594	-	(14,594)	-
Increase of share capital (note 19)	-	53,812	-	-	(53,812)	-
Other transfers	-	-	(113)	-	113	-
Net earnings	-	-	-	-	75,657	75,657
Balances at December 31, 2001	54,681,628	57,526	70,357	8,282	292,297	428,462
Dividends distributed	-	-	-	-	(15,705)	(15,705)
Exchange difference on translation of financial statements	-	-	-	-	(8,387)	(8,387)
Transfer to legal reserve	-	-	2,714	-	(2,714)	-
Net earnings	-	-	-	-	91,438	91,438
Balances at December 31, 2002	54,681,628	57,526	73,071	8,282	356,929	495,808
Dividends distributed	-	-	-	-	(18,045)	(18,045)
Transfer to legal reserve	-	-	7,375	-	(7,375)	-
Transfer for liquidation of subsidiary	-	-	(210)	-	210	-
Net earnings	-	-	-	-	37,300	37,300
Balances at December 31, 2003	54,681,628	57,526	80,236	8,282	369,019	515,063

See accompanying notes to the consolidated financial statements

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001

Expressed in thousands of euros

Cash flows from operating activities:	2003	2002	2001
Net earnings	37,300	91,438	75,657
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	27,221	16,867	13,292
Employees' leaving entitlement	6,776	7,091	6,293
Deferred income taxes	799	401	(310)
Minority interest	158	(38)	(20)
(Gain) loss on disposal of assets	814	30	(101)
Unrealized foreign exchange losses and gains	(264)	(2,923)	3,003
Deferred income for capital grants	(870)	194	3,993
Change in assets and liabilities:			
Receivables, net	5,096	(23,898)	(11,538)
Inventories	(7,251)	3,814	(14,252)
Prepaid expenses and accrued income	(903)	(322)	(632)
Other assets	(2,122)	(2,524)	(1,373)
Accounts payable	(18,370)	5,565	893
Income taxes	(5,041)	3,563	1,837
Salaries, wages and related liabilities	1,383	1,114	2,423
Other liabilities	(1,719)	1,024	443
Employees' leaving entitlement	(4,766)	(3,781)	(3,878)
Total adjustments	941	6,177	73
Net cash provided by operating activities	38,241	97,615	75,730

Cash flows from investing activities:	2003	2002	2001
Property, plant and equipment:			
Additions	(47,259)	(68,653)	(69,146)
Disposals	762	242	558
Government grants received	3,119	10,042	396
Marketable debt securities:			
Purchases	-	-	(1)
Proceeds from sales	21	1	-
Purchase of business and assets	(6,482)	-	(60)
Purchase of minority interest	-	(123)	(33)
Net cash used in investing activities	(49,839)	(58,491)	(68,286)

Cash flows from financing activities:			
Long-term debt:			
Proceeds	1,970	2,166	4,022
Repayments	(1,739)	(1,421)	(333)
Short-term borrowings	299	(134,315)	131,769
Purchase of treasury shares	-	-	(14,594)
Dividends paid to shareholders	(18,045)	(15,705)	(15,894)
Dividends paid to minority interests	(26)	-	-
Capital contribution of minority interest	-	-	576
Net cash provided by (used in) financing activities	(17,541)	(149,275)	105,546
Effect of translation adjustments on cash	(3,991)	(1,354)	609
Increase (decrease) in cash and cash equivalents	(33,130)	(111,505)	113,599
Cash and cash equivalents, beginning of the year	96,695	208,200	94,601
Cash and cash equivalents, end of the year	63,565	96,695	208,200

Supplemental disclosure of cash flow information:			
Cash paid during the year for interest	606	3,588	3,199
Cash paid during the year for income taxes	24,955	20,188	24,343

See accompanying notes to the consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Expressed in thousands of euros, except as otherwise indicated

1 DESCRIPTION OF BUSINESS AND GROUP COMPOSITION

The consolidated financial statements include the accounts of 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, 2003, together with the related percentages of ownership, are as follows:

Name	Percent of ownership	Registered office	Activity
Spagnesi SpA	99.95	Quarrata, Italy	(1)
Italsofa Bahia Ltda	97.99	Bahia, Brazil	(1)
Italsofa (Shanghai) Ltd	100.00	Shanghai, China	(1)
Italsofa Romania Srl	100.00	Baia Mare, Romania	(1)
Minuano Nordeste S.A.	100.00	Pojuca, Brazil	(1)
Natco SpA	99.99	Santeramo in Colle, Italy	(2)
I.M.P.E. SpA	90.83	Qualiano, Italy	(3)
Natuzzi Americas, Inc	100.00	High Point, NC, U.S.A.	(4)
Natuzzi Asia Ltd	100.00	Hong Kong, China	(4)
Natuzzi Ibérica S.A.	100.00	Madrid, Spain	(4)
Natuzzi (Switzerland) AG	97.00	Dietikon, Switzerland	(4)
Natuzzi Nordic A/S	100.00	Copenhagen, Denmark	(5)
Natuzzi Benelux NV	100.00	Herentals, Belgium	(5)
Natuzzi Germany GmbH	100.00	Düsseldorf, Germany	(5)
Castelgate 170 Ltd	100.00	West Thurrock, U.K.	(6)
Esmeralda Holdings Ltd	100.00	West Thurrock, U.K.	(4)
Kingdom of Leather Ltd	100.00	West Thurrock, U.K.	(4)
Natuzzi Trade Service Srl	100.00	Bari, Italy	(7)
Natuzzi Netherlands Holding NV	100.00	Amsterdam, Netherlands	(6)

(1) Manufacture and distribution

(2) Intragroup leather dyeing and finishing

(3) Production and distribution of polyurethane foam

(4) Distribution

(5) Commercial and marketing services

(6) Investment holding

(7) Services

In January 2003 the Company incorporated a new subsidiary, Natuzzi Benelux S.A., which provides sales support for the Group in Belgium, Holland and Luxembourg.
On May 7, 2003 the Company acquired 100% of the outstanding common shares of Castelgate 170 Ltd., based in London, ultimate parent company of the Kingdom of Leather Group (KOL or KOL Group), a leading UK upholstered furniture specialist with a network of 15 stores, mainly located in England. The primary reason for this acquisition was the opportunity to increase market share in the United Kingdom. The factors that contributed to the determination of the price are the presence of stores in key geographic locations and the presence of a well-placed sales force. The acquisition was accounted for using the purchase method and it resulted in a goodwill of 9,179, which represents the excess of purchase price over fair value of net liabilities assumed. The following table summarizes the estimated fair value of the assets acquired and the liabilities assumed at date of acquisition.

Current assets	10,324
Goodwill	9,179
Other non current assets	3,008
Current liabilities	(17,911)
Non current liabilities	(267)
Purchase price	4,333

In addition, the following table summarizes the consolidated statements of earnings of the KOL Group for the years ended December 31, 2003 and 2002.

	2003	**2002**
Net sales	40,483	47,615
Cost of sales	(21,730)	(23,552)
Gross profit	18,753	24,063
Selling expenses	(19,770)	(19,938)
General and administrative expenses	(4,957)	(4,869)
Operating loss	(5,974)	(744)
Other income, net	1,828	(711)
Loss before taxes	(4,146)	(1,455)
Income taxes	-	-
Net loss	(4,146)	(1,455)

On October 6, 2003 the Company acquired 100% of the shares of Minuano Nordeste SA (Minuano), at a price of 4,298, of which 2,149 was paid in cash, with the balance to be paid in instalments before the end of 2006. At December 31, 2003 this payable is included in other liabilities (see notes 13 and 17). The main reason of the acquisition is that the enterprise acquired signed an agreement with the Brazilian government whereby it will enjoy certain export incentives until 2015. At the time of the acquisition the subsidiary was dormant. During the first few months of 2004 the subsidiary has started to build new facilities for the production of leather upholstery furniture labelled “Italsofa”. The acquisition resulted in a goodwill of 4,053, which represents the excess of purchase price over fair value of acquired net assets. The fair value of assets acquired and liabilities assumed were as follows:

Current and non current assets	253
Goodwill	4,053
Current and non current liabilities	(8)
Purchase price	4,298

In an effort to maximize the efficiency of the Group’s organizational structure, at an extraordinary general meeting held on July 15, 2002, the Company’s shareholders approved the merger of Creazioni Ellelle S.p.A., Divani e Poltrone Italia S.r.l., Expan Italia S.r.l., Nagest S.r.l., Softaly S.r.l., Soft Cover S.r.l. and Spagnesi International S.r.l. into the Company (the Company owned 100% of the share capital of all these companies prior to the merger). The merger became effective on January 1, 2003. During 2003 the subsidiaries Italsofa Hong-Kong Ltd, D.L.S. S.r.l., Natuzzi Argentina, Finat Ltd and Natex S.r.l. were wound up. During 2002, the Company set up a subsidiary in Denmark, Natuzzi Nordic, which is engaged in the distribution of the Company’s products in the Scandinavian countries. During 2002, the Company acquired part of minority interest (20%) of Natuzzi Switzerland AG for a consideration of 123 in cash. Goodwill arising from that acquisition amounted to 97. During 2001, the Company acquired all the minority interest of Divani e Poltrone Italia S.r.l. (0.02%) and Expan S.r.l. (1%) for a consideration of 33 in cash. During 2001, the Company acquired 100% of Natuzzi Iberica S.A. and 60% of Natuzzi Switzerland AG, for cash consideration of 60. Goodwill arising from that acquisition amounted to 431. In 2001 and 2000 the Company incorporated subsidiaries in Romania, Brazil and China. At December 31, 2003 these subsidiaries are engaged in the production of leather upholstery furniture labelled “Italsofa”.

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, 2003, 2002 and 2001. The 2002 and 2001 financial statements have been approved by the respective shareholders of the relevant companies. The 2003 financial statements have been approved only by the directors of the respective companies. The financial statements of subsidiaries are adjusted, where necessary, to conform to Natuzzi's accounting principles and policies, 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 Financial Reporting Standards issued by the International Accounting Standards Board (IASB). 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. Information relating to the nature and effect of such differences is presented 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. All intercompany balances and transactions are eliminated in consolidation. On January 1, 2002, the Company adopted the euro as its reporting currency and therefore the accompanying consolidated balance sheet as of December 31, 2003 and 2002, consolidated statement of earnings, consolidated statements of changes in shareholders' equity and consolidated statement of cash flows for the years ended December 31, 2003, 2002 are presented in euros. All consolidated financial statements for each period presented prior to January 1, 2002 have been restated into euros using the official lira-euro exchange rate fixed as of January 1, 1999 (euro 1 is equal to lire 1,936.27). Due to the fixed lira-euro exchange rate, Company's restated consolidated financial statements will depict the same trends as would have been presented if it had continued to present its consolidated financial statements in Italian lire. Natuzzi consolidated financial statements, however, will not be comparable to the euro consolidated financial statements of other companies that previously reported their financial statements in a currency other than lira because of currency fluctuations between the lira and other currencies.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

a FOREIGN CURRENCY TRANSACTIONS

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. Foreign exchange gains and losses resulting from the remeasurement of these assets and liabilities are included in other income (expense), net, in the consolidated statements of earnings. Until December 31, 2002 receivables being hedged by forward exchange contracts were remeasured using the related forward exchange rate. Foreign exchange gains and losses resulting from the remeasurement of hedged receivables were recognized in other income (expense), net, in the consolidated statements of earnings.

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. As from January 1, 2003 the Company adopted a close interpretation of methods for documenting all relationships between its hedging instruments (domestic currency swaps) and its hedged items. As a consequence of this, effective January 1, 2003 forward exchange contracts are not used to hedge any on – or off-balance sheet items. Therefore, at December 31, 2003 all unrealized gains or losses on such contracts are recorded in other income (expense), net, in the consolidated statements of earnings. Until December 31, 2002, the accounting for forward exchange contracts, depending on their use, was as follows:

- Forward exchange contracts used to hedge accounts receivable were 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 were recorded within other income (expense), net, in the consolidated statements of earnings.
- Forward exchange contracts were used to hedge future sales if the sales were supported by sales orders and customer's indications of future purchases as of the balance sheet date which were 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 were deferred.
- Unrealized gains and losses on forward exchange contracts not hedging any on-or off-balance sheet items were recorded in other income (expense), net, in the consolidated statements of earnings. The change in the application of this accounting principle had an immaterial impact on the consolidated statement of earnings for the year ended December 31, 2003.

c FINANCIAL STATEMENTS OF FOREIGN OPERATIONS

The Group's foreign subsidiaries are considered an integral part of the Company due to various factors including significant intercompany transactions, financing, and cash flow indicators. Therefore, the functional currency for these foreign subsidiaries is the functional currency of the parent, namely the euro. As a result all monetary assets and liabilities are remeasured, at the end of each reporting period, using euro and the resulting gain or loss is recognized in the consolidated statements of earnings. For all non monetary assets and liabilities, share capital and retained earnings historical exchange rates are used. The average exchange rates during the year is used for revenues and expenses, except for those revenues and expenses related to assets and liabilities translated at historical exchange rates.

d CASH AND CASH EQUIVALENTS

The Company classifies as cash and cash equivalents cash on hand, amounts on deposit and on account in banks and cash invested temporarily in various instruments with maturities of three months or less at time of purchase.

e 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 (expense), 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 expense, 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.

f ACCOUNTS RECEIVABLE AND PAYABLE

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

g 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) and replacement cost. Goods in process and finished goods are valued at the lower of production cost and net realizable value.

h PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is stated at historical cost, except for certain 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). The related deprecation expense is allocated to cost of goods sold, selling expenses and general and administrative expenses based on the usage of the assets.

i TREASURY SHARES

Treasury shares are accounted for as a non-current assets and an amount equal to the cost of shares acquired is reclassified from retained earnings to an undistributed treasury shares reserve (see note 19). Treasury shares are stated at cost and when a permanent impairment loss exists at the balance sheet date a valuation allowance is established and recorded as a charge to other income (expense), net.

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

k IMPAIRMENT OF LONG-LIVED ASSETS AND LONG-LIVED ASSETS TO BE DISPOSED OF

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. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

l 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.

m GOVERNMENT GRANTS

Capital grants compensate the Group for the partial cost of an asset and 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. 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. Until December 31, 2000 capital grants were recorded, net of tax, within reserves in shareholders' equity. As from January 1, 2001 all new capital grants are recorded in the consolidated balance sheet initially as deferred income and subsequently recognized in the consolidated statement of earnings as revenue on a systematic basis over the useful life of the related asset. At December 31, 2003 and 2002 the deferred income for capital grants amounts to 13,359 and 14,229, respectively. Cost reimbursement grants relating to training and other personnel costs are credited to income when received from government agencies.

n EMPLOYEES' LEAVING ENTITLEMENT

Leaving entitlements represent amounts accrued for each Italian employee that are due and payable upon termination of employment determined in accordance with applicable labour laws. The Group accrues the full amount of employees' vested benefit obligation as determined by such laws for leaving entitlements. The expense recorded for the leaving entitlement for the years ended December 31, 2003, 2002 and 2001 was 6,776, 7,091 and 6,293, respectively. The number of workers employed by the Group totalled 6,230 and 5,742 at December 31, 2003 and 2002, respectively.

o NET SALES

The Company recognizes revenue on sales at the time products are shipped from the manufacturing facilities, and 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 reasonably 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 volumes of homogeneous transactions and historical experience.

p SHIPPING AND HANDLING COSTS

Shipping and handling costs incurred to transport products to customers are included in selling expenses. Shipping and handling expenses recorded for the years ended December 31, 2003, 2002 and 2001 were 68,194, 65,338 and 66,114, respectively.

q ADVERTISING COSTS

Advertising costs are expensed in the periods incurred. Advertising expenses recorded for the years ended December 31, 2003, 2002 and 2001 were 32,114, 23,578 and 19,597, respectively.

r 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.

s 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.

t 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.

u 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 after considering the effect of outstanding treasury shares. The Company does not have any dilutive instruments (such as stock options). Therefore, basic earnings per share is equal to diluted earnings per share. The following table provides the amounts used in the calculation of earnings per share:

	2003	2002	2001
Net earnings attributable to ordinary shareholders	37,300	91,438	75,657
Weighted-average number of ordinary shares outstanding during the year	54,681,628	54,681,628	55,027,496

4 CASH AND CASH EQUIVALENTS

Cash and cash equivalents are analyzed as follows:

	2003	2002
Cash on hand	503	59
Bank accounts in Euro	6,217	32,308
Bank accounts in foreign currency	56,524	63,687
Money market instruments	321	641
Total	63,565	96,695

5 MARKETABLE DEBT SECURITIES

Details regarding marketable debt securities are as follows:

	2003	2002
Foreign corporate bonds	5	6
Italian government bonds	-	20
Total	5	26

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

2003		Gross unrealized		Fair
	Cost	Gains	Losses	value
Foreign corporate bonds	5	-	-	5
Italian government bonds	-	-	-	-
Total	5	-	-	5

2002		Gross unrealized		Fair
	Cost	Gains	Losses	value
Foreign corporate bonds	6	-	-	6
Italian government bonds	20	-	-	20
Total	26	-	-	26

	2003	2002	2001
Proceeds from sales	21	-	-
Realized gains	-	-	-
Realized losses	-	-	-

The contractual maturity of the Group's marketable debt securities at December 31, 2003 is between 1 – 5 years.

6 TRADE RECEIVABLES, NET

Trade receivables are analyzed as follows:

	2003	2002
North American customers	57,730	63,169
Other foreign customers	52,472	57,854
Domestic customers	45,723	38,241
Trade bills receivable	4,238	3,861
Total	160,163	163,125
Allowance for doubtful accounts	(5,662)	(4,727)
Total trade receivables, net	154,501	158,398

Trade receivables are due primarily from major retailers who sell directly to customers. No single customer accounted for more than 5% of the company's sales in 2003, 2002 and 2001 or accounts receivable at December 31, 2003 and 2002. The Company insures its collection risk in respect of a significant portion of accounts receivable outstanding balances and, estimates an allowance for doubtful accounts based on the 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:

	2003	2002	2001
Balance, beginning of year	4,727	5,469	4,451
Charges-bad debt expense	1,441	97	1,398
Reductions-write off of uncollectible accounts	(506)	(839)	(380)
Balance, end of year	5,662	4,727	5,469

Trade receivables denominated in foreign currencies at December 31, 2003 and 2002 and, where applicable, translated at the rate of the related domestic currency swaps, totalled 80,528 (80,528 translated at year-end exchange rates) and 87,264 (78,013 translated at year-end exchange rates), respectively. These receivables consist of the following:

	2003	2002
U.S. dollars	49,887	66,382
Canadian dollars	9,174	5,500
British pounds	9,015	6,563
Australian dollars	6,685	3,678
Other currencies	5,767	5,141
Total	80,528	87,264

7 OTHER RECEIVABLES

Other receivables are analyzed as follows:

	2003	2002
VAT	25,214	35,990
Receivable from tax authorities	18,692	7,951
Government capital grants	4,957	8,076
Advances to suppliers	4,633	2,213
Other	4,661	4,107
Total	58,157	58,337

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 the tax authorities represents principally advance taxes paid in excess of the amounts due and interest thereon.

8 INVENTORIES

Inventories are analyzed as follows:

	2003	2002
Leather and other raw materials	58,830	59,260
Goods in process	15,213	12,714
Finished products	23,475	12,107
Total	97,518	84,081

9 PROPERTY, PLANT AND EQUIPMENT AND ACCUMULATED DEPRECIATION

Fixed assets are listed below together with accumulated depreciation.

2003	Cost or valuation	Accumulated depreciation	Annual rate of depreciation
Land	9,916	-	-
Industrial buildings	158,286	26,417	3 - 10%
Machinery and equipment	102,469	52,530	11.5 - 25%
Airplane	36,800	6,923	6%
Office furniture and equipment	21,203	14,016	12 - 20%
Retail gallery and stores furnishings	12,289	2,114	25 – 35%
Transportation equipment	5,646	3,570	20 - 25%
Leasehold improvements	2,388	1,083	10 - 20%
Construction in progress	11,276	-	-
Advances to suppliers	573	-	-
Total	360,846	106,653	

2002	Cost or valuation	Accumulated depreciation	Annual rate of depreciation
Land	9,979	-	-
Industrial buildings	133,707	21,410	3 - 10%
Machinery and equipment	84,539	41,665	11,5 – 25%
Airplane	12,725	1,527	6%
Office furniture and equipment	20,132	12,444	12 - 20%
Retail gallery and stores furnishings	2,036	106	25 – 35%
Transportation equipment	5,003	2,879	20 - 25%
Leasehold improvements	4,111	1,330	10 - 20%
Construction in progress	20,747	-	-
Advances to suppliers	17,274	-	-
Total	310,253	81,361	

Construction in progress relates principally to manufacturing facilities.

10 OTHER ASSETS

Other assets consist of the following:

	2003	2002
Goodwill	14,338	1,106
Trademarks and patents	10,826	10,744
Others	10,743	8,822
Total, gross	35,907	20,672
Less impairment losses	(232)	-
Less accumulated amortization	(18,588)	(15,620)
Total, net	17,087	5,052

At December 31, 2003 and 2002 the net book value of goodwill may be analyzed as follows:

	2003	2002
Gross carrying amount	14,338	1,106
Less impairment losses	(232)	-
Less accumulated depreciation	(1,982)	(538)
Net book value	12,124	568

At December 31, 2003 and 2002 the net book value of goodwill arising from business acquisitions completed after July 1, 2001 amounts to 12,008 and 337, respectively.

11 SHORT-TERM BORROWINGS

Short-term borrowings consist of the following:

	2003	2002
Bank borrowings	3,547	-
Bank overdrafts	1,223	162
	4,770	162

While bank overdrafts are payable on demand, bank borrowings consist of unsecured line of credit agreements with banks and have various short maturities. At December 31, 2003 the short-term borrowings included 4,362 denominated in foreign currencies. The weighted average interest rates on the above-listed short-term borrowings at December 31, 2003 and 2002 are as follows:

	2003	2002
Bank borrowings	2.28%	3.17%
Bank overdrafts	2.42%	4.10%

Credit facilities available to the Group, including amounts guaranteed under surety bonds, amounted to 209,102 and 171,880 at December 31, 2003 and 2002, respectively. The unused portion of these facilities amounted to 204,332 and 171,760 at December 31, 2003 and 2002, respectively.

12 ACCOUNTS PAYABLE-TRADE

Accounts payable-trade totalling 80,913 and 87,551 at December 31, 2003 and 2002, respectively, represent principally amounts payable for purchases of goods and services in Italy and abroad, and includes 20,782 and 26,069 at December 31, 2003 and 2002, respectively, denominated in foreign currencies.

13 ACCOUNTS PAYABLE-OTHER

Accounts payable-other are analyzed as follows:

	2003	2002
Payable to customers	4,884	1,098
Cooperative advertising and quantity discount	3,705	4,041
Withholding taxes on payroll and on other	3,516	3,445
Provision for returns and other discounts	3,363	4,530
Payable to minority interest for dividends	620	732
Payable to third parties for business acquisition	430	-
Other	1,340	1,812
Total	17,858	15,658

14 TAXES ON INCOME

Italian companies are subject to two income taxes at the following rates:

	2003	2002	2001
IRPEG (state tax)	34.00%	36.00%	36.00%
IRAP (regional tax)	4.25%	4.25%	4.25%

IRPEG is a state tax and 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 34.00%).

On December 12, 2003, the Italian Government approved the legislative decree n. 344 which enacted certain changes in the fiscal legislation for fiscal years beginning on or after January 1, 2004. The principal change made was the introduction of the new state income tax IRES which will replace IRPEG, with the simultaneous elimination of the dual income tax system. The enacted IRES tax rate for 2004 is 33% of taxable income.

As a result of these new tax rules, the Company adjusted the effect of changes in IRPEG tax rates on net deferred tax assets during the year ended December 31, 2003, as it includes the enactment date. These changes in tax rates resulted in a decrease of net deferred tax assets by 55 as of December 31, 2003.

Such tax law did not modify the existing IRAP regime. IRAP is a regional tax and each Italian region has the power to increase the current 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 labour costs, interest expenses and other financial costs).

Under Italian investment incentive schemes for under-industrialized regions, certain of the Group's operating entities are currentlyhave been 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 2003, 2002 and 2001 is derived from companies entitled to some extent to the aforementioned exemptions, the most significant of which expired in 2003. The table below describes the effect of such exemptions on the Group's 2003, 2002 and 2001 income tax charge. The Company is currently eligible for certain tax benefits, available subject to an investment program being initiated pursuant to Law no. 388 of December 23, 2000. This regime entails tax deductions amounting, in 2003, to 29.75% of the value of the newly-made investments and will be available in connection with any such investments made prior to January 1, 2007; however, the amount of the tax credit may vary in future years. Certain foreign subsidiaries enjoy significant tax benefits, such as corporate income tax exemptions or reductions of the corporate income tax rates effectively applicable.

Approximately 57.2%, 88,8% and 88.7% respectively, of the Group's consolidated earnings before taxes were generated by these domestic Italian operations during, which have benefited from the above mentioned beneficial tax regimes in 2003, 2002 and 2001.

Consolidated earnings before taxes are analyzed as follows:

	2003	2002	2001
Domestic	26,319	103,370	86,534
Foreign	19,640	12,991	11,004
Total	45,959	116,361	97,538

The effective income tax rates for the years ended December 31, 2003, 2002 and 2001 were 18.5%, 21.5% and 22.5%, respectively. The actual income tax expense differs from the 'expected' income tax expense (computed by applying the state tax, which is 34% for 2003 and 36% for 2002 and 2001, to income before income taxes and minority interest) as follows:

	2003	2002	2001
Expected income tax charge at full tax rates	15,626	41,890	35,114
Effects of:			
• Tax exempt income	(19,080)	(25,079)	(20,784)
• Aggregate effect of different tax rates in foreign jurisdictions	(863)	(1,806)	(1,083)
• Tax effect of change in tax rates	55	121	-
• Effect of net change in valuation allowance established against deferred tax assets	3,180	1,725	650
• Non-deductible expenses	3,764	1,097	1,201
• Italian regional tax	5,819	7,049	6,803
Actual tax charge	8,501	24,997	21,901

Total taxes for the years ended December 31, 2003, 2002 and 2001 relate to earnings from operations. Total income taxes for the years ended December 31, 2003, 2002 and 2001 were allocated as follows:

	2003	2002	2001
Current:			
Italian	2,812	22,104	18,100
Foreign	4,890	2,492	4,111
Total (a)	7,702	24,596	22,211
Deferred:			
Italian	393	112	331
Foreign	406	289	(641)
Total (b)	799	401	(310)
Total (a + b)	8,501	24,997	21,901

The tax years from January 1, 1998 for the majority of the Italian companies are open to assessment for additional taxes. The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2003 and 2002 are presented below:

	2003	2002
Deferred tax assets:		
• Tax loss carryforwards	4,497	2,272
• Allowance for doubtful accounts	1,387	1,621
• Impairment of fixed assets	1,428	11
• Provision for sales representatives	1,051	1,175
• Provision for returns and discounts	381	732
• Provision for contingent liabilities	368	763
• Other temporary differences	810	624
Total gross deferred tax assets	9,922	7,198
• Less valuation allowance	(8,060)	(4,562)
Net deferred tax assets	1,862	2,636
Deferred tax liabilities:		
• Government grants related to capital expenditures	(851)	(894)
• Other temporary differences	(266)	(198)
Total deferred tax liabilities	(1,117)	(1,092)
Net deferred tax assets	745	1,544

A valuation allowance has been established principally for the tax loss carryforwards, allowance for doubtful accounts, impairment of fixed assets and for provision for termination indemnities of sales representatives.

The valuation allowance for deferred tax assets as of December 31, 2003 and 2002 was 8,060 and 4,562, respectively. The net change in the total valuation allowance for the years ended December 31, 2003 and 2002 was an increase of 3,498 and 1,542, respectively. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that 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, 2003. 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 are included in the consolidated balance sheets as follows:

2003	Current	Non current	Total
Gross deferred tax assets	7,888	2,034	9,922
Valuation allowance	(6,641)	(1,419)	(8,060)
Net deferred tax assets	1,247	615	1,862
Deferred tax liabilities	(292)	(825)	(1,117)
Net deferred tax assets (liabilities)	955	(210)	745

2002	Current	Non current	Total
Gross deferred tax assets	4,864	2,334	7,198
Valuation allowance	(3,008)	(1,554)	(4,562)
Net deferred tax assets	1,856	780	2,636
Deferred tax liabilities	(34)	(1,058)	(1,092)
Net deferred tax assets (liabilities)	1,822	(278)	1,544

The tax loss carryforwards of the Group total 15,000 and expire as follows:

2006	571
2007	2,271
2008	3,797
Indefinite	8,361
Total	15,000

15 SALARIES, WAGES AND RELATED LIABILITIES

Salaries, wages and related liabilities are analyzed as follows:

	2003	2002
Salaries and wages	8,180	7,641
Social security contributions	6,130	5,352
Vacation accrual	1,781	1,715
Total	16,091	14,708

16 LONG-TERM DEBT

Long-term debt is secured by mortages on the Group's properties for a total of nil (2,169 at December 31, 2002). Long-term debt at December 31, 2003 and 2002 consists of the following:

	2003	2002
2.25% long-term debt payable in annual instalments with final payment due May 30, 2015	2,166	2,166
3.0% long-term debt payable in semi-annual instalments with final payment due December 2006	1,970	-
3.5% long-term debt payable in semi-annual instalments with final payment due August 24, 2004	1,106	2,762
4.0% long-term debt payable in quarterly instalments with final payment due in September 2005	267	-
3.7% long-term debt payable in semi-annual instalments with final payment due June 30, 2003	-	83
Total long-term debt	5,509	5,011
Less current instalments	(1,291)	(1,437)
Long-term debt, excluding current instalments	4,218	3,574

Loan maturities after 2004 are summarized below:

2005	150
2006	2,094
2007	197
2008	203
Thereafter	1,574
Total	4,218

At December 31, 2003 long-term debt denominated in foreign currencies amounts to 3,343 (2,762 at December 31, 2002). Interest expense related to long-term debt for the years ended December 31, 2003, 2002 and 2001 was 155, 202 and 162 respectively.

17 OTHER LIABILITIES

Other liabilities consist of:

	2003	2002
Termination indemnities for sales agents	2,822	2,245
Payable to third parties for business acquisition	1,719	-
Provision for contingent liabilities	1,175	3,471
Total	5,716	5,716

18 MINORITY INTEREST

Minority interest shown in the accompanying consolidated balance sheet at December 31, 2003 of 894 (499 at December 31, 2002).

19 SHAREHOLDERS' EQUITY

The share capital is owned as follows:

	2003	2002
Mr. Pasquale Natuzzi	45.3%	45.3%
Miss Anna Maria Natuzzi	2.4%	2.4%
Mrs. Annunziata Natuzzi	2.4%	2.4%
Public investors	45.0%	45.0%
Treasury shares	4.9%	4.9%
	100%	100.0%

An analysis of the reserves is as follows:

	2003	2002
Treasury shares reserve	37,828	37,828
Legal reserve	11,199	3,824
Monetary revaluation reserve	1,344	1,344
Government capital grants reserve	29,865	30,075
Total	80,236	73,071

The number of ordinary shares issued at December 31, 2003 and 2002 is 57,525,528, respectively. The par value of one ordinary share is euro 1. In July 2000, the shareholders of the Company approved a share repurchase program to buy-back up to 4 million shares or 51,646. The Company spent 23,234 in 2000 and 14,594 in 2001 to repurchase shares. The Company repurchased 1,782,700 shares in 2000 at an average cost of US$ 11.3 per share and 1,061,200 shares in 2001 at an average cost of US$ 12.3 per share. As of December 31, 2003 the repurchase program is expired. Under Italian GAAP, the purchase of shares is accounted for as a non-current asset and an amount equal to the cost of shares acquired was reclassified from retained earnings to an undistributed treasury shares reserve. During an extraordinary general meeting on November 21, 2003 shareholders approved the cancellation of all treasury shares. On the basis of the Italian civil code this decision became effective on February 21, 2004. Italian law requires that 5% of net income of the parent company and each of its consolidated Italian subsidiaries be retained as a legal reserve, until this reserve is equal to 20% of the issued share capital of each respective company. The legal reserve may be utilized to cover losses; any portion which exceeds 20% of the issued share capital is distributable as dividends. The combined legal reserves totalled 13,281 and 6,737 at

December 31, 2003 and 2002, respectively. As of December 31, 2003, taxes that would be due on distribution of the portion of shareholders' equity equal to unremitted earnings of foreign subsidiaries is approximately 1,170 (450 at December 31, 2002). The Group has not provided for such taxes as the likelihood of distribution is remote and such earnings are deemed to be permanently reinvested. No taxes would be payable on the distribution of the monetary revaluation reserve and government capital grants reserve.

20 COMMITMENTS AND CONTINGENT LIABILITIES

Several companies of the Group lease manufacturing facilities and stores under non-cancellable lease agreements with expiry dates through 2024. Rental expense recorded for the years ended December 31, 2003, 2002 and 2001 was 11,046, 2,384 and 2,057, respectively. As of December 31, 2003, the minimum annual rental commitments are as follows:

2004	10,165
2005	9,647
2006	10,121
2007	10,389
2008	10,566
Thereafter	37,989
Total	88,877

Certain banks have provided guarantees at December 31, 2003 to secure payments to third parties amounting to 3,658 (4,408 at December 31, 2002). These guarantees are unsecured and have various maturities extending through December 31, 2004.

VAT reimbursed by tax authorities in prior years is secured by surety bonds for 117 (117 at December 31, 2002) 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 the 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 prepared a multi-faceted program of industrial investments for the production of upholstered furniture. Investments are now projected to total approximately 69,772. According to the revised agreement – which is currently subject to approval of the CIPE (Comitato Interministeriale Programmazione Economica) expected to occur during the summer of 2004, the Italian government will contribute approximately 35,614. 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 24,209

(included in the aforesaid total contribution of 35,614). Capital expenditures under the Natuzzi 2000 project amounted to approximately 70,755 at December 31, 2003. The capital grants are secured by surety bonds for 26,041 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 Group is also involved in a number of claims (including tax 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 and abroad (Romania, Brazil and China).
Net sales of upholstered furniture analyzed by coverings are as follows:

	2003	2002	2001
Leather upholstered furniture	550,029	623,755	624,411
Fabric upholstered furniture	123,921	110,997	89,628
Total	673,950	734,752	714,039

Within leather and fabric upholstered furniture, the Company offers furniture in the following categories: stationary furniture (sofas, loveseats and armchairs), sectional furniture, motion furniture, sofa beds and occasional chairs, including recliners and massage chairs. The following tables provide information upon the 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	2003	2002	2001
United States	280,770	330,575	317,927
England	80,409	56,196	51,457
Italy	71,277	76,145	72,623
Canada	37,910	32,586	35,581
Germany	25,392	37,936	39,985
France	23,393	24,370	19,077
Belgium	15,959	17,354	21,060
Australia	15,356	13,186	12,054
Spain	14,045	11,475	11,962
Holland	14,004	16,858	23,294
Norway	10,084	13,281	12,048
Ireland	7,760	16,816	11,509
Other countries (none greater than 2%)	77,591	87,974	85,462
	673,950	734,752	714,039

Long lived assets	2003	2002
Italy	161,292	164,042
Romania	33,277	21,159
United States of America	27,902	22,576
Brazil	14,610	12,380
China	8,454	6,348
Spain	3,375	1,214
Switzerland	2,298	999
England	2,158	-
Other countries	827	174
Total	254,193	228,892

In addition, the Group also sells minor volumes of excess polyurethane foam, leather by-products and certain pieces of furniture (coffee table, lamps and rugs) which, for 2003, 2002 and 2001 totalled 95,629, 70,391 and 72,109, respectively. No single customer accounted for more than 5% of net sales in 2003, 2002 or 2001.

22 COST OF SALES

Cost of sales is analyzed as follows:

	2003	2002	2001
Opening inventories	84,081	87,895	73,644
Purchases	355,867	338,484	366,398
Labor	104,495	106,954	98,102
Third party manufacturers	32,859	38,572	44,656
Other manufacturing costs	28,980	29,599	25,184
Closing inventories	(97,518)	(84,081)	(87,895)
Total	508,764	517,423	520,089

23 OTHER INCOME (EXPENSE), NET

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

	2003	2002	2001
Interest income	1,701	5,423	5,987
Interest expense and bank commissions	(1,317)	(3,870)	(3,701)
Interest income, net	384	1,553	2,286
Gains (losses) on foreign exchange, net	64	7,254	(5,311)
Unrealized exchange gains (losses) on domestic currency swaps	6,276	2,021	(902)
Gains (losses) on foreign exchange	6,340	9,275	(6,213)
Gains (losses) on securities, net	(754)	-	79
Other, net	(2,339)	3,723	3,623
Total	3,631	14,551	(225)

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

	2003	2002	2001
Net realized gains (losses) on domestic currency swaps	25,369	10,930	(12,239)
Net realized gains (losses) on accounts receivable and payables	(7,585)	(8,835)	(1,545)
Net unrealized gains (losses) on accounts receivable and payable	(16,584)	5,796	8,473
Exchange difference loss on translation of foreign financial statements	(1,136)	(637)	-
Total	64	7,254	(5,311)

Other, net consists of the following:

	2003	2002	2001
Impairment loss on fixed assets	(4,292)	-	-
Pre-acquisition loss of KOL	1,694	-	-
Tax liabilities settlements	-	(481)	-
Tax refund	-	1,314	-
Employment incentive grants	-	-	2,259
Other, net	259	2,890	1,364
Total	(2,339)	3,723	3,623

IMPAIRMENT LOSS ON FIXED ASSETS

The Company has evaluated the impairment of long lived assets in accordance with its accounting policy (wherever the event or changes in circumstances indicate that the carrying amount of an asset may be not recoverable). Based on such analysis the Company recorded an impairment loss of 4,292.

PRE-ACQUISITION LOSS FOR KOL GROUP

The pre-acquisition loss related to the KOL acquisition has been eliminated in the consolidated statement of earnings for the year ended at December 31, 2003 (see also note 26 (g)).

TAX LIABILITIES SETTLEMENT

During 2002 the Group settled certain of the tax claims made by the authorities.

TAX REFUND

During 2002, the Company obtained from the tax authorities a refund of 1,314 for taxes not due on a portion of income related to 1993. As these amounts were not recorded previously due to uncertainty, the Company recorded such amounts in the consolidated statement of earnings for that year.

EMPLOYMENT INCENTIVE GRANTS

In prior years Company and certain subsidiaries, on the basis of regional laws, received employment incentive from the regional agencies 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 related to prior years. For the year ended December 31, 2001 these incentives amounted to 2,259.

24 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

A significant portion of the Group's net sales, but only approximately 40% of its costs, are denominated in currencies other than the euro, in particular the U.S. dollar. The remaining costs of the Group are denominated principally in euros. Consequently, a significant portion of the Group's net revenues are exposed to fluctuations in the exchange rates between the euro 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 counterparties 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 or losses 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 euro equivalent the contractual amounts of forward exchange contracts used to hedge principally future cash flows from accounts receivable and sales orders at December 31, 2003 and 2002:

	2003	2002
U.S. dollars	32,942	117,050
British pounds	46,267	22,650
Canadian dollars	19,044	14,937
Australian dollars	10,796	9,579
Swiss francs	3,629	2,844
Japanese yen	3,532	2,863
Total	116,210	169,923

The following table presents information regarding the contract amount in euro 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'.

	2003		2002	
	Contract amount	Unrealized gains (losses)	Contract amount	Unrealized gains (losses)
Assets	104,206	6,544	156,983	14,880
Liabilities	12,004	(268)	12,940	(588)
	116,210	6,276	169,923	14,292

At December 31, 2003, the forward exchange contracts had a net unrealized gain of 6,276. This gain is recorded in other income (expense), net in the consolidated statements of earnings. At December 31, 2002, the forward exchange contracts had a net unrealized gain of 14,292, of which 9,251 related to accounts receivable, 3,020 related to existing sales commitments and 2,021 related to anticipated commitments at year-end. The Company recorded all these amounts, except for 3,020 relating to existing sales commitments.

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. Unrealized gains (losses) on forward exchange contracts is determined by using residual maturity rate. Refer to notes 3 (a) and (b) for the Group's accounting policy on forward exchange contracts.

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:

	2003		2002	
	Carrying value	Fair value	Carrying value	Fair value
Assets:				
• Marketable debts securities	5	5	26	26
• Treasury shares	37,828	22,697	37,828	27,552
Liabilities:				
• Long-term debt	5,509	4,400	5,011	4,100

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.

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)

Under US GAAP, SFAS 133 established comprehensive accounting and reporting standards for derivative instruments and hedging activities. SFAS 133 requires that an entity record all derivatives, freestanding 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 hedges 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 does not currently qualify for hedge criteria under SFAS 133 and has not used hedge accounting for Italian GAAP in 2003 (see note 3(a) and (b)). In particular, the Company does not formally document all relationships between its hedging instruments (forward exchange contracts known in Italian financial markets as domestic currency swaps) and its hedged items which includes linking all derivatives that are designated as foreign-currency hedges to specific accounts receivable on the balance sheet or to specific firm committents or forecasted transactions. The Company also does not formally assess, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging its transactions are highly effective in offsetting changes in fair values of its hedged items.
As a result under Italian GAAP at December 31, 2003 and US GAAP, at December 31, 2003, 2002 and 2001 the Company accounted for all its derivative financial instruments at their fair value and all its accounts receivable in foreign currency were remeasured at year end exchange rates. All mark to market adjustments were recorded in the income statement.

(c)
Until December 31, 2000 government grants related to capital expenditures were recorded, net of tax, within reserves in shareholders' equity (note 3 (m)). For US GAAP purposes, such grants would be classified either 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.

(d)
As indicated in note 19, during 2001 and 2000 the Company repurchased its common shares for a cash consideration of 37,828. Under Italian GAAP, the purchase of these shares was accounted for as non-current assets; under US GAAP, the cost of the acquired shares is reflected as a reduction in shareholders' equity.

(e)
Under Italian GAAP, the Group recognizes sales revenue, and accrued costs associated with the sales revenue, at the time products are shipped from its manufacturing facilities located in Italy and abroad. A significant part of the products are shipped from factories directly to customers under terms that risks and ownership are transferred to the customer when the customer takes possession of the goods. These terms are 'delivered duty paid', 'delivered duty unpaid', 'delivered ex quay' and 'delivered at customer factory'. Delivery to the customer generally occurs within one to six weeks from the time of shipment.

US GAAP requires that revenue should not be recognized until it is realized or realizable and earned, which is generally at the time delivery to the customer occurs and the risks of ownership pass to the customer. Accordingly, the Italian GAAP for revenue recognition is at variance with US GAAP. The principal effects of this variance on the accompanying consolidated balance sheet as of December 31, 2003 and 2002 and related consolidated statement of earnings for each of the years in the three-year period ended December 31, 2003 are indicated below:

Consolidated balance sheet	2003 Effects Increase (Decrease)	2002 Effects Increase (Decrease)	Variation for 2003
Trade receivables, net	(47,263)	(48,004)	741
Inventories	31,194	30,867	327
Total effect on current assets (a)	(16,069)	(17,137)	1,068
Accounts payable-trade	(6,654)	(6,240)	(414)
Income taxes	(1,723)	(2,288)	565
Total effect on current liabilities (b)	(8,377)	(8,528)	151
Total effect on shareholders' equity (a-b)	(7,692)	(8,609)	917

Consolidated statement of earnings	2003 Effects Increase (Decrease)	2002 Effects Increase (Decrease)	2001 Effects Increase (Decrease)
Net sales	(741)	(13,547)	(34,457)
Cost of sales	327	8,057	22,810
Gross profit	(1,068)	(5,490)	(11,647)
Selling expenses	(414)	(1,625)	(4,615)
Operating income	(1,482)	(3,865)	(7,032)
Income taxes	(565)	(741)	(1,547)
Total effect on net earnings	(917)	(3,124)	(5,485)

(f)

In 2001, the Company translated the financial statements of a foreign subsidiary which operates in a highly inflationary economy at (i) year-end exchange rate for assets and liabilities, (ii) historical exchange rates for share capital and retained earnings, and (iii) average exchange rates during the year for the statement of earnings. The resulting exchange differences on translation were recorded as a direct adjustment to consolidated shareholders' equity. A highly inflationary economy is one that has cumulative inflation of approximately 100 percent or more over a 3-year period. Under US GAAP the financial statements of this subsidiary should be translated at (a) year-end exchange rate for monetary assets and liabilities (b) historical exchange rates for non monetary assets and liabilities (for example fixed assets or long term debt) as well as for share capital, reserves and retained earnings (c) average exchange rates during the year for revenues and expenses recorded in the statement of earnings. The resulting exchange differences on translation should be recorded in the statement of earnings. Therefore for US GAAP purposes, in 2001 the Company recorded a net gain of 307 in earnings.

(g)

During 2003 (see note 1) the Company acquired a 100% interest in each of the following two entities: KOL Group and Minuano Nordeste SA. Both acquisitions were accounted for as business combinations under Italian GAAP. The Company believes that the KOL Group acquisition qualifies as a business combination under US GAAP in accordance with the provisions of SFAS 141. However, in accordance with EITF 98-3 the acquisition of 100% interest in Minuano Nordeste SA does not qualified as an acquisition of a business. Therefore, under the Italian GAAP the Minuano acquisition was considered to be a business acquisition, while under US GAAP the same has been accounted as an asset acquisition which does not result in goodwill. The management has determined that the difference between purchase price and the fair value of the net tangible assets acquired is due to export incentive benefit that this entity is entitled to upon completion of its manufacturing facilities and export of the furniture manufactured in Brazil. The export incentive is available until 2015. The related deferred tax liabilities is established by using “simultaneous method”. The allocation of the purchase price is as follows:

	US GAAP	IT GAAP	Difference
Current and non current assets	253	253	-
Intangible assets	6,141	-	6,141
Goodwill	-	4,053	(4,053)
Current and non current liabilities	(8)	(8)	-
Deferred tax liabilities	(2,088)	-	(2,088)
Purchase price	4,298	4,298	-

Also under Italian GAAP the pre-acquisition results of an acquired entity can be reflected in the operating results of the acquiring entity provided the acquisition was completed within 6 months of the beginning of the acquiring entity's fiscal year. Although, the pre-acquisition results may be included in the statement of earning of the acquiring company the resulting pre-acquisition income or loss is not considered for the net earnings, but is considered for the purpose of computing goodwill. The following pre-acquisition amounts of KOL are included in the Italian GAAP consolidated statement of earning for the year ended December 31, 2003:

Net sales	11,945
Cost of sales	(5,798)
Gross profit	6,147
Selling expenses	(7,066)
General and administrative expense	(1,113)
Operating loss	(2,032)
Other income, net	1,481
Loss before taxes	(551)
Income taxes	551
Net loss	-

(h)
Under Italian GAAP, the Company amortizes the goodwill arising from business acquisitions on straight-line basis over a period of five years. US GAAP states that goodwill acquired in a purchase business combination completed after July 1, 2001 is not amortized, but instead tested for impairment at least annually in accordance with provisions of SFAS N. 142.
In addition, under Italian GAAP, the Company has allocated certain intangible assets, having definite lives and arising from a business acquisition, under the caption goodwill. Under US GAAP the Company would have classified such as intangible assets, would have amortized these over their estimated useful lives to their residual values, and would have reviewed these for impairment in accordance with SFAF No. 144.
The changes in the carrying amount of goodwill, intangibles assets and deferred tax liabilities arising from business acquisitions completed after July 1, 2001, are as follows:

	Goodwill		Intangibles		Deferred taxes		
	US	Italian	US	Italian	US	Italian	Difference
Balance at December 31, 2000	-	-	-	-	-	-	-
Acquisition of business	431	431	-	-	-	-	-
Amortization	-	(86)	-	-	-	-	86
Balance at December 31, 2001	431	345	-	-	-	-	86
Acquisition of minority interest	97	97	-	-	-	-	-
Amortization	-	(105)	-	-	-	-	105
Balance at December 31, 2002	528	337	-	-	-	-	191
Acquisition of KOL	9,179	9,179	-	-	-	-	-
Acquisition of Minuano	-	4,053	6,141	-	(2,088)	-	-
Amortization	-	(1,329)	-	-	-	-	1,329
Impairment Losses	(528)	(232)	-	-	-	-	(296)
Balance at December 31, 2003	9,179	12,008	6,141	-	(2,088)	-	1,224

Management has evaluated the carrying value of goodwill for impairment purposes in accordance with the provisions of SFAS 142. Based on that evaluation, on a reporting unit basis, goodwill to the extent of 528 is impaired.

Reported net earnings and basic and diluted earnings per share excluding the impact of the amortization of goodwill, for all periods presented would have been as follows:

Net earnings	2003	2002	2001
Net earnings under US GAAP, as reported	38,027	91,994	71,057
Add back: amortization of goodwill	-	-	116
Net earnings under US GAAP, adjusted	38,027	91,994	71,173

Basic and diluted earning per share			
Net earnings under US GAAP, as reported	0,700	1,680	1,290
Add back: amortization of goodwill	-	-	0,001
Net earnings under US GAAP, adjusted	0,700	1,680	1,291

(i)

During 2003 the Company under Italian GAAP has recognized impairment losses on fixed assets of 4,292 as part of non operating income. Under US GAAP such impairment charge would be included as part of operating income.

(j)

Under Italian GAAP certain costs paid to resellers are reflected as part of selling expenses. Under US GAAP, in accordance with EITF 01-09, these cost should be recorded as a reduction of net sales. Such expenses include advertising contributions paid to resellers which amounted at December 31, 2003, 2002 to 2001 at 3,284, 2,432 and 2,330, respectively.

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

Reconciliation of net earnings:	**2003**	**2002**	**2001**
Net earnings under Italian GAAP	37,300	91,438	75,657
Adjustments to reported income:			
(a) Revaluation of property, plant and equipment	27	44	53
(b) Derivative and hedging activities	(2,713)	3,783	(947)
(c) Government grants	673	1,269	1,269
(e) Revenue recognition	1,482	(3,865)	(7,032)
(f) Highly inflationary economy	-	-	307
(g) Goodwill and intangible assets	1,033	105	86
Effect of minority interests on US GAAP adjustments	-	-	(2)
Tax effect of US GAAP adjustments	225	(780)	1,666
Net earnings in conformity with US GAAP	38,027	91,994	71,057
Basic and diluted earnings per share in conformity with US GAAP	0,70	1,68	1,29

Reconciliation of shareholders' equity:	2003	2002
Shareholders' equity under Italian GAAP	515,063	495,808
(a) Revaluation of property, plant and equipment	(671)	(698)
(b) Derivative and hedging activities	-	2,713
(c) Government grants	(19,220)	(19,893)
(d) Treasury shares	(37,828)	(37,828)
(e) Revenue recognition	(9,415)	(10,897)
(g) Goodwill and intangible assets	1,224	191
Tax effect of US GAAP adjustments	3,144	2,919
Shareholders' equity in conformity with US GAAP	452,297	432,315

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 does not differ from net income.

GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill represents the excess of costs over fair value of assets of businesses acquired. The Company adopted the provisions of SFAS No. 142, Goodwill and Other Intangible Assets, as of January 1, 2002. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets. In connection with SFAS No. 142's transitional goodwill impairment evaluation, the Statement required the Company to perform an assessment of whether there was an indication that goodwill is impaired as of the date of adoption. To accomplish this, the Company was required to identify its reporting units and determine the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of January 1, 2002. The Company was required to determine the fair value of each reporting unit and compare it to the carrying amount of the reporting unit within six months of January 1, 2002. To the extent the carrying amount of a reporting unit exceeded the fair value of the reporting unit, the Company would be required to perform the second step of the transitional impairment test, as this is an indication that the reporting unit goodwill may be impaired. The second step was required for one reporting unit. In this step, the Company compared the implied fair value of the reporting unit goodwill with the carrying amount of the reporting unit goodwill, both of which were measured as of the date of adoption. The implied fair value of goodwill was determined by allocating the fair value of the reporting unit to all of the assets (recognized and unrecognized) and liabilities of the reporting unit in a manner similar to a purchase price allocation, in accordance with SFAS No. 141, Business Combinations. The residual fair value after this allocation was the implied fair value of the reporting unit goodwill. The implied fair value of this reporting unit goodwill exceeded its carrying amount and the Company was not required to recognize an impairment loss.

Prior to the adoption of SFAS No. 142, goodwill was amortized on a straight-line basis over the expected periods to be benefited, generally 5 years, and assessed for recoverability by determining whether the goodwill balance could be recovered through undiscounted future operating cash flows of the acquired operation. All other intangible assets were amortized on a straight-line basis over a period of 5 years. The amount of goodwill and other intangible asset impairment, if any, was measured based on projected discounted future operating cash flows using a discount rate reflecting the Company's average cost of funds.

SFAS NO. 143:

In June 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations (SFAS No. 143). SFAS No. 143 requires the Company to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development and/or normal use of the assets. The Company also records a corresponding asset which is depreciated over the life of the asset. Subsequent to the initial measurement of the asset retirement obligation, the obligation will be adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The Company adopted SFAS No. 143 on January 1, 2003. Application of this statement did not have an impact on the consolidated financial statements of the Company.

SFAS NO. 145:

In April 2002, the FASB issued SFAS No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections. SFAS No. 145 amends existing guidance on reporting gains and losses on the extinguishment of debt to prohibit the classification of the gain or loss as extraordinary, as the use of such extinguishments have become part of the risk management strategy of many companies. SFAS No. 145 also amends SFAS No. 13 to require sale-leaseback accounting for certain lease modifications that have economic effects similar to sale-leaseback transactions. The provisions of the Statement related to the rescission of Statement No. 4 is applied in fiscal years beginning after May 15, 2002. Earlier application of these provisions is encouraged. The provisions of the Statement related to Statement No. 13 were effective for transactions occurring after May 15, 2002, with early application encouraged. The adoption of SFAS No. 145 did not have an effect on the consolidated financial statements of the Company.

SFAS NO. 146:

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity. The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. The adoption of SFAS No. 146 did not have effect on the consolidated financial statements of the Company.

SFAS NO. 149:

In April 2003, the FASB issued SFAS No. 149, Amendment of Statement No. 133 on Derivative Instruments and Hedging Activities. SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. Adoption of SFAS No. 149 did not have a material impact on the consolidated financial statements of the Company.

SFAS NO. 150:

FASB Statements No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, was issued in May 2003. This statement established standards for the classification and measurement of certain financial instruments with characteristics of both liabilities and equity. The statement also includes required disclosures for financial instruments within its scope. For the Company, the statement was effective for instruments entered into or modified after May 31, 2003 and otherwise will be effective as of January 1, 2004, except for mandatorily redeemable financial instruments. For certain mandatorily redeemable financial statements, the statement will be effective for the Company on January 1, 2005. The effective date has been deferred indefinitely for certain other types of mandatorily redeemable financial statements. The Company currently does not have any financial instruments that are within the scope of this statement.

FASB INTERPRETATION NO. 46:

In December 2003, the FASB issued FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities, which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN 46R replaces FASB Interpretation No. 46, Consolidation of Variable Interest Entities, which was issued in January 2003. The Company will be required to apply FIN 46R to variable interests in VIEs created after December 31, 2003. For variable interests in VIEs created before January 1, 2004, the Interpretation will be applied beginning on January 1, 2005. For any VIEs that must be consolidated under FIN 46R that were created before January 1, 2004, the assets, liabilities and noncontrolling interests of the VIE initially would be measured at their carrying amounts with any difference between the net amount added to the balance sheet and any previously recognized interest being recognized as the cumulative effect of an accounting change. If determining the carrying amounts is not practicable, fair value at the date FIN 46R first applies may be used to measure the assets, liabilities and noncontrolling interest of the VIE. The Company does not believe that it has any VIE for consolidation.

SIGNIFICANT DIFFERENCES IN CORPORATE GOVERNANCE PRACTICES UNDER NYSE RULES

OVERVIEW

Corporate governance rules for Italian stock corporations (società per azioni) like the Company whose shares are not listed on a regulated market in the European Union like the Company are set forth in the Civil Code. As described in more detail below, the Italian corporate governance rules set forth in the Civil Code differ in a number of ways from those applicable to U.S. domestic companies under NYSE listing standards, as set forth in the NYSE Manual. As a general rule, a company's main corporate bodies are governed by the Civil Code and are assigned specific powers and duties that are legally binding and cannot be derogated from. The Company follows the traditional Italian corporate governance system, with a board of directors (consiglio di amministrazione) and a separate board of statutory auditors (collegio sindacale), with supervisory functions. See "—By-laws—Board of Directors" and "—By-laws—Statutory Auditors" above for a description of the powers and duties of the board of directors and the board of statutory auditors, respectively. The two boards are separate and no individual may be a member of both boards. Both the members of the board of directors and the members of the board of statutory auditors owe duties of loyalty and care to us. As required by Italian law, a firm of external auditors is in charge of auditing its financial statements. See "—By-Laws– External Auditors". The members of the Company's board of directors and board of statutory auditors, as well as the firm of external auditors, are directly and separately appointed by shareholder resolution at its general shareholders' meetings. This system contrasts with the unitary system envisaged for U.S. domestic companies by the NYSE listing standards, which contemplate the board of directors' serving as the sole governing body. Following is a summary of the significant differences between Italian corporate governance rules and practices, as we have implemented them, and those applicable to U.S. issuers under NYSE listing standards, as set forth in the NYSE Manual.

INDEPENDENT DIRECTORS

NYSE DOMESTIC COMPANY STANDARDS.

The NYSE listing standards applicable to U.S. companies provide that "independent" directors must comprise a majority of the board. In order for a director to be considered "independent", the board of directors must affirmatively determine that the director has no "material" direct or indirect relationship with the company. These relationships "can include commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationship (among others)". More specifically, a director is not independent if such director or his/her immediate family members, has certain specified relationships with the company, its parent, its consolidated subsidiaries, their internal or external auditors, or companies that have significant business relationships with the company, its parent or its consolidated subsidiaries. Ownership of a significant amount of stock is not a per se bar to independence. In addition, a three-year "cooling off" period following the termination of any relationship that compromised a director's independence must lapse before that director can again be considered independent.

OUR PRACTICE.

The presence of a prescribed number of independent directors on the Company's board is neither mandated by any Italian law applicable to the Company nor required by the Company's By-laws. However, Italian law sets forth certain independence requirements applicable to the

Company's statutory auditors. Statutory auditors' independence is assessed on the basis of a few general principles, rather than detailed rules. In particular, a person who (i) is a director, or the spouse or a close relative of a director, of the Company or any of its affiliates, or (ii) has an employment or a regular consulting or similar relationship with the Company or any of its affiliates, or (iii) has an economic relationship with the Company or any of its affiliates which might compromise his/her independence, cannot be appointed to the Company's board of statutory auditors. Although there is no formal cooling-off requirement, any of the Company's statutory auditors who are registered chartered accountants and have had a regular or material consulting relationship with the Company's or its affiliates within two years prior to the appointment, or have been employed by, or served as directors of, the Company or its affiliates, within three years prior to the appointment, may be suspended or cancelled from the register of chartered public accountants.

EXECUTIVE SESSIONS

NYSE DOMESTIC COMPANY STANDARDS.

Non-executive directors of U.S. companies listed on the NYSE must meet regularly in executive sessions, and independent directors should meet alone in an executive session at least once a year.

OUR PRACTICE.

In Italy, neither non-executive directors nor independent directors are required to meet in executive sessions. The members of the Company's board of statutory auditors are required to meet at least every 90 days.

AUDIT COMMITTEE AND INTERNAL AUDIT FUNCTION

NYSE DOMESTIC COMPANY STANDARDS.

U.S. companies listed on the NYSE are required to establish an audit committee that satisfies the requirements of Rule 10A-3 under the Securities Exchange Act of 1934, as amended (the "Exchange Act") and certain additional requirements set by the NYSE. In particular, all members of this committee must be independent and the committee must adopt a written charter. The committee's prescribed responsibilities include (i) the appointment, compensation, retention and oversight of the external auditors; (ii) establishing procedures for the handling of "whistle blower" complaints; (iii) discussion of financial reporting and internal control issues and critical accounting policies (including through executive sessions with the external auditors); (iv) the approval of audit and non-audit services performed by the external auditors and (v) the adoption of an annual performance evaluation. A company must also have an internal audit function, which may be out-sourced, except to the independent auditor.

OUR PRACTICE.

Rule 10A-3 under the Exchange Act provides that foreign private issuers with a board of statutory auditors established in accordance with local law or listing requirements and meeting specified requirements with regard to independence and responsibilities (including the performance of most of the specific tasks assigned to audit committees by the rule, to the extent permitted by local law), (the "Statutory Auditor Requirements") are exempt from the audit committee requirements established by the rule. As a foreign private issuer, the Company must comply with these requirements or qualify for a valid exemption by July 31, 2005. The Company is in the process of evaluating the impact of these rules on its corporate governance system. Should the Company decide to maintain its current governance structure, it will take advantage, to the extent possible, of the exemption afforded to issuers having a board of statutory auditors that meets the Statutory Auditor Requirements, including if need be by expanding the scope of duties of its board of statutory auditors, to the extent permitted by Italian law.

COMPENSATION COMMITTEE

NYSE DOMESTIC COMPANY STANDARDS.

Under NYSE standards, the compensation of the CEO of U.S. domestic companies must be approved by a compensation committee (or equivalent) comprised solely of independent directors. The compensation committee must also make recommendations to the board of directors with regard to the compensation of other officers, incentive compensation plans and equity-based plans. Disclosure of individual management compensation information for these companies is mandated by the Exchange Act's proxy rules, from which foreign private issuers are generally exempt.

OUR PRACTICE.

The Company has not established a compensation committee. As a matter of Italian law, the compensation of executive directors is determined by the board of directors, while the Company's shareholders determine the base compensation of all the Board members, including non-executive directors. Compensation of the Company's executive officers is determined by the Chairman. The Company does not produce a compensation report. However, the Company discloses aggregate compensation of all of its directors in its annual financial statements prepared in accordance with Italian GAAP and in Item 6 of its annual report on Form 20-F.

NOMINATING COMMITTEE

NYSE DOMESTIC COMPANY STANDARDS.

Under NYSE standards, a domestic company must have a nominating committee (or equivalent) comprised solely of independent directors, which is responsible for nominating directors.

OUR PRACTICE.

The Company has not established a nominating committee (or equivalent) responsible for nominating its directors. Directors may be nominated by any of the Company's shareholders or the Company's board of directors. See "—By-laws—Board of Directors".

CORPORATE GOVERNANCE/CODE OF ETHICS

NYSE DOMESTIC COMPANY STANDARDS.

Under NYSE standards, a company must adopt governance guidelines and a code of business conduct and ethics for directors, officers and employees. A company must also publish these items on its website and provide printed copies on request. Section 406 of the Sarbanes-Oxley Act requires a company to disclose whether it has adopted a code of ethics for its principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, and if not, the reasons why it has not done so.

The NYSE listing standards applicable to U.S. companies provide that codes of conduct and ethics should address, at a minimum, conflicts of interest; corporate opportunities; confidentiality; fair dealing; protection and use of company assets; legal compliance; and reporting of illegal and unethical behavior. Corporate governance guidelines must address, at a minimum, directors' qualifications, responsibilities and compensation; access to management and independent advisers; management succession; director orientation and continuing education; and annual performance evaluation of the board.

OUR PRACTICE.

The Company is in the process of improving certain of its corporate governance guidelines (including with respect to its internal control system, significant transactions, transactions with related parties, and internal dealing), and is in the process of adopting a compliance program to prevent certain criminal offenses and a code of ethics for the Company's directors, employees and others acting on the Company's behalf. As noted in Item 16B of this annual report, the Company expects that the code of ethics as it will apply to the Company's Chief Executive Officer, General Manager, who acts as the Company's principal financial officer, and principal accounting officer will address the requirements of Section 406 of the Sarbanes-Oxley Act. The Company believes that its code of ethics and the conduct and procedures adopted by the Company address the relevant issues contemplated by the NYSE standards applicable to U.S. companies noted above. Its corporate governance guidelines, on the other hand, do not address all of the issues contemplated by the NYSE standards.

CERTIFICATIONS AS TO VIOLATIONS OF NYSE STANDARDS

NYSE DOMESTIC COMPANY STANDARDS.

Under NYSE listing standards, the CEO of a U.S. company must certify annually that he or she is unaware of any violation by the company of the NYSE corporate governance standards. This certification must be included in the company's annual report to shareholders (or, if no annual report is prepared, its Form 10-K). The CEO must also notify the NYSE in writing if any executive officer becomes aware of any material non-compliance with the NYSE corporate governance standards.

OUR PRACTICE.

Under the NYSE standards, the Company is required only to notify the NYSE in writing if any executive officer becomes aware of any material non-compliance with NYSE corporate governance standards.

SHAREHOLDER APPROVAL OF ADOPTION AND MODIFICATION OF EQUITY COMPENSATION PLANS

NYSE DOMESTIC COMPANY STANDARDS.

Shareholders of a U.S. company listed on the NYSE must approve the adoption of and any material revision to the company's equity compensation plans, with certain exceptions.

OUR PRACTICE.

Although the Company's shareholders must authorize (i) the issuance of shares in connection with capital increases, and (ii) the buy-back of its own shares, the adoption of equity compensation plans does not per se require prior approval of the shareholders.

CORPORATE PROFILE | VALUES Our most important values are integrity and respect for people and the environment. We are an Italian and an international company. Our mission is to create value for our customers, employees and shareholders. LEADERSHIP Natuzzi was founded in 1959 by Pasquale Natuzzi. The Group designs and produces sofas, armchairs and living room accessories. Natuzzi is the largest Italian furniture company with 2003 revenues of 769,6 million euro, and it is the worldwide leader in the production of leather upholstery. In 1993, Natuzzi became the only foreign furniture company to list on Wall Street. It is a solid company with a sound financial structure that allows it to finance its investments internally: almost 80% of its earnings have been reinvested into the company over the past years. The Group exports its products to 135 countries in five continents. In the 1980s, Natuzzi made leather upholstery available to many thanks to substantial innovations in the design and manufacturing that greatly reduced the costs of making leather sofas. As a result, leather upholstery became affordable for everybody. Until then, only a small elite group could afford it. Today, more than 7,400,000 families in the world own a Natuzzi sofa. At 31st December 2003 the Group employs 6,230 people, 3,983 in Italy and 2,247 abroad. Innovation, efficiency, quality and service are the basis of Natuzzi's culture. INNOVATION Natuzzi is one of the largest investors in research and development in the furniture industry. Pasquale Natuzzi directly manages this strategic activity through the two Style Centres located in Santeramo in Colle, Bari and Bovisio Masciago, Milan. In these Centres, 180 persons are dedicated to the design, the study of the market trends, and the selection of materials. The Style Centres are factories of ideas. Every year the designers draw 6,000 new models, including sofas, armchairs, furnishings and home accents. Pasquale Natuzzi's team chooses the best models and follows the entire product evolution, from the first prototype to the introduction in the market. Every year more than 100 new sofas, in different styles, coverings and colours, set new trends in the world of furniture. This strong commitment to innovation has produced the widest collection of sofas and armchairs in the world with more than 2 million combinations of styles, coverings and functions. EFFICIENCY Natuzzi is vertically integrated through 11 factories in Italy and 3 abroad (China, Brazil and Romania). Raw materials are purchased directly from the primary markets and then finished in the company's facilities, specialized in manufacturing leather, wood or metal frames, foam and finished products. Controlling the entire supply chain, the Group increases efficiency and achieves excellent quality levels. Natuzzi's products are hand-made by expert craftsmen, whose know-how Natuzzi preserves and passes on through its own Training School. QUALITY Every day 293 people are committed to guarantee high quality standards. A constant effort, confirmed since 1995, throughout the ISO 9001 System of Quality certification, and reconfirmed in December 2001 when the Company received the ISO 14001 Certification for Environmental Control and furthermore in July 2003 with the Certification of the Integrate Management System Quality/Environment ISO 9001/2000. Natuzzi products are covered by a 10 year guarantee on the frame and 2 years on foam and leather coverings. SERVICE Customer service and the entire sales network is managed directly in Italy by the headquarter in Santeramo in Colle Bari, and from Natuzzi Americas in the U.S., Natuzzi Asia in China, Natuzzi Nordic in Scandinavia, Natuzzi Benelux in Belgium and the Netherlands, Natuzzi Iberica in Spain and Portugal and Natuzzi Switzerland in Switzerland. The Group guarantees a high level service to its customers: delivery at retailer's premises, anywhere in the world, products invoiced in the retailer's currency, and complete on-line pre- and after-sales assistance through the technologically advanced "Natuzzi Business Portal". The Group directly carries out the research and development of its products; plans its new factories; and develops the management information systems and the extranet that allow customers, everywhere in the world, to directly manage their orders.

PASQUALE NATUZZI
Chief Executive Officer,
Chairman of the Board of Directors

CODE OF ETHICS |
www.natuzzi.com/codeofethics/

Our Group's competitive challenge lies in innovation, internationalization, the creation of Natuzzi brand value, lower costs and greater efficiency at all levels. I am convinced that the correct application of this strategy requires a deep awareness and a huge sense of responsibility within each Natuzzi employee. Today, more than ever, in order to successfully operate in the global market, it is important to rely on competent and efficient personnel who share the same values and believe in the Company's mission. With this in mind, we have developed our Group's code of ethics, which continues to recognise our values, our integrity and our respect for customers, employees and shareholders, the foundations upon which our Company is based.

Pasquale Natuzzi

Pasquale Natuzzi
Chairman of the Board of Directors

GIUSEPPE DESANTIS

General Manager,
Vice Chairman of the Board of Directors

2003 COMPARED TO 2002

Net sales for 2003, including sales of leather- and fabric-upholstered furniture and other sales (principally polyurethane foam and leather sold to third parties, as well as accessories), decreased 4.4% to € 769.6 million compared to 2002. Net sales for 2003 of leather- and fabric-upholstered furniture decreased 8.3% to € 674.0 million compared to 2002. The decrease was due primarily to the strong appreciation of the euro against other major currencies, particularly the U.S. dollar, and to a lesser degree to a decrease in units sold in Europe as a result of the stagnant European economy and a change in the mix of products sold toward lower-priced products. Net sales for 2003 of leather-upholstered furniture decreased 11.8% to € 550.0 million compared to 2002, while net sales for 2003 of fabric-upholstered furniture net sales increased 11.7% to € 124.0 million compared to 2002. In the Americas, net sales for 2003 of upholstered furniture decreased 12.6% to € 320.1 million compared to 2002 because of the unfavourable conversion of US sales made in dollars to euro following the strong appreciation of the European currency. In Europe, net sales for 2003 of upholstered furniture decreased 4.0% to € 313.5 million compared to 2002. In the rest of the world, net sales for 2003 of upholstered furniture decreased 3.6% to € 40.4 million compared to 2002.

Net sales for 2003 of Natuzzi-branded furniture decreased 12.5% to € 533.0 compared to 2002. During the same period, net sales of the lower-priced Italsofa furniture increased 12.5% to € 140.9 million compared to 2002. The growth of Italsofa was due to consumer price sensitivity resulting from sluggish economic conditions worldwide and the ability of the Company to offer a product at an attractive price while maintaining the Company's rigorous quality standards. The Company believes that the growing percentage of sales from the lower-priced Italsofa furniture relative to the higher-priced Natuzzi brand furniture should be counterbalanced in the medium term by the increasing penetration of the Natuzzi brand in the medium-high end of the upholstery market as a result of the marketing initiatives adopted by the Company. Total net sales of Divani & Divani by Natuzzi, Natuzzi Stores and Kingdom of Leather increased 10.3% in 2003 to € 106.0 million compared to 2002. In 2003, total seats sold increased 1.0% to 3,058,835 from 3,027,658 sold in 2002. The slight increase was due to an increase of 8% in the Americas (1,699,160 seats) and a 0.9% increase in the rest of the world (excluding Europe) (178,109 seats), which almost completely offset a 7.6% decrease reported in Europe (1,181,566 seats). The negative performance suffered in Europe reflects the difficult economic conditions reported in many countries: Germany (-24.2%), France (-5.1%), Belgium (-5.6%), Holland (-13.3%), Norway (-16.3%), Sweden (-27.5%), and Ireland (-43.7%). These reductions in sales were only partially offset by the increases in sales in the United Kingdom (+13.6%), mainly due to the acquisition of the Kingdom of Leather group; in Greece (+17.7%); and in Spain (+24.4%). Seats sold in the United States and Canada in 2003 increased 6.8% and 25.0%, respectively. Growth in the United States and Canada was mainly the result of the growing success of the Group's promotional brand, Italsofa. In the rest of the world, seats sold increased from 176,483 in 2002 to 178,109 in 2003. The rise included increases in Australia (+10.5%), Japan (+25.0%), New Zealand (+3.8%) and China (+6.6%), which were partially offset by lower sales in Israel (-19.1%), Korea (-33.8%) and Singapore (-38.9%). In 2003, total leather-upholstered seats sold decreased 5.1% to 2,310,121 from 2,433,509 seats sold in 2002, while total fabric-upholstered seats sold increased 26.0% to 748,714 from 594,149 seats sold in 2002.

The Natuzzi brand sold 2,126,403 seats in 2003, 8.1% less than in 2002, while sales of Italsofa seats increased 30.5% to 932,432 compared to 2002. Other net sales increased 35.8% to € 95.6 million compared to 2002. The increase is due to the upgrade of the distribution channel dedicated to the Natuzzi brand and an increase in sales of accessories. Cost of goods sold as a percentage of net sales increased from 64.3% in 2002 to 66.1% in 2003. When expressed at constant exchange rates, cost of sales as a percentage of net sales decreased slightly in 2003. The improvement of the margin at a constant exchange basis was due to a decrease in the cost of leather and savings resulting from efficiencies achieved in manufacturing operations. The Group's gross profit decreased 9.3% in 2003 to € 260.8 million compared to 2002, as a result of the factors described above.

Selling expenses for 2003 increased 23.3% to € 179.3 million compared to 2002, and as a percentage of net sales increased from 18.1% in 2002 to 23.3% in 2003, mainly due to higher marketing expenses. General and administrative expenses for 2003 decreased 3.2% to € 39.2 million compared to 2002, and as a percentage of net sales increased from 5.0% in 2002 to 5.1% in 2003. Operating income for 2003 decreased 58.4% to € 42.3 million compared to € 101.8 million reported in 2002.
Other income (expense), net decreased to € 3.6 million in 2003 from € 14.6 million in 2002. Net interest income, included in other income (expense), net, in 2003 was € 0.5 million, compared to € 1.6 million in 2002. Foreign exchange transactions, net, also included in other income (expense), net, resulted in a gain of € 6.3 million in 2003, compared to a gain of € 9.3 million in 2002. The gain in 2003 was mainly due to the following:

- An actual gain of € 25.4 million in 2003 (compared to a gain of € 10.9 million in 2002), due to the difference between the forward rate of the domestic currency swaps used to protect against any potential unfavourable effect of the foreign currency at which the company sets its price list and the spot rate at which the domestic currency swaps were closed;

- An actual loss of € 7.6 million in 2003 (compared to a loss of € 8.8 million in 2002), from the difference between the invoice exchange rate and the collection/payment exchange rate;

- An unrealised loss of € 1.1 million (compared to a loss of € 0.6 million in 2002) recorded in the consolidated statement of earnings from the conversion of non-euro financial statements of the Company's subsidiaries;

- An unrealised loss of € 16.6 million in 2003 (compared to an unrealised gain of € 5.8 million in 2002) on accounts receivable and payable; and

- An unrealised gain of € 6.2 million in 2003 (compared to an unrealised gain of € 2.0 million in 2002), from the mark-to-market of domestic currency swaps.

The Group also recorded other expense in 2003 of € 3.2 million compared to other income of € 3.7 million reported in 2002. The amount of € 3.2 million reported for other expense in 2003 included an extraordinary loss of € 4.3 million deriving from the impairment of fixed assets. The Group's effective income tax rate for 2003 was 18.5%, compared to 21.5% in 2002. The lower rate was due to consolidated pre-tax earnings received from domestic and foreign companies that are entitled to tax exemptions. Net earnings decreased from € 91.4 million in 2002 to € 37.3 million in 2003. On a per Ordinary Share, or ADS basis, net earnings decreased from € 1.67 in 2002 to € 0.68 in 2003. As a percentage of net sales, net earnings decreased from 11.4% in 2002 to 4.9% in 2003.

As disclosed in Note 26 to the Consolidated Financial Statements included in Item 18 of this annual report, established accounting principles in Italy vary in certain significant respects from generally accepted accounting principles in the United States. Net earnings under U.S. GAAP for the years ended December 31, 2003, 2002 and 2001 would have been € 38.0 million, € 92.0 million and € 71.1 million, respectively, compared to net earnings under Italian GAAP for the same periods of € 37.3 million, € 91.4 million and € 75.6 million, respectively.

GIAMBATTISTA MASSARO

General Manager,
Member of the Board of Directors

PRODUCTION

The Group's manufacturing system is currently made up of 14 active production plants in Italy, Brazil, Romania and China, covering a total surface area of 316,000 square metres. Production is carried out using the just-in-time method in vertically integrated production plants, controlling each manufacturing phase from wooden frames to finished products. This allows us to achieve a remarkable level of quality and efficiency. The Italian facilities are located in the provinces of Udine, Naples, Bari, Taranto and Matera, while the Group's foreign facilities are dedicated to Italsofa and are located in Salvador de Bahia (Brazil), Baiamare (Romania) and Shanghai (China).

In Brazil, construction of the new manufacturing premise has just been completed, enlarging the plant built in 2001 in Salvador de Bahia. This new unit, 28,000 square metres in size, has allowed us to double capacity from the previous 750 to 1,500 seats per day, with a total number of 624 employees at December 31. We started 2003 with the acquisition of the company Minuano Nordeste and construction of a new plant with 26,000 square metres of covered space on 160,000 square metres of land just 70 km from Salvador de Bahia in the Pojuca area. This plant will be identical to the current one and therefore will have a production capacity of 1,500 seats per day, and will employ more than 700 people. It is expected to be operational by the end of September 2004. Total anticipated investment is approximately 10 million euros.

In Romania, construction of the industrial plant to produce semi-finished wood products, with fir and beech elements, wooden feet, and polyester padding, the majority of which is sent to Italy, as well as sofas and armchairs for the Italsofa range for the European market, has been completed. The production plant in Baiamare has a production capacity of 1,500 seats per day and employed 750 people at December 31.

The Italsofa production plant in Shanghai, China, which had 679 employees on December 31, 2003 and a daily production capacity of 1,200 seats, all exported to the US, completes the picture of the Natuzzi Group's foreign factories. At the end of 2003, construction work began on a new sofa production floor 42,000 square metres in size, with a daily production capacity of 2,400 seats, anticipated employment of 1,200 new workers, and an expected investment of 20 million euros. The plant will go into operation during the third quarter of 2004.

Overall, 2003 investments in production activities outside Italy reached 18 million euros, provided employment to 2,062 people at December 31, 2003, and have a total daily production capacity of 4,200 seats. Further investments made at the end of 2003 will lead to further increases over the years, to production capacity abroad of more than 3,900 seats per day.

The external and interior architecture of all Italsofa factories abroad offer the same features and standards that have inspired the Group as a whole: modern processes using complete, integrated cycles for semi-finished products, and wooden frames and padding are manufactured within the plant, creating significant advantages in terms of product and service quality.

THE ITALSOFA ROMANIA
PLANT IN BAIAMARE

GIOVANNI COSTANTINO
Executive Research and Development Director

RESEARCH & DEVELOPMENT

The Natuzzi Group is constantly investing in research and development, anticipating trends and technologies while at the same time supporting activities already underway. Thanks to a unique and creative organization comprised of designers, architects, decorators, furnishers, colour and materials experts and constant technical and development innovations that simplify, optimise and rationalize the product development process, every year Natuzzi develops more than 100 new sofas, along with a wide range of furnishings and home accessories. This leads to a wider, more varied range of products made up of 346 different sofas and armchairs designed to satisfy all tastes and styles in accordance with the Group's motto - "It's how you live." Our offer is divided into three main product lines:

- The Natuzzi line, an expression of the casual-contemporary style and synonym for Italian design throughout the world.

- The top-of-the-line Pasquale Natuzzi Collection, with finely designed products using high quality materials and finishes.

- The Italsofa sofas and armchairs positioned in the promotional segment, that combines Italian style with an efficient production organization, with plants located in China, Brazil and Romania.

The Natuzzi Group offers the widest range of leathers available on the market: more than 200 colours, available from the two families Protecta or Natural, which meet all needs in terms of beauty and use; a total of 32 articles in 9 different price ranges. The collection of ultra-microfibres (Dreamfibre) includes 5 articles in 66 different colours. The collection of Teflon-treated fabrics, all extremely prestigious and in new colours, includes 12 articles in 108 colours. There are also numerous functions (manual and electric relaxation mechanisms, massage) that are supported by ongoing research and technical and aesthetic innovation.

The new Product Warranty was introduced in 2003; it includes regulations from the Italian government along with European Community directive 1999/44/EC on sales and warranties of consumer goods.

THE NATUZZI STORE
IN MONTERREY, MEXICO
(SEE PAGES 18-19)

Thanks to its in-house laboratory, which is highly specialized and capable of performing the strictest tests, the Natuzzi Group can offer a much better warranty than legally required: 10 years on the sofa frame. Attention to the quality of products and processes is also confirmed by ISO 9001/2000 certification in all of its Italian production plants.

Constant in-house research activities, analysis, development, engineering, industrialization and production are combined with the entire Natuzzi offer, which includes sofas, armchairs and lines dedicated to furniture accessories such as tables, lamps and carpets. The wide range of items should be added to these product categories, which not only sell sofas but lead to an increase in store traffic while completing the decorative harmony of the room setting.

In order to meet demands for speed and flexibility in opening and updating Natuzzi points of sale, the company has developed an area which is dedicated to the design, development and independent production of all visual merchandising elements (the "Natuzzi Display System") for stores and galleries, based on various style and sales needs.

The Group strategy that aims at strengthening and consolidating the brand name in the world is epitomized by the Design & Engineering Retail Department, which involves architects, interior decorators, and construction and process controllers in the design development, architectural and execution activities of Natuzzi points of sale. The process is completed by on-site activities including visual merchandising and training for salespeople on the product and management/maintenance of the showroom area. Complete synergy between the various organizations involved guarantees speed, optimisation of costs and extremely high quality. Proof of this is the opening of 295 Natuzzi stores and galleries world-wide in 2003.


NATUZZI


It's
how
you
live

GIANLUCA MONTELEONE

Executive Marketing and Communication Director,
Member of the Board of Directors

THE NATUZZI BRAND PROJECT

Natuzzi's goal is to deliver the same image and philosophy throughout the world, with the same strength and universe of values. Following is an analysis of the main initiatives in each area.

THE VISUAL IDENTITY SYSTEM

The new visual identity, launched in January 2002 at the International Furniture Fair in Cologne, has become an important part of everyday company life. Reviewing visual identity has created a successful transition through which the brand name has taken on a new aesthetic dimension and strategic position. "It's how you live," the payoff chosen to deliver the new brand positioning, perfectly expresses the Natuzzi evolution from sofa manufacturer to inspirer of furnishing experience.

THE DISPLAY SYSTEM

A brand name that wants to affirm its identity in a very effective manner must consider systems that regulate distribution methods.
The flexible, modular Natuzzi Display System allows each market/channel to be managed. It operates on two levels:

- The store, which guarantees the best possible control of the ways the brand name is presented.

- The gallery, which allows control even in display spaces made available from dealers, using the "shop within shop" formula.

In 2003, 39 stores and 256 galleries were opened in 28 different countries, with the total number of Natuzzi points of sale (stores and galleries) rising to 584 throughout the world by year end.

THE COMMUNICATION SYSTEM

In each market in which it operates, the brand name must communicate in a manner consistent with its global position, but at the same time must be capable of acting efficiently in a local setting. The Natuzzi Communication System, developed to regulate all methods the brand name uses to communicate in each market/channel, operates transversally on different levels. Following are the main activities performed:

• The goal of "Brand building level" is to institutionally establish the brand philosophy: in 2003, 5 new campaign subjects were developed. Each subject explores a different way of enjoying the living room, connecting a specific consumer target by age, spending potential and lifestyle to a specific product. In October 2003 the new Natuzzi Collection 2004 catalogue was presented in advance at High Point in the USA. It included a tale comprised of 16 different stories from 16 different consumers who chose Natuzzi to furnish their homes. The catalogue is currently available in 13 different languages.
  As further support to the brand name, that same October, the new web site was launched, with contents and graphics completely redesigned. The site is now available in 8 different languages, is easy to consult and features a dealer locator function that offers immediate access to Natuzzi points of sale throughout the world.

• The "Traffic building" level aims to attracting consumers to the points of sale, stores and galleries, using various kinds of initiatives: presentation of new collections, announcing new openings and promotional activities. In order to support the "Stores channel," 200 advertising projects in 14 different markets have been devised. Advertising in the "Galleries channel" was carried out with the help of the Retail Advertising Kit, a collection of 95 different templates that permitted advertising to be handled by co-branding with the galleries. Seventy-seven dealers in 17 different countries have used the Retail Advertising Kit.

The 378 advertising activities, carried out in 30 different countries, reflect the worldwide dimension that the brand project assumed in 2003, placing Natuzzi in a unique position within its own product category.

In the future, the work that lies ahead is to continue expanding the project horizontally by looking at new markets, and vertically by looking at markets that are already active. Careful preparation before launching the product, with aim of defining a clear management model, will make this hard task feasible over the next few years.


BEHIND EVERY EXCLUSIVE STYLE
YOU'LL FIND TRUE INNOVATION
Natuzzi is available only at authorized dealers
www.natuzzi.com
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FREDRICK STARR

President and Chief Executive
Officer of Natuzzi Americas

ANTONELLO BRACALELLO

South West Europe, Asia Pacific Sales
and Marketing Director

ENRICO RAGGI DE MARINI

N-E Europe, Middle East and
Africa Sales and Marketing Director

KEY SALES AND MARKETING ACTIVITIES

Natuzzi Americas
South West Europe and Asia Pacific
N-E Europe, Middle East and Africa

In 2003, Natuzzi Americas focused on building the Natuzzi Brand in several ways:

- National Advertising - we began our institutional advertising campaign in March 2003 - beautiful lifestyle ads ran throughout the year in home magazines such as Better Homes and Gardens, House Beautiful, and Good Housekeeping - additionally, we were in general magazines, Oprah and InStyle - during the year, over 200,000,000 impressions were generated with consumers in the United States and Canada.

- Natuzzi Americas had major success with the Natuzzi Gallery Program - after thorough retail testing of this “Store within a Store” concept in 2002, Natuzzi expanded rapidly during 2003 - by the end of the year, Natuzzi had 187 Galleries with 609,000 square feet of retail floor space with leading furniture retailers.

- In September, the Company opened a Natuzzi Boutique in Soho in New York City - this 3,800 square foot “Window to the World” has been designed to present the Natuzzi brand and products to consumers from all over the world in ways that enhance the brand.

- Natuzzi Americas expanded Natuzzi University in 2003 - over 700 retail sales people and other sales people went through 2 days of intensive training in Natuzzi's High Point showroom - new course materials were added to the training program to increase understanding and effectiveness in selling Natuzzi within Galleries and furniture stores.

- The first retailer-owned Natuzzi Store in the Americas was opened in November - located in Monterrey, Mexico, this beautifully designed 7,000 square foot store has enjoyed immediate success.

THE NATUZZI STORE
IN SOHO, NEW YORK

In 2003 the SWEAP division key activities aimed at:

- Consolidating growth of the Natuzzi Store chain in Spain through the opening of 11 new owned stores, bringing the total to 18 stores and reaching considerable coverage of the Spanish territory. Natuzzi brand awareness increased thanks to investments in branding and promotional campaigns and Direct Marketing/One to One activities.

- Establishing a new organization for the Natuzzi Store chain management in Switzerland. This allowed us to open 4 new stores (including a flagship location in downtown Zurich) and brought the total of the chain to 10 owned stores at the end of 2003. As in Spain, in Switzerland we also worked to increase Natuzzi brand awareness through both branding and promotion activities. All the marketing activities have been developed both in German and French to meet the language needs of the country.

- Strengthening our partnership with the Roche Bobois group to continue the development of the Natuzzi Store chain in France, with the opening of 3 stores in prestigious locations (like the two flagships in Paris, one in Montparnasse and the other in Orgeval). As of December 2003, our Group totalled 14 Natuzzi franchised stores in France.

- Expanding our presence in the UK through the acquisition of the 14-store leather upholstery chain Kingdom of Leather in the United Kingdom. To achieve this important objective we started a business cooperation with Marks & Spencer, the oldest department store in the United Kingdom. At the same time we also signed a strategic agreement with Reid Furniture for the development of more than 25 galleries throughout Scotland and Ireland and rolled out a total of almost 60 galleries in the United Kingdom. We started investing in co-op advertising and developed a strong galleries launch campaign in July and new collection ones in December.

- Re-positioning the Divani & Divani chain in Italy, Greece and Portugal through their re-branding to Divani & Divani by Natuzzi. This was managed through "tailor-made" marketing activities: branding campaigns to increase brand awareness, promotional campaigns and co-marketing to reach the sales objective, direct marketing to start to work with specific target.

- Starting a strategic alliance with David Jones Department Stores in Australia for the opening of Natuzzi Galleries in all DJ stores carrying furniture.

- Activating country web sites to use them as a marketing lever for our consumer communication.

- Defining common marketing tools for all countries (marketing calendar, point of purchase materials, formats) to make our initiative consistent and effective.

In 2003 the NEEMEA sales division has been developing sales leveraging on both the Natuzzi and Italsofa lines:

- We completed work on the organization side by establishing a subsidiary in Benelux and Germany, in addition to the one already existing in Copenhagen. These local organizations gave us the huge opportunity of monitoring the market very closely and responding much quicker to the changes and the needs of the markets.

- We continued to drive the evolution towards a more “brand oriented” distribution by opening 83 new "shops within shops" between March and December 2003 and by negotiating 67 more galleries for 2004. Meanwhile we have also closed several accounts or passed them on to Italsofa.

- We started cooperating very closely with our gallery partners on local marketing activities (through the Natuzzi partnership Program) and we started national advertising campaigns in Benelux and Germany, with Belgium showing an extraordinarily good response.

- 36 galleries were opened in Belgium. The sales trend has shown very encouraging signs starting in October 2003, after the beginning of the first national campaign run both in Belgium and in Holland.

- 11 galleries were opened in Germany. We are committed to implementing the brand strategy and aware that this difficult market requires a specific marketing approach. It is for this reason that we decided to fund a new sales organization based in Frankfurt directly reporting to our headquarter, with appropriate responsibilities and skills. Through this organization, by year end we finalized gallery agreements with 8 dealers who represent the opinion leaders in the trade community and who will then become the benchmark on the market. The first example was the opening of a Gallery at Karstadt-Munchen.

- In the Scandinavian area, given the limited possibilities of covering the territories with a wide network of galleries of the appropriate quality, after a thorough market analysis, we decided to go ahead with opening Natuzzi stores in Denmark and Sweden in 2004. The first Natuzzi store will open in Denmark before summer, followed by another 4 (Copenhagen and Stockholm) after the summer holidays.

- In Norway we have finalized agreements for opening 8 new galleries in 2004 in addition to the current 7, and the same in Finland, where we have already opened 6 galleries.

- In Eastern Europe the environment is very favourable to the Natuzzi brand strategy and retail development is going ahead, both through opening new Natuzzi stores (Belgrade-Serbia and Celje-Slovenia are the latest examples) and through new galleries. In 2003 we took full control of strategic markets like Russia and Ukraine by terminating the relationship with the former importer and establishing our local organization, recruiting a sales manager employed by the Group. We are planning to open Natuzzi stores in Russia and Ukraine starting in 2004, following a clear distribution plan. Poland, the Czech Republic and Romania will also soon see Natuzzi stores opening.

- In the Middle East (including Israel) we have opened 3 galleries and we have concluded agreements for opening 14 Natuzzi stores between 2004 and 2005. One store in a splendid location in Beirut opened in February 2004.

- Italsofa has grown by double digits and is steady on all markets, and we still see areas of strong growth on many markets. Overall sales grew 50%, with particular peaks in Holland +110%, Belgium +86%, Germany + 63 %, Norway + 43%, Sweden 30%. Belgium, Holland, Germany, Norway, Sweden, and Russia are markets where we also foresee higher growth potential in 2004. The importance of Italsofa in consolidating and preserving market share on the middle-low end of the market is such that we have decided to establish a dedicated sales force for this line in Germany and Russia. Should this decision prove to be successful, we will also apply it in other strategic markets.

ENRICO CARTA

Human Resources and
Organization Director

HUMAN RESOURCES

As of December 31, 2003, the Natuzzi Group employed 6,230 people. The following figures clearly show the Group's human resources development strategy:

- Natuzzi continues to invest in human resources: there was an increase of 8.5% in the number of individuals employed compared with the previous year.

- Natuzzi confirms and expands internationalisation: the number of people employed abroad is 2,247, 36 % of the total number compared with 22% for the previous year.

- Natuzzi accelerates its “market oriented” development in human resources: the number of employees operating in Italy and abroad, on a corporate level and in terms of countries, in sales departments, in marketing and in communication is constantly increasing, accounting for 9.5% of the total versus 4% for the previous year.

The year 2003 was also important for continuing with:

- Internationalisation of management and commercial local structures, through introduction, management and integration processes according to their own particular context and also appropriately guarantee the idea of “one firm” with one common company culture.

- Introduction of new professional skills required to complete the brand name project by covering operating areas that are new, sophisticated and difficult to source.

- Ongoing training: not only aimed at transferring technical know-how, but to support and promote the brand philosophy: total quality and customer service.

The year 2003 was also characterized by the rigorous reorganization of supporting functions in terms of production and services, with the goal of reducing operating costs and creating a more balanced relationship between direct and indirect individuals involved in production; this process, which involved social agencies and the Italian Ministry of Employment, achieved its objectives without generating any kind of conflict.

CREDITS

BOARD OF DIRECTORS
at July 15th, 2004

Pasquale Natuzzi	***Chairman of the Board of Directors***
Giuseppe Desantis	***Vice Chairman of the Board of Directors***
Giambattista Massaro	***Director***
Gianluca Monteleone	***Director***
Armando Branchini	***Outside Director***
Stelio Campanale	***Outside Director***
Pietro Gennaro	***Outside Director***
Giuseppe Russo Corvace	***Outside Director***
Enrico Vitali	***Outside Director***

BOARD OF INTERNAL AUDITORS

Francesco Venturelli	***Chairman***
Cataldo Sferra	
Costante Leone	

INDEPENDENT AUDITORS

KPMG spa

MANAGEMENT

at July 15th, 2004

Pasquale Natuzzi	***Chief Executive Officer, Chairman of the Board of Directors***
Giuseppe Desantis	***General Manager, Vice Chairman of the Board of Directors***
Giambattista Massaro	***General Manager, Member of the Board of Directors***
Gianluca Monteleone	***Executive Marketing and Comm. Director, Member of the Board of Directors***
Giuseppe Russo Corvace	***Managing Director for Accounting and Finance***
Armando Branchini	***Outside Director***
Stelio Campanale	***Outside Director***
Pietro Gennaro	***Outside Director***
Enrico Vitali	***Outside Director***
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