SUPERIOR UNIFORM GROUP INC
Form 10-Q
April 21, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 or 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarter ended March 31, 2011

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 001-05869

SUPERIOR UNIFORM GROUP, INC.

Incorporated - Florida

Employer Identification No. 11-1385670

10055 Seminole Boulevard

Seminole, Florida 33772-2539

Telephone No.: 727-397-9611

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one)

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller Reporting Company	x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of April 19, 2011 the registrant had 5,993,039 common shares outstanding, which is the registrant s only class of common stock.

PART I - FINANCIAL INFORMATION

ITEM 1. Financial Statements

SUPERIOR UNIFORM GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

		Three Months Ended March 31, 2011	2010
Net sales		$ 26,898,600	$ 25,979,862
Costs and expenses:			
Cost of goods sold		17,047,681	17,048,374
Selling and administrative expenses		8,905,850	8,120,797
Interest expense		6,147	2,474
		25,959,678	25,171,645
Earnings before taxes on income		938,922	808,217
Income tax expense		340,000	300,000
Net earnings		$ 598,922	$ 508,217
Weighted average number of shares outstanding during the period	(Basic)	5,978,828	5,908,054
	(Diluted)	6,070,970	5,960,009
Per Share Data:			
Basic			
Net earnings		$ 0.10	$ 0.09
Diluted			
Net earnings		$ 0.10	$ 0.09
Cash dividends per common share		$ 0.135	$ 0.135

See accompanying notes to condensed consolidated interim financial statements.

SUPERIOR UNIFORM GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

	March 31, 2011 (Unaudited)	December 31, 2010 (1)
CURRENT ASSETS:		
Cash and cash equivalents	$ 1,888,926	$ 9,107,461
Accounts receivable and other current assets	27,517,775	21,827,978
Inventories*	30,964,068	31,029,947
TOTAL CURRENT ASSETS	60,370,769	61,965,386
PROPERTY, PLANT AND EQUIPMENT, NET	9,354,258	9,463,884
OTHER INTANGIBLE ASSETS, NET	3,472,341	911,225
DEFERRED INCOME TAXES	1,938,400	1,680,000
OTHER ASSETS	151,723	173,403
	$ 75,287,491	$ 74,193,898

LIABILITIES AND SHAREHOLDERS EQUITY

CURRENT LIABILITIES:		
Accounts payable	$ 5,672,752	$ 5,103,768
Other current liabilities	2,416,266	3,713,038
TOTAL CURRENT LIABILITIES	8,089,018	8,816,806
LONG-TERM PENSION LIABILITY	3,611,405	3,535,470
OTHER LONG-TERM LIABILITIES	770,000	742,000
SHAREHOLDERS EQUITY:		
Preferred stock, $1 par value - authorized 300,000 shares (none issued)		
Common stock, $.001 par value - authorized 50,000,000 shares, issued and outstanding - 5,990,669 and 5,959,975, respectively.	5,990	5,960
Additional paid-in capital	18,676,909	16,753,094
Retained earnings	48,113,176	48,402,710
Accumulated other comprehensive loss, net of tax:		
Pensions	(3,979,007)	(4,062,142)
TOTAL SHAREHOLDERS EQUITY	62,817,068	61,099,622
	$ 75,287,491	$ 74,193,898

* Inventories consist of the following:

	March 31, 2011 (Unaudited)	December 31, 2010

Finished goods	$ 22,853,003	$ 23,828,283
Work in process	42,490	66,853
Raw materials	8,068,575	7,134,811
	$ 30,964,068	$ 31,029,947

(1) The balance sheet as of December 31, 2010 has been derived from the audited balance sheet as of that date and has been condensed.
See accompanying notes to condensed consolidated interim financial statements.

SUPERIOR UNIFORM GROUP, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Three Months Ended March 31,

(Unaudited)

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net earnings	$ 598,922	$ 508,217
Adjustments to reconcile net earnings to net cash used in operating activities:		
Depreciation and amortization	793,734	680,271
Provision for bad debts	28,168	44,602
Share-based compensation expense	788,021	381,704
Deferred income tax benefit	(301,400)	(270,250)
Gain on sales of property, plant and equipment		(37,937)
Changes in assets and liabilities:		
Accounts receivable and other current assets	(5,717,965)	(870,835)
Inventories	65,879	(1,738,144)
Other assets	21,680	39,211
Accounts payable	568,984	(256,182)
Accrued expenses	(1,296,772)	(43,973)
Pension liability	202,070	28,047
Other long-term liabilities	28,000	25,000
Net cash flows used in operating activities	(4,220,679)	(1,510,269)
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to property, plant and equipment	(394,778)	(616,924)
Disposals of property, plant and equipment	10,986	44,156
Proceeds from notes receivable collections		7,626
Acquisition of intangible assets	(2,061,432)	
Net cash used in investing activities	(2,445,224)	(565,142)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from long-term debt	3,320,000	3,035,000
Repayment of long-term debt	(3,320,000)	(3,035,000)
Payment of cash dividends	(806,776)	(797,847)
Proceeds received on exercise of stock options	366,774	28,008
Common stock reacquired and retired	(112,630)	(182,881)
Net cash used in financing activities	(552,632)	(952,720)
Net decrease in cash and cash equivalents	(7,218,535)	(3,028,131)
Cash and cash equivalents balance, beginning of year	9,107,461	6,365,557
Cash and cash equivalents balance, end of period	$ 1,888,926	$ 3,337,426

See accompanying notes to condensed consolidated interim financial statements.

SUPERIOR UNIFORM GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

THREE MONTHS ENDED MARCH 31, 2011 AND 2010

(Unaudited)

NOTE 1 Summary of Significant Interim Accounting Policies:

a) Basis of presentation

The condensed consolidated interim financial statements include the accounts of Superior Uniform Group, Inc. and its wholly owned subsidiaries Fashion Seal Corporation and Superior Office Solutions, and their jointly owned subsidiaries, The Office Gurus and The Office Masters. They also include Superior Office Solutions S.A. and Scratt Kit S.R.L., wholly owned subsidiaries of Superior Office Solutions. Intercompany items have been eliminated in consolidation. The accompanying unaudited interim financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010, and filed with the Securities and Exchange Commission. The interim financial information contained herein is not certified or audited; it reflects all adjustments (consisting of only normal recurring accruals) which are, in the opinion of management, necessary for a fair statement of the operating results for the periods presented, stated on a basis consistent with that of the audited financial statements. The unaudited financial information included in this report as of and for the three months ended March 31, 2011 has been reviewed by Grant Thornton LLP, independent registered public accounting firm, and their review report thereon accompanies this filing. Such review was made in accordance with established professional standards and procedures for such a review. The results of operations for any interim period are not necessarily indicative of results to be expected for the full year.

b) Revenue recognition

The Company records revenue as products are shipped and title passes. A provision for estimated returns and allowances is recorded based on historical experience and current allowance programs.

c) Recognition of costs and expenses

Costs and expenses other than product costs are charged to income in interim periods as incurred, or allocated among interim periods based on an estimate of time expired, benefit received or activity associated with the periods. Procedures adopted for assigning specific cost and expense items to an interim period are consistent with the basis followed by the registrant in reporting results of operations at annual reporting dates. However, when a specific cost or expense item charged to expense for annual reporting purposes benefits more than one interim period, the cost or expense item is allocated to the interim periods.

d) Amortization of other intangible assets

The Company amortizes identifiable intangible assets on a straight line basis over their expected useful lives. Amortization expense for other intangible assets was $300,000 and $96,000 for the three-month periods ended March 31, 2011 and 2010, respectively.

e) Advertising expenses

The Company expenses advertising costs as incurred. Advertising costs for the three-month periods ended March 31, 2011 and 2010, respectively, were $22,000 and $8,000.

f) Shipping and handling fees and costs

The Company includes shipping and handling fees billed to customers in net sales. Shipping and handling costs associated with in-bound and out-bound freight are generally recorded in cost of goods sold. Other shipping and handling costs such as labor and overhead are included in selling and administrative expenses and totaled $1,471,000 and $1,603,000 for the three months ended March 31, 2011 and 2010, respectively.

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g) Inventories

Inventories at interim dates are determined by using both perpetual records on a first-in, first-out basis and gross profit calculations.

h) Accounting for income taxes

The provision for income taxes is calculated by using the effective tax rate anticipated for the full year.

i) Employee benefit plan settlements

The Company recognizes settlement gains and losses in its financial statements when the cost of all settlements in a year is greater than the sum of the service cost and interest cost components of net periodic pension cost for the plan for the year.

j) Earnings per share

Historical basic per share data is based on the weighted average number of shares outstanding. Historical diluted per share data is reconciled by adding to weighted average shares outstanding the dilutive impact of the exercise of outstanding stock options and stock appreciation rights.

	Three Months Ended March 31, 2011	2010
Net earnings used in the computation of basic and diluted earnings per share	$ 598,922	$ 508,217
Weighted average shares outstanding - basic	5,978,828	5,908,054
Common stock equivalents	92,142	51,955
Weighted average shares outstanding - diluted	6,070,970	5,960,009
Per Share Data:		
Basic		
Net earnings	$ 0.10	$ 0.09
Diluted		
Net earnings	$ 0.10	$ 0.09

Awards to purchase 533,000 and 608,000 shares of common stock with weighted average exercise prices of $11.96 and $11.61 per share were outstanding during the three-month periods ending March 31, 2011 and 2010, respectively, but were not included in the computation of diluted EPS because the awards exercise prices were greater than the average market price of the common shares.

k) Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

l) Comprehensive income

Total comprehensive income represents the change in equity during a period from sources other than transactions with shareholders and, as such, includes net earnings. For the Company, the only other component of total comprehensive income is the change in pension costs.

	Three Months Ended March 31, 2011	2010
Net earnings	$ 598,922	$ 508,217
Other comprehensive income:		
Pensions - reclassification to net earnings during the period	83,135	74,930
	$ 682,057	$ 583,147

m) Operating Segments

Accounting standards require disclosures of certain information about operating segments and about products and services, geographic areas in which the Company operates, and their major customers. The Company has evaluated its operations and has determined that currently it operates in one segment, as defined in the standards.

n) Share-Based Compensation

The Company awards share-based compensation as an incentive for employees to contribute to the Company s long-term success. Historically, the Company has issued options and stock settled stock appreciation rights. At March 31, 2011, the Company had 1,424,250 shares of common stock authorized for awards of share-based compensation under its 2003 Incentive Stock and Awards Plan.

For the three months ended March 31, 2011 and 2010, respectively, the Company recognized $788,000 and $382,000 of share-based compensation recorded in selling and administrative expense in the Condensed Consolidated Statements of Earnings. This expense was offset by a $132,000 and a $29,000 deferred tax benefit for non-qualified share-based compensation for the three months ended March 31, 2011 and 2010, respectively. As of March 31, 2011, the Company had no unrecognized compensation cost expected to be recognized for prior share-based awards.

The Company grants stock options and stock settled stock appreciation rights (SARS) to employees that allow them to purchase shares of the Company s common stock. Options are also granted to outside members of the Board of Directors of the Company. The Company determines the fair value of stock options and SARS at the date of grant using the Black-Scholes valuation model.

All options and SARS vest immediately at the date of grant. Awards generally expire five years after the date of grant with the exception of options granted to outside directors, which expire ten years after the date of grant. The Company issues new shares upon the exercise of stock options and SARS.

During the three-month periods ended March 31, 2011 and 2010, respectively, the Company received $367,000 and $28,000 in cash from stock option exercises. No tax benefit was recognized for these exercises, as the options exercised were qualified incentive stock options.

A summary of options transactions during the three months ended March 31, 2011 follows:

	No. of Shares		Weighted Average Exercise Price			
Outstanding December 31, 2010	(16,992)	(22,424)				
Other Income (Expenses) Net	(62,066)	(41,994)	(34,924)	(42,092)	(77,810)	(102,686)
Income Before Provision for Income Taxes	539,442	389,793	444,575	539,309	678,177	894,990
Provision for Income Taxes	(162,696)	(117,328)	(156,852)	(199,266)	(238,757)	(315,088)
Income Before Minority Interests in Consolidated Subsidiaries	376,746	272,465	287,723	340,043	439,420	579,902
Minority Interests in Income of Consolidated Subsidiaries	(4,669)	(5,122)	(8,614)	(9,253)	(8,715)	(11,501)
Net Income from Continuing Operations	372,077	267,343	279,109	330,790	430,705	568,401
Discontinued Operations Net of Taxes and Gain on Sale (8)	0	0	7,765	11,504	(6,419)	(8,471)
Net Income	372,077	267,343	286,874	342,294	424,286	559,930
Weighted Average Shares Outstanding (thousands)						
Basic	453,174.0	448,664.4	448,275.0	450,179.1	452,898.0	452,898.0
Diluted	455,353.5	450,202.1	450,360.9	453,303.4	456,186.0	456,186.0
Basic Earnings per Share from Continuing Operations (2)	0.82	0.60	0.62	0.73	0.95	1.25
Basic Earnings per Share from Discontinued Operations (2)(8)	0.00	0.00	0.02	0.03	(0.01)	(0.01)
Basic Earnings per Share (2)	0.82	0.60	0.64	0.76	0.94	1.24
Diluted Earnings per Share from Continuing Operations (2)	0.82	0.59	0.62	0.73	0.94	1.24
Diluted Earnings per Share from Discontinued Operations (2)(8)	0.00	0.00	0.02	0.03	(0.01)	(0.01)
Diluted Earnings per Share (2)	0.82	0.59	0.64	0.76	0.93	1.23

Cash Dividends Declared per Share (4)(5)	0.17	0.21	0.21	0.23	0.29	0.38

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(1) Translated for convenience at the rate of Euro 1.00 = U.S.$1.3197, based on the Noon Buying Rate of Euro to U.S. dollar on December 31, 2006. See Exchange Rate Information below for more information regarding the Noon Buying Rate.

(2) Earnings per Share for each year have been calculated based on the weighted-average number of shares outstanding during the respective years. Each American Depositary Share, or ADS, represents one ordinary share.

(3) Except per Share amounts, which are in Euro and U.S. dollars, as applicable.

(4) Cash Dividends Declared per Share are expressed in gross amounts without giving effect to applicable withholding or other deductions for taxes.

(5) Our dividend policy is based upon, among other things, our consolidated net income for each fiscal year, and dividends for a fiscal year are paid in the immediately following fiscal year. The dividends reported in the table were declared and paid in the fiscal year for which they have been reported.

(6) We acquired 82.57 percent of the outstanding shares of OPSM Group Limited (OPSM) in August 2003. As such, the results for 2003 include approximately five months of operating results of OPSM and its subsidiaries. In March 2005, we acquired the remaining 17.43 percent of the outstanding shares of OPSM and, from that date, 100 percent of the operating results of OPSM and its subsidiaries are included above.

(7) We acquired all of the outstanding shares of Cole National Corporation (Cole) in October 2004. Therefore, 2004 includes approximately three months of operating results of Cole.

(8) Certain amounts in prior years have been reclassified to conform to the 2006 presentation. The 2006 presentation includes the reclassification of the operations of the Things Remembered, Inc. (Things Remembered) specialty gift business, which was acquired as part of the Cole acquisition in 2004 and was sold to a private equity consortium in September 2006. The TR operations have been reclassified as discontinued operations for all periods presented.

	As of December 31, 2002	**2003**	**2004 (3)**	**2005 (3)**	**2006 (3)**	**2006 (3)**
	(In thousands of Euro except share data)					**(In thousands of U.S.$)(1)**
BALANCE SHEET DATA:						
Working Capital(2)	141,390	(56,185)	218,807	368,863	59,539	78,574
Total Assets	3,586,332	3,912,676	4,556,058	4,973,522	4,915,025	6,486,359
Total Debt(4)	1,033,989	1,253,427	1,680,452	1,528,909	1,319,262	1,741,030
Shareholders Equity	1,417,895	1,374,534	1,495,607	1,954,033	2,215,849	2,924,256
Capital Stock	27,256	27,269	27,312	27,479	27,613	36,441
Number of Shares Adjusted to Reflect Changes in Capital (thousands)	454,263.6	454,477.0	455,205.5	457,975.7	460,216.2	

(1) Translated for convenience at the rate of Euro 1.00 = U.S.$1.3197, based on the Noon Buying Rate of Euro to U.S. dollar on December 31, 2006. See Exchange Rate Information below for more information regarding the Noon Buying Rate.

(2) Working capital is total current assets minus total current liabilities. See Item 5 Operating and Financial Review and Prospects Liquidity and Capital Resources.

(3) Certain amounts in prior years have been reclassified to conform to the 2006 presentation. The 2006 presentation includes the reclassification of the operations of the Things Remembered specialty gift business which was acquired as part of the Cole acquisition in 2004 and was sold to a private equity consortium in September 2006. The Things Remembered assets and liabilities have been reclassified as assets and liabilities held for sale for all periods presented.

(4) The current portion of long-term debt was Euro 178.3 million, Euro 390.9 million, Euro 405.1 million, Euro 111.0 million and Euro 359.5 million for the years ended December 31, 2002, 2003, 2004, 2005 and 2006, respectively.

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Dividends

We are required to pay an annual dividend on our ordinary shares if such dividend has been approved by a majority of our shareholders at the annual ordinary meeting of shareholders. Before we may pay any dividends with respect to a fiscal year, we are required to set aside an amount equal to five percent of our statutory net income for such year in our legal reserve until the reserve, including any amounts set aside during prior years, is at least equal to one-fifth of the nominal value of our issued share capital.

At our annual ordinary meeting of shareholders held on May 15, 2007, our shareholders approved the distribution of a cash dividend in the amount of Euro 0.42 per ordinary share. Our Board of Directors proposed, and the shareholders approved, the date of May 24, 2007 as the date for the payment of such dividend to all holders of record of our ordinary shares on May 18, 2007, including Deutsche Bank Trust Company Americas, as depositary on behalf of holders of our American Depositary Shares, or ADSs. Each ADS represents the right to receive one ordinary share and is evidenced by an American Depositary Receipt, or ADR. The ADSs were traded ex-dividend on May 21, 2007, and dividends in respect of the ordinary shares represented by ADSs were paid to Deutsche Bank Trust Company Americas on May 24, 2007. Deutsche Bank Trust Company Americas converted the Euro amount of such dividend payment into U.S. dollars on May 24, 2007. The dividend amount for each ADS holder was paid commencing on June 1, 2007 to all such holders of record on May 23, 2007. Future determinations as to dividends will depend upon, among other things, our earnings, financial position and capital requirements, applicable legal restrictions and such other factors as the Board of Directors and our shareholders may determine.

The table below sets forth the cash dividends declared and paid on each ordinary share in each year indicated.

Year	Cash Dividends per Ordinary Share(1)(2)(3) (Euro)		Translated into U.S.$ per Ordinary Share(4) (U.S.$)
2002	0.170		0.165
2003	0.210		0.242
2004	0.210		0.254
2005	0.230		0.276
2006	0.290		0.363
2007	0.420	(5)	0.564

(1) Cash dividends per ordinary share are expressed in gross amounts without giving effect to applicable withholding or other deductions for taxes.

(2) Each ADS represents one ordinary share.

(3) Our dividend policy is based upon, among other things, our consolidated net income for each fiscal year, and dividends for a fiscal year are paid in the immediately following fiscal year. The dividends reported in the table were declared and paid in the fiscal year for which they have been reported.

(4) Translated at the Noon Buying Rate on the payment date to holders of ADSs. See Exchange Rate Information below for more information regarding the Noon Buying Rate. Holders of ADSs received their dividend denominated in U.S. dollars based on the conversion rate used by our paying agent, Deutsche Bank Trust Company Americas, on the ADS dividend payment date. Deutsche Bank Trust Company Americas converted the dividend in respect of the 2006 fiscal year to U.S.$0.564 per ADS on May 24, 2007.

(5) The dividend of Euro 0.42 per ordinary share was approved by our Board of Directors on March 5, 2007 and was voted upon and approved by our shareholders at the annual ordinary meeting of shareholders held on May 15, 2007.

Exchange Rate Information

The following tables set forth, for each of the periods indicated, certain information regarding the Noon Buying Rate in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York, which we refer to as the Noon Buying Rate, expressed in U.S.$ per Euro 1.00:

Period	High	Low	Average(1)	End of Period
Year Ended December 31, 2002	0.8594	1.0485	0.9495	1.0485
Year Ended December 31, 2003	1.0361	1.2597	1.1411	1.2597
Year Ended December 31, 2004	1.1801	1.3625	1.2478	1.3538
Year Ended December 31, 2005	1.1667	1.3476	1.2400	1.1842
Year Ended December 31, 2006	1.1860	1.3327	1.2661	1.3197

(1) The average of the Noon Buying Rates in effect on the last business day of each month during the period. When the Company consolidates its profit and loss statement, it translates U.S. dollar denominated amounts into Euro using an average U.S. dollar/Euro exchange rate of each business day during the applicable period.

Month	High	Low
December 2006	1.3073	1.3327
January 2007	1.2904	1.3286
February 2007	1.2933	1.3246
March 2007	1.3094	1.3374
April 2007	1.3363	1.3660
May 2007	1.3416	1.3616

On June 26, 2007, the Noon Buying Rate was U.S.$ 1.3468 per Euro 1.00.

Unless otherwise indicated, all convenience translations included in this annual report of amounts expressed in Euro into U.S. dollars for the relevant period or date have been made using the Noon Buying Rate in effect as of the end of such period or date, as appropriate.

In this annual report, unless otherwise stated or the context otherwise requires, references to $, U.S.$, dollars or U.S. dollars are to United State dollars, references to Euro and are to the Common European Currency, the Euro, references to Rs are to Indian rupees, and references to AUD or A$ are to Australian dollars.

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Risk Factors

Our future operating results and financial condition may be affected by various factors, including those set forth below.

If we are not successful in completing and integrating strategic acquisitions to expand or complement our business, our future profitability and growth will be at risk.

As part of our growth strategy, we have made, and may continue to make, strategic business acquisitions to expand or complement our business. For example, we announced on June 20, 2007 that we entered into a merger agreement for the acquisition of Oakley, Inc (Oakley). Our acquisition activities, however, can be disrupted by overtures from competitors for the targeted candidates, governmental regulation and rapid developments in our industry. We may face additional risks and uncertainties following an acquisition, including: (i) difficulty in integrating the newly-acquired business and operations in an efficient and effective manner; (ii) inability to achieve strategic objectives, cost savings and other benefits from the acquisition; (iii) the lack of success by the acquired business in its markets; (iv) the loss of key employees of the acquired business; (v) the diversion of the attention of senior management from our operations; and (vi) liabilities that were not known at the time of acquisition or the need to address tax or accounting issues. If we fail to timely recognize or address these matters or to devote adequate resources to them, we may fail to achieve our growth strategy or otherwise not realize the intended benefits of any acquisition.

If we are unable to successfully introduce new products, our future sales and operating performance will suffer.

The mid- and premium-price categories of the prescription frame and sunglasses markets in which we compete are particularly vulnerable to changes in fashion trends and consumer preferences. Our historical success is attributable, in part, to our introduction of innovative eyewear products which are perceived to represent an improvement over products otherwise available in the market. Our future success will depend on our continued ability to develop and introduce such innovative products. If we are unable to continue to do so, our future sales could decline, inventory levels could rise, leading to additional costs for storage and potential writedowns relating to the value of excess inventory, and production costs would be negatively impacted since fixed costs would represent a larger portion of total production costs due to the decline in quantities produced.

If we fail to maintain an efficient distribution network in our highly competitive markets, our business, results of operations and financial condition could suffer.

The mid- and premium-price categories of the prescription frame and sunglasses markets in which we operate are highly competitive. We believe that, in addition to successfully introducing new products, responding to changes in the market environment and maintaining superior production capabilities, our ability to remain competitive is highly dependent on our success in maintaining an efficient distribution network. If we are unable to maintain an efficient distribution network, our sales may decline due to the inability to timely deliver products to customers and our profitability may decline due to an increase in our per unit distribution costs in the affected regions, which may have an adverse impact on our business, results of operations and financial condition.

If we do not correctly predict future economic conditions and changes in consumer preferences, our sales of premium products and profitability will suffer.

The fashion eyewear industry is cyclical. Downturns in general economic conditions or uncertainties regarding future economic prospects, which affect consumer disposable income, have historically adversely affected consumer spending habits in our principal markets and thus made the growth in sales and profitability of premium-priced product categories difficult during such downturns. Therefore, future economic downturns or uncertainties could have a material adverse effect on our business, results of operations and financial condition, including sales of our designer and other premium brands.

The eyewear industry is also subject to rapidly changing consumer preferences and future sales may suffer if the fashion eyewear industry does not continue to grow or if consumer preferences shift away from our products. Changes in fashion could also affect the popularity and, therefore, the value of the fashion licenses granted to us by designers. Any event or circumstance resulting in reduced market acceptance of one or more of these designers could reduce our sales and the value of our inventory of models based on that design. Unanticipated shifts in consumer preferences may also result in excess

inventory and underutilized manufacturing capacity. In addition, our success depends, in large part, on our ability to anticipate and react to changing fashion trends in a timely manner. Any sustained failure to identify and respond to such trends would adversely affect our business, results of operations and financial condition and may result in the write down of excess inventory and idle manufacturing facilities.

If we are unable to achieve and manage growth, operating margins will be reduced as a result of decreased efficiency of distribution.

In order to achieve and manage our growth effectively, we are required to increase and streamline production and implement manufacturing efficiencies where possible, while maintaining strict quality control and the ability to deliver products to our customers in a timely and efficient manner. We must also continuously develop new product designs and features, expand our information systems and operations, and train and manage an increasing number of management level and other employees. If we are unable to manage these matters effectively, our efficient distribution process could be at risk and we could lose market share in affected regions.

If we do not continue to negotiate and maintain favorable license arrangements, our sales or cost of sales will suffer.

We have entered into license agreements that enable us to manufacture and distribute prescription frames and sunglasses under certain designer names, including *Chanel, Prada, Miu Miu, Dolce & Gabbana, D&G, Versace, Versus, Bvlgari, Salvatore Ferragamo, Donna Karan, DKNY, Brooks Brothers, Anne Klein, Burberry*, *Polo Ralph Lauren* and, most recently, *Tiffany & Co.* These license agreements typically have terms of between three and ten years and may contain options for renewal for additional periods and require us to make guaranteed and contingent royalty payments to the licensor. See Item 4 Information on the Company Business Overview Recent Developments regarding our new license agreement for the Tiffany & Co. name. We believe that our ability to maintain and negotiate favorable license agreements with leading designers in the fashion and luxury goods industries is essential to the branding of our products and, therefore, material to the success of our business. For the years ended December 31, 2006 and 2005, the sales realized through the Prada and Miu Miu trade names together represented approximately 5.5 percent and 4.4 percent of total sales, respectively. Accordingly, if we are unable to negotiate and maintain satisfactory license arrangements with leading designers, our growth prospects and financial results could suffer from a reduction in sales or an increase in advertising costs and royalty payments to designers.

If vision correction alternatives to prescription eyeglasses become more widely available, or consumer preferences for such alternatives increase, our business could be adversely affected.

Our business could be negatively impacted by the availability and acceptance of vision correction alternatives to prescription eyeglasses, such as contact lenses and refractive optical surgery. According to industry estimates, over 45 million people wear contact lenses in the United States, and disposable contact lenses is the fastest growing segment of the lens subsector. In addition, the use of refractive optical surgery has grown substantially since it was approved by the U.S. Food and Drug Administration in 1995.

Increased use of vision correction alternatives could result in decreased use of our prescription eyewear products, including a reduction of sales of lenses and accessories sold in our retail outlets, which would have a material adverse impact on our business, results of operations, financial condition and prospects.

If the Euro continues to strengthen relative to certain other currencies, our profitability as a consolidated group will suffer.

Our principal manufacturing facilities are located in Italy. We also maintain manufacturing facilities in China as well as sales and distribution facilities throughout the world. As a result, we are vulnerable to foreign exchange rate fluctuations in two principal areas:

we incur most of our manufacturing costs in Euro and receive a significant part of our revenues in other currencies, particularly the U.S. and Australian dollars. Therefore, a strengthening of the Euro relative to other currencies in which we receive revenues could negatively impact the demand for our products or decrease our profitability in consolidation, thus adversely affecting our business and results of operations; and

a substantial portion of our assets, liabilities, revenues and costs are denominated in various currencies other than Euro, with most of our operating expenses being denominated in U.S. dollars. As a result, our operating results, which are reported in Euro, are affected by currency exchange rate fluctuations, particularly between the U.S. dollar and the Euro.

As our international operations grow, future changes in the exchange rate of the Euro against the U.S. dollar and other currencies may negatively impact our reported results.

See Item 11 Quantitative and Qualitative Disclosures about Market Risk.

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If our international sales suffer due to changing local conditions, our profitability and future growth will be affected.

We currently operate worldwide and have begun to expand our operations in many countries, including certain developing countries in Asia. Therefore, we are subject to various risks inherent in conducting business internationally, including the following:

exposure to local economic and political conditions;

export and import restrictions;

currency exchange rate fluctuations and currency controls;

withholding and other taxes on remittances and other payments by subsidiaries;

investment restrictions or requirements; and

local content laws requiring that certain products contain a specified minimum percentage of domestically produced components.

The likelihood of such occurrences and their potential effect on us vary from country to country and are unpredictable, but any such occurrence may result in the loss of sales or increased costs of doing business and may have a significant effect on our business, results of operations, financial condition and prospects.

If we are unable to protect our proprietary rights, our sales might suffer, and we may incur significant costs to defend such rights.

We rely on trade secret, unfair competition, trade dress, trademark, patent and copyright laws to protect our rights to certain aspects of our products and services, including product designs, proprietary manufacturing processes and technologies, product research and concepts and recognized trademarks, all of which we believe are important to the success of our products and services and our competitive position. However, pending trademark applications may not generate registered trademarks, and any trademark registration that is granted may be ineffective in preventing competition and could be held invalid if subsequently challenged. In addition, the actions we take to protect our proprietary rights may be inadequate to prevent imitation of our products and services. Our proprietary information could become known to competitors, and we may not be able to meaningfully protect our rights to proprietary information. Furthermore, other companies may independently develop substantially equivalent or better products or services that do not infringe on our intellectual property rights or could assert rights in, and ownership of, our proprietary rights. Moreover, the laws of certain countries do not protect proprietary rights to the same extent as the laws of the United States.

We devote significant resources toward defending our proprietary rights. However, if the level of potentially infringing activities by others were to increase substantially, we might have to significantly increase the resources we devote to protecting our rights. Additionally, an adverse determination in any dispute involving our proprietary rights could, among other things, (i) require us to grant licenses to, or obtain licenses from, third parties, (ii) prevent us from manufacturing or selling our products or (iii) subject us to substantial liability. Any of these possibilities could have a material adverse effect on our business including by reducing our future sales or causing us to incur significant costs to defend our rights.

If we are unable to maintain our current operating relationship with Cole Licensed Brands host stores, we could suffer loss of sales and possible impairment of certain intangible assets.

Our sales depend in part on our relationships with the host stores that allow us to operate our Cole s Licensed Brands division, including Sears. Our leases and licenses with Sears are terminable upon short notice. If our relationship with Sears were to end, we would suffer a loss of sales and the possible impairment of certain intangible assets. This could have a material adverse effect on our business, results of operations, financial condition and prospects.

If we become subject to adverse judgments or determinations in legal proceedings to which we are, or may become, a party, our future profitability could suffer through a reduction of sales or increased costs.

We are currently a party to certain legal proceedings as described in Item 8 Financial Information Legal Proceedings. In addition, in the ordinary course of our business, we become involved in various other claims, lawsuits, investigations and governmental and administrative proceedings, some of which are significant. Adverse judgments or

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determinations in one or more of these proceedings could require us to change the way we do business or use substantial resources in adhering to the settlements and could have a material adverse effect on our business including, among other consequences by significantly increasing our costs to operate our business.

If we become subject to additional regulation by governmental authorities, our compliance with these regulations could have an adverse effect on our financial condition, including adversely affecting the way we manufacture or distribute our products.

Our operations are subject to regulation by governmental authorities in the United States and other jurisdictions in which we conduct business. Governmental regulations, both in the United States and other jurisdictions, have historically been subject to change. New or revised requirements imposed by governmental regulatory authorities could have an adverse effect on us, including increased costs of compliance. We may also be adversely affected by changes in the interpretation or enforcement of existing laws and regulations by governmental authorities that could affect sales or the way we currently manufacture or distribute our products. See Item 4 Information on the Company Regulatory Matters and Item 8 Financial Information Legal Proceedings.

Adverse weather conditions could affect consumer spending which could adversely impact our future sales and financial results.

Weather conditions around the world can affect consumer spending and could have a significant impact on our sales. Our sunglass sales are particularly vulnerable to weather conditions. Unusually bad weather during the spring and summer months in one or more of our markets could adversely affect sales of our sunglasses in those markets. Additionally, severe weather such as snowstorms and hurricanes, can inhibit consumers from discretionary shopping. This could affect both our ophthalmic and sunglass sales and create excess inventory which may cause writedowns in the future.

If our implementation of procedures designed to comply with Section 404 of the Sarbanes-Oxley Act of 2002 causes us to identify material weaknesses in our internal control over financial reporting, the trading price of our securities may be adversely impacted.

Commencing with this annual report, we have included a report from our management relating to its evaluation of our internal control over financial reporting as required under Section 404 of the U.S. Sarbanes-Oxley Act of 2002. There are inherent limitations on the effectiveness of internal controls, including collusion, management override and failure of human judgment. In addition, control procedures are designed to reduce rather than eliminate business risks. As a consequence of the systems and procedures we have implemented to comply with these requirements, we may uncover circumstances that we determine, with guidance from our independent auditors, to be material weaknesses, or that otherwise result in disclosable conditions. Although we intend to take prompt measures to remediate any such identified material weaknesses in our internal control structure, measures of this kind may involve significant effort and expense, and any disclosure of such material weaknesses or other disclosable conditions may result in a negative market reaction to our securities.

ITEM 4. INFORMATION ON THE COMPANY

Overview

We are a world leader in the design, manufacture and distribution of prescription frames and sunglasses in the mid- and premium-price categories, based on sales. We operate in two industry segments: (i) manufacturing and wholesale distribution and (ii) retail distribution. See Item 18 Financial Statements for additional disclosures about our operating segments. Through our manufacturing and wholesale distribution segment, we are engaged in the design, manufacture, wholesale distribution and marketing of house and designer lines of mid- to premium-priced prescription frames and sunglasses. We operate our retail segment principally through LensCrafters, Sunglass Hut, OPSM and Cole.

Our manufacturing activities are carried out through six production facilities in Italy and two manufacturing facilities in China. In 2006, we manufactured approximately 37 million prescription frames and sunglasses.

We operate our distribution activities through an extensive worldwide wholesale and retail distribution network based primarily in North America, Australia and, with the acquisitions in 2006, in mainland China and in Hong Kong. In 2006, through our wholesale and retail networks, we distributed approximately 18.6 million prescription frames and approximately 24.8 million sunglasses in approximately 5,100 models. Our products are distributed in approximately 130 countries worldwide.

Our products are marketed under a variety of well-known brand names. Our house brands include *Ray-Ban, Revo, Arnette, Killer Loop, Persol, Vogue, Luxottica* and *Sferoflex*. Our designer lines include *Prada, Chanel, Miu Miu, Dolce & Gabbana, D&G, Versace, Versus, Bvlgari, Salvatore Ferragamo, Donna Karan, DKNY, Brooks Brothers, Anne Klein, Burberry*, *Polo Ralph Lauren* and *Puma* (distribution license only). In early 2008, we will launch the first collection of *Tiffany & Co.* eyewear. The distribution of the Tiffany collections will start with Tiffany s own stores as well as through certain of our other distribution channels in North America, Japan, Hong Kong, South Korea, key Middle East markets and Mexico and will extend over time to additional markets and through new distribution channels.

Our wholesale network is comprised of 32 wholly or majority owned subsidiaries operating in principal markets, over 1,700 sales representatives and approximately 100 independent distributors. Our primary wholesale customers include retailers of mid- and premium-priced eyewear such as independent opticians, optical and sunglass chains, optical superstores, sunglass specialty stores and duty-free shops. In certain countries, and especially in North America, wholesale customers also include optometrists and ophthalmologists, health maintenance organizations, or HMOs, and department stores.

Our retail network is mainly comprised of our subsidiaries: in North America, LensCrafters, Inc. (LensCrafters), Sunglass Hut International, Inc. and its subsidiaries (Sunglass Hut) and Cole, which operates Pearle Vision and our Licensed Brands (Sears Optical, Target Optical and BJ s Optical); and in Australia, New Zealand and Asia, OPSM Group Limited (OPSM). Our North American retail business is the largest optical retail business in North America based on total sales. Our retail network in Asia expanded in 2006 with three acquisitions that included an aggregate of 274 retail locations located in Beijing, Guangdong and Shanghai, China. In 2007, we continued to strengthen our North American retail business with the acquisition of certain assets of D.O.C Optics, which operates approximately 100 stores located primarily in the midwest United States. In addition, we expanded our global retail business by acquiring two prominent specialty sun chains in South Africa with a total of approximately 65 retail locations.

See Products and Services below for a more detailed discussion of our business.

Company History

In 1961, Leonardo Del Vecchio and others established our original operations in Agordo, near Belluno, in northeastern Italy. Since that time, we have enjoyed significant growth in the scope and size of our operations. We have developed and grown in several phases, each of which is related to a specific business strategy. Throughout most of the 1960 s, we manufactured molds, metal-cutting machinery, frame parts and semi-finished products for the optical market. We then progressively expanded our production capabilities to enable us to produce a finished frame product.

In 1969, we launched our first line of Luxottica brand frames and began our transformation from a third-party supplier to an independent manufacturer with a line of branded products.

In the early 1970 s, we distributed our products exclusively through wholesalers. In 1974, with the acquisition of the distributor that had marketed the Luxottica product line in Italy since 1971, we took our first step towards vertical integration.

Luxottica Group S.p.A. was organized as a corporation on November 23, 1981 under the laws of the Republic of Italy. During the early 1980 s, we continued to pursue vertical integration by acquiring independent optical distributors and forming wholesale subsidiaries in strategic markets. In 1981, with our acquisition of La Meccanoptica Leonardo S.p.A., the owner of the *Sferoflex* brand and the holder of an important patent for a flexible hinge, we increased our market share in Italy and various key European markets. During the late 1980 s, we began to expand our product lines to include the design, manufacture and distribution of designer frames through license agreements with major fashion designers.

In 1990, our ADSs were listed on the New York Stock Exchange. Throughout the 1990 s, we continued to expand our distribution network by forming new wholesale subsidiaries. In 1995, we became the first frame manufacturer to enter the North American retail market through the acquisition of LensCrafters. Throughout the 1990 s, we also expanded into the sunglasses business through various acquisitions. In 1990, we acquired Florence Line S.p.A., the owner of the Vogue brand. In 1995, we acquired the medium- to high-end brand product line of Persol S.p.A.

In June 1999, we acquired the Global Eyewear Division of Bausch & Lomb Incorporated, which we refer to as our Ray-Ban business. The Ray-Ban acquisition significantly increased our presence in the sunglasses market, strengthened our house brand portfolio and provided us with sunglass crystal lens manufacturing technology, manufacturing facilities and equipment.

In December 2000, our ordinary shares were listed on the Mercato Telematico Azionario della Borsa Italiana S.p.A., which we refer to as the Italian Stock Exchange.

In April 2001, we continued to strengthen our sunglasses business by acquiring Sunglass Hut, a leading retailer of sunglasses worldwide based on sales. In May 2001, we acquired all of the issued and outstanding common stock of First American Health Concepts, Inc., which at that time was a leading provider of managed vision care plans in the United States based on sales. In August 2003, we acquired 82.57 percent of the outstanding shares of OPSM (we acquired the remaining 17.43 percent interest in March 2005), resulting in our leadership position in the prescription business based on sales in the Australian and New Zealand markets, while at the same time presenting us with new growth opportunities in the Asia-Pacific markets. In October 2004, we strengthened and expanded our North American retail and managed vision care business with the acquisition of Cole. In 2006, we expanded our retail presence in China by acquiring three premium retail chains, Beijing Xueliang Optical Technology Co. Ltd. Ming Long Optical, and Modern Sight Optics to become a leading operator of premium optical stores in China based on the number of stores, with a total of 274 locations in three of the top premium optical markets in mainland China, as well as Hong Kong, an important market in Asia for luxury goods.

Our capital expenditures for our continuing operations were Euro 272.2 million for the year ended December 31, 2006 and Euro 53.5 million for the three-month period ended March 31, 2007. We expect 2007 aggregate capital expenditures to be approximately Euro 300.0 million, in addition to investment for any acquisitions. We will fund these future capital expenditures with our current available borrowing capacity and available cash. For a description of capital expenditures for the previous three years, see Item 5 Operating and Financial Review and Prospects Liquidity and Financial Resources Our Cash Flows Investing Activities.

Our principal executive offices are located at Via C. Cantù 2, Milan, 20123, Italy, and our telephone number at that address is (011) 39-02-863341. Our agent for service for limited purposes in the United States is CT Corporation, 111 Eighth Avenue, New York, New York 10011, telephone number (212) 894-8940. We are domiciled in Milan, Italy.

Business Overview

Recent Developments

Acquisitions

On June 20, 2007, we announced that we entered into a definitive merger agreement with Oakley, a worldwide specialist in sport performance optics with brands including Dragon, Eye Safety Systems, Fox Racing, Mosley Tribes, Oliver Peoples and Paul Smith Spectacles, and retail chains including Bright Eyes, Oakley Stores, Sunglass Icon and The Optical Shop of Aspen. As part of the merger, we will acquire all of the outstanding shares of Oakley for a cash purchase price of U.S.$29.30 per share, together with the purchase of all outstanding options and other equity rights at the same price per share less the exercise price. The total purchase price will be approximately U.S.$2.1 billion (approximately Euro 1.6 billion). The transaction is expected to close in the second half of 2007 and is subject to certain conditions, including regulatory approvals.

In February 2007, we completed the acquisition of the retail optical business of D.O.C Optics, comprising approximately 100 stores located primarily in the midwest United States, for approximately U.S.$110 million in cash. We expect to rebrand the acquired stores as LensCrafters and Pearle Vision.

During the second quarter of 2007, we completed the acquisitions of two prominent specialty sun chains in South Africa, with a total of 65 stores, for approximately Euro 10 million. The two acquisitions represent an important step in the expansion of our sun retail presence worldwide.

Ray Ban Indian Holdings Offer

On August 29, 2003, the Securities Appellate Tribunal, or SAT, in India upheld the decision of the Securities Exchange Board of India to require our subsidiary Ray Ban Indian Holdings, Inc. to make a public offer in India to acquire up

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to an additional 20 percent of the outstanding shares of RayBan Sun Optics India Ltd. (RayBan Sun Optics). The Supreme Court of India, by an order dated December 12, 2006, directed that a public offer be made within 45 days of the order, using April 28, 1999 as the reference date for calculating the offer price. The Supreme Court also directed that interest be paid at the rate of 10 percent per annum for the period between August 27, 1999 and the closing date to all persons who were shareholders of RayBan Sun Optics throughout such period. On April 25, 2007, pursuant to the December 12, 2006 Supreme Court order and in compliance with Regulation 10 and 12 of Chapter III of the SEBI Regulations 1997, we launched a public offer through our subsidiary, Ray Ban Indian Holdings, Inc., to acquire up to 4,895,900 shares, representing approximately 20 percent of the equity share capital of RayBan Sun Optics, which we subsequently increased to up to 7,545,200 shares, representing approximately 31 percent of the equity share capital of RayBan Sun Optics. 6,454,280 shares were tendered in the offer, which closed on May 14, 2007. Effective upon the entry of the share transfers in the share register on June 26, 2007, our stake in RayBan Sun Optics increased to 70.5 percent. We paid total consideration of approximately Euro 13.0 million for the tendered shares. RayBan Sun Optics is listed on the Bombay Stock Exchange. We acquired our interest in RayBan Sun Optics in connection with the purchase of the RayBan eyewear business from Bausch & Lomb in 1999.

Sale of Things Remembered

In September 2006, we completed the sale of Things Remembered, a personalized gift retail chain based in the United States, for consideration with an approximate value of U.S.$200 million. This business, which had been acquired in October 2004 through the acquisition of Cole, was non-core for us.

License Agreements

In December 2006, we signed a 10-year license agreement for the design, manufacturing and worldwide distribution of ophthalmic and sun collections under the Tiffany & Co. brand. The launch of the first collection is expected in early 2008. The distribution of the Tiffany collections will start with Tiffany s own stores as well as through certain of our other distribution channels in North America, Japan, Hong Kong, South Korea, key Middle East markets and Mexico, and will extend over time to additional markets and through new distribution channels.

Credit Agreement

In February 2007, we exercised an option included in the Amended Euro 1,130 Million and U.S.$325 Million Credit Facility to extend the maturity date of Tranches B and C to March 2012. For additional information, see Note 9 to our Consolidated Financial Statements included in Item 18 of this annual report.

Products and Services

Wholesale Operations

Our Brands

In our wholesale operations, we manufacture and sell our prescription frames and sunglasses as either house brands or designer lines. House brands consist of eyewear sold under brand names that we own. Designer lines are produced under designer names held by us under license agreements with third parties. Our products, for both house brands and designer lines, consist of a variety of different styles, from conventional to contemporary and fashion forward styling. Each brand is tailored for a specific market segment based on certain characteristics, such as the consumer s age, lifestyle and fashion consciousness.

House Brands: Our house brands are sold worldwide under brand names such as *Ray-Ban*. We currently produce approximately 1,850 distinct styles of frames within our house brands. Each style is typically produced in three sizes and at least four colors. Actual availability of product styles, colors and sizes varies among geographic markets depending upon local demand.

The following is a summary description of each of our most significant house brands:

- **Ray-Ban**: Created in 1937, the *Ray-Ban* line is the brand leader in the eyewear market based on sales and consumer awareness, bringing together renowned sunglass lenses and a timeless style.

- **Persol**: Created in 1917 and acquired by Luxottica in 1995, the *Persol* brand is synonymous with design, elegance, tradition, and technical precision. Our *Persol* line, which includes a wide range of prescription frames and sunglasses, is marketed as a timeless fashion accessory due to the elegance and design of our products.

- **Vogue**: Acquired by us in 1990, the *Vogue* brand is recognized as trendy and innovative and symbolizes a young and dynamic style that stresses attention to detail and fashion.

- **Arnette**: Targeted to young consumers, this sports product line is characterized by a very forward-thinking design.

- **Revo**: A product line targeted towards sport and leisure wearers, the *Revo* line is known for its high quality lenses which are treated with a specialized coating process.

- **Luxottica**: *Luxottica* is our original product line, comprised of prescription frames and sunglasses. *Luxottica* targets a broad mix of consumers of eyewear.

- **Sferoflex**: This product line, which in 1981 became the first brand name acquired by Luxottica Group, the *Sferoflex* line is comprised of prescription frames characterized by a classic and comfortable style, with flexible hinges that allow the frame to adapt to the unique face shape of each wearer.

- **Killer Loop**: Created in 1989 as a sun and sports eyewear brand that combines design and quality, this brand has evolved throughout the years from exclusively sports eyewear to also include leisure eyewear.

Designer Lines: Our designer lines are produced and distributed through license agreements with major fashion houses. Currently, we sell designer lines under the names *Chanel, Prada, Miu Miu, Dolce & Gabbana, D&G, Versace, Versus, Bvlgari, Salvatore Ferragamo, Donna Karan, DKNY, Brooks Brothers, Anne Klein, Burberry* and *Polo Ralph Lauren* with its six lines (*Purple Label, Polo, Ralph Lauren, Ralph, Chaps* and *Club Monaco*). Beginning early in 2008, they will also include *Tiffany & Co*. The license agreements governing these designer lines are exclusive contracts and typically have terms of between three and ten years. See Trademarks, Trade Names and License Agreements License Agreements. Designer collections are developed through the collaborative efforts of our in-house design staff and the brand designer. Our designer lines presently feature approximately 3,200 different styles.

The following is a summary description of our main designer lines:

- **Chanel**: In 1999, we became the first company licensed to produce *Chanel* products. The *Chanel* product line, targeting the high-end consumer, reflects the essential characteristics of the brand: style, elegance and class.

- **Prada**: The *Prada* license agreement was signed in 2003. The *Prada* collections offer a range of glasses proposed in optical frames and sunglasses collections, and also a series of models created for leisure time, identified by the unmistakable red stripe. The *Prada* collections have always been distinctive not only for their high quality but also for their forward-thinking approach and style, enabling the brand to anticipate and often inspire trends across all sectors. Sophisticated, elegant and refined, *Prada* products are identified by their strong character and unique style.

- **Miu Miu**: The *Miu Miu* license agreement was signed in 2003 and it comprises both optical frames and sunglasses. This brand addresses a clientele particularly attentive to the free and easy as well as to the sophisticated new trends. This collection expresses Miuccia Prada s vision of an alternative style, always characterized by a strong personality. The brand *Miu Miu* can be defined as: urban, young, sophisticated and sensual, an alternative vision, a new classic.

- **Dolce & Gabbana:** Our *Dolce & Gabbana* eyewear collection draws its inspiration from the 60s and 70s. This collection brings the period s shapes up to date and highlights its materials, characterized by precious details such as logos in Swarovski crystals or elegant metal circles.

- **D&G**: The *D&G* eyewear collection has a youthful, innovative and unconventional spirit. The *D&G* models are characterized by vintage forms that take their inspiration from the 70s and 80s, as well as loud and colorful sporty frames reminiscent of the racing world.

- **Versace**: *Versace* is a lifestyle brand for the modern man or woman who chooses to express his/her strength, confidence and uniqueness through a bold and distinctive personal style. *Versace* represents the ideal of a sophisticated, free and highly desirable lifestyle.

- **Versus**: While staying true to the essence of the core brand, *Versus* represents a younger, edgier take on those themes. Filled with spirit and energy, *Versus* challenges convention, always in the vanguard of modern urban style.

- **Bvlgari**: *Bvlgari* eyewear is distinguished by the high quality of its material, attention to detail and elegant design. This product line is targeted towards a clientele who seek something exclusive.

- **Salvatore Ferragamo:** The *Salvatore Ferragamo* collections include both optical frames and sunglasses; they are characterized by the greatest attention to detail as well as by an original use of materials and choice of colors. The eyewear collection is inspired like all the other *Salvatore Ferragamo* products by the craftsmanlike tradition of this fashion house, reinterpreted according to contemporary trends.

- **Donna Karan**: This product line reflects the design sensibility and spirit of the *Donna Karan* collection, offering men and women styles that are sophisticated, using modern and lightweight materials.

- **DKNY**: *DKNY* is fast fashion with an urban mind-set, the New York City street-smart look. *DKNY* eyewear addresses modern, urban, fashion-conscious women and men with multifaceted lifestyles: international, eclectic, fun and real.

- **Brooks Brothers**: Characterized by lightweight materials and a slender line, the *Brooks Brothers* collections reflect the unique features of the style of this American brand. This is an affordable product line with classic style that delivers functionality, lightness and high quality.

- **Anne Klein**: This product line targets successful professional women who place an emphasis on quality and image.

- **Burberry**: A license agreement between Burberry Group Plc and Luxottica was signed in October 2005 with the first release of the *Burberry* eyewear collection in October 2006. This collection features the brand s core values of form and function, innovation and the essence of classic style.

- **Polo Ralph Lauren**: *Polo Ralph Lauren* is comprised of six collections:

- **Purple Label**: A small and exclusive eyewear collection, the *Purple Label* combines the elegance of tradition with the requirements of the modern gentleman: high quality, precious materials, details and style.

- **Ralph Lauren**: The *Ralph Lauren* eyewear collection embraces a youthful sophisticated elegance that mixes refined luxury with cinematic glamour and an air of mystery. For the fashion-conscious woman seeking timeless styling with a modern attitude.

- **Polo**: The *Polo* collection focuses on refined designs, inspired by the heritage of *Polo Ralph Lauren* apparel. Emblematic models that are classic and never out of style. *Polo* is the ideal collection for men who appreciate quality and tradition and are seeking classic styles with a fresh design.

- **Ralph**: This line is an expression of the *Ralph Lauren* spirit at an accessible price point. It features the latest looks and trends, as well as some more classic looks. Vibrant colors for a feminine, flirty and fun look.

- **Chaps**: *Chaps* features easy, wearable designs in the classic tradition of *Polo Ralph Lauren*. The line offers a designer name to the young moderately priced sportswear consumer. Since its introduction, *Chaps* has come to represent classic design, excellent quality and value.

- **Club Monaco**: *Club Monaco* offers individuals a unique brand of quality eyewear at exceptional value and uncompromised style for an accessible luxury. The styling targets are: men and women, between 20 and 40 years old, who are urban professionals, style enthusiasts, and who appreciate sophisticated design at a mid-level price point.

- **Tiffany & Co.**: This world renowned jeweler operates jewelry and specialty retail stores and manufactures products through its subsidiary corporation. For 169 years, *Tiffany & Co.* has designed and produced standard-setting jewelry and accessories. We expect our first collection of *Tiffany & Co.* eyewear, which is to launch in early 2008, to remain true to the brand s high standards.

The following table presents the respective percentages of our total unit (a unit represents an eyeglass frame or sunglass and excludes sales of other materials) sales that our designer and house brands comprised during the periods indicated:

	Year Ended December 31,				
(as a percentage of total unit sales)	**2002**	**2003**	**2004**	**2005**	**2006**
Designer brands	39.5	33.6	32.8	35.9	41.2
House brands	60.5	66.4	67.2	64.1	58.8
Total unit sales	100.0	100.0	100.0	100.0	100.0

Prescription Frames and Sunglasses

In 2006, our manufacturing facilities produced a combined total of approximately 37.0 million prescription frames and sunglasses. In 2005 and 2004, our manufacturing facilities produced a combined total of approximately 28.5 million and 27.8 million prescription frames and sunglasses, respectively.

Since 1990, sunglasses have become an increasingly significant product line for us as we seek to capitalize on growth opportunities in the sunglasses segment. In 1990, we acquired a distributor that supplied sunglasses under the *Vogue* brand name. In 1995, we expanded our activities in the sunglasses market by acquiring Persol S.p.A., an Italian producer of high-quality, fashionable sunglasses and prescription frames in the premium-priced segment of the market. In 1999, we acquired the Ray-Ban business from Bausch & Lomb Incorporated, including the *Ray-Ban, Revo, Arnette* and *Killer Loop* brand names. As a result of our acquisition of the Ray-Ban business, the percentage of our unit sales represented by sunglasses that we manufacture has grown significantly. This trend continued with the acquisition of Sunglass Hut and in

2007, with the expansion of our sunglass based retail business in South Africa. We expect it to continue to develop once the announced acquisition of Oakley has been completed.

Unit sales of sunglasses manufactured by us and third parties in 2006, as a percentage of our total aggregate unit sales, were 57.2 percent, as compared to 55.8 percent in 2005 and 57.3 percent in 2004.

The following table presents the respective percentages of our total unit sales that our prescription frames and sunglasses comprised for the periods indicated:

	Year Ended December 31, (as a percentage of total unit sales)				
	2002	**2003**	**2004**	**2005**	**2006**
Prescription frames	40.3	41.1	42.7	44.2	42.8
Sunglasses	59.7	58.9	57.3	55.8	57.2
Total unit sales	100.0	100.0	100.0	100.0	100.0

Retail Operations

Our retail division is operated by our subsidiaries LensCrafters, Sunglass Hut, OPSM, several subsidiaries in Asia and, starting in 2007, in South Africa, and the Cole group of companies. LensCrafters and Sunglass Hut are strong trade names in the North American retail market place, and OPSM owns three main trade names in the Asia-Pacific market. The Cole group of companies operates Pearle Vision and our Licensed Brands Sears Optical, Target Optical and BJ s Optical. In addition to ophthalmic products and sunglasses, we continue to sell watches and accessories in certain of our retail locations in North America. In September 2006, we sold Things Remembered, a personalized gift retail chain based in the United States.

LensCrafters. Through LensCrafters in North America, we operate a retail network of 902 locations which offer a wide selection of prescription frames, sunglasses, lenses and other optical products. LensCrafters is currently the largest optical retail chain in North America in terms of sales. LensCrafters stores sell not only Luxottica products, but also a wide range of lenses and optical products made by other suppliers. LensCrafters products include innovative lenses, such as FeatherWates® (lightweight, thin and impact-resistant lenses), DURALENS® (super scratch-resistant lenses), ByeLines™ (bifocal lenses without visible lines), Invisibles® (anti-reflective lenses) and MVP Maximum View Progressives® (multi-focal lenses without visible lines). Substantially all of our LensCrafters stores are located in high-traffic commercial malls and shopping centers, have an employed optometrist or an independent, licensed optometrist on site (thereby allowing the customer to have an eye examination on site), provide a large range of prescription eyewear choices and include a laboratory, which enables us to provide the selected frame with prescription lenses to our customers in approximately one hour.

We believe that our acquisition of LensCrafters in 1995 has allowed us to:

obtain a significant competitive advantage for market share in the North American market; and

enter a complementary segment that allows for a direct distribution to, and closer relationship with, the end customer.

When we acquired LensCrafters in 1995, LensCrafters had approximately 600 stores. Between 1995 and 1998, we opened new stores and acquired other retail chains, reaching over 850 stores in North America by 1999.

From 1999 to 2004, LensCrafters expansion focused primarily on further development of those stores opened between 1996 and 1998. We continue to evaluate potential retail expansion opportunities in North America through the opening of retail chains and stores in areas where we are not already heavily represented and in other prime locations. As of December 31, 2006, LensCrafters leased 902 retail stores in North America.

Since the LensCrafters acquisition, we have improved the efficiency of LensCrafters stores by managing the inventory from our central worldwide distribution center in Italy. This has improved inventory service and allowed for a more rapid supply of styles based on daily sales and inventory data. This has also increased the percentage of our products available in LensCrafters stores. In addition, we have focused our promotional activities on those customers looking for a better purchase experience with high-quality products, rapid and efficient customer service and innovative lens and frame technology. As a result of these initiatives, LensCrafters net sales have increased significantly since 1995.

During the last few years we have shifted LensCrafters to a more premium brand. During this time we have added additional elements such as a new store concept, associate training, advertising and marketing that together represent the premium brand and future direction of LensCrafters. With these new initiatives, we have seen the average transaction per customer grow. LensCrafters is becoming known as one of the best places to purchase fashionable, designer prescription frames and sunglasses. LensCrafters hopes to shorten the purchase cycle of typically two to three years with this new focus on prescription frames as fashion. LensCrafters is also working to increase its share of the contact lens market. This initiative focuses on selected products (mostly national brand names) and more competitive pricing. This new push for contact lenses is being supported through in-store displays, marketing and associate training.

One of the most visible changes in LensCrafters shift toward a premium and stylish eyewear shopping experience is a new design for the stores, which will be adopted in new and remodeled store locations across North America. The store design features elegant eyewear display boxes, wood flooring, fashion graphics, sleek decorative accents and artistic lighting fixtures. Every feature of the design directs the spotlight on the shopping gallery of designer eyewear collections, while the fit and finish stations are more private and separated from the shopping and frame selection. We have begun to display the eyewear collections by designer brand to help our customers shop for the style that is right for them.

As part of the brand transformation, in North America LensCrafters has rolled out a new style-focused magazine advertising campaign to communicate the brand s approach to eyewear style. The ads have appeared in more than two dozen premium fashion, lifestyle, cultural and entertainment magazines for women and men. Titled Make an Appearance, they are distinguished from other LensCrafters ads, using bold, engaging visuals to emotionally appeal to the fashion and style desires within eyeglass wearers. In 2007, the LensCrafters brand launched a new television and print campaign in North America called Open Your Eyes that positions eyewear as a prized wardrobe item, just as a favorite black dress, handbag or shoes.

In 2006, we began to expand the use of the LensCrafters name by rebranding certain retail locations that we acquired in China to LensCrafters . We expect to have rebranded 153 locations in China and Hong Kong with the LensCrafters name by the end of 2007.

Mainland China and Hong Kong. In 2006, we acquired three optical retailers operating in the premium optical markets in mainland China, with a total of 274 retail locations in Asia. In addition, they will expand our presence in Hong Kong, which we believe to be one of the most important markets for luxury goods.

Hong Kong is one of the most significant Chinese luxury markets where middle class and affluent mainland Chinese visit frequently to purchase luxury goods. Launching LensCrafters as a premium brand in Hong Kong increases awareness and consumer demand for our products and services. This strategy supports our next stage of expansion into mainland China, rebranding the stores we acquired to LensCrafters and developing worldwide recognition for our premium retail brand.

In September of 2006, we launched LensCrafters in Beijing, beginning the re-branding strategy of our acquisitions.

Sunglass Hut. With the acquisition of Sunglass Hut in 2001, we became the world s leading specialty retailer of sunglasses based on sales, and a specialty retailer of popular priced watches. Sunglass Hut has 1,818 retail locations located throughout North America, Europe and Australia. Sunglass Hut operates in-line stores and kiosks in shopping malls, as well as stores in street centers in high-traffic streets and in airports. We have increased sales of Luxottica-manufactured products at Sunglass Hut locations from approximately 14.3 percent of total Sunglass Hut net sales in April 2001 (the first month following the acquisition) to 69 percent in December 2006. In addition to sunglasses that we manufacture, Sunglass Hut continues to sell a variety of frames manufactured by third-party vendors, including Oakley, Maui Jim, Inc. and others. Oakley is our largest third-party supplier, accounting for approximately 6.8 percent, 4.9 percent and 5.7 percent of our total merchandise purchases from suppliers in 2004, 2005 and 2006, respectively. See Item 4 Information on the Company Recent Developments Acquisitions. Although we buy products from third parties, including Oakley, we do not believe that the loss of any one supplier would have a significant impact on our future operations as we could easily replace lost supply with other sunglasses manufactured by us or other third-party vendors. After the acquisition of Sunglass Hut and Cole, we consolidated the administrative and certain other functions of these businesses with our existing business to allow significant synergies between sun and optical retail operations. Sunglass Hut outlets are located mostly in enclosed malls and airports with an average retail space of approximately 400 square feet per kiosk/store.

In the second quarter of 2007, we completed the acquisitions of two prominent specialty sun chains in South Africa, for a total of 65 stores, which will be converted into Sunglass Hut stores. Both chains have prominent locations in shopping centers in urban areas including Johannesburg and Cape Town as well as attractive airport locations.

Cole. With the acquisition of Cole in October 2004, we acquired a group of distribution outlets and a provider and administrator of managed vision care services under one group. Cole, through its wholly owned subsidiaries, operates retail vision locations under the name Pearle Vision as well as under the names Sears Optical, Target Optical and BJ Optical, which we refer to as our Licensed Brands. Managed vision care programs and benefits were previously sold through the Cole Managed Vision Division; renewals and new sales are now administered through Eyemed Vision Care. Additionally, Cole operated a chain of personalized gift stores, e-commerce and catalogs under the name Things Remembered, which was sold in September 2006.

The Licensed Brands optical retail locations are located in the host stores that bear the names of the hosts. Pearle Vision stores are mostly located in strip malls outside of the conventional malls where most LensCrafters and Sunglass Hut stores are located. In addition, we have franchised Pearle Vision locations located throughout North America. We believe that

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this combination with Cole has allowed us to:

strengthen our retail operations in the United States;

strengthen our managed vision care business by increasing the number of people for whom we provide managed vision care benefits as well as by adding well established retailers to our existing family of retailers; and

increase our sales of frames manufactured by us in Cole retail stores.

We substantially completed our strategic integration plan with respect to Cole in the third quarter of 2006. As of December 31, 2006, Cole operated 1,781 owned and leased department locations and 417 franchise locations throughout North America.

Our retail network in North America has expanded in 2007 with the completion of our acquisition of D.O.C. Optics, an optical retail business with approximately 100 stores located primarily in the midwest United States. This acquisition represents another key step in our strategy to maximize growth opportunities for our optical retail brands, including LensCrafters and Pearle Vision. We will continue to look to expand our retail operations in North America through the opening of new stores or kiosks, or strategic acquisitions when we deem them to be appropriate.

OPSM. In August 2003, we completed the acquisition of 82.57 percent of OPSM, and we completed the acquisition of the minority interest in OPSM in March 2005. This acquisition has resulted in what we believe is a leadership position in the prescription business in the Australian and New Zealand markets and provided us with new growth opportunities in the Asian market. As of December 31, 2006, OPSM had 466 stores in Australia operating under three brands, OPSM, Laubman & Pank and Budget Eyewear, each of which targets a clearly defined market segment, and operates 22 franchise locations throughout Australia. OPSM is the market leader in New Zealand, based on corporate-owned store locations, with 39 stores as of December 31, 2006. OPSM sold its businesses in Singapore and Malaysia during 2005.

Our Principal Markets

The following table presents our net sales by geographic market for the periods indicated:

	Year Ended December 31, (In thousands of Euro)		
	2004	**2005**	**2006**
Italy Wholesale	832,813	998,420	1,321,887
North America Retail(1)	1,861,797	2,632,265	2,840,977
North America Wholesale	146,076	179,595	235,526
Asia-Pacific Retail	348,300	365,867	388,505
Asia-Pacific Wholesale	116,605	150,926	215,135
Other Retail	60,898	61,165	64,678
Other Wholesale	425,732	514,031	697,278
Adjustment/Eliminations(2)	(612,608)	(768,006)	(1,087,828)
Total	3,179,613	4,134,263	4,676,156

(1) Excludes the sales of our Things Remembered specialty retail business, which was sold in September 2006. Things Remembered sales for fiscal 2004, 2005 and 2006 were Euro 75.7 million, Euro 236.5 million and Euro 157.1 million, respectively.

(2) Adjustment/Eliminations represents the elimination of intercompany sales.

Seasonality and Effect of 53-Week Year

We have also historically experienced sales volume fluctuations by quarter due to seasonality associated with the sale of sunglasses, which represented 57.2 percent and 55.8 percent of our units sold in 2006 and 2005, respectively. As a result, our net sales are typically higher in the second quarter, which includes sales to customers and increased sales in our Sunglass Hut stores, and lower in the first quarter, as sunglass sales are lower in the cooler climates of North America, Europe and Northern Asia. These seasonal variations could affect the comparability of our results from period to period. Our retail fiscal year is either a 53-week year or a 52-week year, which also can affect the comparability of our results from period to period. When a 53-week year occurs, we generally add the extra week to the fourth quarter. A 53-week year occurs in five to six year intervals and is expected to occur again in fiscal 2008.

Production Process

Overview

We produce both metal and plastic frames. In addition to our frame manufacturing capacity, since 1999 we have also produced crystal and polycarbonate sunglass lenses exclusively for our sunglasses collections. Production is principally carried out in our six Italian manufacturing facilities. In China, we produce certain products distributed mainly by our North American retail group and certain finished products for our wholesale business, mainly in our owned production facilities. Each of our facilities is tailored to a specific production technology that we believe allows us to achieve a high level of productivity.

Design and Prototype Selection

We believe that an important aspect of our success has been our emphasis on design and the continuous development of new styles. Our in-house designers work jointly with external designers to develop new models.

For our designer line products, our design team works with licensors to discuss the basic themes and fashion concepts for each product and then works closely with the licensor s designers to refine such themes. In addition, our design team works directly with our marketing and sales departments, which monitor demand for our current models as well as general style trends in eyewear. The data obtained from our marketing and sales departments is then used to refine existing product designs and market positioning in order to react to changing consumer preferences.

Once the product concepts have been selected and approved, we produce prototypes that are used to evaluate the proposed design. Our prototypes are developed using computer-aided design/computer-aided manufacturing technology, known as CAD/CAM, which is fully integrated with our manufacturing processes. CAD/CAM technology allows a designer to view and modify two- and three-dimensional images of a new frame. Because this technology is fully integrated with the manufacturing processes, the conversion from prototype to production is streamlined.

All prototypes are subject to review and approval by our licensors and our designers to ensure consistency with the distinctive image of each product line. Our collections consist of both new models and the most successful existing models. Each year, we add approximately 1,800 new models to our eyewear collections. The ability to constantly renew our product base has enabled us to meet consumer demand in each market segment in which our brands are targeted. See Item 3 Key Information Risk Factors If we do not correctly predict future economic conditions and changes in consumer preferences, our sales of premium products and profitability will suffer.

Sourcing

The principal raw materials and parts purchased for our manufacturing process include plastic resins, metals, lenses and frame parts. We purchase a substantial majority of our raw materials in Europe and to a lesser extent in Asia and the United States. In addition, we use certain external suppliers for frames, eyeglass cases and packaging materials. The Ray-Ban acquisition provided us with know-how and sunglass crystal lens manufacturing capabilities. We believe that our ability to produce sunglass crystal lenses is strategically important given our expanded presence in the sunglasses market.

We do not depend on any single supplier for any of our principal raw materials or frames. Although we do not have formal, long-term contracts with our suppliers, we have not experienced any significant interruptions in our supplies. Historically, prices of the principal raw materials used in our manufacturing process have been stable.

Manufacturing

We have six frame manufacturing facilities in Italy. Five facilities are located in northeastern Italy, the area in which most of the country s optical industry is based, and the remaining facility is located near Turin. All of our facilities are highly automated, which has allowed us to maintain a high level of production without significant capital outlay. In certain of these facilities, we also produce sunglass crystal lenses and polycarbonate lenses. In 2006, we rationalized our operations in Italy by building a new, approximately 32,000 square meters manufacturing facility to produce acetate frames and sunglasses for a total investment of approximately Euro 20.0 million. We were able to re-dedicate one of our former facilities to our logistics operation for a total investment of Euro 6.2 million. From 1998 to 2001, we operated, through our 50 percent-owned joint venture (Tristar Optical Company Ltd.) with a Japanese partner, a facility in China to manufacture prescription frames. In 2001, we acquired the remaining 50 percent interest in this Chinese company so that it became one of our wholly owned subsidiaries. In 2006, we increased our manufacturing capacity in mainland China through the construction of a new, approximately 26,000 square meters manufacturing facility to produce both metal and plastic frames for a total investment of approximately Euro 20.0 million. After the construction of this new facility, our annual average daily production in mainland China increased by approximately 80 percent compared to 2005. The percentage of private label products produced at our facilities in China has been decreasing in favor of increased production of certain of our core, fashion and North American brands.

Over the past several years, we have consolidated our manufacturing processes by tailoring each of our manufacturing facilities in Italy to a specific production technology. This consolidation has allowed us to improve both the productivity and quality of our operations. We produce plastic frames in our facilities in Sedico, Pederobba and Turin, while metal frames are produced in our facilities in Agordo and Rovereto. Certain frame parts are produced in our facility in Cencenighe. In 2006, approximately 56 percent of the frames manufactured by us were metal-based, and the remainder was plastic.

The manufacturing process for both metal and plastic frames and sunglasses begins with the fabrication of precision tooling and molds based on prototypes developed by our in-house design and engineering staff. We believe that our in-house capacity to engineer and produce precision tooling and molds gives us a strong competitive advantage by enabling us to reduce the lead time for product development and thereby adapt quickly to market trends, contain production costs, and maintain smaller and more efficient production runs so that we can better respond to the varying needs of different markets.

The manufacturing process for metal frames is comprised of approximately 70 phases, beginning with the production of basic components such as rims, temples and bridges, which are produced through a molding process. These components are welded together to form frames through numerous stages of detailed assembly work. Once assembled, the metal frames are treated with various coatings to improve their resistance and finish, and then prepared for lens fitting and packaging.

We manufacture plastic frames using either a milling process or injection molding, depending upon the style and color of the frame. In the milling process, a computer-controlled machine carves frames from colored plastic sheets. This process produces rims, temples and bridges that are then assembled, finished and packaged. In the injection molding process, plastic resins are liquefied and injected in molds. The plastic parts are then assembled, coated, finished and packaged.

Our efficient distribution network allows us to track sales and inventory data on a weekly basis. As a result, we are able to:

make and revise manufacturing plans on the basis of current sales information;

reallocate inventory within our wholesale subsidiaries, thereby reducing overall inventory levels and the risk of obsolescence; and

react quickly to changing market trends by providing rapid feedback to our in-house design team.

We engage in research and development activities relating to our manufacturing processes on an on-going basis. As

a result of such activities, we have invested, and will continue to invest, in automation, thus increasing efficiency while improving quality. Much of our manufacturing process is automated, including the production of metal and plastic frame parts and the galvanization of metal frames.

Costs associated with research and development activities are expensed when incurred and are not significant.

Quality Control

One of our key strategic objectives is ensuring the quality of our products. In 1997, we were among the first companies in the eyewear industry to obtain ISO 9001 certifications. Subsequently, in 2003, we obtained the Vision 2000 certification, which is the third-generation industry recognition for quality production. To ensure the high quality of our products, our quality control and process control teams regularly inspect work-in-progress at various stages of the production cycle. In addition, the majority of materials that we purchase are quality tested. We also conduct inspections of, and certify compliance with, the production processes of our main suppliers. Each of our prescription frames and sunglasses undergoes several stages of quality inspection. Due to the efficiency of our quality controls, the return rate for defective merchandise manufactured by us is approximately one percent.

Distribution

We distribute our products through wholesale and retail channels.

Distribution by Wholesale Division

We currently distribute our products in approximately 130 countries and operate 32 wholly or majority owned wholesale distribution subsidiaries strategically located in major markets worldwide. In markets where we do not have wholesale distribution subsidiaries, we employ approximately 100 independent distributors.

Each wholesale distribution subsidiary operates its own network of sales representatives, who are normally retained on a commission basis. Our network of wholesale distribution subsidiaries represents a key element of our business. We believe that control over an extensive distribution network provides us with a competitive advantage, because it enables us to maximize our brand image, marketing efforts and customer service activities by tailoring our operations to meet the specific needs and peculiarities of local markets.

The following table sets forth certain information regarding our wholesale distribution subsidiaries and affiliates:

Subsidiary	Country of Formation	Percentage Ownership	
Luxottica S.r.l.	Italy	100	%
Luxottica Fashion Brillen GmbH	Germany	100	%
Luxottica Portugal S.A.	Portugal	100	%
Luxottica France S.A.R.L.	France	100	%
Luxottica Iberica S.A.	Spain	100	%
Luxottica U.K. Ltd.	United Kingdom	100	%
Luxottica Belgium N.V.	Belgium	100	%
Luxottica Sweden AB.	Sweden	100	%
Oy Luxottica Finland AB.	Finland	100	%
Luxottica Vertriebsgesellschaft MbH	Austria	100	%
Luxottica Norge AS.	Norway	100	%
Avant-Garde Optics, LLC	U.S.A.	100	%
Luxottica Canada Inc.	Canada	100	%
Luxottica Do Brasil Ltda	Brazil	100	%
Luxottica Mexico S.A. de C.V.	Mexico	100	%
Luxottica Argentina S.r.l.	Argentina	75	%
Mirari Japan Co Ltd.	Japan	100	%
Luxottica South Africa Pty Ltd.	South Africa	100	%
Luxottica Middle East FZE	United Arab Emirates	100	%
Luxottica (Switzerland) A.G.	Switzerland	97	%

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Luxottica Australia Pty Ltd.	Australia	100	%
Luxottica Optics Ltd.	Israel	74.9	%
Luxottica Hellas A.E.	Greece	70	%
Luxottica Nederland B.V.	The Netherlands	51	%
Luxottica Gozluk Endustri Ve Ticaret A.S.	Turkey	64.84	%
Luxottica Poland Sp. Z.o.o.	Poland	100	%
Luxottica Central Europe Ltd.	Hungary	100	%
Luxottica South Eastern Europe Ltd.	Croatia	100	%
Luxottica Trading and Finance Limited	Ireland	100	%
Mirarian Marketing Ltd.	Singapore	51	%
RayBan Sun Optics India Ltd.(1)	India	70.5	%
Luxottica Korea Ltd.	Korea	100	%

(1) The shares of RayBan Sun Optics are publicly traded on the BSE Stock Exchange, Mumbai. Since we did not own a 50 percent equity interest in the entity as of December 31, 2006, we accounted for this entity under the equity method of accounting for the year ending December 31, 2006. Effective as of June 26, 2007, we acquired approximately 70.5 percent of RayBan Sun Optics through a public tender offer. See Item 4 Information on the Company Business Overview Recent Developments Ray Ban Indian Holdings Offer above for more information.

We maintain close contact with our distributors in order to monitor sales and to control the quality of the points of sale that display products. We typically enter into distribution agreements with importers and distributors that establish minimum annual purchases and impose territorial limitations. In addition, to the extent permitted by law, we allow for distribution only through specifically authorized retail channels and qualified sales agents.

No single customer or group of related customers accounted for more than five percent of our consolidated net sales in any of the past three years. We do not believe that the loss of any single customer would have a material adverse effect on our financial condition or results of operations.

Our distribution system is integrated internationally. A worldwide computerized information network links the distribution and sales systems with the production facilities in Italy. This network enables us to monitor worldwide sales trends and inventory positions on a daily basis and to allocate production resources accordingly.

We believe that one of our key competitive strengths is our ability to promptly satisfy customer demand in a timely manner, both prior to and following a sale. In order to further improve our customer service capabilities, we have centralized our distribution centers in Europe (Italy) and Asia (Japan). Since the Cole acquisition, we have consolidated our distribution centers in Memphis and Atlanta, the main distribution center for our retail division, and are in the final stages of centralizing our wholesale distribution centers in North America. We believe that centralizing our distribution centers improves the efficiency of our distribution operations while reducing the related costs.

Distribution by Retail Division

Through our retail division, we believe we operate the largest group of optical superstores in both the United States and Canada based on both sales and store count. We believe we are the largest specialty retailer of sunglasses in the world based on 2006 revenues and believe we have become a leading player in the Australian prescription segment. We also sell watches and accessories in certain sunglass retail locations and, until September 2006, sold personalized gifts under the name Things Remembered.

In our optical retail stores, customers can choose from a large selection of frames and lenses offering a high level of comfort and fit. LensCrafters customers can obtain a completed pair of prescription glasses in approximately one hour because of on-site lens grinding laboratories. In our Sunglass Hut locations, customers can choose from a large selection of Luxottica and third-party vendor manufactured sunglasses. In addition, Sunglass Hut locations can assist customers in purchasing other accessories to complement their sunglasses. As of December 31, 2006, our retail division consisted of 5,280 owned or leased department retail locations and 454 franchised locations as follows:

	North America	Europe/ Middle East	Australia / New Zealand	China / Hong Kong	Total
LensCrafters	902			75	977
Sunglass Hut	1,502	92	224		1,818
Pearle Vision and Licensed Brands	1,781				1,781
OPSM Group			505	199	704
Franchised Locations	417	15	22		454
	4,602	107	751	274	5,734

In 2006, units manufactured with our own brand names or our licensed brands, represented approximately 72.4 percent, 42.1 percent, 42.1 percent and 66.6 percent of the total sales of frames based on units sold by LensCrafters, Cole, OPSM and Sunglass Hut, respectively. OPSM was acquired in August 2003 and at such time 3.5 percent of the total sales of frames sold were supplied by us. Cole was acquired in October 2004, and at such time less than one percent of the total sales of frames sold were supplied by us. The retail division s outlets sell not only frames that we manufacture but also a wide range of frames, lenses and other ophthalmic products manufactured by other companies.

Substantially all LensCrafters (excluding the LensCrafters rebranded stores in China), Cole and OPSM stores have an employed or independent optometrist on site, allowing the customer to have an eye examination, select from a large range of prescription eyewear, and receive the selected frame with prescription lenses from one location. In addition, substantially all of our LensCrafters stores (excluding the LensCrafters rebranded stores in China), have a lens grinding laboratory on site, which allows our customers to receive a complete set of prescription frames or sunglasses in approximately one hour.

Competition

The prescription frame and sunglasses industry is highly competitive and fragmented. As we market our products throughout the world, we compete with many prescription frame and sunglasses companies in various local markets. We believe that our principal competitor in the design, manufacture and distribution of eyewear within the prescription frames market is Safilo Group S.p.A., or Safilo. We believe that our principal competitors in the sunglasses market include Safilo, De Rigo S.A. and Oakley. See Business Overview Recent Developments Acquisitions for more information regarding the Oakley acquisition. Several of our most significant competitors in the manufacture and distribution of eyewear are significant vendors to our retail division. Our success in these markets will depend on, among other things, our ability to manage an efficient distribution network and to market our products effectively as well as on the popularity and market acceptance of our brands. See Item 3 Key Information Risk Factors If we are unable to successfully introduce new products, our future sales and operating performance will suffer and If we fail to maintain an efficient distribution network in our highly competitive markets, our business, results of operations and financial condition could suffer.

The highly competitive optical retail market in North America includes a large number of small independent competitors and several national and regional chains of optical superstores. In recent years, a number of factors, including consolidation among retail chains and the emergence of optical departments in discount retailers, have resulted in significant competition within the optical retailing industry. We compete against several large optical retail chains in North America, including Wal-Mart and Eye Care Centers of America, and, in the sunglasses area, numerous sunglass outlet centers. Our optical retail operations emphasize product quality, selection, customer service and convenience. We do not compete primarily on the basis of price.

Marketing

Our marketing and advertising activities are designed primarily to enhance the image of Luxottica and our brand portfolio and to drive traffic into our retail locations. Advertising expenses amounted to approximately six percent of our net sales in each of 2004, 2005 and 2006.

Marketing Strategy for Our Wholesale Distribution Business

Our marketing strategy in the wholesale distribution business is focused on promoting our extensive brand portfolio, our corporate image and the value of our products. Advertising is extremely important in supporting our marketing strategy, and we therefore engage in extensive advertising activities, both at the point-of-sale and through various media directed at the end consumer of our products.

In our media advertising, we utilize direct media, such as print, radio and television, as well as billboard advertising. The extent of our advertising activities and the selection of different media depend upon the competitive conditions in each particular market. In addition, we advertise in publications targeted to independent practitioners and other market-specific magazines.

Our point-of-sale marketing materials consist of displays, counter cards, catalogs, posters and product literature. Many of these materials are linked to our consumer advertising campaigns. Because the point-of-sale has become increasingly important both as a communication medium and in terms of the consumer brand experience. In 2007, we have developed a new approach for our Ray-Ban brand with a shop-in-shop modular concept. This concept can be adapted to the stores we identify as the most suitable, permitting the best delivery of Ray-Ban s clear and unique brand signature.

We also benefit from brand-name advertising carried out by licensors of our designer lines intended to promote the image of the designer line. Our advertising and promotional efforts in respect of our licensed brands are developed in coordination with our licensors. We contribute to the designer a specified percentage of our sales of the designer line to be devoted to advertising and promotion.

Finally, we participate in major industry trade fairs (including the MIDO fair in Milan, Vision Expo in the United States and the SILMO in Paris), where our new collections are displayed and promoted to the market.

Marketing Strategy for Our Retail Business

In addition to the marketing activities described above, we engage in promotional and advertising activities through our retail business with both short- and long-term objectives. Our short-term objectives are to attract customers to our stores and promote sales. Our long-term objective is to build the image and visibility of our retail brands throughout the world, such as the LensCrafters and Pearle Vision brands in North America, the Sunglass Hut brand worldwide, the OPSM, Laubman & Pank and Budget Eyewear brands in Australia and New Zealand, thereby encouraging customer loyalty and return purchases. We believe that the product quality and service provided by our retail business contribute to our short- and long-term marketing objectives.

A considerable amount of our retail business s marketing budget is dedicated to direct marketing activities, such as communications with customers (*e.g.*, mailings and catalogues). Our direct marketing activities benefit from our large database of customer information in the United States and in Australia. Another significant portion of the marketing budget is allocated to broadcast and print media (*e.g.*, television, radio and magazines) designed to reach the broad markets in which we operate with image-building messages about our retail business.

Trademarks, Trade Names and License Agreements

Trademarks and Trade Names

As of December 31, 2006, our principal trademarks or trade names included *Luxottica, Ray-Ban, Persol, Vogue, LensCrafters, Sunglass Hut, Pearle Vision, OPSM, Laubman & Pank and Budget Eyewear*. Our principal trademarks are registered world-wide. Other than *Luxottica, Ray-Ban, LensCrafters, Sunglass Hut, Pearle Vision*, *OPSM, Laubman & Pank* and *Budget Eyewear*, we do not believe that any single trademark or trade name is material to our business or results of operations. *Ray-Ban* products accounted for approximately 13.5 percent of our net sales in 2006. Management believes that our trademarks have significant value in marketing our products.

LensCrafters has introduced several trademarked lenses in recent years that contain innovative technology, such as FeatherWates®) (lightweight, thin and impact resistant lenses), DURALENS® (super scratch-resistant lenses), Invisibles® (anti-reflective lenses) and MVP Maximum View Progressives® (multi-focal lenses without visible lines). LensCrafters purchases these lenses under non-exclusive arrangements with third parties. The names of the lenses used by LensCrafters are typically trademarked, and the trademarks are typically owned by us. OPSM has trademarked several lenses in recent years that it uses in its advertising. They include Activise™ for contact lenses, Active™ for polycarbonate eyeglass lenses and Invisibles™ for multi-coated eyeglass lenses.

We do not have any patents that we believe are, individually or in the aggregate, material to our results of operations or financial condition.

See Item 3 Key Information Risk Factors If we are unable to protect our proprietary rights, our sales might suffer and we may incur significant costs to defend such rights.

License Agreements

We have entered into certain license agreements to manufacture and distribute prescription frames and sunglasses with numerous designers. These license agreements have terms expiring through 2022. The table below summarizes the principal terms of our most significant license agreements.

Licensor	Licensed Marks	Territory	Expiration
Jones Investment Co. Inc	Anne Klein	U.S. and rest of world exclusive licenses	December 31, 2009
Bulgari S.p.A.	Bulgari	Worldwide exclusive license	December 31, 2010
Salvatore Ferragamo Italia S.p.A.	Salvatore Ferragamo Ferragamo	Worldwide exclusive license	December 31, 2008 (Renewable until December 31, 2013)
Retail Brand Alliance, Inc.*	Brooks Brothers	Worldwide exclusive license	December 31, 2009
Prada S.A.	Prada, Miu Miu	Worldwide exclusive license	December 31, 2013 (Renewable until December 31, 2018)
Gianni Versace S.p.A.	Gianni Versace, Versace, Versace Sport, Versus	Worldwide exclusive license	December 31, 2012 (Renewable until December 31, 2022)
Chanel SARL Chanel SA, Chanel SAS (FR), Chanel Limited (UK), Chanel Inc. (USA) and Chanel Sok RL (Panama)	Chanel	Worldwide exclusive license	March 31, 2008
Donna Karan Studio LLC	Donna Karan, DKNY	Worldwide exclusive license	December 31, 2009 (Renewable until December 31, 2014)
Adrienne Vittadini LLC**	Adrienne Vittadini	Worldwide exclusive license	December 31, 2009
Dolce & Gabbana S.r.l.	D&G, Dolce & Gabbana	Worldwide exclusive license	December 31, 2010 (Renewable until December 31, 2015)
Burberry Limited	Burberry	Worldwide exclusive license	December 31, 2015
PRL USA	Polo Ralph Lauren	Worldwide exclusive license	March 31, 2017
The Polo/Lauren Company LP	Ralph Lauren		
	Ralph (Polo Player Design) Lauren		
	RLX		
	RL		
	Ralph		
	Ralph/Ralph Lauren Lauren by Ralph Lauren Polo Jeans Company Chaps***		
Club Monaco Corp.	Club Monaco	U.S. and Canada exclusive license	March 31, 2012 (renewable until March 31, 2017)
Tiffany & Co.	TIFFANY & CO.	Selective worldwide exclusive license	December 31, 2017
	Tiffany		

* Retail Brand Alliance, Inc. is indirectly owned and controlled by one of our directors.

** Adrienne Vittadini LLC was indirectly owned and controlled by one of our directors until November 2006, at which time it was transferred to a third party.

*** U.S., Canada, Mexico and Japan only.

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Under these license agreements, we are required to pay a royalty which generally ranges from five percent to twelve percent of net sales of the relevant collection, which may be offset by any guaranteed minimum royalty payments. The license agreements also provide for a mandatory marketing contribution that generally amounts between five percent and ten percent of net sales. The particular licensor is responsible for the manner and form of advertising for its collection. These license agreements typically have terms ranging from three to ten years, but may be terminated early by either party for a variety of reasons, including non-payment of royalties, failure to meet minimum sales thresholds, product alteration and, under certain agreements, any change in the ownership of the ordinary shares resulting in a change in control of Luxottica Group S.p.A.

Other than Prada and Miu Miu (which in aggregate account for 5.5 percent of net sales), no single designer line accounted for more than five percent of net sales for the year ended December 31, 2006. Management believes that, while the early termination of one or a small number of the current license agreements may have an adverse effect on our results of operations in the short term, any such termination would not have a material adverse effect on our long-term results of operations or financial condition. Upon any early termination of an existing license agreement, we expect that we would seek to enter into alternative arrangements with other designers to reduce any negative impact of such a termination.

Regulatory Matters

Our products are subject to governmental health and safety regulations in most of the countries where they are sold, including the United States. We regularly inspect our production techniques and standards to ensure compliance with applicable requirements. Historically, compliance with such requirements has not had a material effect on our operations.

In addition, governments throughout the world impose import duties and tariffs on products being imported into their countries. Although in the past we have not experienced situations in which the duties or tariffs imposed materially impacted our operations, we can provide no assurances that this will be true in the future.

Our past and present operations, including owned and leased real property, are subject to extensive and changing environmental laws and regulations pertaining to the discharge of materials into the environment, the handling and disposition of waste or otherwise relating to the protection of the environment. We believe that we are in substantial compliance with the applicable environmental laws and regulations. However, we cannot predict with any certainty that we will not in the future incur liability under environmental statutes and regulations with respect to contamination of sites formerly or currently owned or operated by us (including contamination caused by prior owners and operators of such sites) and the off-site disposal of hazardous substances.

Our retail operations are also subject to various legal requirements in the United States, Australia, Canada, New Zealand, Hong Kong, Singapore and Malaysia that regulate the permitted relationships between licensed optometrists or ophthalmologists, who primarily perform eye examinations and prescribe corrective lenses, and opticians, who fill such prescriptions and sell eyeglass frames.

Organizational Structure

We are a holding company, and virtually all of our operations are conducted through our wholly owned subsidiaries. We operate in two industry segments: (i) manufacturing and wholesale distribution, and (ii) retail distribution. In the retail segment, we primarily conduct our operations through LensCrafters, Sunglass Hut, Pearle Vision, Cole Licensed Brands and OPSM. In the manufacturing and wholesale distribution segment, we operate through approximately eight manufacturing plants and 32 geographically oriented wholesale distribution subsidiaries. See Distribution for a breakdown of the geographic areas.

The significant subsidiaries controlled by Luxottica Group S.p.A., including holding companies, are:

Subsidiary	Country of Incorporation	Percentage of Ownership
Manufacturing		
Luxottica S.r.l.	Italy	100 %
Luxottica Tristar Optical Ltd	China	100 %
Distribution		
Avant-Garde Optics, LLC	U.S.A.	100 %
Cole Vision Corporation	U.S.A.	100 %
LensCrafters Inc.	U.S.A.	100 %
Sunglass Hut Trading Corporation	U.S.A.	100 %
Pearle Vision, Inc.	U.S.A.	100 %
OPSM Group Limited	Australia	100 %
Holding companies		
Luxottica U.S. Holdings Corp.	U.S.A.	100 %
Luxottica South Pacific Pty Ltd	Australia	100 %
Sunglass Hut International, Inc.	U.S.A.	100 %
Cole National Corporation	U.S.A.	100 %

Property, Plants and Equipment

Our corporate headquarters is located at Via C. Cantù 2, Milan, Italy. Information regarding the location, use and approximate size of our principal offices and facilities as of December 31, 2006 is set forth below:

Location	Use	Owned/Leased	Approximate Area in Square Feet
Milan, Italy	Corporate Headquarters	Owned	51,548
Agordo, Italy	Administrative offices and manufacturing facility	Owned	827,292
Mason (Ohio), United States	North American retail division headquarters	Owned	415,776
Atlanta (Georgia), United States	North American retail division distribution center	Owned	183,521
Port Washington (NY), United States	U.S. offices and U.S. wholesale distribution center	Owned	140,700
Espoo, Finland	Offices, warehouse	Leased	2,884
Oulu, Finland	Offices	Leased	484
Goteborg, Sweden	Offices, warehouse	Owned	6,942
Stockholm, Sweden	Offices	Leased	258
Kongsberg, Norway	Offices	Leased	3,132
Macquarie Park, Australia	Offices	Leased	61,496
Chipping Norton, Australia	Ophthalmic laboratory	Leased	60,172
Revesby, Australia	Distribution center	Leased	61,054
Auckland, New Zealand	Offices	Leased	31,011
Millennium City, Hong Kong	Offices,	Leased	9,072
Kwong Sang, Hong Kong	Distribution center and warehouse	Leased	3,760
Heemstede, Holland	Offices	Leased	8,073
São Paulo, Brazil	Offices, warehouse	Leased	18,363
Buenos Aires, Argentina	Offices, warehouse, showroom	Leased	3,438
Cincinnati (Ohio), United States	Ophthalmic laboratory, warehouse, distribution center	Leased	132,000
Dallas (Texas), United States	Ophthalmic laboratory, distribution center	Leased	80,000
Memphis (Tennessee), United States	Ophthalmic laboratory	Leased	59,350
Columbus (Ohio), United States	Ophthalmic laboratory, distribution center	Leased	43,392
Knoxville (Tennessee), United States	Ophthalmic laboratory	Leased	38,500
Winnipeg (Manitoba), Canada	Ophthalmic laboratory, distribution center	Leased	21,687

Salonica - Thessalinki, Greece	Sales office	Leased	2,813
Athens-Anthousa, Greece	Offices	Leased	40,137
Deurne, Belgium			