

NATUZZI S P A  
Form 20-F  
April 30, 2014  
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**Natuzzi S.p.A**

Annual Report on Form 20-F

2013

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 20-F**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the Fiscal Year Ended: December 31, 2013  
Commission file number: 001-11854**

**NATUZZI S.p.A.**

**(Exact name of Registrant as specified in its charter)**

**Republic of Italy**

**(Jurisdiction of incorporation or organization)**

**Via Iazzitiello 47, 70029, Santeramo in Colle, Bari, Italy**

**(Address of principal executive offices)**

**Mr. Pietro Direnzo**

**Tel.: +39 080 8820 812; [pdirenzo@natuzzi.com](mailto:pdirenzo@natuzzi.com); Via Iazzitiello 47, 70029 Santeramo in Colle, Bari, Italy**

**(Name, telephone, e-mail and/or facsimile number and address of company contact person)**

**Securities registered or to be registered pursuant to Section 12(b) of the Act:**

| <b>Title of each class</b>  | <b>Name of each exchange on which registered</b> |
|---|--|
| <b>American Depositary Shares, each representing one Ordinary Share</b> | <b>New York Stock Exchange</b>                   |
| <b>Ordinary Shares, with a par value of 1.00 each</b>                   | <b>New York Stock Exchange</b>                   |

**(for listing purposes only)**

**Securities registered or to be registered pursuant to Section 12(g) of the Act:**

**None**

**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:**

**None**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:

As of December 31, 2013 **54,853,045 Ordinary Shares**

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes  No

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  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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP

IFRS

Other

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.  Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

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**PRESENTATION OF FINANCIAL INFORMATION**

In this annual report on Form 20-F (the Annual Report ), references to Euro are to the Euro and references to U.S. dollars, dollars, U.S.\$ or \$ are to United States dollars.

Amounts stated in U.S. dollars, unless otherwise indicated, have been translated from the Euro amount by converting the Euro amounts into U.S. dollars at 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 (the Noon Buying Rate ) for euros on December 31, 2013 of U.S.\$ 1.3779. The foreign currency conversions in this Annual Report should not be taken as representations that the foreign currency amounts actually represent the equivalent U.S. dollar amounts or could be converted into U.S. dollars at the rates indicated.

The Consolidated Financial Statements included in Item 18 of this Annual Report are prepared in conformity with accounting principles established by the Italian Accounting Profession ( Italian GAAP ). These principles vary in certain significant respects from generally accepted accounting principles in the United States ( U.S. GAAP ). See Note 29 to the Consolidated Financial Statements included in Item 18 of this Annual Report. All discussions in this Annual Report are in relation to Italian GAAP, unless otherwise indicated.

In this Annual Report, the term seat is used as a unit of measurement. A sofa consists of three seats; an armchair consists of one seat.

The terms Natuzzi, Natuzzi Group , Company, Group, we, us, and our, unless otherwise indicated or as the may otherwise require, mean Natuzzi S.p.A. and its consolidated subsidiaries.



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**FORWARD-LOOKING INFORMATION**

The Company makes forward-looking statements in this Annual Report. Statements that are not historical facts, including statements about the Group's beliefs and expectations, are forward-looking statements. Words such as believe, expect, intend, plan and anticipate and similar expressions are intended to identify forward-looking statements but are not exclusive means of identifying such statements. These statements are based on management's current plans, estimates and projections, and therefore readers should not place undue reliance on them. Forward-looking statements speak only as of the dates they were made, and the Company undertakes no obligation to update or revise any of them, whether as a result of new information, future events or otherwise.

Projections and targets included in this Annual Report are intended to describe our current targets and goals, and not as a prediction of future performance or results. The attainment of such projections and targets is subject to a number of risks and uncertainties described in the paragraph below and elsewhere in this Annual Report. See Item 3. Key Information Risk Factors.

Forward-looking statements involve inherent risks and uncertainties, as well as other factors that may be beyond our control. The Company cautions readers that a number of important factors could cause actual results to differ materially from those contained in any forward-looking statement. Such factors include, but are not limited to: effects on the Group from competition with other furniture producers, material changes in consumer demand or preferences, significant economic developments in the Group's primary markets, the Group's execution of its reorganization plans for its manufacturing facilities, significant changes in labor, material and other costs affecting the construction of new plants, significant changes in the costs of principal raw materials, significant exchange rate movements or changes in the Group's legal and regulatory environment, including developments related to the Italian Government's investment incentive or similar programs. The Company cautions readers that the foregoing list of important factors is not exhaustive. When relying on forward-looking statements to make decisions with respect to the Company, investors and others should carefully consider the foregoing factors and other uncertainties and events.

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**PART I**

**ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

Not applicable.

**ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

Not applicable.

**ITEM 3. KEY INFORMATION**

**Selected Financial Data**

The following table sets forth selected consolidated financial data for the periods indicated and is qualified by reference to, and should be read in conjunction with, the Consolidated Financial Statements and the notes thereto included in Item 18 of this Annual Report and the information presented under Operating and Financial Review and Prospects included in Item 5 of this Annual Report. The statement of operations and balance sheet data presented below have been derived from the Consolidated Financial Statements.

The Consolidated Financial Statements, from which the selected consolidated financial data set forth below has been derived, were prepared in accordance with Italian GAAP, which differ in certain respects from U.S. GAAP. For a discussion of the principal differences between Italian GAAP and U.S. GAAP as they relate to the Group's consolidated net loss and shareholders' equity, see Note 29 to the Consolidated Financial Statements included in Item 18 of this Annual Report.

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|   |   | Year Ended At December 31,                    |                   |                   |                   |                   |  |
|---|---|---|-------------------|-------------------|-------------------|-------------------|--|
|   | 2013  | 2013  | 2012              | 2011              | 2010              | 2009              |  |
|   | (millions of<br>dollars,<br><br>except per<br>Ordinary<br>Share) <sup>(1)</sup> |   |                   |                   |                   |                   |  |
|   |   | (millions of euro, except per Ordinary Share) |                   |                   |                   |                   |  |
| <b>Statement of Operations Data:</b>  |   |   |                   |                   |                   |                   |  |
| <i>Amounts in accordance with Italian GAAP:</i>                                     |   |   |                   |                   |                   |                   |  |
| Net sales:  |   |   |                   |                   |                   |                   |  |
| Leather- and fabric-upholstered furniture   | \$ 535.0  | 402.8   | 409.4             | 425.3             | 460.5             | 450.6             |  |
| Other <sup>(2)</sup>  | 61.5  | 46.3  | 59.4              | 61.0              | 58.1              | 64.8              |  |
| Total net sales   | 599.2   | 449.1   | 468.8             | 486.3             | 518.6             | 515.4             |  |
| Cost of sales   | (421.4)   | (317.3)                                       | (313.8)           | (326.1)           | (321.5)           | (329.8)           |  |
| Gross profit  | 175.0   | 131.8   | 155.0             | 160.2             | 197.1             | 185.6             |  |
| Selling expenses  | (168.1)   | (126.6)                                       | (132.4)           | (144.3)           | (154.3)           | (149.6)           |  |
| General and administrative expenses   | (49.8)  | (37.5)  | (39.9)            | (43.3)            | (42.4)            | (46.6)            |  |
| Operating income (loss)   | (42.9)  | (32.3)  | (17.3)            | (27.3)            | 0.4               | (10.6)            |  |
| <i>Operating income (loss) per Ordinary Share</i>                                   | <i>(0.78)</i>   | <i>(0.59)</i>                                 | <i>(0.32)</i>     | <i>(0.50)</i>     | <i>0.01</i>       | <i>(0.19)</i>     |  |
| Other income (expense),   |   |   |                   |                   |                   |                   |  |
| Net (3) (4)   | (42.4)  | (31.9)  | (4.6)             | 17.3              | (4.4)             | 3.1               |  |
| Income (loss) before taxes and minority interests                                   | (85.3)  | (64.2)  | (21.9)            | (10.0)            | (4.0)             | (7.5)             |  |
| Income taxes  | (5.4)   | (4.1)   | (4.1)             | (8.9)             | (7.0)             | (9.8)             |  |
| Income (loss) before non-controlling interests                                      | (90.8)  | (68.4)  | (26.0)            | (18.9)            | (11.0)            | (17.3)            |  |
| Non-controlling interest  | 0.3   | 0.2   | 0.1               | 0.7               | 0.1               | 0.4               |  |
| Net income (loss)   | (91.1)  | (68.6)  | (26.1)            | (19.6)            | (11.1)            | (17.7)            |  |
| <i>Net income (loss) per Ordinary Share</i>   | <i>(1.66)</i>   | <i>(1.25)</i>                                 | <i>(0.48)</i>     | <i>(0.36)</i>     | <i>(0.20)</i>     | <i>(0.32)</i>     |  |
| <i>Dividends declared per share</i>   |   |   |                   |                   |                   |                   |  |
| <i>Amounts in accordance with U.S. GAAP:</i>  |   |   |                   |                   |                   |                   |  |
| Net sales   | \$ 591.3  | 445.2   | 459.3             | 488.3             | 510.8             | 506.0             |  |
| Operating income (loss) (5)   | (74.1)  | (55.8)  | (19.5)            | (31.9)            | 0.4               | (14.2)            |  |
| <i>Operating income (loss) per Ordinary Share (5)</i>                               | <i>(1.35)</i>   | <i>(1.02)</i>                                 | <i>(0.35)</i>     | <i>(0.58)</i>     | <i>0.01</i>       | <i>(0.26)</i>     |  |
| Net income (loss)   | (82.1)  | (61.8)  | (29.5)            | (12.4)            | (8.8)             | (25.9)            |  |
| <i>Net income (loss) per Ordinary Share (basic and diluted)</i>                     | <i>(1.50)</i>   | <i>(1.13)</i>                                 | <i>(0.54)</i>     | <i>(0.23)</i>     | <i>(0.16)</i>     | <i>(0.47)</i>     |  |
| <i>Weighted average number of Ordinary Shares outstanding</i>                       | <i>54,853,045</i>   | <i>54,853,045</i>                             | <i>54,853,045</i> | <i>54,853,045</i> | <i>54,853,045</i> | <i>54,853,045</i> |  |
| <b>Balance Sheet Data:</b>  |   |   |                   |                   |                   |                   |  |
| <i>Amounts in accordance with Italian GAAP:</i>                                     |   |   |                   |                   |                   |                   |  |
| Current assets  | \$ 372.3  | 270.2   | 307.5             | 327.3             | 298.6             | 301.9             |  |
| Total assets  | 581.3   | 421.9   | 476.1             | 511.0             | 503.9             | 508.6             |  |
| Current liabilities   | 190.4   | 138.2   | 133.2             | 122.9             | 107.8             | 116.8             |  |
| Long-term debt  | 5.8   | 4.2   | 7.3               | 10.8              | 13.6              | 5.9               |  |
| Non-controlling interest  | 3.7   | 2.7   | 2.5               | 3.0               | 2.1               | 1.9               |  |
| Shareholders' equity attributable to Natuzzi S.p.A. and Subsidiaries <sup>(6)</sup> | 287.8   | 208.9   | 281.1             | 310.5             | 323.2             | 325.0             |  |

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|   |    |       |       |       |       |       |       |
|---|----|-------|-------|-------|-------|-------|-------|
| et Asset  |    | 291.6 | 211.6 | 283.7 | 313.5 | 325.3 | 326.9 |
| <i>amounts in accordance with U.S. GAAP:</i>                          |    |       |       |       |       |       |       |
| total assets  | \$ | 591.0 | 428.9 | 480.6 | 511.0 | 508.5 | 521.1 |
| shareholders' equity attributable to Natuzzi<br>p.A. and Subsidiaries |    | 299.1 | 217.1 | 279.1 | 308.6 | 321.7 | 327.6 |
| et Asset  |    | 302.9 | 219.8 | 281.6 | 311.6 | 323.8 | 329.5 |

- 1) Income Statement amounts are converted from euros into U.S. dollars by using the average Federal Reserve Bank of New York Euro exchange rate for 2013 of U.S.\$ 1.3303 per 1 Euro. Balance Sheet amounts are converted from euros into U.S. dollars using the Federal Reserve Bank of New York Noon Buying Rate of U.S.\$ 1.3779 per 1 Euro as of December 31, 2013. Source: Bloomberg (USCFEURO Index).
- 2) Sales included under Other principally consist of sales of polyurethane foam and leather to third parties and sales of living room accessories.

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- 3) Other income (expense), net in 2013 was negatively affected by impairment losses of long-lived assets in use of 2 million, by the write-off of 5.7 million attributable to an airplane to be sold, by impairment losses of 0.4 million for closed plants, by a provision of 19.9 million for one-time employee termination benefits and by other provisions for contingent liabilities.
- 4) Other income (expense), net in 2011 was positively affected by the net Chinese relocation compensation and negatively affected by the impairment losses of long-lived assets, a one-time employee termination benefit and the provision for contingent liabilities. See Note 26 to the Consolidated Financial Statements included in Item 18 of this Annual Report.
- 5) Under US GAAP, impairment losses of 8.6 million for 2013, have been classified as general and administrative expenses and are included as part of operating loss (See Note 29). Impairment losses of 5.9 million for 2011 and of 0.7 million for 2010, respectively, have been reclassified to general and administrative expenses from the line other income/(expenses), net, where they were classified in 2011 and 2010 under Italian GAAP. These reclassifications are not material to the Company's financial statements (See Note 29).
- 6) Share capital as of December 31, 2013, 2012, 2011, 2010 and 2009 amounted to 54.9 million, 54.9 million, 54.9 million, 54.9 million and 54.9 million, respectively. Shareholder's Equity represents the Total Equity attributable to Natuzzi S.p.A. and its subsidiaries.

**Exchange Rates**

The following table sets forth, for each of the periods indicated, the Federal Reserve Bank of New York Noon Buying Rate for the Euro expressed in U.S. dollars per Euro.

| <b>Year:</b> | <b>Average<sup>(1)</sup></b> | <b>At Period End</b> |
|--------------|------------------------------|----------------------|
| 2009         | 1.3955                       | 1.4332               |
| 2010         | 1.3216                       | 1.3269               |
| 2011         | 1.4002                       | 1.2973               |
| 2012         | 1.2909                       | 1.3186               |
| 2013         | 1.3303                       | 1.3779               |

| <b>Month ending on:</b> | <b>High</b> | <b>Low</b> |
|-------------------------|-------------|------------|
| 31-Oct-2013             | 1.3810      | 1.3490     |
| 30-Nov-2013             | 1.3606      | 1.3357     |
| 31-Dec-2013             | 1.3816      | 1.3552     |
| 31-Jan-2014             | 1.3682      | 1.3500     |
| 28-Feb-2014             | 1.3806      | 1.3507     |
| 31-Mar-2014             | 1.3927      | 1.3731     |

- (1) The average of the Noon Buying Rates for the relevant period, calculated using the average of the Noon Buying Rates on the last business day of each month during the period. Source: Federal Reserve Statistical Release on Foreign Exchange Rates Historical Rates for Euro Area; Bloomberg (USCFEURO Index).

The effective Noon Buying Rate on April 18, 2014 was U.S.\$ 1.3816 to 1 Euro.

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**Risk Factors**

Investing in the Company's ADSs involves certain risks. You should carefully consider each of the following risks and all of the information included in this Annual Report.

**The Group has a recent history of losses; the Group's future profitability and financial condition depend to a large extent on its ability to overcome macroeconomic and operational challenges** The Group reported net losses in 2013 ( 68.6 million), 2012 ( 26.1 million), 2011 ( 19.6 million), 2010 ( 11.1 million) and 2009 ( 17.7 million), while it reported an operating loss in each of 2013, 2012 and 2011 ( 32.5 million, 17.3 million and 27.3 million respectively) and an operating income of 0.4 million in 2010 after another year of operating losses ( 10.6 million in 2009). In addition, the Group's net sales declined from 515.4 million in 2009 to 449.1 million in 2013. As evidenced by these financial results, we may not be able to achieve or maintain profitability on a consistent basis.

The Group attributes its negative results in 2013 to a persistent difficult macroeconomic environment affecting the furniture industry as a whole (particularly evident in some mature markets such as Europe), including extreme weakness in economic activity in the Euro-zone, a general strengthening of the Euro versus major currencies, stagnant or declining disposable income for consumers, particularly in some countries of the EU, continued high prices for raw materials and price competition from low-cost manufacturers. These negative trends have been partially offset by moderate signs of sales recovery from fast growing markets, such as those located in Eastern Europe, Asia-Pacific, Latin America and the Middle East. See Item 5. Operating and Financial Review and Prospects. The Group has also faced increased labor costs for some of its manufacturing plants operating abroad. See Item 4. Information on the Company Manufacturing for further information.

Our results of operations in the future will depend on our ability to overcome these and other challenges. Our failure to achieve profitability in the future could adversely affect the trading price of our shares and our ability to raise additional capital and, accordingly, our ability to grow our business. There can be no assurance that we will succeed in addressing any or all of these risks, and the failure to do so could have a material adverse effect on our business, financial condition and operating results.

**The worldwide economic downturn over the past few years has impacted the Group's business and could continue to significantly impact our operations, sales, earnings and liquidity in the foreseeable future** Economic conditions deteriorated significantly in the United States and worldwide in late 2008 and general economic conditions did not fully recover in 2009. During 2010, the global economy started to show, on the whole, small signs of recovery, although there were considerable differences in the rate of recovery (if any) among regions. During 2011, the global economy, after an encouraging first half, subsequently lost momentum, with particular reference to the Euro-zone, as a consequence of the sovereign debt crisis affecting Greece, Portugal, Spain, Italy and Ireland. In 2012 and 2013, the global economy continued to grow at a modest pace, but this growth was curbed by the stagnation of economic activity in Europe, as well as the slow-down of some emerging economies.

Prospects for full economic recovery, therefore, still remain uncertain, especially in the so-called western economies, where private consumption continues to be negatively impacted by a general weakness in the job market, ongoing vulnerability in the real-estate sector, a decreasing level of savings among families, high levels of public indebtedness in most developed countries, austerity measures designed to reduce public expenditures and consequent decreased consumer credit and spending.

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Furthermore, the persistent funding difficulties of Europe's banking industry, or a resurgence of the sovereign debt crisis in Europe, could diminish the banking industry's ability to lend to the real economy, thus setting in motion a negative spiral of declining production, higher unemployment and a weakening financial sector ..

These persistently difficult conditions have resulted in a decline in our sales and earnings over the past few years and could continue to impact our sales and earnings in the future. Sales of residential furniture are impacted by downturns in the general economy primarily due to decreased discretionary spending by consumers. The general level of consumer spending is affected by a number of factors, including, among others, general economic conditions, inflation, consumer confidence and the availability of consumer credit, all of which are generally beyond our control.

Consumer purchases of residential furniture decline during periods of economic downturn, when disposable income is lower. The economic downturn also impacts retailers, our primary customers, and may result in the inability of our customers to pay the amounts owed to us. In addition, if our retail customers are unable to sell our products or are unable to access credit, they may experience financial difficulties leading to bankruptcies, liquidations, and other unfavorable events. If any of these events occur, or if unfavorable economic conditions continue to challenge the consumer environment, our future sales, earnings, and liquidity would likely be adversely impacted.

**The Group's ability to generate the significant amount of cash needed to service our debt obligations and our ability to refinance all or a portion of our indebtedness or obtain additional financing depends on multiple factors, many of which may be beyond our control** Our ability to make scheduled payments due on our existing and anticipated debt obligations, to refinance and to fund planned capital expenditure and development efforts will depend on our ability to generate cash. We will require generation of sufficient operating cash flow from our projects to service our current and future projected indebtedness. Our ability to obtain cash to service our existing and projected debts is subject to a range of economic, financial, competitive, legislative, regulatory, business and other factors, many of which are beyond our control. We may not be able to generate sufficient cash flow from operations to satisfy our existing and projected debt obligations, in which case, we may have to undertake alternative financing plans, such as refinancing or restructuring our debt, selling assets, reducing or delaying capital investments, or seek to raise additional capital on terms that may be onerous or highly dilutive. Our ability to refinance our indebtedness will depend on the financial markets and our financial condition at such time. To the extent we have borrowings under bank overdrafts that are payable upon demand or which have short maturities, we may be required to repay or refinance such amounts on short notice, which may be difficult to do on acceptable financial terms or at all. At December 31, 2013, we had 25.0 million of bank overdrafts outstanding. In addition, while we had 61.0 million of cash and cash equivalents at December 31, 2013, 78% of this amount was held by our Chinese subsidiary and cannot be paid to us as a dividend without incurring withholding taxes. We cannot assure you that any refinancing or restructuring would be possible, that any assets could be sold, or, if sold, of the timing of the sales or the amount of proceeds that would be realized from those sales. We cannot assure you that additional financing could be obtained on acceptable terms, if at all, or would be permitted under the terms of our various debt instruments then in effect. Our failure to generate sufficient cash flow to satisfy our existing and projected debt obligations, or to refinance our obligations on commercially reasonable terms, would have an adverse effect on our business, financial condition and results of operations.

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**The Group's operations have benefited in 2013 and in previous years from a temporary work force reduction program that, if not continued despite management's desire to do so, may have an impact on the Group's future performance**

Due to the persistently difficult business environment that has negatively affected the Group's order flow over the past few years, the Company has entered into an agreement with Italian trade unions and the Ministry of Labor and Social Policy pursuant to which it is entitled to benefit from the *Cassa Integrazione Guadagni Straordinaria* (or CIGS), an Italian temporary layoff program pursuant to which government funds pay a substantial majority of the salaries of redundant workers who are subject to layoffs or reduced work schedules. On October 10, 2013, the Company entered into a separate agreement (the Italian Reorganization Agreement) with local institutions, Italian trade unions, the Ministries of Economic Development and of Labor and Social Policy and the regions of Puglia and Basilicata governing the reorganization plan for the Group's Italian operations. The plan contemplated by the Italian Reorganization Agreement anticipates future layoffs of 1,506 employees. Due to the complexity of the measures envisioned by the plan and in order to better manage workforce reductions, the Company and the trade unions obtained a one-year extension of the Company's participation in the CIGS, which was otherwise due to expire in October 2013, through October 15, 2014.

The extraordinary and temporary layoff programs have been extended several times in the past by the Ministry of Labor and Social Policy but there is no guarantee that the Group will be able to renew this layoff program, even if management deems ongoing participation in the program to be in the Company's best interest, which could adversely impact our future performance. For more information see Item 6. Directors, Senior Management and Employees Employees .

**The Group's operations may be adversely impacted by strikes, slowdowns and other labor relations matters**

Many of our employees, including many of the laborers at our Italian plants, are unionized and covered by collective bargaining agreements. As a result, we are subject to the risk of strikes, work stoppages or slowdowns, particularly in our Italian plants. These collective bargaining agreements also limit our ability to close plants, reduce wages or adjust work schedules in response to market conditions or competition without the agreement of Italian trade union representatives. During 2013 and the first few months of 2014, we have experienced strikes and slowdowns in connection with our Italian reorganization efforts, which resulted in lower productivity levels for the effected plants. Our operations may also be adversely impacted by future strikes or slowdowns, which we anticipate could occur in the future in connection with the announcement of layoffs, and in particular, in connection with the expiration of our participation in the CIGS program in October 2014 and the subsequent termination of redundant employees.

Any strikes, threats of strikes, slowdowns or other resistance in connection with our reorganization plan, the negotiation of new labor agreements or otherwise could adversely affect our business as well as impair our ability to implement further measures to reduce structural costs and improve production efficiencies. A lengthy strike that involves a significant portion of our manufacturing facilities could have an adverse effect on our financial condition, results of operations, and cash flows.



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**We may not execute our 2014-2016 Business Plan, including reorganization plans for our Italian industrial operations, successfully, which could lead to ongoing losses from operations and failure to achieve the objectives set forth in our plans** On February 28, 2014, the Natuzzi board of directors approved the 2014-2016 Business Plan (the Business Plan ), which also incorporates the plan for the reorganization of the Group's Italian operations that was the subject of the Italian Reorganization Agreement in October 2013. The reorganization of the Group's Italian operations foresees a reduction in our Italian workforce, closure of certain Italian facilities and the implementation of more efficient production processes in those plants that remain in operation. The Business Plan reflects these objectives, while also contemplating efficiency improvements in our worldwide production and back office procedures, efficiency improvements in our supply chain, rationalization and realignment of our retail network and streamlining the number of brands within the group and store insignias, as well as marketing and commercial investments. Our objective of returning our operations to profitability is dependent upon our successful execution of the objectives under the Business Plan, including the successful reorganization of our Italian industrial operations. The failure to execute these objectives successfully could result in ongoing losses for the Group and a failure to reduce costs and improve sales as contemplated by the Business Plan.

**A failure to offer a wide range of products that appeal to consumers in the markets we target and at different price-points could result in a decrease in our future earnings** The Group's sales depend on our ability to anticipate and reflect consumer tastes and trends in the products we sell in various markets around the world, as well as our ability to offer our products at various price points that reflect the spending levels of our target consumers. While we have broadened the offering of our products in terms of styles and price points over the past several years in order to attract a wider base of consumers, our results of operations are highly dependent on our continued ability to properly anticipate and predict these trends. The potential inability of the Group to anticipate consumer tastes and preferences in the various markets in which we operate, and to offer these products at prices that are competitive to consumers, may negatively affect the Group's ability to generate future earnings.

In addition, the Group is a leading player in the production of leather-upholstered furniture, with 94.9% of net sales of upholstered furniture in 2013 derived from the sale of leather-upholstered furniture. Consumers have the choice of purchasing upholstered furniture in a wide variety of styles and materials, and consumer preferences may change. There can be no assurance that the current market for leather-upholstered furniture will grow consistent with our projections under the Business Plan or that it will not decline.

**Our Business Plan contemplates the rationalization and realignment of our retail network. If we and our dealers do not execute on these plans successfully or fail to effectively launch new stores in growing markets, our ability to grow and our profitability could be adversely affected** Our Business Plan contemplates the closure of certain under-performing stores and the opening of new stores and launching of new points of sale in markets with greater growth potential, particularly in the Asia-Pacific region, the Middle East, India, Russia, Eastern Europe and Latin America. Our ability and the ability of our dealers to identify and open new stores in desirable locations and operate such stores profitably is an important factor in our ability to grow successfully. We have in the past and will likely continue to purchase or otherwise assume operation of company-brand stores from independent dealers to the extent that such stores are considered strategic for the promotion of the *Natuzzi Italia* brand. Increased demands on our operational, managerial, and administrative resources could cause us to operate our business, including our existing and new stores, less effectively, which in turn could cause deterioration in our profitability.

**Demand for furniture is cyclical and may fall in the future** Historically, the furniture industry has been cyclical, fluctuating with economic cycles, and sensitive to general economic conditions, housing starts, interest rate levels, credit availability and other factors that affect consumer spending habits. Due to the discretionary nature of most furniture purchases and the fact that they often represent a significant expenditure to the average consumer, such purchases may be deferred during times of economic uncertainty such as those being recently experienced in some of

our markets, such as the United States and, particularly, Europe.

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In 2013, the Group derived 40.3% of its leather and fabric-upholstered furniture net sales from the Americas (Brazil included), 47.0% from EMEA and 12.6% from the Asia-Pacific region. A failure to recover from the economic slowdown or renewed economic pressures in the United States or Europe may have a material adverse effect on the Group's results of operations.

**The furniture market is highly competitive** The Group operates in a highly competitive industry that includes a large number of manufacturers. No single company has a dominant position in the industry. Competition is generally based on product quality, brand name recognition, price and service.

The Group principally competes in the upholstered furniture sub-segment of the furniture market. In Europe, the upholstered furniture market is highly fragmented. In the United States, the upholstered furniture market includes a number of relatively large companies, many of which are larger and have greater financial resources than the Group. Some of the Group's competitors offer extensively advertised, well-recognized branded products.

Competition has increased significantly in recent years as foreign producers from countries with lower manufacturing costs have begun to play an important role in the upholstered furniture market. Such manufacturers are often able to offer their products at lower prices, which increases price competition in the industry. In particular, manufacturers in Asia and Eastern Europe have increased competition in the lower-priced segment of the market. As a result of the actions and strength of the Group's competitors and the inherent fragmentation in some markets in which it competes, the Group is continually subject to the risk of losing market share, which may lower its sales and profits.

Market competition may also force the Group to reduce prices and margins, thereby reducing its cash flows.

The highly competitive nature of the industry means that we are constantly at risk of losing market share, which would likely result in a loss of future sales and earnings. In addition, due to high levels of competition, it may not be possible for us to raise the prices of our products in response to inflationary pressures or increasing costs, which could result in a decrease in our profit margins.

**Fluctuations in currency exchange rates have adversely affected and may adversely affect the Group's results**

The Group conducts a substantial part of its business outside of the Euro zone. An increase in the value of the Euro relative to other currencies used in the countries in which the Group operates has in the past, and may in the future, reduce the relative value of the revenues from its operations in those countries, and therefore may adversely affect its operating results or financial position, which are reported in Euro. In addition to this risk, the Group is subject to currency exchange rate risk to the extent that its costs are denominated in currencies other than those in which it earns revenues. In 2013, a significant portion of the Group's net sales (almost 62%), but approximately 52% of its costs, were denominated in currencies other than the Euro. The Group also holds a substantial portion of its cash and cash equivalents in currencies other than the Euro, including a large amount in RMB received as compensation for the relocation of its Chinese manufacturing plant. The Group is therefore exposed to the risk that fluctuations in currency exchange rates may adversely affect its results, as has been the case in recent years. For more information, see Item 11, Quantitative and Qualitative Disclosures about Market Risk.

**The Group faces risks associated with its international operations** The Group is exposed to risks that arise from its international operations, including changes in governmental regulations, tariffs or taxes and other trade barriers, price, wage and exchange controls, political, social, and economic instability in the countries where the Group operates, inflation, exchange rate and interest rate fluctuations. Any of these factors could have a material adverse effect on the Group's results.



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**The price of the Group's principal raw materials is difficult to predict** In 2013, approximately 85% of the Group's revenues came from leather-upholstered furniture sales. The acquisition of cattle hides represents approximately 23% of total cost of goods sold. The dynamics of the raw hides market are dependent on the consumption of beef, the levels of worldwide slaughtering, worldwide weather conditions and the level of demand in a number of different sectors, including footwear, automotive, furniture and clothing.

**The Group's past results and operations have significantly benefited from government incentive programs, which may not be available in the future** Historically, the Group derived significant benefits from the Italian Government's investment incentive programs for under-industrialized regions in Southern Italy, including tax benefits, subsidized loans and capital grants. See Item 4. Information on the Company Incentive Programs and Tax Benefits. In recent years, the Italian Parliament replaced these incentive programs with an investment incentive program for all under-industrialized regions in Italy, which is currently being implemented by the Group through grants, research and development benefits. There are no indications at this time that the Italian Government will implement new initiatives to support companies located in under-industrialized regions in Italy. Therefore, there can be no assurance that the Group will continue to be eligible for such grants, benefits or tax credits for its current or future investments in Italy.

In recent years, the Group has opened manufacturing operations in China, Brazil and Romania and up through 2011, was granted tax benefits and export incentives by the relevant governmental authorities in those countries. There can be no assurance that the Group will benefit from such tax benefits or export incentives in connection with future investments.

**The Group is dependent on qualified personnel** The Group's ability to maintain its competitive position will depend to some considerable degree upon the personal commitment of its founder, chairman and CEO, Mr. Pasquale Natuzzi, as well as its ability to continue to attract and maintain highly qualified managerial, manufacturing and sales and marketing personnel. There can be no assurance that the loss of key personnel would not have a material adverse effect on the Group's results of operations.

**Investors may face difficulties in protecting their rights as shareholders or holders of ADSs** The Company is incorporated under the laws of the Republic of Italy. As a result, the rights and obligations of its shareholders and certain rights and obligations of holders of its ADSs (as defined below) are governed by Italian law and the Company's *statuto* (or by-laws). These rights and obligations are different from those that apply to U.S. corporations. Furthermore, under Italian law, holders of ADSs have no right to vote the shares underlying their ADSs; however, pursuant to the Deposit Agreement (as defined below), ADS holders do have the right to give instructions to The Bank of New York Mellon, the ADS depository, as to how they wish such shares to be voted. For these reasons, the Company's ADS holders may find it more difficult to protect their interests against actions of the Company's management, board of directors or shareholders than they would if they were shareholders of a company incorporated in the United States.

**One shareholder has a controlling stake of the Company** Mr. Pasquale Natuzzi, who founded the Company and is currently Chief Executive Officer and Chairman of the board of directors, beneficially owns, as of April 25, 2014, 30,217,521 Ordinary Shares, representing 55.1% of the Ordinary Shares outstanding (60.2% of the Ordinary Shares outstanding if the Ordinary Shares owned by members of Mr. Natuzzi's immediate family (the Natuzzi Family) are aggregated). As a result, Mr. Natuzzi has the ability to exert significant influence over our corporate affairs and to control the Company, including its management and the selection of its board of directors. Since December 16, 2003, Mr. Natuzzi has held his entire beneficial ownership of Natuzzi S.p.A. shares through INVEST 2003 S.r.l., an Italian holding company wholly-owned by Mr. Natuzzi and with its registered office located at Via Gobetti 8, Taranto, Italy.



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In addition, under the Deposit Agreement dated as of May 15, 1993, as amended and restated as of December 23, 1996 and as of December 31, 2001 (the Deposit Agreement), among the Company, The Bank of New York Mellon, as Depositary (the Depositary), and owners and beneficial owners of American Depositary Receipts (ADRs), the Natuzzi Family has a right of first refusal to purchase all the rights, warrants or other instruments which The Bank of New York Mellon, as Depositary under the Deposit Agreement, determines may not lawfully or feasibly be made available to owners of ADSs in connection with each rights offering, if any, made to holders of Ordinary Shares.

Because a change of control of the Company would be difficult to achieve without the cooperation of Mr. Natuzzi and the Natuzzi Family, the holders of the Ordinary Shares and the ADSs may be less likely to receive a premium for their shares upon a change of control of the Company.

**Purchasers of our Ordinary Shares and ADSs may be exposed to increased transaction costs as a result of the Italian financial transaction tax or the proposed European financial transaction tax** On 14 February 2013, the European Commission adopted a proposal for a directive on the financial transaction tax (hereafter EU FTT) to be implemented under the enhanced cooperation procedure by eleven Member States initially (Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovenia, Slovakia and Spain). Member States may join or leave the group of participating Member States at later stages. The proposal will be negotiated by Member States, and, subject to an agreement being reached by the participating Member States, a final directive will be enacted. The participating Member States will then implement the directive in local legislation. The aim of the European Commission is for the EU FTT to enter into force on 1 January 2014. If the proposed directive is adopted and implemented in local legislation, investors in Ordinary Shares and ADSs may be exposed to increased transaction costs.

Italy approved a financial transaction tax in 2012 (the IFTT), which, beginning March 1, 2013, applies with respect to trades entailing the transfer of (i) shares or equity-like financial instruments issued by companies resident in Italy, such as the Ordinary Shares; and (ii) securities representing the shares and financial instruments under (i) above (including depositary receipts such as the ADSs), regardless of the residence of the issuer. The IFTT may also apply to the transfer of Ordinary Shares and ADSs by a U.S. resident. The IFTT does not apply to companies having an average market capitalization lower than 500 million in the month of November of the year preceding the year in which the trade takes place. In order to benefit from this exemption, companies whose securities are listed on a foreign regulated market, such as the Company, need to be included on a list published annually by the Italian Ministry of Economy and Finance. As of the date of this Annual Report, the Company is yet to be included on such a list. As a result of the IFTT, investors in the Ordinary Shares and ADSs may be exposed to increased transaction costs. See [Taxation](#) Other Italian Taxes The Italian Financial Transaction Tax.

**Our auditors, like other independent registered public accounting firms operating in Italy, are not currently permitted to be subject to inspection by the Public Company Accounting Oversight Board, and as such, investors may be deprived of the benefits of such inspection** Our independent registered public accounting firms that issue the audit reports included in our Annual Reports filed with the U.S. Securities and Exchange Commission (the SEC), as auditors of companies that are traded publicly in the United States and firms registered with the Public Company Accounting Oversight Board, or PCAOB, are required by the laws of the United States to undergo regular inspections by the PCAOB to assess its compliance with SEC rules and PCAOB professional standards. Because our auditors are a registered public accounting firm in Italy, a jurisdiction where the PCAOB is currently unable under Italian law to conduct inspections, our auditors, like other independent registered public accounting firms in Italy, are currently not inspected by the PCAOB.

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Inspections of audit firms that the PCAOB has conducted where allowed have identified deficiencies in those firms audit procedures and quality control procedures, which may be addressed as part of the inspection process to improve future audit quality. The lack of PCAOB inspections in Italy prevents the PCAOB from regularly evaluating our auditor's audits and quality control procedures. As a result, the inability of the PCAOB to conduct inspections of auditors in Italy may deprive investors of the benefits of PCAOB inspections.

### **ITEM 4. INFORMATION ON THE COMPANY**

#### **Introduction**

The Natuzzi Group is engaged in designing, manufacturing and distributing upholstered furniture. The Group's offering primarily includes linear and sectional sofas, including those with reclining and motion functions, armchairs and sofa beds, as well as living room and bedroom furnishings and accessories.

The Group is one of the world's leading companies for the production of leather-upholstered furniture and according to the World Luxury Tracking survey by Lagardère Global Advertising, the Natuzzi brand was ranked as the best-known global brand within the furniture category, and the second best-known brand if all sectors are considered, based on a sample of 7,700 luxury consumers from six countries (France, UK, Germany, Spain, Italy and the United States) (Source: World Luxury Tracking 2013 (Lagardère Global Advertising/IPSOS)).

Natuzzi began operations in Italy in 1959. The Company first targeted the U.S. market in 1983 and subsequently began entering other European markets. In 2008, Natuzzi started to focus its attention on Brazil, Russia, India and China and other developing markets. Today the distribution network covers approximately 100 countries on five continents.

The Group currently offers products under the following brands: *Natuzzi Italia*, *Natuzzi Editions/Leather Editions* and, beginning in 2014, *Natuzzi Re-vive*. Each of these brands targets a specific type of customer, based on different price points. The Group also offers unbranded and private label products. As part of the Business Plan, during 2014 the Group plans on relabeling the *Leather Editions* portfolio of products as *Natuzzi Editions* to capitalize on the strength of the Natuzzi name and streamline its offerings. For a detailed description of these brands and their target markets, please see Strategy The Brand Portfolio Strategy and Products below.

As of February 28, 2014 the Group distributed its products as follows:

*Natuzzi Italia*: 177 *Natuzzi Italia* stores, 95 *Divani & Divani by Natuzzi* stores (located solely in Italy and Portugal), 11 *Natuzzi Italia* concessions (store-in-store points of sale, directly managed by the UK subsidiary of the Group), 314 *Natuzzi Italia* galleries (store-in-store points of sales managed by independent partners). Forty-four of these points of sales (of which 27 are *Natuzzi Italia* stores and 17 are *Divani & Divani by Natuzzi* stores) are directly managed by the Group.



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*Natuzzi Editions / Leather Editions* : 47 stores and 369 galleries. Fifteen of these point of sales, all of which are located in China, are directly managed by the Group. Consistent with the Business Plan, the *Leather Editions* stores, apart from those stores located in China which will remain *Leather Editions* points of sale in the short term, will be gradually rebranded worldwide into *Natuzzi Editions* points of sales.

*Natuzzi Re-vive*: Following a well-received launch at the end of 2013 at the High Point Furniture Market (USA) and the furniture fairs in Brussels and Paris, in 2014 approximately 150 direct customers will begin distributing the *Natuzzi Re-vive* recliner in over 25 different markets and through approximately 500 points of sale.

Private label collection: Includes our unbranded and *Softaly* products and is currently marketed in North America, Europe, Brazil and Asia-Pacific principally through a selected number of customers, such as IKEA on a worldwide basis; Macy's, Rooms-to-Go, The Brick, Leon's and American Signature in North America; Conforama, Begros, BUT and Harvey's in Europe; Magazine Luiza and Tok&Stok in Brazil; Nitori in the Asia-Pacific region.

The Natuzzi Group also presents its products at the world's leading furniture fairs: *Il Salone del Mobile* in Milan, Italy, *IMM* in Cologne, Germany, *Furniture Market* in High Point, USA, *100% Design* in London, United Kingdom, *I Saloni Worldwide* in Moscow, Russia, among others.

On February 28, 2014, the Natuzzi board of directors approved the 2014-2016 Business Plan, prepared in cooperation with specialized external business advisors, establishing a new brand strategy for the Group. According to this new approach, three brands *Natuzzi Italia*, *Natuzzi Editions* and *Natuzzi Re-vive* will all be developed as product lines leveraging the strength of the Natuzzi brand name, which is our most recognized brand among consumers. Our *Softaly* line will continue to be offered within our business unit aimed at generating sales volumes through private label offerings, which is designed and manufactured to meet the specific needs of key accounts.

On June 7, 2002, the Company changed its name from *Industrie Natuzzi S.p.A.* to *Natuzzi S.p.A.* The *statuto*, or by-laws, of the Company provide that the duration of the Company is until December 31, 2050. The Company, which operates under the trademark *Natuzzi*, is a *società per azioni* (joint stock company) organized under the laws of the Republic of Italy and was incorporated in 1959 by Mr. Pasquale Natuzzi, who is currently the Chairman of the Board of Directors, Chief Executive Officer, and controlling shareholder of the Company. Most of the Company's operations are carried out through various subsidiaries that individually conduct a specialized activity, such as leather processing, foam production and shaping, furniture manufacturing, marketing or administration.

The Company's principal executive offices are located at Via Iazzitiello 47, 70029 Santeramo in Colle, Italy, which is approximately 25 miles from Bari, in southern Italy. The Company's telephone number is: +39 080 882-0111. The Company's general sales agent subsidiary in the United States is Natuzzi Americas, Inc. ( *Natuzzi Americas* ), located at 130 West Commerce Avenue, High Point, North Carolina 27260. Natuzzi Americas telephone number is: +1 336 887-8300.

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Natuzzi S.p.A. is the parent company of the Natuzzi Group. As of March 30, 2014, the Company's principal operating subsidiaries were:

| <b>Name</b>                     | <b>Percentage of ownership</b> | <b>Registered office</b>  | <b>Activity</b> |
|---------------------------------|--------------------------------|---------------------------|-----------------|
| Italsofa Nordeste S/A           | 100.00                         | Salvador de Bahia, Brazil | (1)             |
| Italsofa Shanghai Ltd           | 96.50                          | Shanghai, China           | (1)             |
| Natuzzi China Ltd               | 100.00                         | Shanghai, China           | (1)             |
| Italsofa Romania                | 100.00                         | Baia Mare, Romania        | (1)             |
| Natco S.p.A.                    | 99.99                          | Santeramo in Colle, Italy | (2)             |
| I.M.P.E. S.p.A.                 | 100.00                         | Bari, Italy               | (3)             |
| Nacon S.p.A.                    | 100.00                         | Santeramo in Colle, Italy | (4)             |
| Lagene S.r.l.                   | 100.00                         | Santeramo in Colle, Italy | (4)             |
| Natuzzi Americas Inc.           | 100.00                         | High Point, NC, USA       | (4)             |
| Natuzzi Iberica S.A.            | 100.00                         | Madrid, Spain             | (4)             |
| Natuzzi Switzerland AG          | 100.00                         | Dietikon, Switzerland     | (4)             |
| Natuzzi Nordic                  | 100.00                         | Copenhagen, Denmark       | (4)             |
| Natuzzi Benelux S.A.            | 100.00                         | Hereentals, Belgium       | (4)             |
| Natuzzi Germany GmbH            | 100.00                         | Köln, Germany             | (4)             |
| Natuzzi Japan KK                | 100.00                         | Tokyo, Japan              | (4)             |
| Natuzzi Services Limited        | 100.00                         | London, UK                | (4)             |
| Natuzzi Trading Shanghai Ltd    | 100.00                         | Shanghai, China           | (4)             |
| Natuzzi Oceania PTI Ltd         | 100.00                         | Sydney, Australia         | (4)             |
| Natuzzi Russia OOO              | 100.00                         | Moscow, Russia            | (4)             |
| Natuzzi India Furniture PVT Ltd | 100.00                         | New Delhi, India          | (4)             |
| Italholding S.r.l.              | 100.00                         | Bari, Italy               | (5)             |
| Natuzzi Netherlands Holding     | 100.00                         | Amsterdam, Holland        | (5)             |
| Natuzzi Trade Service S.r.l.    | 100.00                         | Santeramo in Colle, Italy | (6)             |
| SALENA SRL                      | 49.00                          | Milan, Italy              | (7)             |

- (1) Manufacture and distribution
- (2) Intragroup leather dyeing and finishing
- (3) Production and distribution of polyurethane foam
- (4) Services and distribution
- (5) Investment holding
- (6) Transportation services
- (7) Dormant

See Note 1 to the Consolidated Financial Statements included in Item 18 of this Annual Report for further information on the Company's subsidiaries.

**Strategy**

The negative performance of the Group in 2013 and in recent years has largely been the result of several challenges specific to the furniture industry and prevalent in the economy at large. For instance, the discretionary spending of consumers on furnished goods has been negatively impacted in recent years by the persistent effects of the global economic downturn, largely as a result of lower home values, high levels of unemployment and personal debt, austerity measures to consolidate public imbalances in advanced economies (within the EU in particular), and generally reduced access to consumer credit.

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On February 28, 2014, the Company's board of directors approved its 2014-2016 Business Plan (the "Business Plan"), prepared in cooperation with specialized external business advisors, which seeks to address and counteract these trends. The Business Plan, which is anchored by the company's foundational values of ethics and social responsibility and based on its points of strength (high brand awareness, innovation, industrial know-how and a global presence), has the following primary objectives: regaining market competitiveness, reducing losses in 2014 and spurring a new phase of growth in revenues, with a return to profitability beginning in 2015.

The company will seek to regain market competitiveness and eliminate losses through a restructuring phase that envisions:

1. **Strong recovery of the competitiveness of its Italian operations**, which will be accomplished through the joint efforts of the company, unions, government and Italian regions of Puglia and Basilicata in implementing the industrial reorganization plan that was agreed upon on October 10, 2013 and entails both investments and a reduction in production costs.
2. **Strong recovery of worldwide productive efficiency**, which will be accomplished through the adoption of 24 industrial product platforms, which are the result of the re-engineering of existing models and the design of new models according to the new moving-line production process; and the complete implementation of the moving-line production process in all of the Group's factories worldwide (in Italy, China, Romania and Brazil).
3. **Efficiency improvements in the back office processes on a worldwide basis**, through the implementation of a centralized shared service structure that has been designed to reduce costs and address unemployment among white collar workers in the Company's home region.
4. **Efficiency improvements in the supply chain**, through a reduction in inventory levels, optimization of transportation and a new logistics organization.
5. **Rationalization of the retail network** through the closure of 13 under-performing stores that are owned and managed directly by the Group.

Beginning in 2015, the Business Plan foresees a gradual growth in revenues and a return to operating profit, through the implementation of:

1. A **marketing and distribution strategy** aimed at:
  - a) capitalizing on investments in the Natuzzi brand, which will become the sole brand within the Group;

- b) organizing its offerings into three lines of products: *Natuzzi Italia*, *Natuzzi Editions* and *Natuzzi Re-vive*;
  - c) expanding the distribution of the Natuzzi brand through wholesale distribution channels and through the strengthening of the retail network;
  - d) reinforcing the division dedicated to the sale of private label products to mass-market dealers.
2. **A commercial strategy** that is focused on increasing sales in markets with high growth rates (primarily Asia, the Middle East, India, Russia, Eastern Europe and Latin America) and on reorganizing our operations to promote sales in those mature markets where the Natuzzi brand is most recognized (including the U.S. and Canada), as well as defending market share in Western Europe and Italy.

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3. Strengthening investments in **marketing and communications**, during the term of the Business Plan.
4. **A new commercial organization**, both at a centralized level and in local markets, that is calibrated based on growth forecasts.

**The Brand Portfolio Strategy** The Group competes in all price segments of the upholstered furniture market with a complementary offer of furnishings and accessories divided into different business propositions each one with specific brand name, identity, target and positioning. This differentiated brand portfolio is designed to address all market segments and increase sales and profitability.

Precise market segmentation, clear brand positioning and clearly defined customer and consumer targets are intended to enhance the Group's competitive strengths in all market segments to gain market share:

**a)** The *Natuzzi Italia* brand is the most established consumer brand within the Group's portfolio. It is sold exclusively through the retail channel in mono-brand stores, concessions and galleries and beginning in 2014, we will begin selling this product line in high-end department stores. The offer includes sofas designed and manufactured in Italy at the Company's facilities, priced at the middle to high-end of the market, with unique and customized materials, workmanship and finishes thanks to the Natuzzi heritage of fine craftsmanship in the leather sofas segment. The *Natuzzi Italia* product line includes complementary furnishings and accessories for the living room and the bedroom. We believe that the brand benefit consists in helping consumers make their home a harmonious, beautiful environment. Through the style and quality of its products and the merchandizing in its stores, the Group aims to make this brand an affordable luxury. From the identification of market trends to the delivery to the consumer's home, Natuzzi directly controls the upholstered production and distribution value chain with the aim of ensuring ultimate quality at competitive prices.

**b.1)** The *Natuzzi Editions* brand dates back to 2005 and at the beginning it was designed specifically for the U.S. market. The collection includes a wide range of leather upholstery products targeting the medium/medium-high segment of the market and leveraging on the know-how and the high credibility of Natuzzi in the leather upholstery business. *Natuzzi Editions* products are manufactured at the Group's overseas plants (Romania, China and Brazil) and sold solely in the Americas where the Natuzzi Group historically has a notable market share. These stores are provided with a specific display system and merchandising materials designed to emphasize the brand's core values of Leather & Craftsmanship.

**b.2)** The *Leather Editions* brand was officially launched in 2010. *Leather Editions* is similar to *Natuzzi Editions* in terms of collection, target consumers, distribution channel and merchandising. The primary difference is that through 2013, the *Leather Editions* brand was distributed in Europe and the rest of the world, excluding the Americas. Under the Business Plan, the Group contemplates gradually relabeling its *Leather Editions* products and stores as *Natuzzi Editions* beginning in 2014, apart from stores in China, which will continue, at least in the short term, to use the *Leather Editions* store name.

**c)** The *Natuzzi Re-vive* is the Group's first performance recliner. In this product, innovative technology meets Natuzzi high craftsmanship to offer complete support as well as intuitively respond to movement. The *Natuzzi Revive* is positioned in the medium/medium-high segment of the market targeting a wide range of consumers who we see as culturally open to innovation, sensitive to their well-being and willing to rediscover the human-dimension of their lives. The distribution of this product, which will begin in 2014, will mainly be through points of sale and galleries within Natuzzi stores, department stores and multi-brands stores.



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d) *Private label* production was introduced by the Group in 2011 as key-account program to compete in low-end segments of the market. The objective was to recover business from large distributors and develop additional volumes. The Group aims to replicate the best practices applied in connection with the most demanding customers in terms of quality, service and price. These products are also occasionally sold under the *Softaly* brand name. Each account is managed by dedicated key-account teams under the following guidelines to maintain efficiency:

accurate forecasting;

product offerings to create production efficiency through synergies on raw materials, components and coverings, resulting in a focused collection with few models, versions and coverings;

dedicated manufacturing plants: China for Asia-Pacific and American accounts (other than those located in Brazil), Romania for European accounts, Brazil for Brazilian accounts;

dedicated supply chain and transportation service (full truck or full container).

The Group's brand portfolio also included the *Italsofa* brand that was launched in 2007 with the objective of positioning it as a higher market alternative to very low-cost Chinese competitors, specifically targeting young consumers. With the aim of better rationalizing its product offering, the Group has decided not to make further investments in the *Italsofa* brand. All the models thus far developed will be progressively absorbed by the Group's other brand offerings. The Group will continue to assist those partners that have opened *Italsofa* points of sale and to convert the existing *Italsofa* stores or galleries into new projects of the Group.

**Improvement of the Group's Retail Program and Brand Development** The Group has made significant investments to improve its existing distribution network and strengthen its brands, primarily through an increase in the number of Natuzzi stores and galleries worldwide. See Item 4. Information on the Company Markets.

The high level of recognition of the Natuzzi brand among luxury consumers from developed countries is the result of investments the Company has made over the past decade in its products, communication, in-store experience and customer service, thus securing a premium inherent in the brand itself. This consumer brand awareness encourages the Company to carry on in its brand development, through the rationalization of the Group's brand portfolio and enhancement of the Group's distribution network, in order to further increase consumers' familiarity with the Natuzzi brand, and their association of it as a luxury brand. As of February 28, 2014, the Group sells its furniture through 95 *Divani & Divani by Natuzzi* and 177 *Natuzzi Italia* stores, of which 44 are directly owned by the Group, and through 11 concessions in the United Kingdom. The concessions are a store-in-store concept managed directly by a subsidiary of the Company located in the United Kingdom. As of February 28, 2014, there were 314 Natuzzi Italia galleries worldwide (store-in-store concepts managed by independent partners).

Apart from the *Natuzzi Italia* stores and *Divani & Divani by Natuzzi* network, as of February 28, 2014, there were 369 *Natuzzi Editions/Leather Editions* galleries, 47 *Leather Editions* stores (all located in China), including 15 stores operated by the Group, 12 *Italsofa* stores and 156 *Italsofa* galleries.



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The Group's expansion, with particular focus on fast developing markets continued in 2013. During 2013, the Group opened 46 mono-brand stores, of which 20 were opened under the *Natuzzi Italia* name (namely five in China, two in each of Australia and Vietnam, and one each in Algeria, Côte d'Ivoire, the Netherlands, India, Italy, South Korea, Malta, Russia, Serbia-Montenegro, Ukraine and the United States), four under the *Divani & Divani by Natuzzi* name (all located in Italy) and 22 under the *Leather Editions* name (all located in China). During the same period, the Group opened 82 galleries, of which 32 were opened under the *Natuzzi Italia* name (namely, five in Austria, four in Russia, three each in Finland and the United Kingdom, two each in Brazil, Germany and the United States, and one each in Albania, Canada, Croatia, India, Kazakhstan, Mexico, Qatar, Romania, Slovenia, Spain and Turkey), and 43 under the *Natuzzi Editions* (or *Leather Editions*) names (namely, 18 in Brazil, five in India, three each in Austria and Hungary, two each in Belgium, Germany, Poland, Russia and the United States, and one each in Nigeria, Romania, Serbia-Montenegro and Spain).

The expansion of products that the Group offers for the high-end segment has required an adjustment to the presentation of these products at their points-of-sale. The Natuzzi product offering is increasingly oriented towards the concept of "total living". Therefore, single-brand Natuzzi points-of-sale have been recently refurbished in order to recreate a complete living room environment, including the use of interior decorations.

**Product Diversification and Innovation** The Group believes that it is important to offer consumers carefully developed, coordinated living rooms at competitive prices through its "Total Look" offer, which was first introduced in 2006. The Total Look offer is conceived in accordance with the latest trends in design, materials and colors, and includes high quality sofas, furnishings (including wall units, dining tables and chairs) and accessories, all of which are developed in-house and presented in harmonious and personalized solutions. The Group has taken a number of steps to broaden its product lines, including the development of new models, such as modular and motion frames, and the introduction of new materials and colors, including exclusive fabrics and microfibers. The Group believes that expanding its Total Look offerings will strengthen its relationships with the world's leading distribution chains, which are interested in offering branded packages. The Group has also invested in the Natuzzi Style Center in Santeramo in Colle, Italy, to serve as a creative hub for the Group's design activities.

On April 9, 2014, the Group announced that beginning in 2014, it will also begin distributing beds, bed linens and bedroom furnishings to further expand its product offerings.

**Manufacturing**

As of February 28, 2014, our manufacturing facilities are located in China, Romania, Brazil and Italy.

Our Chinese plant is located in Shanghai, extending over 88,000 square meters, and has been operating since 2011. As of December 31, 2013, our Chinese plant employed 1,424 people, of whom 1,331 were laborers. It manufactures *Natuzzi Editions* and private label products for the Americas (apart from Brazil) and for the Asia-Pacific market. In 2013, the Chinese plant produced about 40% of the Group's total consolidated upholstery revenue.

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Our Romanian plant is located in Baia Mare, extending over 75,600 square meters, and has been operating since 2003. As of December 31, 2013, our Romanian plant employed 1,242 people, of whom 1,088 were laborers. It produces *Natuzzi Editions* and private label products for the EMEA region. In 2013 the plant generated about 25% of the Group's total consolidated upholstery revenue.

Our Brazilian plant is located in Salvador De Bahia, extending over 28,700 square meters, and has been operating since 2000. As of December 31, 2013, our Brazilian plant employed 221 people, of whom 177 were laborers. It produces *Natuzzi Editions* and private label products exclusively for the local market. In 2013 the plant generated about 2% of the Group's total consolidated upholstery revenue. In addition to the Salvador De Bahia plant, we have another Brazilian plant that is currently dormant.

Our three Italian plants dedicated to the production of upholstered products and two warehouses are located in Santaremo Iesce, Matera Iesce and Laterza, all of which are located either in or within a 25 kilometer radius of Santeramo in Colle, where the Group's headquarters are located. Collectively the three plants extend over 82,000 square meters. As of December 31, 2013, these sites (together with the Group's headquarters) employed 2,168 laborers, the majority of whom were subject to the layoff program. See Item 6. Directors, Senior Managers and Employees. The Italian plants produce exclusively *Natuzzi Italia* products for the world market and, beginning in the first quarter of 2014, these plants also began producing the *Re-vive* performance recliner. In 2013 these plants generated about 33% of the Group's total consolidated upholstery revenue. If orders exceed production capacity at the foreign plants, *Natuzzi Editions* products are also manufactured in the Company's Italian plants. In addition to these three Italian plants, we have two plants elsewhere in Italy: one dedicated to the production of leather and another dedicated to the production of flexible polyurethane foam, as further described below.

These operations retain many characteristics of hand-crafted production coordinated through a management information system usage that identifies by number (by means of a bar-code system) each component of every piece of furniture and facilitates its automatic transit and traceability through the different production phases up to the warehouse.

Since June 2010, the Group has been investing in the reorganization of its production processes, following the Lean Production approach. We believe that ongoing implementation of these more efficient production processes will allow us to regain competitiveness by reducing costs (both in terms of labor and consumption of materials) and improving the quality of our services (by reducing defects and lead time for production).

In December 2010, a new prototype for our more efficient production process was introduced in our Matera Iesce plant. This new prototype was developed through an alignment of industrial phases and the implementation of moving-line production processes, from assembly through to packaging of the final product on the same line, within the same production facility. This initial prototype did not incorporate the leather cutting and sewing phases.

The industrialization of the prototyped product lines was further defined in May 2011, and in December 2011, three new production lines were completed in a new dedicated plant in Matera Iesce. We also moved the manufacturing of wooden frames that was originally carried out in the production site located in Santeramo in Colle, Italy, to the Matera Iesce plant, thus further optimizing both productivity and logistics costs through a direct, *in-loco* integration of sofa assembly.

During 2011 and 2012, these new moving lines were gradually introduced in all of the Group's production facilities.



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In 2013, the Group integrated new production phases in the moving line production process within our plants:

a direct integration with wood and foam suppliers to serve each plant according to daily needs ( just in time supplying) with the advantage of reducing the stock level for semi-finished goods; and

leather cutting and sewing.

This upgrade in the industrial process allows us to better control every stage in the moving line sequence in terms of quality, since every worker at every stage supervises the quality of the piece he receives from the immediately previous stage as well as the piece he passes forward; should a quality issue arise, it must be resolved immediately before getting re-introduced into the production chain. This on-the-spot product quality monitoring should significantly reduce our defect claims rate.

Testing of limited model samples produced with the moving line process demonstrated a 7% decline in cost of goods sold for certain *Natuzzi Editions* and private label products and a decline in cost of goods sold of 12% for certain *Natuzzi Italia* products. Following these tests, management confirmed its decision to transform all the Group's plants, substituting the old Isle Production models, with a roll out of moving line production processes to all plants by the end of the second quarter of 2014. Our objective is to have up to 10 moving lines in Italy, up to 12 moving lines in Romania, up to 32 in China and up to three in Brazil. Each moving line is estimated as being capable of producing up to 130 seats per day when utilized for two eight-hour shifts per day.

Beginning in 2014, we have also deployed software that assists in assigning models to the moving line to which they are best-suited and where production would be most efficient.

Consistent with its commitments under the Italian Reorganization Agreement, the Company has reorganized its Italian operations by deciding to close its plant located in Ginosa and its warehouse located in Matera La Martella, the former having been closed in January 2014, and the latter is expected to be closed by June 2014. These closures had the main advantages of reducing logistics costs and industrial costs. This also had the advantage of concentrating all upholstered furniture production activities within just three facilities.

Furthermore, the Group also utilizes two facilities for the processing of leather (NATCO, located in Udine), and for the production of polyurethane foam (IMPE, located near Naples).

The Group remains involved in the processing of leather hides to be used as upholstery and served by Udine plant whose main activities are leather dyeing and finishing. The Udine facility, which had 180 employees as of December 31, 2013, of whom 21 employees were subject to the CIGS program, receives both raw and tanned cattle hides, sends raw cattle hides to subcontractors for tanning, and then dyes and finishes the hides. Hides are tanned, dyed and finished on the basis of orders given by the Group's central office in accordance with the Group's on demand planning system, as well as on the basis of estimates of future requirements. The movement of hides through the various stages of processing is monitored through the management information system. See Item 4. Information on the Company Manufacturing Supply-Chain Management.

The Group produces, directly and by subcontracting, ten grades of leather in approximately 30 finishes and 200 colors. The hides, after being tanned, are split and shaved to obtain uniform thickness and separated into top grain and split (top grain leather is primarily used in the manufacture of most *Natuzzi Italia*-branded leather products, while split leather is used, in addition to top grain leather, in the manufacture of some *Natuzzi Italia*-branded products and most *Natuzzi Editions* products. The hides are then colored with dyes and treated with fat liquors and resins to soften and smooth the leather, after which they are dried. Finally, the semi-processed hides are treated to improve the appearance

and strength of the leather and to provide the desired finish. The Group also purchases finished hides from third parties.

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The other Group's production facility, IMPE S.p.A. ( IMPE ), employed up to 50 workers as of December 31, 2013, and is engaged in the production of flexible polyurethane foam, and also sells foam to third parties because the facility's production capacity is in excess of the Group's needs. In 2012, IMPE obtained ISO 14001 certification in accordance with the environmental policy of the Natuzzi Group and also improved safety conditions at the plant. As part of the Group's efforts to improve its production process, we have substituted some chemical compounds with more ecologically-friendly materials.

As a result of intensive research and development activity, the Company has developed a new family of highly resilient materials. The new polymer matrix is safer than others available in the market because of its improved flame resistance, and it is more environmentally-friendly because it can be disposed of without releasing harmful by-products and because the raw materials used to make it cause less harmful environmental impacts during handling and storage.

**Chinese Production:** The original Chinese plant owned by the Group was subject to an expropriation process by local Chinese authorities, since the plant was located on land that was intended for public utilities. Negotiations involving the expropriation process began in 2009 and were concluded in 2011. The agreement setting forth the payment of compensation for the expropriated plant was signed with Chinese authorities on January 26, 2011. As compensation for this expropriation, the parties agreed upon a total indemnity of Chinese Yuan (CNY or RMB, hereafter) 420 million, which was equivalent to approximately 46.7 million based on the Yuan-Euro exchange rate as of December 31, 2011. The Company collected the full amount of the indemnity payment from the local Chinese authorities in 2011. During 2013, a second supplementary agreement was signed between the Company and the Shanghai Municipality, by which the Company obtained the reimbursement ( 8.7 million) of taxes due and paid on the 2011 relocation compensation.

The Group identified its current production plant in Shanghai and its was made available in January 2011, to compensate for the production capacity reduction caused by the expropriation. The relocation process began in February 2011 and was completed, as planned, by the end of May 2011, after equipment and machinery was moved to the new plant. The relocation produced a turn-over of approximately 20% in manpower because of the distance of the new plant to the old one (approximately 35 kilometers). Management had already reabsorbed the turn-over effect by hiring new manpower by the end of April 2011.

**Brazilian Production:** The Group owns two plants in Brazil that, in the past, have been used for the production of furnishings for the Americas region. Only our Salvador de Bahia plant remains open and active, while the other plant was put up for sale with a board of directors resolution in 2010. Due to the appreciation of the Brazilian Real versus the U.S. dollar since these plants were opened and a consequent decline in competitiveness, the Group decided to temporarily close one plant and reduce the production capacity of the Salvador de Bahia plant down to a level that remains sufficient to serve only the Brazilian market. In order to minimize the potential future effects of currency fluctuations, our Brazilian subsidiary plans to increase its local sourcing beginning in 2014.

After frequent interactions between the Group and top local retailers in the past few years, as well as in light of the high level of fragmentation of the Brazilian market, which consists primarily of small producers with low levels of know-how, the Group believes that the Latin American region currently represents a very good opportunity for the development of additional business.

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Therefore, the Group intends to continue investing in the Latin American market, with a particular focus on Brazil, by better organizing operating, sales and marketing activities, developing the current distribution channel of *Natuzzi Editions* points-of-sale as well as by improving relations with the most important local key accounts through a dedicated private label production.

**Raw Materials** The principal raw materials used in the manufacture of the Group's products are cattle hides, polyurethane foam, polyester fiber and wood.

The Group purchases hides from slaughterhouses and tanneries located mainly in Italy, Brazil, Germany, Paraguay, other countries in South America and Europe. The hides purchased by the Group are divided into several categories, with hides in the lowest categories being purchased mainly in Brazil or South America. The hides in the middle categories are purchased in Europe or South America and hides in the highest categories are purchased in Germany and in the United Kingdom. A significant number of hides in the lowest categories are purchased at the wet blue stage *i.e.*, after tanning while some hides purchased in the middle and highest categories are unprocessed. The Group has implemented a leather purchasing policy according to which a percentage of leather is purchased at a finished or semi-finished stage. Therefore, the Group has had a smaller inventory of split leather to sell to third parties. Approximately 80% of the Group's hides are purchased from ten suppliers, with whom the Group enjoys long-term and stable relationships. Hides are generally purchased from the suppliers pursuant to orders given every one to two months specifying the number of hides, the purchase price and the delivery date.

Hides purchased from Europe are delivered directly by the suppliers to the Group's leather facilities near Udine, while those purchased outside of Italy are delivered to an Italian port and then sent to the Udine and inspected by technicians of the Group. Management believes that the Group is able to purchase leather hides from its suppliers at reasonable prices as a result of the volume of its orders, and that alternative sources of supply of hides in any category could be found quickly at an acceptable cost if the supply of hides in such category from one or several of the Group's current suppliers ceased to be available or was no longer available on acceptable terms. The supply of raw cattle hides is principally dependent upon the consumption of beef, rather than on the demand for leather.

During 2013, the prices for hides increased about 15% compared to 2012. Due to the volatile nature of the hides market, there can be no assurance that any current prices will remain stable or that price trends will remain consistent. See Item 3. Key Information Risk Factors The price of the Group's principal raw materials is difficult to predict.

The Group also purchases fabrics and microfibers for use in coverings. Both kinds of coverings are divided into several price categories. Most fabrics are purchased in Italy from about a dozen suppliers which provide the product at the finished stage. Microfibers are purchased in Italy, South Korea and China through some suppliers who provide them at the finished stage. Fabrics and microfibers are generally purchased from suppliers pursuant to orders given every week specifying the quantity (in linear meters) and the delivery date.

Fabrics and microfibers for the *Natuzzi Italia* branded products that are purchased from Italian suppliers are delivered directly by the suppliers to the Group's facility in Laterza, while those that are purchased outside of Italy are delivered to an Italian port and then sent to the Laterza facility.

Fabrics and microfibers for the *Natuzzi Editions/Leather Editions* and private label products are delivered directly by the suppliers to Chinese, Romanian and Brazilian ports and then sent to the Group's Shanghai, Bahia Mare and Salvador de Bahia facilities.





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The Group continuously searches for alternative supply sources in order to obtain the best product at the best price.

Price performance of fabrics is quite different from that of microfibers, depending on the different range of the products' quality. Because fabrics are purchased exclusively in Italy and are composed of natural fibers, their prices are influenced by the cost of labor and the quality of the product. The price of microfibers is mainly influenced by the international availability of high-quality products and raw materials at low costs, especially from Asian markets.

The Group obtains the chemicals required for the production of polyurethane foam from major chemical companies located in Europe (including Germany, Italy and the United Kingdom) and the polyester fiber filling for its polyester fiber-filled cushions from several suppliers located mainly in Indonesia, China, Taiwan and India. The chemical components of polyurethane foam are petroleum-based commodities, and the prices for such components are therefore subject to, among other things, fluctuations in the price of crude oil, which has remained high in 2012 and 2013 compared to 2011. Within our Romanian industrial plant, we have a woodworking facility that provides wooden frames for all our plants worldwide.

The Group also offers a collection of home furnishing accessories (tables, lamps, rugs, home accessories and wall units in different materials). Most of the suppliers are located in Italy and other European countries, while some hand-made products (such as rugs) are made in India and China. On April 9, 2014, the Company officially presented its new collections of beds, bedroom furniture and bed linens in Milan. They will be produced by Italian companies that are external to the Group. Before being introduced in the collection, all items are tested in accordance with European and world safety standards. In the design phase particular attention is paid to the choice of innovative technological solutions that add value to the product and ensure long lasting quality. The Group's packaging for each product has a higher standard than the average products marketed by its competitors, in an effort to ensure better customer service.

## **Supply-Chain Management**

**Procurement Policies and Operations Integration** In order to improve customer service and reduce industrial costs, the Group in 2009 established a policy for handling suppliers and supply logistics. All of the sub-departments working in the Logistics Department have been reorganized to maximize efficiency throughout the supply-chain. The Logistics Department coordinates periodic meetings among all of its working groups in order to identify areas of concern that arise in the supply-chain, and to identify solutions that will be acceptable to all groups. The Logistics Department is responsible for monitoring the proposed solutions in order to ensure their effectiveness. Additionally, in order to improve access to supply-chain information throughout the Group, the Logistics Department utilizes a portal that allows it and other departments (such as Customer Service and Sales) to monitor the movement of goods through the supply-chain. The Company continues to invest in this area to advance continuous improvement in terms of tools and processes.

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**Production Planning (Order Management, Production, Procurement)** The Group's commitment to reorganizing procurement logistics has led to:

- 1) the development of a logistics-production model to customize the level of service to customers;
- 2) a stable level of the size of the Group's inventory of raw materials and/or components, particularly those pertaining to coverings. This positive impact was made possible by both the development of software that allows more detailed production programming and broader access by suppliers themselves, and a more general reorganization of supplier relationships. Suppliers are now able to provide assembly lines at Italian plants with requested components within four hours;
- 3) the planning and partial completion of the industrial reorganization of the local production center; and
- 4) since January 2009, the SAP system has been implemented throughout the organization.

The Group also plans procurements of raw materials and components:

- i) **On demand** for those materials and components (which the Group identifies by code numbers) that require a shorter lead time for order completion than the standard production planning cycle for customers' orders. This system allows the Group to handle a higher number of product combinations (in terms of models, versions and coverings) for customers all over the world, while maintaining a high level of service and minimizing inventory size. Procuring raw materials and components on demand eliminates the risk that these materials and components would become obsolete during the production process; and
- ii) **Upon forecast** for those materials and components requiring a long lead time for order completion. The Group utilizes a forecast methodology that balances the Group's desire to maintain low inventory levels against the Sales Department's needs for flexibility in filling orders, all the while maintaining high customer satisfaction levels. This methodology was developed together with the Group's Information Systems Department, in order to create an intranet portal, called Advanced Planning and Optimization ( APO ). APO was launched in March 2011 for sales coming from the North American and Asia Pacific markets, under the supervision of a forecast manager and, beginning in June 2011, was implemented worldwide. This tool currently supports corporate logistics, operations managers and sales managers in better forecasting the future demand for the Group's products and to improve communication between the Sales Department and the Logistics Department, therefore reducing inventory levels and improving the availability of raw materials.

Since 2012, a new methodology concerning furnishing management has been introduced. A better supplier's partnership enabled the Group to handle furnishings components without storing them in our warehouses, resulting in improved service and reducing inventory levels.

Lead times can be longer than those mentioned above when a high number of unexpected orders are received.

Delivery times vary depending on the place of discharge (transport lead times vary widely depending on the distance between the final destination and the production plant).

All planning activities (finished goods load optimization, customer order acknowledgement, production and suppliers planning) are synchronized in order to guarantee that during the production process, the correct materials are located in the right place at the right time, thereby achieving a maximum level of service while minimizing handling and transportation costs.

**Load Optimization and Transportation** The Group delivers goods to customers by common carriers. Those goods destined for the Americas and other markets outside Europe are transported by sea in 40-foot high cube containers, while those produced for the European market are generally delivered by truck and, in some cases, by railway. In 2013, the Group shipped 9,946 containers to overseas countries and approximately 5,442 full load mega-trailer trucks to European destinations, serving more than 3,000 different delivery points.

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With the aim of decreasing costs and safeguarding product quality, the Group uses software developed through a research partnership with the University of Bari and the University of Copenhagen that permits us to manage load optimization.

As far as the load composition by truck is concerned, the Group uses software designed to minimize total transport costs by taking into account volume, route and optimization of carriers for customers' orders in defined areas. To maintain service levels, we use a supplier vendor rating that measures performance of carriers and distributors providing direct service over land.

The Group relies principally on several shipping and trucking companies operating under time-volume service contracts to deliver its products to customers and to transport raw materials to the Group's plants and processed materials from one plant to another. In general, the Group prices its products to cover its door-to-door shipping costs, including all customs duties and insurance premiums. Some of the Group's overseas suppliers are responsible for delivering raw materials to the port of departure, therefore transportation costs for these materials are generally under the Group's control.

## **Products**

Products are mainly designed in the Company's Style Center, but the Group also collaborates with acclaimed international designers for the conception and prototyping of certain products in order to enhance brand visibility, especially with respect to the *Natuzzi Italia* brand.

New models are the result of a constant information flow from the market, in which preferences are analyzed, interpreted and turned into a brief for designers in terms of style, function and price point. Designers draw the sketches of new products in accordance with the guidelines they are provided and, through collaboration with the prototype department, approximately 70 new sofa models are generally introduced each year. The diversity of customer tastes and preferences as well as the Group's inclination to offer new solutions results in the development of products that are increasingly personalized. More than 100 highly-qualified employees conduct the Group's research and development efforts from its headquarters in Santeramo in Colle, Italy.

The Group's wide range of products includes a comprehensive collection of sofas and armchairs with particular styles, coverings and functions, with more than two million combinations.

The *Natuzzi Italia* collection stands out for high quality in the choice of materials and finishes, as well as for the creativity and details of its design. As of December 31, 2013, this line of products offered 126 models. With respect to coverings, the *Natuzzi Italia* collection has 16 leather articles in 97 colors and 29 softcover articles in 129 colors. The collection also includes a selection of additional furniture (wall units, coffee tables, tables, chairs, lamps and carpets) and accessories (vases, mirrors, magazines racks, trays and decorative objects) to offer complete furnishings with the aim of enabling the Group to become a lifestyle company. For instance, in 2012, new coffee tables and matching wall units were introduced to the *Natuzzi Italia* collection using precious materials such as Carrara marble, as well as new dining room sets and cupboards designed by Claudio Bellini.

The *Natuzzi Editions/Leather Editions* collection, as of December 31, 2013, consisted of 173 models. The increase in the number of models in this collection is mainly due to the introduction of this collection in the

European and Asian markets, which resulted in the addition of more modern styles to the product portfolio. Regarding the range of coverings offered in the collection, *Natuzzi Editions/Leather Editions* offer 12 articles in leather available in 94 colors and 1 article in fabric with 6 colors.

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The *Natuzzi Re-vive* armchair was designed by Formway Design Studio of New Zealand and is the subject of two patents, one covering the design and one covering the unique mechanism made of 120 different parts. *Natuzzi Re-vive* armchairs are available in four styles (Quilted, Linear, Tailored and beginning later in 2014 Casual), two sizes (King and Queen), two configurations (with/without headrest), eleven leather colors, four spine/base finishing and a coordinated ottoman. The finished product and each of its components are subject to rigorous quality controls.

The private label collection, as of December 31, 2013 is composed of about 70 models, including exclusive models for key accounts. These products are sometimes sold under the *Softaly* brand name, depending upon client requests, and the products are mainly leather and split and leather match (or leather matched with Next Leather®, a bonded leather that contains a minimum of 17 per cent of leather). During 2013 all the products already in the collection have been re-engineered in order to meet the requirements of the moving line manufacturing process and all the new ones have been designed according to this production system. This investment has improved quality, while reducing industrial costs.

The Group operates in accordance with strict quality standards and has earned the ISO 9001 certification for quality and the ISO 14001 certification for its low environmental impact. The ISO 14001 certification also applies to the Company's tannery subsidiary, Natco S.p.A., located near Udine, Italy. The Group's plant in Laterza and the Santeramo in Colle headquarters have also received an ISO 9001 certification for their roles in design and production.

**Innovation** The company has been implementing a new production model based on the Lean Production principles.

The sofa production model, which traditionally was developed into a department-based factory (or Isle Production model), was subject to rigorous review with a view toward implementing moving line manufacturing processes, which would lead to improvements in efficiency, quality, and lead time. The moving line production model improves job area ergonomics by splitting products into lighter pieces at individual phases and also coordinates workers by ensuring that they work at a similar pace. The finished product tends to be of higher quality and produced more quickly. Tests and development of the moving line production model at all stages of the production process are ongoing and are coordinated with our product design.

We are also conducting research and analysis, both internally and in cooperation with Italian research institutions, to investigate the potential for incorporating new, alternative materials into our products.

In the field of process and product innovation, the Group implemented the Modular Industrial Platform System in late 2013, reducing manufacturing costs. Industrial platforms represent an industrial base common to many models that can be technically and aesthetically modified in order to meet customers' requests. The utilization of such platforms grants substantial benefits in terms of product simplification (easy assembly), management (fewer codes to be managed), quality (fewer production failures), and production costs (economies of scale), leading to an increase in competitiveness.

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In 2013, management has continued to encourage innovation and the introduction of new products, as evidenced by the introduction of the *Re-vive* performance armchair, which we believe will open up new market opportunities.

Research and development expenses, which include labor costs for the research and development department, design and modeling consultancy expenses and other costs related to the research and development department, were 7.9 million in 2013, 7.9 million in 2012, and 7.3 million in 2011.

### **Advertising**

The Group's Communications System was developed to regulate all methods used in each market to advertise the Natuzzi brand name and it operates simultaneously on different levels: the brand-building level establishes the brand's philosophy, while the traffic-building level aims to attract consumers to points-of-sale using various kinds of initiatives, such as presentations of new collections, new store openings and promotional activities.

In particular, the Company approach to communication campaigns is differentiated according to the identity of each product line: the *Natuzzi Italia* home philosophy is narrated with the support of famous international photographers; advertising for the *Natuzzi Editions/Leather Editions* products transfers, thanks to collaboration with local professionals in the markets where they are sold, the value of the unique comfort of such products coupled with a style suitable to the local market tastes; *Natuzzi Re-vive* advertising primarily focuses on innovation in support of its global launch.

Advertising for galleries is carried out with the help of the Retail Advertising Kit, a collection of templates that enable direct advertising of consumer brands or the advertising of such brands in conjunction with the retailer's brand.

The Group has also invested heavily in its online digital channel that represents and, considering the trends of past years, more and more will represent the future of communication worldwide.

### **Retail Development**

During 2013, our Retail Department continued the development of the Your Design By Natuzzi software program, which is now being used in *Natuzzi Italia* stores in over 40 countries, in conjunction with increased efforts to target interior decorators and architects.

In our flagship and other prominent *Natuzzi Italia* stores, we launched the new Design Studio, which includes a number of sales support tools and design kits for on-site use by designers in the space where the furniture will be used or in-store use with the final consumers, together with a dedicated training program for our design and sales staff.

In order to support sales of the *Re-vive* armchair, a specific tool using Augmented Reality Technology has been developed and recently launched.

We have also developed a retail format, known as the Essence Area, that is country-specific and is aimed at providing, in no more than 120 square meters of sales area, the best selection of the *Natuzzi Italia* product range, displayed within a small set of branded and easy to assemble items. The Essence Area is utilized mainly within multi-brand high-end furniture stores, mostly in emerging markets but also in mature markets where the brand is going through a repositioning.





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The greatest effort in terms of new points of sale openings has been focused on the Chinese market, where 22 new *Leather Editions* stores and five new *Natuzzi Italia* stores were opened in 2013, as well as in the U.S., where a large *Natuzzi Italia* store was opened in Orlando, Florida. In February 2014, we opened a new, directly-operated *Natuzzi Italia* flagship store in New York City on Madison Avenue, with the aim of anchoring the Group's expansion in the New York-Connecticut-New Jersey Tristate area. We expect to close our New York City store located in Soho.

The third directly-operated flagship *Natuzzi Italia* store in Italy opened in November 2013 in Rome, and we anticipate that it will increase brand awareness and boost sales within the Group's home country.

**Markets**

The Group markets its products internationally as well as in Italy. Outside Italy, the Group sells its furniture principally on a wholesale basis to major retailers and furniture stores. In 1990, the Group began selling its leather-upholstered products in Italy and abroad through franchised *Divani & Divani by Natuzzi* and *Natuzzi* (now *Natuzzi Italia*) furniture stores. Since 2001, the Group has also sold its furniture through directly owned *Natuzzi* (now *Natuzzi Italia*) stores and *Divani & Divani by Natuzzi* stores. In 2005 the Group introduced the *Natuzzi Editions* brand to the U.S. market, and it continues to be sold in the Americas through galleries and concessions. The *Leather Editions* brand targets a similar customer to *Natuzzi Editions* and was introduced in markets outside the Americas in 2010 and also is sold through galleries and concessions. The *Italsofa* brand was introduced in 2007 with the intent of competing with low-priced competitors. In 2013, the Group decided not to make further investments in the *Italsofa* brand. All the *Italsofa* models thus far developed will be progressively absorbed by the Group's other brand offerings.

The following tables show the number of the Group's stores and galleries as of February 28, 2014 according to the main geographical areas and brands.

| Stores               | Divani & Divani |            |                                    |           | TOTAL      |
|----------------------|-----------------|------------|------------------------------------|-----------|------------|
|                      | Natuzzi Italia  | by Natuzzi | Natuzzi Editions /Leather Editions | Italsofa  |            |
| <b>Americas</b>      | <b>15</b>       |            |                                    | <b>4</b>  | <b>19</b>  |
| U.S. and Canada      | 9               |            |                                    |           | 9          |
| Latin America        | 6               |            |                                    | 4         | 10         |
| <b>EMEA</b>          | <b>99</b>       | <b>95</b>  |                                    | <b>7</b>  | <b>201</b> |
| Europe               | 78              | 11         |                                    |           | 89         |
| Italy                | 3               | 84         |                                    |           | 87         |
| Middle East & Africa | 18              |            |                                    | 7         | 25         |
| <b>Asia-Pacific</b>  | <b>63</b>       |            | <b>47</b>                          | <b>1</b>  | <b>111</b> |
| Asia                 | 56              |            | 47                                 | 1         | 104        |
| Oceania              | 7               |            |                                    |           | 7          |
| <b>TOTAL</b>         | <b>177</b>      | <b>95</b>  | <b>47</b>                          | <b>12</b> | <b>331</b> |

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| Galleries/ Concessions* | Natuzzi Editions / |               |                     |            | TOTAL      |
|-------------------------|--------------------|---------------|---------------------|------------|------------|
|                         | Natuzzi<br>Italia  | Private label | Leather<br>Editions | Italsofa   |            |
| <b>Americas</b>         | <b>74</b>          | <b>6</b>      | <b>222</b>          | <b>125</b> | <b>427</b> |
| U.S. and Canada         | 53                 |               | 179                 | 106        | 338        |
| Latin America           | 21                 | 6             | 43                  | 19         | 89         |
| <b>EMEA</b>             | <b>233</b>         |               | <b>135</b>          | <b>15</b>  | <b>383</b> |
| Europe                  | 226                |               | 132                 | 10         | 368        |
| Italy                   |                    |               |                     |            |            |
| Middle East & Africa    | 7                  |               | 3                   | 5          | 15         |
| <b>Asia-Pacific</b>     | <b>18</b>          |               | <b>12</b>           | <b>16</b>  | <b>46</b>  |
| Asia                    | 12                 |               | 11                  | 14         | 37         |
| Oceania                 | 6                  |               | 1                   | 2          | 9          |
| <b>TOTAL</b>            | <b>325</b>         | <b>6</b>      | <b>369</b>          | <b>156</b> | <b>856</b> |

\* The concessions are store-in-store concept selling *Natuzzi Italia* branded products, and are managed directly by a subsidiary of the Company located in the United Kingdom.

The following tables show the leather and fabric-upholstered furniture net sales and number of seats sold of the Group broken down by geographic market for each of the years indicated:

**Leather and Fabric Upholstered Furniture, Net Sales (in millions of Euro)**

|                                 | 2013         |               | 2012         |               | 2011         |               |
|---------------------------------|--------------|---------------|--------------|---------------|--------------|---------------|
| <b>Americas<sup>(1)</sup></b>   | <b>162.5</b> | <b>40.3%</b>  | <b>169.9</b> | <b>41.5%</b>  | <b>143.5</b> | <b>33.7%</b>  |
| Natuzzi Italia                  | 15.0         | 3.7%          | 15.9         | 3.9%          | 16.2         | 3.8%          |
| Natuzzi Editions <sup>(2)</sup> | 86.0         | 21.3%         | 97.0         | 23.7%         | 110.0        | 25.9%         |
| Private label                   | 61.5         | 15.3%         | 57.0         | 13.9%         | 17.3         | 4.1%          |
| <b>EMEA</b>                     | <b>189.7</b> | <b>47.1%</b>  | <b>193.6</b> | <b>47.3%</b>  | <b>235.7</b> | <b>55.4%</b>  |
| Natuzzi Italia                  | 95.0         | 23.6%         | 100.5        | 24.5%         | 136.2        | 32.0%         |
| Natuzzi Editions <sup>(2)</sup> | 50.4         | 12.5%         | 50.2         | 12.3%         | 56.4         | 13.3%         |
| Private label                   | 44.3         | 11.0%         | 42.9         | 10.5%         | 43.1         | 10.1%         |
| <b>Asia-Pacific</b>             | <b>50.6</b>  | <b>12.6%</b>  | <b>45.9</b>  | <b>11.2%</b>  | <b>46.1</b>  | <b>10.8%</b>  |
| Natuzzi Italia                  | 22.1         | 5.5%          | 21.3         | 5.2%          | 24.7         | 5.8%          |
| Natuzzi Editions <sup>(2)</sup> | 24.3         | 6.0%          | 19.9         | 4.9%          | 18.6         | 4.4%          |
| Private label                   | 4.2          | 1.1%          | 4.7          | 1.1%          | 2.8          | 0.7%          |
| <b>Total</b>                    | <b>402.8</b> | <b>100.0%</b> | <b>409.4</b> | <b>100.0%</b> | <b>425.3</b> | <b>100.0%</b> |

(1) Includes the United States, Canada and Latin America (including Brazil) (collectively, the Americas ).

(2) Includes *Italsofa*.



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|                                 | 2013             |               | 2012             |               | 2011             |               |
|---------------------------------|------------------|---------------|------------------|---------------|------------------|---------------|
| <b>Americas</b>                 | <b>809,310</b>   | <b>48.0%</b>  | <b>832,977</b>   | <b>49.6%</b>  | <b>776,171</b>   | <b>43.4%</b>  |
| Natuzzi Italia                  | 33,416           | 2.0%          | 37,293           | 2.2%          | 45,777           | 2.6%          |
| Natuzzi Editions <sup>(1)</sup> | 392,086          | 23.3%         | 454,714          | 27.1%         | 601,399          | 33.6%         |
| Private label                   | 383,808          | 22.8%         | 340,970          | 20.3%         | 128,995          | 7.2%          |
| <b>EMEA</b>                     | <b>703,368</b>   | <b>41.7%</b>  | <b>685,771</b>   | <b>40.8%</b>  | <b>837,614</b>   | <b>46.9%</b>  |
| Natuzzi Italia                  | 240,756          | 14.3%         | 231,024          | 13.7%         | 329,985          | 18.5%         |
| Natuzzi Editions <sup>(1)</sup> | 189,611          | 11.2%         | 195,252          | 11.6%         | 246,454          | 13.8%         |
| Private label                   | 273,001          | 16.2%         | 259,495          | 15.4%         | 261,175          | 14.6%         |
| <b>Asia-Pacific</b>             | <b>173,669</b>   | <b>10.3%</b>  | <b>162,023</b>   | <b>9.6%</b>   | <b>174,035</b>   | <b>9.7%</b>   |
| Natuzzi Italia                  | 45,077           | 2.7%          | 43,079           | 2.6%          | 55,866           | 3.1%          |
| Natuzzi Editions <sup>(1)</sup> | 98,471           | 5.8%          | 86,555           | 5.1%          | 96,055           | 5.4%          |
| Private label                   | 30,121           | 1.8%          | 32,389           | 1.9%          | 22,013           | 1.2%          |
| <b>Total</b>                    | <b>1,686,347</b> | <b>100.0%</b> | <b>1,680,770</b> | <b>100.0%</b> | <b>1,787,820</b> | <b>100.0%</b> |

(1) Includes *Italsofa*.

### 1. United States and the Americas.

In 2013, net sales of leather and fabric-upholstered furniture in the United States and the rest of the Americas (including Brazil) were 162.5 million, down 4.3% from 169.9 million, reported in 2012, and the number of seats sold decreased by 2.8%, from 832,977 in 2012 to 809,310 in 2013.

The Group's principal customers are major retailers. The Group advertises its products to retailers and, recently, to consumers in the United States, Canada, and Latin America (excluding Brazil) both directly and through the use of various marketing tools. The Group also relies on its network of sales representatives and on the furniture fairs held at its High Point, North Carolina offices each spring and fall to promote its products.

The Group's sales in the United States, Canada and Latin America (excluding Brazil) were handled by Natuzzi Americas until June 30, 2010. Starting on July 1, 2010, as a part of a general reorganization of the Group's commercial activities, world-wide third-party sales have been handled by the parent company, Natuzzi S.p.A. Natuzzi Americas maintains offices in High Point, North Carolina, the heart of the most important furniture manufacturing and distribution region in the United States, and provides Natuzzi S.p.A with agency services. The staff at High Point provides customer service, trademarks and products promotions, credit collection assistance, and generally acts as the customers contact for the Group. As of February 28, 2014, the High Point North Carolina operation had 51 employees, including 33 independent sales representatives and 13 sub-representatives for the United States, Canada and Latin America. They are regionally supervised by four Vice Presidents.

The Company is in the process of reorganizing its commercial and distribution structure in the Americas, consistent with the Business Plan, in order to better exploit market opportunities in the region. This reorganization includes developing its retail presence in large department stores to increase visibility of Natuzzi-branded products and the establishment of a separate business unit aimed at generating sales volumes through private label offerings.



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All of our commercial activities in Brazil are overseen from our Salvador de Bahia facility. The Group commercial structure in Brazil has been reinforced, from 12 representatives in 2012 to 16 as of the end of 2013 and positive growth in sales was recognized in: from 6.6 million in 2012 to 8.7 million in 2013. Nevertheless, Brazilian operations remain unprofitable, reflecting sales volumes that were inconsistent with our overall cost structure and production capacity in that market. In this regard, the Company has already begun targeted due diligence to quickly identify those measures that are necessary to eliminate losses in that country.

In 2013, 20 new *Leather Editions* galleries and six new *Natuzzi Italia* galleries opened in the United States and the Americas (Brazil included). The *Leather Editions* galleries are in the process of being rebranded as *Natuzzi Editions* galleries.

As noted above, in February 2014, we opened a new, directly-operated *Natuzzi Italia* flagship store in New York City on Madison Avenue, with the aim of anchoring the Group's expansion in the New York-Connecticut-New Jersey Tristate area. We expect to close our New York City store located in Soho. In addition, as of February 28, 2014, there were also thirteen *Natuzzi Italia* single-brand stores operating in the Americas that are owned by local dealers (five in the United States, four in Mexico, two in Canada and one each in Venezuela and Panama). Furthermore, as of the same date, there were three *Italsofa* single-brand stores in Brazil and one in Venezuela.

## **2. EMEA**

During 2013, the Group continued to consolidate its position in Western Europe, and increase its presence in Eastern Europe, the Middle East and Africa (collectively, EMEA), by investing in stores and galleries. Net sales of leather and fabric-upholstered furniture in EMEA (including Italy) decreased by 2.0% in 2013 to 189.7 million (from 193.6 million in 2012), with the number of seats sold increasing by 2.6%, from 685,771 in 2012 to 703,368 in 2013.

**2a) Italy.** Since 1990, the Group has sold its upholstered products within Italy principally through the *Divani & Divani by Natuzzi* franchised network of furniture stores. As of February 28, 2014 there were 84 *Divani & Divani by Natuzzi* stores, and three *Natuzzi Italia* stores located in Italy. The Group directly owns 20 of these stores, including the three stores operating under the *Natuzzi Italia* name.

**2b) Europe (Outside Italy).** The Group expands into the other European markets mainly through single-brand stores (local dealers, franchisees or directly operated stores). As of February 28, 2014, 89 single-brand stores were operating in Europe: 11 under the *Divani & Divani by Natuzzi* franchise brand, all located in Portugal; and the remaining 78 were under the *Natuzzi Italia* name (13 in France, 12 in each of Spain and Holland, seven in Russia, six in Switzerland, five in the United Kingdom, four each in the Czech Republic and Poland, three in Cyprus, two in Ukraine and one each in Armenia, Bosnia-Herzegovina, Croatia, Estonia, Germany, Hungary, Latvia, Malta, Serbia-Montenegro and Slovenia. Of these stores, 22 were directly owned by the Group as of February 28, 2014 and all were operated under the *Natuzzi Italia* name: 12 in Spain, six in Switzerland and four in the United Kingdom. Apart from the *Natuzzi Italia* stores, the Group also operates 11 concessions in the United Kingdom.

Given the size of the Russian market and its strategic relevance to the Group's future growth, a local representative office was opened in Moscow in February 2010, with the aim of managing sales, marketing and customer service for Russia and the Ukraine, and to supervise the opening of new single-brand stores in the Russian market. During the course of 2013 through February 28, 2014, one new *Natuzzi Italia* store has opened in Russia, bringing the total number of the *Natuzzi Italia* stores in that country to seven.

**2c) Middle East & Africa.** In 2013, net sales of leather and fabric-upholstered furniture in the Middle East & Africa increased 33.6% to 17.5 million, and the number of seats sold increased 43.0% to 69,201 in 2013. As of February 28,

2014, the Group had a total of 18 *Natuzzi Italia* stores in the Middle East & Africa: four in Israel, three each in Turkey and Saudi Arabia, two in the United Arab Emirates, and one each in Algeria, Côte d'Ivoire, Egypt, Kuwait, Lebanon and Qatar. In addition, seven single-brand stores were operating under the brand *Italsofa*, all located in Israel.

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In January 2012, following the worsening of the European Union's diplomatic relations with Iran and Syria, the Company decided to cease any kind of business relations with these two countries. No impairment issue arose following the interruption of business relations with those two countries.

The tables below summarize the Group's yearly turnover (in thousands of Euro) before this decision was taken and the relative percentage of total upholstery net sales for 2012 and 2013 with particular reference to turnover generated in countries currently subject to sanctions by the Office of Foreign Assets Control of the United States Department of the Treasury.

| 2012<br>Country                   | Natuzzi Italia brand |                | Other *          |                | Total 2012       |                |
|-----------------------------------|----------------------|----------------|------------------|----------------|------------------|----------------|
|                                   | Net Sales            | %              | Net Sales        | %              | Net Sales        | %              |
| IRAN                              | 75.0                 | 0.05%          | 0.0              | 0.00%          | 75.0             | 0.02%          |
| SUDAN                             | 0.0                  | 0.00%          | 0.0              | 0.00%          | 0.0              | 0.00%          |
| SYRIA                             | 0.0                  | 0.00%          | 0.0              | 0.00%          | 0.0              | 0.00%          |
| NORTH KOREA                       | 0.0                  | 0.00%          | 0.0              | 0.00%          | 0.0              | 0.00%          |
| CUBA                              | 0.0                  | 0.00%          | 0.0              | 0.00%          | 0.0              | 0.00%          |
| All Other Countries               | 137,612.0            | 99.95%         | 271,718.0        | 100.00%        | 409,330.0        | 99.98%         |
| <b>Total upholstery net Sales</b> | <b>137,687.0</b>     | <b>100.00%</b> | <b>271,718.0</b> | <b>100.00%</b> | <b>409,405.0</b> | <b>100.00%</b> |

\* Including *Italsofa* and *Natuzzi Editions/Leather Editions* brands, as well as *Softaly* /private label and unbranded products.

| 2013<br>Country                   | Natuzzi Italia brand |                | Other *          |                | Total 2013       |                |
|-----------------------------------|----------------------|----------------|------------------|----------------|------------------|----------------|
|                                   | Net Sales            | %              | Net Sales        | %              | Net Sales        | %              |
| IRAN                              | 0.0                  | 0.00%          | 0.0              | 0.00%          | 0.0              | 0.00%          |
| SUDAN                             | 0.0                  | 0.00%          | 0.0              | 0.00%          | 0.0              | 0.00%          |
| SYRIA                             | 0.0                  | 0.00%          | 0.0              | 0.00%          | 0.0              | 0.00%          |
| NORTH KOREA                       | 0.0                  | 0.00%          | 0.0              | 0.00%          | 0.0              | 0.00%          |
| CUBA                              | 0.0                  | 0.00%          | 0.0              | 0.00%          | 0.0              | 0.00%          |
| All Other Countries               | 132,040.9            | 100.00%        | 270,817.5        | 100.00%        | 402,858.4        | 100.00%        |
| <b>Total upholstery net Sales</b> | <b>132,040.9</b>     | <b>100.00%</b> | <b>270,817.5</b> | <b>100.00%</b> | <b>402,858.4</b> | <b>100.00%</b> |

Considering that the combined sales for Iran and Syria have never exceeded one-fifth of one-percent of Natuzzi total upholstery net sales and there were no sales in these countries in 2013, Natuzzi does not believe that its previous activities in and contacts with Iran and Syria constituted a material part of its operations. No turnover has ever been generated in Sudan. Furthermore, the Group does not believe that a reasonable investor would consider Natuzzi's prior interests and activities in Iran or Syria to be a material investment risk, either from an economic, financial or reputational point of view, given their extremely limited extent and nature.

The Group has not had, nor does it plan to have, any commercial contacts with the governments of Iran or Syria, or with entities controlled by such governments. To the best of Natuzzi's knowledge, the Group was in business with



independent Iranian dealers that were not controlled by, owned or otherwise related to the governments of Iran.

**Table of Contents****3. Asia-Pacific Region.**

In 2013, net sales of leather and fabric-upholstered furniture in the Asia-Pacific region increased to 50.6 million from 45.9 million in 2012, and the number of seats sold increased 7.2%, from 162,023 in 2012 to 173,669 in 2013.

Natuzzi Trading (Shanghai) Co., Ltd. acts as a regional office and manages the commercial part of the business throughout the region. Furthermore, the Group also controls a subsidiary in Japan, an agency in South Korea and an agency for Australia and New Zealand. All of these offices report to the regional office in Shanghai. The general strategy for the Natuzzi brand is to further expand the store network throughout the region, with a strong emphasis on the Chinese market.

As of February 28, 2014, 63 single-brand *Natuzzi Italia* stores were operating in the Asia-Pacific market: 35 in China, seven in Australia, six each in Taiwan and India, two each in South Korea and Vietnam, and one each in Indonesia, Malaysia, Philippines, Singapore and Thailand. In addition, as of the same date, the Group had 47 single-brand *Leather Editions* stores located in China (of which 15 are operated by the Group) and one *Italsofa* store located in India. The Group also maintains 46 galleries in the Asia-Pacific region, of which 18 are under the *Natuzzi Italia* name (eight located in Japan, six in Australia, two each in Thailand and India), 16 under the *Italsofa* name (seven located in India, six in Taiwan, two in Australia, and one in Japan), and 12 under the *Leather Editions* name (eight located in India, three in Taiwan, and one in Australia).

The Group is currently planning to further expand its presence in China, specifically with single-brand stores located in medium-sized cities across the country.

The Group is also focusing its efforts and seeking to further invest in the Indian market. A local representative office was opened in New Delhi in the beginning of 2010 to manage sales, marketing and customer service and supervise the *Natuzzi* stores and *Italsofa* retail roll-out in the Indian market.

**Customer Credit Management**

The Group maintains an active credit management program. The Group evaluates the creditworthiness of its customers on a case-by-case basis according to each customer's credit history and information available to the Group. Throughout the world, the Group utilizes open terms in 82% of its sales and obtains credit insurance for 61% of this amount; less than 12% of the Group's sales are commonly made to customers on a cash against documents and cash on delivery basis; and lastly, about 6% of the Group's sales are supported by a letter of credit or payment in advance.

**Incentive Programs and Tax Benefits**

Historically, the Group derived benefits from the Italian Government's investment incentive program for under-industrialized regions in Southern Italy, which includes the area that serves as the center of the Group's operations. The investment incentive program provided tax benefits, capital grants and subsidized loans. There can be no assurance that the Group will continue to be eligible for such grants, benefits or tax credits for its current or future investments in Italy.

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In December 1996, the Company and the Contract Planning Service of the Italian Ministry of Industrial Activities signed a Program Agreement with respect to the Natuzzi 2000 project. In connection with this project, the Group prepared a multi-faceted program of industrial investments for the increase of the production capacity of leather and fabric upholstered furniture in the area close to its headquarters in Italy. According to this Program Agreement, the Company should have made investments for 295.2 million and at the same time the Italian government should have contributed 145.5 million in the form of capital grants. In 1997, the Company received, under the aforementioned project, capital grants for 24.2 million. During 2003, the Company revised its growth and production strategy due to the strong competition from competitors in countries like China and Brazil. Therefore, as a consequence of this change in the economic environment, in 2003 the Company requested a revision to the original Program Agreement from the Italian Ministry of Industrial Activities as follows: reduction of the investment to be made from 295.2 million to 69.8 million, and reduction of the related capital grants from 145.5 million to 35.0 million. In April 2005, the Company received the final approval of the Program Agreement from the Italian Government confirming these revisions. In 2010, a committee appointed by the Ministry of Industrial Activities prepared the final technical report according to which the overall industrial investments acknowledged under the last version of the Program Agreement as agreed in 2005 changed from 69.8 million to the final amount of 66.0 million. Accordingly, the related total capital grants under the Program Agreement changed from 35.0 million to the final amount of 33.3 million. Therefore, the receivable for capital grants still due to the Company as of that time totaled 9.1 million. However, in 2010, the Ministry of Industrial Activities determined that the Company was entitled to a net receivable grant of only 7.1 million, claiming that interest in arrears of 1.8 million had accrued on capital grants paid in advance in 1997 for investments originally planned and subsequently not included in the final version of the Program Agreement, as agreed in 2005. The remaining part of the reduction of 0.2 million was attributable to fees owed to the Committee appointed by the Ministry.

On November 5, 2013, the Company and the Ministry of Economic Development reached an Agreement (*Atto di Compensazione Volontaria*) according to which the total amount of the capital grant under the Program Agreement was re-determined and set equal to 33.1 million (from 33.0 million) and the residual receivable for capital grants still due to the Company is equal to 4.8 million. The 4.8 million still due to the Company is thus composed of 33.1 million for the initial capital grant, adjusted to reflect 24.2 million that was already been paid to the Company in 1997, 3.9 million for interest accrued on sums actually collected by the Company but for investments that were not approved, and 0.2 million for fees owed to the Committee appointed by the Ministry. As a consequence of the new amount to be collected, the Company has accrued 2.3 million as extraordinary contingent liabilities. The Company anticipates that these funds will be disbursed as soon as the Ministry of Economics and Finance allocates the 4.8 million during budget approvals.

In 2006, the Company entered into an agreement with the Italian Ministry of Industrial Activities for the incentive program denominated Integrated Package of Benefits Innovation of the working national program Developing Local Entrepreneurs for the creation of a centralized information system in Santeramo in Colle that will be utilized by all Natuzzi points-of-sale around the world. This agreement anticipated costs of 7.2 million and 1.9 million for the development and industrialization program, respectively. On March 20, 2006, the Italian Industrial Ministry issued a concession decree providing for a provisional grant to the Company of 2.8 million and a loan of 4.3 million, to be repaid at a rate of 0.74% over 10 years. Between December 2006 and September 2008, the Company provided the aforementioned Committee with the list of expenses to be recognized under this project and that have been incurred between July 2005 and November 2007 (date of completion of the program) totaling 10.8 million. In April 2009, the Italian Government provided, as advance payment, a 3.9 million subsidized loan and a 1.9 million operating subsidy to the Company. These payments were approved in 2010 by the Ministry Committee, and operating subsidies of 0.6 million and 0.2 million were paid in April 2012 and October 2013, respectively, as well as the residual subsidized loan amount of 0.4 million in October 2013. The Company is still awaiting receipt of 0.1 million of operating grants.



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During 2008, the Italian Ministry of Industrial Activities approved a new incentive program, entitled *Made in Italy Industry 2015*. The objective of this program is to facilitate the realization and development of new production technologies and services with high innovation value in order to stimulate awareness for products that are made in Italy. In December 2008, the Company submitted to the Italian Ministry of Industrial Activities its proposal, entitled *i-sofas*. The *i-sofas* program envisions a total investment of 3.9 million, up to 1.7 million of which may be contributed as a grant by the Italian Ministry of Industrial Activities. In October 2011, the Italian Ministry of Industrial Activities issued a concession decree reducing the total investment from 3.9 to 1.9 million and, accordingly, capital grants from up to 1.7 million to 0.7 million. No capital grant was collected in 2013. On April 1, 2014, the Company collected 0.2 million of grants.

In April 2010, Natuzzi S.p.A., as the leader of a coalition of 19 institutions (including universities, research centers and other industrial companies), submitted to the Italian Ministry of Education, University and Research a project proposal entitled *Future Factory*, which hopes to be financed using National Operating Plan (*Piano Operativo Nazionale*) funds. This project concerns the research and development of technologies and advanced applications for the control, monitoring and management of industrial processes. This project anticipates an overall cost of 17.4 million, of which Natuzzi is supposed to bear 3.3 million ( 2.6 million as industrial research-related costs, and 0.7 million as experimental activity-related costs). In March 2011, the Ministry informed the Company that it was included on a short list of companies being considered for the grant. In April 2012 the Ministry approved the Feasibility Study, but during 2013 the Company did not receive an update from the Ministry. There can be no guarantee that the Company will receive the aforementioned grant from the Italian Government.

**Management of Exchange Rate Risk**

The Group is subject to currency exchange rate risk in the ordinary course of its business to the extent that its costs are denominated in currencies other than those in which it earns revenues. Exchange rate fluctuations also affect the Group's operating results because it recognizes revenues and costs in currencies other than Euro but publishes its financial statements in Euro. The Group also holds a substantial portion of its cash and cash equivalents in currencies other than the Euro, including a large amount in RMB received as compensation for the relocation of its Chinese manufacturing plant. The Group's sales and results may be materially affected by exchange rate fluctuations. For more information, see Item 11. Quantitative and Qualitative Disclosures about Market Risk.

**Trademarks and Patents**

The Group's products are sold under the *Natuzzi*, *Leather Editions*, *Natuzzi Editions*, *Natuzzi Re-vive*, *Softaly* and *Italsofa* trademarks. These trademarks and certain other trademarks, such as *Divani & Divani by Natuzzi*, have been registered in all those countries in which the Group has a commercial interest, such as Italy, the European Union and elsewhere. In order to protect its investments in new product development, the Group has also undertaken the practice of registering certain new designs in most of the countries in which such designs are sold. The Group currently has more than 1,500 design patents and patents pending. Applications are made with respect to new product introductions that the Group believes will enjoy commercial success and have a high likelihood of being copied.

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The Natuzzi Group has recently launched *Re-vive*<sup>®</sup>, an innovative armchair that was a collaborative effort between Natuzzi's Style Center and the Formway Design Studio of Wellington, New Zealand. The *Re-vive* recliner combines style and comfort, Italian artisan expertise and innovative New Zealand design. This innovative armchair is internationally protected by two patents covering both its shape and all of its components (about 120) in 144 Countries. Natuzzi has entered into a 20-year licensing agreement, signed in January 2011, with Formway that allows it to utilize the design and mechanisms developed for the *Re-vive* armchair in exchange for a licensing fee, payable in installments, and royalties representing a percentage of sales of the armchair.

As for the distribution of the products that are manufactured in the Group's plant and identified under various names (*Natuzzi Italia*, *Natuzzi Editions*, *Natuzzi Re-vive*), the Group has in place with its customers (retailers and/or wholesalers) business agreements under the form of a sales license (product supply and brand usage license).

Furthermore, the Group also has supply agreements in place with large wholesalers for the supply of private label products that are manufactured by the Group's industrial plants outside of Italy.

### **Regulation**

The Company is incorporated under the laws of the Republic of Italy. The principal laws and regulations that apply to the operations of the Company—those of Italy and the European Union—are different from those of the United States. Such non-U.S. laws and regulations may be subject to varying interpretations or may be changed, and new laws and regulations may be adopted, from time to time. Our products are subject to regulations applicable in the countries where they are manufactured and sold. Our production processes are regularly inspected to ensure compliance with applicable regulations. While management believes that the Group is currently in compliance in all material respects with such laws and regulations (including rules with respect to environmental matters), there can be no assurance that any subsequent official interpretation of such laws or regulations by the relevant governmental authorities that differs from that of the Company, or any such change or adoption, would not have an adverse effect on the results of operations of the Group or the rights of holders of the Ordinary Shares or the owners of the Company's ADSs. See Item 4. Information on the Company—Environmental Regulatory Compliance, Item 10. Additional Information—Exchange Controls and Item 10. Additional Information—Taxation.

### **Environmental Regulatory Compliance**

The Group operates all of its facilities in compliance with all applicable laws and regulations.

### **Insurance**

The Group maintains insurance against a number of risks. The Group insures against loss or damage to its facilities, loss or damage to its products while in transit to customers, failure to recover receivables, certain potential environmental liabilities, product liability claims and Directors and Officer Liabilities. While the Group's insurance does not cover 100% of these risks, management believes that the Group's present level of insurance is adequate in light of past experience.

**Table of Contents****Description of Properties**

The location, approximate size and function of the principal physical properties used by the Group as of February 28, 2014 are set forth below:

| <b>Country</b> | <b>Location</b>                | <b>Size<br/>(approximate<br/>square meters)</b> | <b>Function</b>   | <b>Production<br/>Capacity per<br/>day</b> | <b>Unit of<br/>Measure</b> |
|----------------|--------------------------------|---|---|--|----------------------------|
| Italy          | Santeramo in Colle (BA)        | 29,000  | Headquarters,<br>prototyping, showroom<br>(Owned)   | N.A.                                       | N.A.                       |
| Italy          | Santeramo in Colle, Iesce (BA) | 28,000  | Sewing and product<br>assembly (Owned)  | 1,400                                      | Seats                      |
| Italy          | Matera La Martella             | 38,000  | General warehouse of<br>sofas and accessory<br>furnishing (Owned)<br>(planned for closure in<br>June 2014)  | N.A.                                       | N.A.                       |
| Italy          | Matera, Iesce                  | 10,000  | Motion product<br>assembly, manufacturing<br>of wooden frames<br>(Owned)  | 200 /<br>500                               | Seats /<br>Wooden Frames   |
| Italy          | Laterza (TA)                   | 11,000  | Leather cutting (Owned)   | 7,500                                      | Square Meters              |
| Italy          | Laterza (TA)                   | 13,000  | Fabric and lining cutting,<br>leather warehouse<br>(Owned)  | 6,000                                      | Linear Meters              |
| Italy          | Laterza (TA)                   | 20,000  | Accessory Furnishing<br>Packaging and<br>Warehouse (Owned)  | N.A.                                       | N.A.                       |
| Italy          | Qualiano (NA)                  | 12,000  | Polyurethane foam<br>production (Owned)   | 87   | Tons                       |
| Italy          | Pozzuolo del Friuli (UD)       | 21,000  | Leather dyeing and<br>finishing (Owned)   | 14,000                                     | Square Meters              |
| U.S.A.         | High Point, North Carolina     | 10,000  | Office and showroom<br>for Natuzzi Americas<br>(Owned)  | N.A.                                       | N.A.                       |
| Romania        | Baia Mare                      | 75,600  | Leather cutting, sewing<br>and product assembly,<br>manufacturing of<br>wooden frames,<br>polyurethane foam<br>shaping, fiberfill<br>production and wood<br>and wooden product<br>manufacturing (Owned) | 2,900                                      | Seats                      |
| China          | Shanghai                       | 88,000  |   | 3,000                                      | Seats                      |

|        |                   |       |        |  |     |       |
|--------|-------------------|-------|--------|--|-----|-------|
|        |                   |       |        | Leather cutting, sewing and product assembly, manufacturing of wooden frames, polyurethane foam shaping, fiberfill production (Leased) |     |       |
| Brazil | Salvador de Bahia | Bahia | 28,700 | Leather cutting, sewing and product assembly, manufacturing of wooden frames, polyurethane foam shaping, fiberfill production (Owned)  | 700 | Seats |

The Group believes that its production facilities are suitable for its production needs and are well maintained.



**Table of Contents****Capital Expenditures**

The following table sets forth the Group's capital expenditures for each year for the three-year period ended December 31, 2013:

|                   | Year ending December 31, (millions of Euro) |      |      |
|-------------------|---|------|------|
|                   | 2013  | 2012 | 2011 |
| Land and plants   | 0.1   | 0.1  | 0.9  |
| Equipment         | 7.0   | 7.4  | 18.8 |
| Intangible assets | 1.1   | 0.3  | 1.3  |
| Total             | 8.2   | 7.8  | 21.0 |

Capital expenditures during the last three years were primarily made to make improvements to property, plant and equipment, for the expansion of the Company's retail network as well as for SAP implementation. In 2013, capital expenditures were primarily made to make improvements at the Group's existing facilities in order to accelerate the implementation of the moving line production process and to set up a dedicated plant for the innovative *Natuzzi Re-vive* armchair.

The Group expects that capital expenditures in 2014 will be approximately 16.7 million, which is expected to be financed with cash flow from operations and from disposal of assets held for sale. The Group plans to direct such capital expenditures mainly to complete the lean production plan in its existing plants, to make improvements in the *Natuzzi Re-vive* production site and to develop its launch campaign in new markets, and to carry on the updating and implementation of the SAP system.

**ITEM 4A. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

The following discussion of the Group's results of operations, liquidity and capital resources is based on information derived from the audited Consolidated Financial Statements and the notes thereto included in Item 18 of this Annual Report. These financial statements have been prepared in accordance with Italian GAAP, which differ in certain respects from U.S. GAAP. For a discussion of the principal differences between Italian GAAP and U.S. GAAP as they relate to the Group's consolidated net losses and shareholders' equity, see Note 29 to the Consolidated Financial Statements included in Item 18 of this Annual Report. All information that is not historical in nature and disclosed under Item 5 Operating and Financial Review and Prospects is deemed to be a forward-looking statement. See Item 3. Key Information Forward Looking Information.

**Critical Accounting Policies**

**Use of Estimates** The significant accounting policies used by the Group to prepare its financial statements are described in Note 3 to the Consolidated Financial Statements included in Item 18 of this Annual Report. The application of these policies requires management to make estimates, judgments and assumptions that are subjective and complex, and which affect the reported amounts of assets and liabilities as of any reporting date and the reported

amounts of revenues and expenses during any reporting period. The Group's financial results could be materially different if different estimates, judgments or assumptions were used. The following discussion addresses the estimates, judgments and assumptions that the Group considers most material based on the degree of uncertainty and the likelihood of a material impact if a different estimate, judgment or assumption were used. Actual results could differ from such estimates, due to, among other things, uncertainty, lack or limited availability of information, variations in economic inputs such as prices, costs, and other significant factors including the matters described under Risk Factors.

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**Long-lived Assets** Management reviews long-lived assets for impairment whenever changes in circumstances indicate that the carrying amount of the assets may not be recoverable and would record an impairment charge if necessary. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the recoverable amount, which is the higher of the estimated fair value less cost to sell of future undiscounted and discounted net cash flows expected to be generated by the asset and are significantly impacted by estimates of future prices for our products, capital needs, economic trends and other factors. If the carrying value of a long-lived asset is considered impaired, an impairment charge is recorded for the amount by which the carrying value of the long-lived asset exceeds its estimated recoverable amount, in relation to its use or realization, as determined by reference to the most recent corporate plans. The Company analyzes its overall valuation and performs an impairment analysis of its long-lived assets in accordance with Italian GAAP and U.S. GAAP (long-lived assets have to be tested for impairment whenever the events or changes in circumstances indicate that the carrying amount of an asset may be not recoverable).

Due to a market capitalization that falls below the carrying amount of the company, and history of operating loss and revenues decline, management has performed impairment tests on certain long-lived assets where losses have been generated.

The fair value analysis of each long-lived asset in use is unique and requires that management use estimates and assumptions that are deemed prudent and reasonable for a particular set of circumstances. Management believes that the estimates used in the analyses are reasonable; however, changes in estimates could affect the relevant valuations and the recoverability of the carrying values of the assets. The cash flows employed in our 2013 undiscounted and discounted cash flow analyses for impairment analysis of long lived assets in use were based on 2014-2016 Business Plan developed in cooperation with specialized external advisors and adopted by the board of directors on February 28, 2014.

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While management believes its estimates are reasonable, many of these matters involve significant uncertainty, and actual results may differ from the estimates used. The key inputs that were used in performing the 2013 impairment test for long-lived assets in use are as follows:

| Long lived assets (in use)<br>located in |  | Cash flows    | Year Ended Dec. 31, 2013   |     |      |                    |
|--|--|---------------|--|-----|------|--------------------|
|  |  |               | Net book value of the asset after impairment test<br>(thousands of ) | G   | WACC | Sales CAGR 2014-16 |
| Italy (Production site)                  | Undiscounted                                   | 60,854        | n/a  | n/a | 14%  |                    |
| Italy (Retail site)                      | Discounted + Third party independent appraisal | 334           | 0.5%   | 12% | 7%   |                    |
| Italy (Polyurethane site)                | Undiscounted                                   | 2,682         | n/a  | n/a | 5%   |                    |
| Brazil(Production site)                  | Third-party independent appraisal              | 6,390         | n/a  | n/a | n/a  |                    |
| Spain (Retail site)                      | Discounted                                     |               | 0.5%   | 11% | -1%  |                    |
| Germany (Retail site)                    | Discounted                                     |               | 0.5%   | 9%  | -6%  |                    |
| U.K. (Retail site)                       | Discounted                                     | 1,019         | 0.5%   | 10% | 7%   |                    |
| <b>Total assets tested</b>               |  | <b>71,279</b> |  |     |      |                    |
| n/a Not Applicable                       |  |               |  |     |      |                    |

G estimated long term growth rate from Damodaran Online at <http://pages.stern.nyu.edu/~adamodar/>

WACC Weighted Average Cost of Capital

Sales CAGR Sales Compound Annual Growth Rate

The fair value analysis of each long-lived asset not in use/to be disposed of is determined by means of third party independent appraisal and, for the airplane, through the most recent market value determined on the basis of a preliminary sale agreement stipulated early in 2014.

With reference to Italian production site which represents the most significant carrying amount, management believe that the fair value calculated with the discounted cash flow method exceeds the carrying value with a sufficient cushion.

The compound annual growth rate for sales for Italian production sites is based on the Business Plan approved by the Board of Directors of the Company. The growth is due to the brand Natuzzi Italia expansion in wholesale markets and to the launch of the new *Re-vive* brand, both produced at the Italian production site and sold at a worldwide level. Included in the cash flow analysis is the assumption of costs saving for certain programs already implemented or expected to be implemented during 2014 in the Italian industrial site.

The deterioration of the macroeconomic environment, retail industry and the deterioration of our performance, could affect our Italian production long lived assets. In performing the impairment analysis management has performed a sensitivity analysis, which results in an undiscounted cash flow exceeding the carrying amount of long lived assets

with an adequate cushion.

However, long lived assets impairment charges may be recognized also for future periods to the extent changes in factors or circumstances occur, including deterioration in the macroeconomic environment, retail industry, deterioration in our performance or our future projections, or changes in our plans for one or more long lived assets.

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During 2013 the Company performed an impairment review of its retail fixed assets: an impairment loss of 0.7 million was recorded for the assets related to retail stores in Italy, an impairment loss of 0.6 million was recorded for the assets related to retail stores in Spain and an impairment loss of 0.8 million was recorded for the German retail assets. Also, an impairment test was performed for a specific asset (airplane), which resulted in an impairment loss of 6.0 million, and 0.4 million for plants not in use/to be disposed of. During 2012, the Company recorded an impairment loss of 0.9 million for the assets related to retail stores in Spain. During 2011 the Company recorded an impairment loss of 1.0 million for its Pojuca plant in Brazil. No impairment losses arose in 2010.

For a discussion of the differences between Italian GAAP and U.S. GAAP with respect to the above impairment analysis and the effect on net loss and shareholders' equity as of December 31, 2013, please see Note 29(g) of the Consolidated Financial Statements included in item 18 of this Annual Report.

**Goodwill and intangible assets** Management tests goodwill and intangible assets for impairment by reporting unit at least once a year or whenever the events or changes in circumstances indicate that the carrying amount of goodwill and intangible assets may be not recoverable.

The Company analyzes its overall valuation and performed the impairment analysis of its goodwill and intangible assets in accordance with Italian and U.S. GAAP. Under Italian GAAP the Company amortizes the goodwill and intangible assets arising from business acquisition on a straight-line basis over a period of five years. Under U.S. GAAP goodwill and intangible assets are not amortized but annually tested for impairment.

At December 31, 2013, 2012 and 2011, the Company recorded an impairment loss for its goodwill and intangible assets of nil, 0.9 million and 5.9 million respectively.

Furthermore, the Company would like to highlight that the net book value of goodwill as of December 31, 2013 under Italian GAAP and U.S. GAAP was nil, respectively (see notes 12 and 29(d) of the Consolidated Financial Statements included in Item 18 of this Annual Report).

For a discussion of the differences between Italian GAAP and U.S. GAAP with respect to the above impairment analysis and the effect on net loss and shareholders' equity as of December 31, 2013, please see Note 29(d) of the Consolidated Financial Statements included in Item 18 of this Annual Report.

Although management believes its estimates are reasonable, actual results may differ, and future downward revisions to management's estimates, if any, may result in further charges in future periods.

**Recoverability of Deferred Tax Assets** Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the accounting in the consolidated financial statements of existing assets and liabilities and their respective tax bases, as well as for losses available for carrying forward in the various tax jurisdictions. Deferred tax assets are reduced by a valuation allowance to an amount that is reasonably certain to be realized. Deferred tax assets and liabilities are calculated using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date.

In assessing the feasibility of the realization of deferred tax assets, management considers whether it is reasonably certain that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible and the tax loss carry forwards are utilized. Estimating future taxable income requires estimates about matters that are inherently uncertain and requires significant management judgment, and different

estimates can have a significant impact on the outcome of the analysis.

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In 2013, because most of the Italian and foreign subsidiaries realized significant pre-tax losses and were in a cumulative loss position, management did not consider it reasonably certain that the deferred tax assets of those companies would be realized in the scheduled reversal periods (see Note 16 to the Consolidated Financial Statements included in Item 18 of this Annual Report). In making its determination that a valuation allowance was required, management considered the scheduled reversal of deferred tax liabilities and tax planning strategies but was unable to identify any relevant tax planning strategies available to reduce the need for a valuation allowance.

Changes in the assumptions and estimates related to future taxable income, tax planning strategies and scheduled reversal of deferred tax liabilities could affect the recoverability of the deferred tax assets. If actual results differ from such estimates and assumptions the Group financial position and results of operation may be affected.

**One-Time Termination Benefits** In September 2011, the Company renewed its agreement with the Italian trade unions and the Ministry of Labor and Social Policy that permitted it to participate in a temporary workforce reduction program and to benefit from the *Cassa Integrazione Guadagni Straordinaria*, or CIGS, for a period of 24 months beginning on October 16, 2011. Pursuant to the CIGS, government funds pay a substantial majority of the salaries of redundant workers who are subject to layoffs or reduced work schedules. For the 2011-2013 period, an average of 1,273 employees from the Group's headquarters and production facilities were covered by the program, which contemplated a surplus of 1,060 employees at the end of the period on October 15, 2013.

Pursuant to this agreement, as of December 31, 2011, the Company, accrued a one-time termination benefits reserve with an accrual of 5.4 million (for the 1,060 employees to be dismissed) recorded as a non-operating expense, under the line Other Income/(Expense), Net of the consolidated statement of operations for the year ended December 31, 2011, of which 1.4 million has been paid.

On October 10, 2013, shortly before the expiration of the 2011 agreement, the Company entered into a separate agreement (the Italian Reorganization Agreement) with local institutions, Italian trade unions, the Ministries of Economic Development and of Labor and Social Policy and the regions of Puglia and Basilicata governing the reorganization plan for the Group's Italian operations. The plan contemplated by the Italian Reorganization Agreement anticipates future layoffs of 1,506 employees (instead of the 1,060 contemplated by the agreement signed in 2011). Due to the complexity of the measures envisioned by the plan and in order to better manage workforce reductions, the Company and the trade unions obtained a one-year extension of the Company's participation in the CIGS program through October 15, 2014.

The Company anticipates making incentive payments to induce the voluntary resignation of up to 600 employees (as of the day of the filing of this Annual Report, 372 people have already accepted such incentives) at the conclusion of the period covered by the CIGS program. As a result, in 2013, the Company increased the one-time termination benefits reserve (reflecting both voluntary payments and those that must be made under Italian law in the event of employee terminations) with an accrual of 19.9 million, which is recorded as a non-operating expense, under the line Other Income/(Expense), Net. The payment of these amounts is expected to be made by the Company in October 2014, upon the expiration of its participation in the CIGS program and the commencement of anticipated layoffs, unless its participation in the CIGS program is renewed. See Note 19.



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In accordance with Italian GAAP this cost was recognized in 2011 and 2013, due to the fact that in those years the Company formally decided to adopt the termination plans (which were approved by the Company's board of directors) and was able to reasonably estimate the related one-time termination benefits. Under Italian GAAP, the communication or announcement to third parties of the plan of termination of workers is not relevant to the recognition of the cost for the termination benefits related to the terminated workers.

Although management believes its estimates of the one-time termination benefits are reasonable, different assumptions regarding the number of employees to be laid off, the outcome of the negotiations with the trade unions and the relevant Italian Ministries, and other factors, could lead to different conclusions, which could have a significant impact on the figures determined.

Under U.S. GAAP, considering the guidance of ASC 420, the one-time termination benefits have to be recorded in the consolidated statement of operations when the termination plan is communicated to the employees and meets all the criteria indicated in paragraph 420-10-25-4. Therefore, under U.S. GAAP the cost of the one-time termination benefits: (i) reclassified the accrual of the year of 19.9 million made to the provision for one-time termination benefits that was classified under the line other income/(expense), net in the consolidated statement of operations prepared according to Italian GAAP to cost of sales, included therefore as part of operating loss, (ii) as a consequence of some agreements (372 workers) reached with individual workers during the year, reversed 7,987 out of the consolidated statement of operations, connected to the portion of workers for whom no notification/agreements were reached in 2013. The residual difference of equity under US GAAP of 14,120 is attributable to the 1,134 workers that represent the remaining redundant workers and for which the criteria in ASC 420 have not yet been met.

**Allowances for Returns and Discounts** The Group records revenues net of returns and discounts. The Group estimates sales returns and discounts and creates an allowance for them in the year of the related sales. The Group makes estimates in connection with such allowances based on its experience and historical trends in its large volumes of homogeneous transactions. However, actual costs for returns and discounts may differ significantly from these estimates if factors such as economic conditions, customer preferences or changes in product quality differ from the ones used by the Group in making these estimates.

**Allowance for Doubtful Accounts** The Group makes estimates and judgments in relation to the collectability of its accounts receivable and maintains an allowance for doubtful accounts based on losses it may experience as a result of failure by its customers to pay amounts owed. The Group estimates these losses using consistent methods that take into consideration, in particular, insurance coverage in place, the creditworthiness of its customers and general economic conditions. Changes to assumptions relating to these estimates could affect actual results. Actual results may differ significantly from the Group's estimates if factors such as general economic conditions and the creditworthiness of its customers are different from the Group's assumptions.

**Revenue Recognition** Under Italian GAAP, the Group recognizes sales revenue, and accrues associated costs, at the time products are shipped from its manufacturing facilities located in Italy and abroad. A significant part of the products are shipped from factories directly to customers under sales terms such that ownership, and thus risk, is transferred to the customer when the customer takes possession of the goods. These sales terms are referred to as delivered duty paid, delivered duty unpaid, delivered ex quay and delivered at customer factory. Delivery to the customer generally occurs within one to six weeks from the time of shipment. The Group's revenue recognition under Italian GAAP is at variance with U.S. GAAP. For a discussion of revenue recognition under U.S. GAAP, see Note 29(c) to the Consolidated Financial Statements included in Item 18 of this Annual Report.



**Table of Contents****Results of Operations**

**Summary** During 2013, the Company dedicated significant efforts to defining those actions that are necessary for the reorganization of the Group, and to optimize and streamline processes to reduce costs and recover efficiency. The restructuring of the Group's operations has also generated extraordinary items that significantly affected our overall results of operations for 2013.

In 2013, the Group had net losses of 68.6 million (compared to a net loss of 26.1 million in 2012), reflecting 28.5 million in extraordinary items and costs linked to the restructuring of operations. Group net sales decreased by 4.2%, from 468.8 million in 2012 to 449.1 million in 2013. Total upholstery net sales decreased by 1.6% to 402.8 million due primarily to negative exchange rate fluctuations, which more than offset the 0.3% increase in terms of seats sold, from 1,680,770 in 2012 to 1,686,347 in 2013. The decrease in the Other sales item (-22.2%) was focused on sales such as furnishings, polyurethane and other minor revenues.

In 2013, net sales of the *Natuzzi Italia* branded products, which target the high-end of the market, decreased by 4.1% to 132.1 million, with the number of *Natuzzi Italia*-branded seats sold increasing by 2.5% to 319,249 as compared to 2012. Net sales of the *Natuzzi Editions/Leather Editions* products decreased by 3.8% in 2013 over the previous year, to 160.7 million, with the number of seats sold decreasing by 7.7% to 680,168. Net sales of private label products (including *Softaly*) increased by 5.2%, to 110.0 million, with the number of seats sold increasing by 8.5% to 686,930. See Item 4. Information on the Company Markets for tables setting forth the Group's net leather- and fabric-upholstered furniture sales and seats sold, which are broken down by geographic market, for the years ended December 31, 2011, 2012 and 2013.

The overall Group performance in 2013 was strongly affected by the persisting poor trend in sales from Europe, which suffered from weak household consumption that were further burdened by austerity-driven policies in place in certain countries, but also by the extension of the slowdown in some emerging economies.

The general recessionary climate that the Group has operated within over the past few years, especially in those markets that have historically been important to us, such as Europe, has had an adverse effect on consumers' disposable incomes, which has also contributed to a change in consumer preferences towards products within the medium-to-lower end of the market.

Despite these challenges, the Group is committed to focusing on reorganization activities that will improve the competitiveness of its operating structure. Specifically, the Group will continue to invest in product and process innovations according to Lean Production principles. In addition, our commercial organization is being reviewed in order to have it more effectively respond to market demands, with particular attention on fast-growing markets. The Company will also continue to further implement cost-saving measures aimed at overhead costs and to develop our business relations with important customers by leveraging our capability in offering quality service and competitive products.

The following table sets forth certain statement of operations data expressed as a percentage of net sales for the years indicated:

|           | <b>Year Ended December 31,</b> |             |             |
|-----------|--------------------------------|-------------|-------------|
|           | <b>2013</b>                    | <b>2012</b> | <b>2011</b> |
| Net sales | 100.0%                         | 100.0%      | 100.0%      |

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|                                     |        |       |       |
|-------------------------------------|--------|-------|-------|
| Cost of sales                       | 70.7   | 66.9  | 67.0  |
| Gross profit                        | 29.3   | 33.1  | 33.0  |
| Selling expenses                    | 28.2   | 28.2  | 29.7  |
| General and administrative expenses | 8.3    | 8.5   | 8.9   |
| Operating margin                    | (7.2)  | (3.7) | (5.6) |
| Other income (expense), net         | (7.1)  | (1.0) | 3.6   |
| Income taxes                        | 0.9    | 0.9   | 1.8   |
| Net loss                            | (15.2) | (5.6) | (4.0) |

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**2013 Compared to 2012**

Total net sales for 2013, including sales of leather and fabric-upholstered furniture and other sales (principally sales of polyurethane foam and leather sold to third parties as well as of accessories), decreased 4.2% to 449.1 million, as compared to 449.1 million in 2012.

Net sales for 2013 of leather and fabric-upholstered furniture decreased 1.6% to 402.8 million, as compared to 409.4 million in 2012. The 1.6% decrease was due principally to the general strengthening of the Euro versus major currencies, such as the United States Dollar, Canadian Dollar, British Pound, Japanese Yen, Australian Dollar, and Brazilian Reals (for an overall contribution of -3.0% on sales), partially offset by an increase of seats sold (+0.3% over 2012) and unit prices.

Net sales of *Natuzzi Italia* branded furniture accounted for 32.8% of our total upholstery net sales in 2013 (as compared to 33.6% in 2012); net sales of *Natuzzi Editions/Leather Editions* accounted for 39.9% in 2013 (as compared to 40.8% in 2012); net sales of the private label production accounted for 27.3% of our total upholstery net sales in 2013 (as compared to 25.5% in 2012). These trends reflect a shift, year-over-year, toward the lower end of our market segment of products.

Net sales for 2013 of leather-upholstered furniture decreased 1.9% to 382.2 million, as compared to 389.8 million in 2012, and net sales for 2013 of fabric-upholstered furniture increased 5.1% to 20.6 million, as compared to 19.6 million in 2012, reflecting a change in consumer preferences for lower-priced products and those with fabric (as opposed to leather) upholstery. We anticipate expanding the range of fabric-upholstered offerings, which were not previously an area of strategic focus, under the Business Plan to reflect these trends.

According to a geographic total upholstery net sales breakdown, in the Americas (Brazil excluded), net sales in 2013 decreased by 5.7% to 154.0 million, as compared to 163.3 million in 2012, and seats sold decreased by 4.0% to 768,038. This decline in sales reflects a shift within the middle of the market toward private label sales, and a decline mainly in purchases of *Natuzzi Editions* products. To counteract this trend, we anticipate realigning our sales force to focus certain representatives solely on Natuzzi name branded products, while a specific business unit will focus on private label sales. We also plan to increase our presence in large department stores to help expand our geographic reach in the Americas, particularly in the U.S. and Canada.

In Brazil, total upholstery net sales increased 30.1% at 8.5 million, and the number of seats sold increased by 26.5% to 41,272 units, reflecting increased sales and marketing activity by our Brazil commercial office and an improvement in the sales mix.

In EMEA, net sales of upholstered furniture in 2013 decreased 2.0% to 189.7 million, as compared to 193.6 million in 2012, due primarily to a decrease in *Natuzzi Italia* branded offerings by 5.5%, which was partially offset by an increase of 3.1% in sales of our private label offerings, while sales for the *Natuzzi Editions/Leather Editions* brands were essentially flat year over year. Seats sold in the region in 2013 increased by 2.6% to 703,368 units, although these trends reflected a shift toward lower-priced models.

In the Asia-Pacific region, net sales of upholstered furniture increased 10.3% to 50.6 million, as compared to 45.9 million in 2012. Seats sold increased by 7.2% in that region to 173,669. This growth was mainly attributable to the Group's expansion in the Chinese market, where we opened 22 new *Leather Editions* and five new *Natuzzi Italia* stores during 2013.

According to a brand breakdown, net sales for 2013 of the *Natuzzi Italia* branded furniture decreased 4.1% over 2012 to 132.1 million, and the number of seats sold increased by 2.5%. Net sales of *Natuzzi Editions/Leather Editions* decreased by 3.8% to 160.7 million over 2012, and the number of seats sold decreased by 7.7%. Net sales of the private label production increased by 5.2% over 2012 to 110.0 million and the number of seats sold increased by 8.5% to 686,930.

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In 2013, total seats sold increased 0.3% to 1,686,347 from 1,680,770 units sold in 2012.

See Item 4. Information on the Company Markets for tables setting forth the Group's net leather- and fabric-upholstered furniture sales and seats sold, which are broken down by geographic market, for the years ended December 31, 2011, 2012 and 2013.

The following provides a more detailed country-by-country examination of the changes in volumes in our principal markets, according to the Group's main sales categories:

**Natuzzi Italia.** In terms of seats sold under the *Natuzzi Italia* brand, the Group recorded negative results in the United Kingdom (-10.5%), Germany (-15.7%), Canada (-14.0%), the United States (-8.2%), France (-21.9%), South Korea (-11.5%), Belgium (-28.3%), Australia (-10.0%), Mexico (-9.0%) and India (-6.4%). Positive results were reported in Italy (+14.9%), the Netherlands (+32.9%), Spain (+2.3%), China (+24.5%), Russia (+17.9%), Saudi Arabia (+34.6%), Israel (+29.8%), Switzerland (+3.4%), United Arab Emirates (+40.4%), Taiwan (+6.2%), and Austria (+24.7%).

**Natuzzi Editions/Leather Editions.** The Group recorded a decrease over 2012 in terms of seats sold in countries such as the United States (-16.0%), Canada (-15.9%), Australia (-1.2%), Belgium (-28.1%), South Korea (-5.9%), Spain (-13.1%), Chile (-10.1%) and Puerto Rico (-29.9%). Positive results were reported in the United Kingdom (+11.1%), Japan (+13.6%), China (+112.8%), Germany (+17.4%), France (+14.5%), Brazil (+34.0%), Russia (+6.2%), Mexico (+63.2%) and Israel (+3.6%).

**Private label production.** In 2013 the Group reported negative results in Germany (-10.3%), United Kingdom (-18.0%), Norway (-25.2%), Spain (-25.2%), Austria (-20.1%), the Netherlands (-16.9%), and Japan (-35.0%). Positive results were recorded in the United States (+2.6%), France (+13.1%), Canada (+90.0%), Brazil (+21.1%), Switzerland (+13.7%), China (+73.8%), Sweden (+20.8%), Belgium (+34.2%), Israel (+806.4%), and United Arab Emirates (+47.4%).

**Other Net Sales,** principally sales of polyurethane foam and leather sold to third parties, as well as of accessories, decreased 22.2% to 46.3 million, as compared to 59.4 million in 2012.

**Cost of Sales** in 2013 increased by 1.1% to 317.3 million (representing 70.7% of net sales), as compared to 313.8 million (or 66.9% of net sales) in 2012. In particular, consumption costs (defined as purchases plus beginning stock minus final stock and plus leather processing) increased as a percentage of total net sales, passing from 44.6% in 2012 to 46.4% in 2013. These increases were mainly due to a different sales mix (more private label products sold), higher raw material costs and higher production costs, deriving from a lower level of productivity, especially in the Group's Italian plants. In addition, we experienced six days of labor strikes in June and July 2013, and a slowdown campaign by Italian labor from July through September 2013 in reaction to the announcement of the reorganization of the Group's Italian operations on July 1, 2013. These negative trends were partially offset by the positive impact of efficiency measures that have been introduced, including better management of outsourced materials and components. Transformation costs (defined as manufacturing labor costs and industrial costs) increased slightly from 22.4% in 2012 to 23.8% in 2013 mainly because of a negative sales mix and increased costs of labor in China and Romania.

**Gross Profit.** The Group's gross profit in 2013 amounted to 131.8 million (29.3% of net sales), as compared to 155.0 million in 2012 (33.1% of net sales) as a result of the factors described above.

**Selling Expenses** decreased in 2013 to 126.6 million, as compared to 132.4 million in 2012, and, as a percentage of net sales, was the same as in 2012, at 28.2%.





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**General and Administrative Expenses.** In 2013, the Group's general and administrative expenses decreased by 2.4 million to 37.5 million, from 39.9 million in 2012, and, as a percentage of net sales, from 8.5% in 2012 to 8.4% in 2013, due to cost control measures implemented over the past few quarters.

**Operating Income (Loss).** As a result of the factors described above, the Group had an operating loss of 32.3 million for 2013, compared to an operating loss of 17.3 million in 2012.

**Other Income (expenses), net.** The Group registered Other expense, net, of 31.9 million in 2013 as compared to Other expense, net, of 4.6 million in 2012.

Net interest expense, included in other expense, net, in 2013 was 0.5 million, as compared to net expenses of 0.2 million in 2012. See Note 26 to the Consolidated Financial Statements included in Item 18 of this Annual Report.

The Group recorded a 2.9 million foreign-exchange net loss in 2013 (included in other income (expense), net), as compared to a net loss of 2.5 million in 2012. The foreign exchange loss in 2013 primarily reflected the following factors:

a net realized gain of 2.1 million in 2013 (as compared to a net realized loss of 1.1 million in 2012) on domestic currency swaps due to the difference between the forward rates of the domestic currency swaps and the spot rates at which the domestic currency swaps were closed (the Group uses forward rate contracts to hedge its price risks against unfavorable exchange rate variations);

a net realized loss of 2.6 million in 2013 (compared to a gain of 2.3 million in 2012), from the difference between invoice exchange rates and collection/payment exchange rates;

a net unrealized loss of 2.9 million in 2013 (compared to an unrealized loss of 4.6 million in 2012) on accounts receivable and payable; and

a net unrealized gain of 0.5 million in 2013 (compared to an unrealized gain of 0.9 million in 2012), from the mark-to-market evaluation of domestic currency swaps.

The Group recorded expenses of 28.5 million during 2013 that were recorded under Other expenses, net, compared to Other expenses, net of 1.9 million reported in 2012. The 28.5 million under Other expenses, net mainly reflected the following factors:

1.4 million of other provisions for contingent liabilities mainly related to claims and legal actions;

8.5 million related to the impairment of long-lived assets;

19.9 million accrual for one-time employee termination benefits;

8.7 million as extraordinary gain on fixed asset disposal and related to the second supplementary agreement that was signed between the Company and the Shanghai Municipality, pursuant to which the Company obtained the reimbursement of taxes due on relocation compensation; and

6.1 million as other expenses, net, of which 2.3 million consists of extraordinary contingent liabilities related to the partial write off of certain government capital grants receivables and 1.7 million of extraordinary costs related to the restructuring of the Group.

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The Group does not use hedge accounting and records all fair value changes of its domestic currency swaps in its statement of operations. See Note 26 to the Consolidated Financial Statements included in Item 18 of this Annual Report.

**Income Taxes.** In 2013, the Group had an effective tax rate of 6.44% on its losses before taxes and non-controlling interests, compared to the Group's effective tax rate of 19.08% reported in 2012.

For the Group's Italian companies the effective tax rate (*i.e.*, the obligation to accrue taxes despite reporting a loss before taxes) was, in part, due to the regional tax known as IRAP (*Imposta Regionale sulle Attività Produttive*; see Note 16 to the Consolidated Financial Statements included in Item 18 of this Annual Report). This regional tax is generally levied on the gross profits determined as the difference between gross revenue (excluding interest and dividend income) and direct production costs (excluding labor costs, interest expenses and other financial costs). As a consequence, even if an Italian company reports a pre-tax loss, it could still be subject to this regional tax. In 2013, some Italian companies within the Group reported losses but had to pay IRAP.

As in 2012, because most of the Italian and foreign subsidiaries realized significant pre-tax losses and were in a cumulative loss position, management did not consider it reasonably certain that the deferred tax assets of those companies would be realized in the scheduled reversal periods (see Note 16 to the Consolidated Financial Statements included in Item 18 of this Annual Report).

**Net Loss.** Reflecting the factors above, the Group reported a net loss of 68.6 million in 2013, as compared to a net loss of 26.1 million in 2012. On a per-Ordinary Share, or per-ADS basis, the Group had net losses of 1.25 in 2013, as compared to net losses of 0.48 in 2012.

As disclosed in Note 29 to the Consolidated Financial Statements included in Item 18 of this Annual Report, established accounting principles in Italy vary in certain significant respects from generally accepted accounting principles in the United States. Under U.S. GAAP, the Group would have had net losses of 62.0 million, 29.5 million and 13.1 million in 2013, 2012 and 2011, respectively, compared to net losses of 68.6 million, 26.1 million and 19.6 million in 2013, 2012 and 2011, respectively under Italian GAAP.

### 2012 Compared to 2011

**Total Net Sales** for 2012, including sales of leather and fabric-upholstered furniture and other sales (principally sales of polyurethane foam and leather sold to third parties as well as of accessories), decreased 3.6% to 468.8 million, as compared to 486.4 million in 2011.

Net sales for 2012 of leather and fabric-upholstered furniture decreased 3.7% to 409.4 million, as compared to 425.3 million in 2011. The 3.7% decrease was due principally to a 6.0% decrease in the number of seats sold. Net sales of *Natuzzi Italia*-branded furniture accounted for 34.2% of our total furniture net sales in 2012 (as compared to 42.6% in 2011), and net sales of the other brands, namely *Natuzzi Editions/Leather Editions, Italsofa*, and *private label* products accounted for 65.8% of our total net sales for 2012 (as compared to 57.4% in 2011).

Net sales for 2012 of leather-upholstered furniture decreased 3.3% to 389.8 million, as compared to 403.0 million in 2011, and net sales for 2012 of fabric-upholstered furniture decreased 11.8% to 19.6 million, as compared to 22.2 million in 2011.



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In the Americas, net sales of upholstered furniture in 2012 increased by 18.4% to 169.9 million, as compared to 143.5 million in 2011, and seats sold increased by 7.3% to 832,977. Net sales of *Natuzzi Editions/Leather Editions, Italsofa* and private label products increased 21.0% over 2011 at 154.0 million, while net sales of the higher-priced *Natuzzi Italia*-branded furniture were 15.9 million, down 1.7% as compared to 2011. In Europe, net sales of upholstered furniture in 2012 decreased 18.3% to 180.0 million, as compared to 220.3 million in 2011, due to the combined effect of a 27.4% decrease in net sales of *Natuzzi Italia*-branded furniture and to a 4.7% decrease in net sales of *Natuzzi Editions/Leather Editions, Italsofa* and private label products. In the rest of the world, net sales of upholstered furniture decreased 3.3% to 59.5 million, as compared to 61.5 million in 2011.

Net sales for 2012 of the *Natuzzi Italia*-branded furniture decreased 22.9% over 2011 to 139.9 million, with the number of *Natuzzi Italia*-branded seats sold decreasing by 28.4%. During 2012 net sales of *Natuzzi Editions/Leather Editions, Italsofa* and private label products increased 10.5% to 269.5 million, as compared to 243.9 million in 2011, with the number of seats sold increased by 1.7%.

In 2012, total seats sold decreased 6.0% to 1,680,770 from 1,787,820 units sold in 2011. Negative performance was recorded in Europe (down 18.5% to 635,955 seats) and in Asia-Pacific, the Middle East and Africa (down 8.2% to 211,839 seats), whereas the Group reported positive results in the Americas (up 7.3% to 832,977 seats).

The following provides a more detailed country-by-country examination of the changes in volumes in our principal markets, according to the Group's main sales categories:

***Natuzzi Italia* brand.** In terms of seats sold under the *Natuzzi* brand, the Group recorded negative results in Canada (-1.6%), the United States (-19.6%), Mexico (-39.5%), South Korea (-16.9%), Australia (-27.0%), China (-36.0%), Taiwan (-19.6%), Israel (-20.2%), United Kingdom (-35.6%), Germany (-24.9%), France (-40.0%), Belgium (-40.1%), Spain (-44.0%), Netherlands (-29.1%), Switzerland (-32.1%), and Italy (-27.9%). Positive results were reported in Saudi Arabia (+9.5%), India (+33.5%), Russia (+36.9%) and Chile (+71.2%).

***Natuzzi Editions/Leather Editions, Italsofa* and private label products.** The Group recorded a decrease over 2011 in terms of seats sold in countries, such as Chile (-18.8%), Puerto Rico (-18.3%), Saudi Arabia (-7.4%), Taiwan (-26.4%), Israel

(-23.9%), Turkey (-13.4%), Japan (-27.3%), Germany (-23.6%), France (-21.3%), Spain (-32.4%), Netherlands (-24.2%), Russia

(-20.5%), Czech Republic (-18.8%), Cyprus (-63.0%), Portugal (-28.6%), Ireland (-11.8%) and Sweden (-22.6%). Positive results were reported in Canada (+22.7%), the United States (+1.9%), Mexico (+20.4%), Venezuela (+151.6%), Brazil (+151.5%), Peru (+220.6%), South Korea (+17.4%), Australia (+35.8%), China (+14.3%), India (+45.5%), UAE (+4.7%), United Kingdom (+14.0%), France (+5.9%), Switzerland (+22.4%), Finland (+10.7%), Austria (+20.2%), Poland (+23.7%) and Denmark (+7.6%).

**Other Net Sales** (principally sales of polyurethane foam and leather sold to third parties, as well as of accessories) decreased 2.7% to 59.4 million, as compared to 61.0 million in 2011.

**Cost of Sales** in 2012 decreased by 3.7% to 313.8 million (representing 66.9% of net sales), as compared to 326.1 million (or 67.0% of net sales) in 2011. In particular, consumption costs (defined as purchases plus beginning

stock minus final stock and plus leather processing) increased slightly as a percentage of total net sales, passing from 44.3% in 2011 to 44.6% in 2012, mainly due to a different sales mix (more private label products sold), but these results reflect the positive impact of efficiency measures that have been introduced, including better management of outsourced materials and components, in the absence of which consumption costs would have been higher as a percentage of total net sales. Transformation costs (defined as manufacturing labor costs and industrial costs) saw an improvement, in terms of the percentage of the total net sales, declining slightly from 22.7% in 2011 to 22.4% in 2012, mainly due to higher efficiency in the Group's operations following the extension of the moving line approach in our manufacturing plants.

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**Gross Profit.** The Group's gross profit decreased 3.3% in 2012 to 155.0 million (33.1% of net sales), as compared to 160.3 million in 2011 (33.0% of net sales) as a result of the factors described above.

**Selling Expenses** decreased 8.2% in 2012 to 132.4 million, as compared to 144.3 million in 2011, and, as a percentage of net sales, decreased to 28.2% from 29.7% in 2011.

In particular, in 2012 transportation costs increased in Euro terms to 47.6 million, from 46.4 million reported in 2011, but also as percentage of total net sales (10.2% from 10.5% one year ago) due to a different sales-mix (higher sales of lower-priced private label products), as well as to more shipments with longer routes, especially towards North America. These costs would have been higher if we had not implemented efficiency recovery measures to rationalize the Group's logistics, such as renegotiation of transportation tariffs, better management of customs expenses and a reduced number of third-party storage, together with a renegotiation of storage fees.

Commissions to agents increased slightly in 2012 over 2011, passing from 1.9% of total net sales to 2.1% in 2012. Advertising expenses decreased by 4.8 million compared to 2011, representing 4.2% of total net sales in 2012 (5.0% in 2011).

**General and Administrative Expenses.** In 2012, the Group's general and administrative expenses decreased by 7.9% to 39.9 million, from 43.3 million in 2011, and, as a percentage of net sales, from 8.9% in 2011 to 8.5% in 2012. The reduction both in absolute terms and as percentage on net sales is the results of the reorganization measure implemented at Group level.

**Operating Income (Loss).** As a result of the factors described above, the Group had an operating loss of 17.3 million for 2012, compared to an operating loss of 27.3 million in 2011.

**Other Income (expenses), net.** The Group registered other expense, net, of 4.6 million in 2012 as compared to other income, net, of 17.3 million in 2011, which was higher in 2011 primarily due to the refund from the Chinese government following the expropriation of one of the Group's plants.

Within the line other income / (expenses), net of the consolidated statement of operations for the year ended December 31, 2012, the Company has charged the amount of 0.7 million, ( 2.5 million for 2011), for the estimated probable liabilities related to some claims (including tax claims) and legal actions in which it is involved.

In 2012, Natuzzi Iberica, one of the Group's controlled companies, performed an impairment review of its fixed assets and an impairment loss of 0.9 million was recorded. This impairment loss was due, in particular, to the decline in cash flow projections related to the uncertain prospects for full economic recovery in Spain, since private consumption was negatively impacted by a general weakness in the job market, high levels of public indebtedness, and a decreasing level of savings among families. See Note 26 to the Consolidated Financial Statements included in Item 18 of this Annual Report.

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Net interest expenses, included in other expense, net, in 2012 was 0.2 million, as compared to net expenses of 0.5 million in 2011. See Note 26 to the Consolidated Financial Statements included in Item 18 of this Annual Report.

The Group recorded a 2.5 million foreign-exchange net loss in 2012 (included in other income (expense), net), as compared to a net gain of 0.5 million in 2011. The foreign exchange gain in 2012 primarily reflected the following factors:

a net realized loss of 1.6 million in 2012 (as compared to a net realized gain of 1.9 million in 2011) on domestic currency swaps due to the difference between the forward rates of the domestic currency swaps and the spot rates at which the domestic currency swaps were closed (the Group uses the forward rate to hedge its price risks against unfavorable exchange rate variations);

a net realized gain of 2.3 million in 2012 (compared to a loss of 1.2 million in 2011), from the difference between invoice exchange rates and collection/payment exchange rates;

a net unrealized loss of 4.6 million in 2012 (compared to an unrealized gain of 0.4 million in 2011) on accounts receivable and payable; and

a net unrealized gain of 1.4 million in 2012 (compared to an unrealized loss of 0.6 million in 2011), from the mark-to-market evaluation of domestic currency swaps.

The Group also recorded in 2012 other expenses, net, included in other income (expense), net, of 1.9 million, compared to other income, net of 17.3 million reported in 2011. The 1.9 million under Other, net reflected the following factors:

a 0.7 million contingent-liabilities provision for estimated losses related to some claims (including tax claims) and legal actions in 2012, while in 2011, the provisions for contingent liabilities amounted to 2.5 million;

other expenses of 0.3 million deriving from the write-off of fixed assets in 2012, almost the same amount as reported for 2011;

a 0.9 million loss deriving from the impairment of long-assets (Natuzzi Iberica).

The Group does not use hedge accounting and records all fair value changes of its domestic currency swaps in its statement of operations. See Note 26 to the Consolidated Financial Statements included in Item 18 of this Annual Report.

**Income Taxes.** In 2012, the Group had an effective tax rate of 19.42% on its losses before taxes and non-controlling interests, compared to the Group's effective tax rate of 88.9% reported in 2011.



For the Group's Italian companies the effective tax rate (*i.e.*, the obligation to accrue taxes despite reporting a loss before taxes) was, in part, due to IRAP; see Note 16 to the Consolidated Financial Statements included in Item 18 of this Annual Report). In 2012, some Italian companies within the Group reported losses but had to pay IRAP.

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As in 2011, because most of the Italian and foreign subsidiaries realized significant pre-tax losses and were in a cumulative loss position, management did not consider it reasonably certain that the deferred tax assets of those companies would be realized in the scheduled reversal periods (see Note 16 to the Consolidated Financial Statements included in Item 18 of this Annual Report).

**Net Loss.** Reflecting the factors above, the Group reported a net loss of 26.1 million in 2012, as compared to a net loss of 19.6 million in 2011. On a per-Ordinary Share, or per-ADS basis, the Group had net losses of 0.48 in 2012, as compared to net losses of 0.36 in 2011.

**Liquidity and Capital Resources**

In the ordinary course of business, our principal uses of funds are for the payment of operating expenses, working capital requirements, capital expenditures and restructuring of operations. The Group's principal source of liquidity has historically been its existing cash and cash equivalents and cash flow from operations, supplemented to the extent needed to meet the Group's short term cash requirements by accessing the Group's existing lines of credit. Management believes that the Group has sufficient sources of liquidity to fund working capital expenditures and other contractual obligations for the next 12 months.

In light of the downturn of the global economy and the continuing uncertainty about these conditions in the foreseeable future, we are focused on effective cash management, controlling costs, and preserving cash in order to continue to make necessary capital expenditures.

As of December 31, 2013, the Group had cash and cash equivalents on hand of 61.0 million, and unsecured lines of credit for cash disbursements totaling 47.0 million (48.3 million as of December 31, 2012). The Group uses these lines of credit to manage its short-term liquidity needs. The unused portions of these lines of credit amounted to approximately 1 million (see Note 13 to the Consolidated Financial Statements included in Item 18 of this Annual Report) as of December 31, 2013. At December 31, 2013, we had 25.0 million in bank overdrafts outstanding. Amounts borrowed by the Group under these credit facilities are not subject to any restrictions on their use, but are repayable either on demand (for bank overdrafts) or on a short-term basis (for other bank borrowings under existing credit lines). In March 2014, 20.0 million of these bank overdrafts were renewed. Given their nature, these lines of credit may be terminated by the banks at any time. If these lines of credit are terminated on short notice, we would need to find alternative sources of liquidity or refinance these amounts on short notice, which could be difficult to do on favorable terms. See Item 3 Key Information Risk Factors. The Group's borrowing needs generally are not subject to significant seasonal fluctuations.

Although we had 61.0 million in cash and cash equivalents on hand at December 31, 2013, 78% of this amount consists of the unused portion of the relocation compensation payment received in connection with our Chinese plant in 2011. To the extent management intends to move the cash from China by a dividend distribution, a withholding tax of 10% and the income taxes in Italy (equal to 27.5% of 5% of the dividends distributed) would have to be paid. Tax liabilities that would result from repatriation of cash from China have been recorded in the financial statements.

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**Cash Flows** The Group's cash and cash equivalents were 61.0 million as of December 31, 2013, as compared to 77.7 million as of December 31, 2012. The most significant changes in the Group's cash flows between 2012 and 2013 are described below.

Net cash used by operating activities was - 2.2 million in 2013, as compared to net cash used in operations of - 8.2 million in 2012.

As at December 31, 2013, we had a general decrease in inventory levels of 3.3 million in comparison with December 31, 2012, due mostly to more efficient warehouse management. Furthermore, a positive contribution to operating cash flow derived from a more efficient management of receivables and payables.

Net cash used in investment activities in 2013 was - 8.2 million compared to - 6.5 million in 2012, mainly due to the investments made in connection with the newly-introduced Re-vive armchair and for the expansion of the Company's retail network.

In 2013, the main investments carried out by the Group were related primarily to adapting the structure of the Group's existing facilities and in particular in Italy (Santeramo in Colle, Pozzuolo del Friuli and Qualiano), in Romania and in China and to further develop the SAP system and its related software.

Cash used by financing activities in 2013 totaled - 5.2 million, as compared to - 0.9 million of cash used by financing activities in 2012; this change is mainly due to a decrease in short term borrowings.

Management believes that the Group has sufficient sources of liquidity to fund working capital expenditures and other contractual obligations for the next 12 months. The Group's principal source of liquidity is its existing cash and cash equivalents, supplemented to the extent needed to meet the Group's short term cash requirements by accessing the Group's existing lines of credit. The Group has the ability to renew the various lines of credit available; in fact, as indicated previously, in March 2014 20.0 million of expiring bank overdrafts were renewed. Moreover, management highlights that the Group's cash liquidity is sufficient for its normal course of business, even if most of the cash is mainly in China and, in that management decides to move this cash from China by means of a dividend distribution, a withholding tax of 10% has to be paid, according to the Chinese law currently in force, in addition to income taxes in Italy (equal to 27.5% of 5% of the distributed dividends). Tax liabilities that would result from repatriation of cash from China have been recorded in the financial statements.

As of December 31, 2013, the Group's long-term contractual cash obligations amounted to 112.1 million, of which 45.0 million will come due in 2014. See Item 5. Operating and Financial Review and Prospects Contractual Obligations and Commitments. The Group's long-term debt represented less than 5.0% of shareholders' equity as of December 31, 2013 and 2012 (see Note 18 to the Consolidated Financial Statements included in Item 18 of this Annual Report). As of December 31, 2013 and 2012 there were no covenants on the above long-term debt. The Group's principal uses of funds are expected to be the payment of operating expenses, working capital requirements, capital expenditures and restructuring of operations. See Item 4. Products for further description of our research and development activities. See Item 4. Incentive Programs and Tax Benefits for further description of certain government programs and policies related to our operations. See Item 4. Capital expenditure for further description of our capital expenditures.

**Contractual Obligations and Commitments**

The Group's current policy is to fund its cash needs, accessing its cash on hand and existing lines of credit, consisting of short-term credit facilities and bank overdrafts, to cover any short-term shortfall. The Group's policy is to procure

financing and access credit at the Company level, with the liquidity of Group companies managed through a cash-pooling zero-balancing arrangement with a centralized bank account at the Company level and sub-accounts for each subsidiary. Under this arrangement, cash is transferred to subsidiaries as needed on a daily basis to cover the subsidiaries' cash requirements, but any positive cash balance at subsidiaries must be transferred back to the top account at the end of each day, thus centralizing coordination of the Group's overall liquidity and optimizing the interest earned on cash held by the Group.

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As of December 31, 2013, the Group's long-term debt consisted of 7.5 million (including 3.3 million of the current portion of such debt) outstanding under subsidized loans granted by the Italian government (see Item 4. Incentive Programs and Tax Benefits) and its short-term debt consisted of 25.0 million outstanding under its existing lines of credit, comprised entirely of bank overdrafts. This compares to 26.9 million of short-term debt as of December 31, 2012. In March 2014, 20.0 million of such bank overdrafts were renewed.

As of December 31, 2013, all of the Group's long-term debt and short-term debt were denominated in euro. For the maturity profile of the Group's long-term debt, please consult the table labeled "Contractual Obligations" below. Short-term overdrafts are payable on demand. Other bank borrowings under existing lines of credit have other short-term maturities. The bulk of the group's long-term debt bears interest at a 3-month Euribor (360) plus a 1.0% spread per annum, with 34.1% of its long-term debt bearing interest at 0.74% per annum. The Group's short-term debt bears interest at floating rates, with a weighted average interest rate per annum of 3.89% on the Group's overdraft borrowing as of December 31, 2013, compared to 2.16% as of December 31, 2012. The Group does not have outstanding any other debt instruments, except that it has entered derivative instruments to reduce its exposure to the risk of short-term declines in the value of its foreign currency denominated revenues and not for speculative or trading purposes. For additional information on these derivative instruments, see Item 11. Quantitative and Qualitative Disclosures About Market Risk - Exchange Rate Risks.

The Group maintains cash and cash equivalents in the currencies in which it conducts its operations, principally Chinese Yuan, U.S. dollars, euro, New Romanian Leu, British pounds and Canadian dollars.

The following table sets forth the material contractual obligations and commercial commitments of the Group (of the type required to be disclosed pursuant to Item 5F of Form 20-F) as of December 31, 2013:

| Contractual Obligations                   | Payments Due by Period (thousands of euro) |                  |           |           |               |
|---|--|------------------|-----------|-----------|---------------|
|   | Total                                      | Less than 1 year | 2-3 years | 4-5 years | After 5 years |
| Long-term debt                            | 7,646                                      | 3,342            | 3,135     | 1,036     |               |
| Bank overdrafts                           | 25,020                                     | 25,020           |           |           |               |
| Total Debt <sup>(1)</sup>                 | 32,666                                     | 28,362           | 3,135     | 1,036     |               |
| Interest due on Total Debt <sup>(2)</sup> | 1,320                                      | 1,152            | 147       | 21        |               |
| Operating Leases <sup>(3)</sup>           | 78,079                                     | 15,446           | 30,656    | 31,977    |               |
| Total Contractual Cash Obligations        | 112,065                                    | 44,960           | 33,938    | 33,034    |               |

(1) Please see Note 18 to the Consolidated Financial Statements included in Item 18 of this Annual Report for more information on the Group's long-term debt. See Notes 13 and 18 of the Consolidated Financial Statements included in Item 18 of this Annual Report on Form 20-F.

(2) Interest due on Total debt has been calculated using rates contractually agreed with lenders.

(3) The leases relate to the leasing of manufacturing facilities and stores by several of the Group's companies. Under Italian law, the Company and its Italian subsidiaries are required to pay a termination indemnity to their employees when these cease their employment with the Company or the relevant subsidiary. Likewise, the Company and its Italian subsidiaries are required to pay an indemnity to their sales agents upon termination of the sales agent's agreement. As of December 31, 2013, the Group had accrued an aggregate employee termination indemnity of 24.8 million. In addition, as of December 31, 2013, the Company had accrued an aggregate sales agent termination indemnity of 1.1 million and a one-time termination indemnity benefit of 24.7 million. The one-time termination benefit includes the amount to be paid on the separation date to certain workers to be terminated on an involuntary

basis. See Notes 3(o) and 19 of the Consolidated Financial Statements included in Item 18 of this Annual Report. These amounts are not reflected in the table above. It is not possible to determine when the amounts that have been accrued will become payable.

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In September 2011, the Company renewed its agreement with the trade unions and the Ministry of Labor and Social Policy that permitted it to participate in a temporary workforce reduction program and to benefit from the *Cassa Integrazione Guadagni Straordinaria*, or CIGS, for a period of 24 months beginning on October 16, 2011. Pursuant to the CIGS, government funds pay a substantial majority of the salaries of redundant workers who are subject to layoffs or reduced work schedules. For the 2011-2013 period, an average of 1,273 employees from the Group's headquarters and production facilities were covered by the program, which contemplated a surplus of 1,060 employees at the end of the period on October 15, 2013.

Under the program, during the 24-month layoff period the Company was subject to a formal commitment to make investments (*e.g.*, equipment related to the production activities; marketing, sales and distribution network development; research and development; patents; trademarks; training requalification) for a total amount of 50.0 million. These amounts are not reflected in the table above because it is not possible to determine when this investment will be carried out.

On October 10, 2013, shortly before the expiration of the 2011 agreement, the Company entered into the Italian Reorganization Agreement with local institutions, Italian trade unions, the Ministries of Economic Development and of Labor and Social Policy and the regions of Puglia and Basilicata governing the reorganization plan for the Group's Italian operations. The plan contemplated by the Italian Reorganization Agreement anticipates future layoffs of 1,506 employees (instead of the 1,060 contemplated by the agreement signed in 2011). Due to the complexity of the measures envisioned by the plan and in order to better manage workforce reductions, the Company and the trade unions obtained a one-year extension of the Company's participation in the CIGS through October 15, 2014.

The Company anticipates making incentive payments to induce the voluntary resignation of up to 600 employees (as of the day of the filing of this Annual Report, 372 people have already accepted such incentives) at the conclusion of the period covered by the CIGS program. As a result, in 2013, the Company increased the one-time termination benefits reserve with an accrual of 19.9 million, which is recorded as a non-operating expense, under the line Other Income/(Expense), Net. Please See Notes 3(o) and 19 of the Consolidated Financial Statements included in Item 18 of this Annual Report.

The Group is also involved in a number of claims (including tax claims) and legal actions arising in the ordinary course of business. As of December 31, 2013, the Group had accrued provisions relating to these contingent liabilities in the amount of 7.3 million. See Item 8. Financial Information Legal and Governmental Proceedings and Notes 19 and 26 to the Consolidated Financial Statements included in Item 18 of this Annual Report.

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**Trend information**

Global economic activity has been expanding for the last few quarters, albeit at a moderate pace, reflecting to some extent changes in growth dynamics across regions. While growth is trending up in most advanced economies, hence contributing to an increasing support to the global recovery, major emerging market economies have somewhat slowed.

In particular, real GDP in the Euro area rose for the last three quarters and the latest disclosure of survey-based confidence indicators confirm a moderate growth also in the first part of this year. Looking ahead, the current recovery is expected to proceed, albeit at a slow pace. In fact, some further improvements in domestic demand should emerge, supported by accommodative monetary conditions, improving financing conditions, progress in the fiscal adjustment process and structural reforms. Economic activity is also expected to benefit from a gradually increasing demand for the euro-area exports. At the same time, unemployment in the euro remains high, and the necessary balance sheet consolidation in the public and private sectors will continue to curb the pace of the economic recovery.

In the United States, real GDP growth remained robust in the fourth quarter of 2013 supported by strong private consumption, non-residential investment and exports. Although recent indicators suggest some moderation in the first months of 2014, reflecting the strong build-up of inventories in previous quarters and adverse weather conditions, this is expected to be temporary.

In China, the economy continued to be relatively weak also in 2013, as slightly stronger domestic demand failed to offset weaker net exports. Overall, the main indicators in early 2014 pointed to a gradual weakening in growth, confirming that the slowdown in growth is expected to continue. Economic prospects for other major emerging Asian economies remain relatively modest.

The Group's order flow during the first quarter of 2014 was up by low single-digits over the comparable period in the prior year. Orders from North and Central America are consistent with these overall trends, up by low single-digits compared to last year.

Initial orders for mature European markets suggest growth is still weak, with orders remaining nearly flat compared to last year, reflecting general economic conditions, although the region has seen some encouraging signs. For instance, in Italy (which in 2013 represented about 7% of our net upholstery sales), we have seen high single-digit growth versus the same period in 2013, which we attribute to improvements in product offerings, pricing and communications that are beginning to show positive results. Eastern Europe and Scandinavian countries together are reporting low single-digit increases in order flow.

The Middle East, Africa and India have registered an overall increase over the same period in 2013 of approximately 20%, although the absolute number of sales in these markets remains relatively small.

In the first quarter of 2014, Latin America, excluding Mexico, has reported a low single-digit decrease in orders compared to the prior year.

In the Asia-Pacific region (and in China in particular) order flow for the first quarter of 2014 has been quite weak, down by high single digits compared to the prior year. We attribute this decline to the fact that we have been in contract negotiations with one of our major partners in China, but we recently reached an agreement on this contract and expect to see an increase in orders in the coming months, in part due to a planned retail expansion in China in 2014.





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With respect to sales and revenues, which the Group recognizes once products are shipped, we have seen a decline of approximately 11% in the first quarter of 2014 compared with 2013, largely due to production delays, particularly in China and Italy.

The increase in orders for our Chinese plant seen in the first few weeks of 2014 was not accompanied by a sufficient, corresponding increase in our labor force, increasing our backlog of orders and production times. In response, additional Chinese laborers were hired in early March 2014, however, these laborers had to undergo training after being hired. We expect to have reduced our backlog and to be back to a more normal production schedule by May 2014.

In Italy, our productivity levels were also low during the first quarter of 2014, largely due to our reorganization efforts and commitments under the CIGS program. In particular, this decline is attributable to the application of social criteria, including age, family obligations or time spent in the CIGS program, in determining which staff are employed in production, as opposed to selection based solely on efficiency. We experienced a temporary increase in orders for our Italian plants during this period, and staffed our plants with workers on rotation, which also lowered our productivity levels. In addition, during February 2014, our Italian plants were closed for two days while we announced the names of those employees that would be subject to termination at the conclusion of the CIGS program. Subsequently our Italian laborers protested the announcement of layoffs by blocking any goods from entering or leaving our Italian plants for another three days, effectively stopping production.

Production in our Brazilian and Romanian plants during 2014 has continued under normal conditions.

### **Off-Balance Sheet Arrangements**

As of December 31, 2013, neither Natuzzi S.p.A. nor any of its subsidiaries was a party to any off-balance sheet arrangements.

### **Related Party Transactions**

Please see Item 7. Major Shareholders and Related Party Transactions of this Annual Report.

### **New Accounting Standards under Italian and U.S. GAAP**

**Process of Transition to International Accounting Standards** Following the entry into force of European Regulation No. 1606 of July 2002, EU companies whose securities are traded on regulated markets in the EU have been required, since 2005, to adopt International Financial Reporting Standards ( IFRS ), formerly known as IAS, in the preparation of their consolidated financial statements. Given that the Company's securities are only traded on the NYSE, the Company is not subject to this requirement and continues to report its financial results in accordance with Italian GAAP and to provide the required reconciliation of certain items to U.S. GAAP in the Company's Annual Reports on Form 20-F.

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**Italian GAAP** There are no recently issued accounting standards under Italian GAAP that have not been adopted by the Group.

**U.S. GAAP Recently issued but not yet adopted** U.S. accounting pronouncements relevant for the Company are outlined below:

In July 2013, the Financial Accounting Standards Board, or the FASB, issued Accounting Standards Update, or ASU, No. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*, or ASU No. 2013-11, which concludes that, under certain circumstances, unrecognized tax benefits should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. ASU No. 2013-11 will be effective for us beginning January 1, 2014. We do not anticipate that the adoption of this standard will have a material impact on our financial position.

In March 2013, the FASB issued ASU No. 2013-05, *Parent's Accounting for the Cumulative Translation Adjustment upon De-recognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity*, or ASU No. 2013-05. The objective of ASU No. 2013-05 is to resolve the diversity in practice regarding the release into net income of the cumulative translation adjustment upon de-recognition of a subsidiary or group of assets within a foreign entity. ASU No. 2013-05 will be effective for us beginning January 1, 2014. We do not anticipate that the adoption of this standard will have an impact on our results of operations or financial position.

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The board of directors of Natuzzi S.p.A. currently consists of nine members, all of whom were elected at the Company's annual general shareholders' meeting held on April 28, 2014 and whose terms will expire on the date on which the shareholders' meeting will approve the financial statements for fiscal year 2016. The directors and senior executive officers of the Company as of April 30, 2014, were as follows:

| <b>Name</b>                | <b>Age</b> | <b>Position with the Company</b>  |
|----------------------------|------------|---|
| Pasquale Natuzzi           | 74         | Chairman of the Board of Directors, Chief Executive Officer and <i>ad interim</i> Chief HR & Organization Officer |
| Antonia Isabella Perrone   | 44         | Director  |
| Giuseppe Antonio D' Angelo | 48         | Outside Director  |
| Dimitri Duffeleer          | 44         | Outside Director  |
| Cristina Finocchi Mahne    | 48         | Outside Director  |
| Ernesto Greco              | 63         | Outside Director  |
| Giuseppe Marino            | 48         | Outside Director  |
| Vincenzo Perrone           | 55         | Outside Director  |
| Stefania Saviolo           | 49         | Outside Director  |
| Umberto Bedini             | 58         | Chief Operations Officer  |
| Vittorio Notarpietro       | 51         | Chief Financial Officer   |
| Pasquale De Ruvo           | 39         | Chief Legal and Security Officer  |
| Angelo Colacicco           | 45         | Chief Information Officer   |
| Antonio Cavallera          | 34         | Chief Strategic Planning and Integrated Comm. Officer   |
| Giuseppe Cacciapaglia      | 45         | Chief Internal Control Systems Officer  |
| Simone Ferrari             | 49         | Chief Marketing Officer   |
| Marco Saltalamacchia       | 52         | Chief Commercial Officer  |

**Pasquale Natuzzi**, currently Chairman of the Board of Directors, Chief Executive Officer and *ad interim* Chief HR & Organization Officer. He founded the Company in 1959. Mr. Natuzzi held the title of sole director of the Company from its incorporation in 1972 until 1991, when he became the Chairman of the Board of Directors. Mr. Natuzzi has creative skills and is directly involved with brand development and product styling. He takes care of strategic partnerships with existing and new accounts.

**Antonia Isabella Perrone** is a Director and is involved in the main areas of Natuzzi Group management, from the definition of strategies to retail distribution, marketing and brand development, and foreign transactions. In 1998, she was appointed sole director of a company in the agricultural-food sector, wholly owned by the Natuzzi Family (as defined above). She became part of the Natuzzi Group in 1994, dealing with marketing and communication for the Italian market under the scope of retail development management until 1997. She has been married to Pasquale Natuzzi since 1997.

**Giuseppe Antonio D' Angelo** is an Outside Director of the Company and is currently Executive Vice President of Anglo-America & CIS regions with Ferrero International SA. Before joining Ferrero in 2009, he acquired significant international experience in general management of multinational companies such as General Mills (from 1997 to 2009), S.C. Johnson & Son (from 1991 to 1997) and Procter & Gamble (from 1989 to 1991). Mr. D' Angelo earned his Bachelor of Arts degree in Economics from LUISS University of Rome in 1988. He received certification from Harvard Business School in the Advanced Management Program in 2004.



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**Dimitri Duffeleer** is an Outside Director of the Company and since June 2003 has been a Managing Director & Co-Founder of Quaeroq CVBA, an investment firm that focuses on small and mid-sized companies and that is a holder of 5.0% of the Company's outstanding share capital. He founded the research company At Infinitum in 1998 and prior to that worked in engineering. He is currently a director and a member of the audit committee at RealDolmen NV, a director, president of the audit committee and member of the remuneration committee for Connect NV, a member of the supervisory board and the strategic committee at Generix Group and a director and a member of the audit and remuneration committee at Fountain SA.

**Cristina Finocchi Mahne** is an Outside Director of the Company and is currently Professor of Advanced Business Administration at the Faculty of Economics of the University of Rome La Sapienza and Lecturer of Corporate Governance at Luiss Guido Carli. She is a member of the board of directors and of the remuneration, related parties and control and risk committees of Trevi Group, a listed high-technology engineering company (since 2013) and a member of the board and of the control and risk committee of Banco di Desio e della Brianza, a listed banking group (since 2013). She previously served from 2010 to 2013 on the board of directors of the PMS Group, a listed public relations firm. She is Co-Chair of the Italian Chapter of Women Corporate Directors, an international think tank focused on best practices in corporate governance. She began her career in corporate finance at Euromobiliare, a merchant bank owned by HSBC and then gained additional experience in finance at Tamburi & Associati, followed by experiences with JP Morgan and Hill & Knowlton. She is the author of articles published in leading Italian economic newspapers and international publications.

**Ernesto Greco** is an Outside Director of the Company and since October 2007 has been the Chief Financial Officer and General Manager for Administration, Control and Information Systems of the Ferragamo Group. He started his professional career working in large chemical groups, including Montedison and Eni, as well as in high tech companies such as Hewlett Packard and Wang Laboratories in controllership and finance related positions. From 1989 to 2006 he served as Chief Financial Officer at the Bulgari Group and, from 2006 to 2007, he served as Chief Executive Officer of the Natuzzi Group.

**Giuseppe Marino** is an Outside Director of the Company and currently is an associate professor of tax law at the University of Milan. Mr. Marino is admitted to the Milan Bar and to the Italian Supreme Court, he is a chartered accountant and an official auditor and coordinator of the Master in Tax Law program at Bocconi University of Milan. He is a member of important tax law associations, within the role of member of the Academic Committee of the European Association of Tax Law Professors (EATLP), member of the Committee Rules of Behavior in Tax Law in the Chartered Accountant Association in Milan, and a member of various Editorial Boards of tax law reviews. He is also a member of the board of directors of Alcofinance SA and Alcogroup SA (Belgium), a member of the board of statutory auditors of SOL S.p.A. (listed on the Milan Stock Exchange) as well as of two other non-listed financial companies.

**Vincenzo Perrone** is an Outside Director of the Company and is currently Professor of Organizational Theory and Behavior at Bocconi University Milan, Italy, where he also previously served as Director of the Organizational and Human Resource Management Department of the Bocconi School of Management (1996-2002), Chairman of the Institute of Organization and Information Systems (2001-2007) and Vice-Rector for Research (2008-2012). He was a visiting professor at Carlson School of Management at the University of Minnesota from 1992 to 1994. He currently serves on the board of energy company Egea S.p.A. (since June 2009) and as a strategic advisor to the CEO of Fiera Milano S.p.A., a trade fair and exhibition organizer (since 2013). He has prior experience as a member of the board of directors of ClarisVita S.p.A. (2003-2005), ACTA S.p.A. (2004), IP Cleaning S.p.A. (2004-2008) and Società Autostrada Pedemontana Lombarda S.p.A. (2009-2011) and served on the advisory boards of Arthur Andersen MBA S.r.l. (1999-2000) and SAP Italia S.p.A. (2000-2001), as a member of the Technical and Scientific Oversight Board for procurement studies overseen by the Ministry of Economy and Finance Treasury Department, on board committees

responsible for awarding public tenders organized by Consip S.p.A. (2000-2003), on the Technical Committee for Research and Innovation of Confindustria (2004-2008) and on the Technical Commission for Public Finance at the Ministry of Economy and Finance (2007-2008). He has served as the Director of the Bocconi School of Management's *Economia & Management* journal and has served as a reviewer for the *Academy of Management Journal*, *Academy of Management Review*, *Organization Science* (editorial board member) and *Journal of International Business Studies*. He has published several books and articles both in Italian and international journals.

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**Stefania Saviolo** is an Outside Director of the Company. Since 2013 she has been the Director of the Luxury & Fashion Knowledge Center at SDA Bocconi School of Management where she also was the founding director for the Master in Fashion, Experience & Design Management program. She also teaches courses in Bocconi's MBA program. She has gained expertise in brand management, product marketing and internationalization strategies as a management consultant for international fashion and luxury companies. She was a visiting scholar at the Stern School of Business at New York University from 1992 to 1993 and continues to organize programs for the study of Italian fashion and luxury for the Stern MBA program. She has also served as a visiting professor at Fudan University of Shanghai, China and is a member of the China Lab for the Bocconi School of Management. She is the author and co-author of several books and articles on management, particularly in the luxury, fashion and design industries.

**Umberto Bedini** is the Chief Operations Officer of the Company. He rejoined the Company in May 2013, after serving as Chief Executive Officer of Edilcemento SpA (a subsidiary of Gruppo Colacem SpA) from June 2012 to April 2013. From January 2011 to May 2012, within the Gruppo Colacem, he served as Chairman and Chief Executive Officer for Mirsovito M.D., Chief Executive Officer for Novito D.O.O and Chairman and Chief Executive Officer for Eurocem Trade D.O.O. From 2008 to 2010 he was Senior Vice President at Natuzzi Spa. He previously occupied key functions within a number of international businesses, including Angelini Pharmaceutical Group, Rockwell Rimoldi, Indesit and Candy Group. From 2004 to 2008, Mr Bedini was a partner and CEO of ECA Consulting.

**Antonio Cavallera** is the Chief Strategic Planning & Integrated Communications Officer of the Company. He joined the Company in December 2005 and covered roles of increasing responsibility in the Human Resources & Organization Department. From November 2010 to August 2011 he was Corporate & Commercial Human Resources Manager and from June 2009 to November 2010 as Commercial Human Resources Manager. He has also served as Training & Change Management Manager from July 2008 to June 2009 and HR Retail Specialist from September 2006 to June 2009.

**Giuseppe Cacciapaglia** is the Chief Internal Control Systems Officer and he joined the Company in July 1996, primarily focusing on carrying out financial audit activities of the Group. Previously Mr. Cacciapaglia worked with Reconta Ernst & Young within the financial audit services. From 2006 to 2009, he was also member of the Statutory Audit Committee of Santeramo in Colle Municipality.

**Simone Ferrari** is the Chief Marketing Officer. He joined the Company in October 2012 as Brand Communications Manager. After graduating with a degree in international marketing from the Bocconi University, he started his professional experience in New York at Warwick Baker & Fiore advertising agency with customers including Knorr, US Tobacco and Panasonic. He returned to Italy to found Ideocomunicazione, a communications agency of which he was a partner and Creative Director. From January 2010 until October 2012, he was a board member and Executive Creative Director of BCUBE Publicis Group.



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**Vittorio Notarpietro** is the Chief Financial Officer of the Company and the so-called Italy Project Leader (in which role he coordinates the initiatives aimed at promoting the re-industrialization of the upholstered furniture district in Puglia and Basilicata regions). He re-joined the Group in September 2009. From 1991 to 1998, he was the Finance Director and Investor Relations Manager for the Group. From 1999 to 2006, he was Vice President for Finance for IT Holding Group. From 2006 to 2009, he was the CEO of Malo S.p.A., a leading Italian company in the luxury sector.

**Pasquale De Ruvo** is the Chief Legal & Security Officer. He joined the Company in April 2003 as Security Manager. He held this role until May 2012 when he was promoted to his current position. Prior to joining the Natuzzi Group, Mr. Pasquale De Ruvo developed his professional career in the Department of Defence 186° RGT Paracadutisti Folgore .

**Angelo Colacicco** is the Chief Information Officer of the Company, a position he has served in since October 2007. He joined the Company in its HR & Organization department in 1994. In 1996, he served as a software specialist in the IT department and from 2000 to 2007, he was the IT manager for all Sales and distribution processes.

**Marco Saltalamacchia** is the Chief Commercial Officer, a position he has served in since January 2014. He joined the Group after having worked in the automotive business: from 2006 to 2009 he was Senior Vice President for the Europe Region in BMW and from 2002 to 2006 he was Chairman and CEO of BMW Italia. Previously, he served in different roles in Sales and Marketing at Fiat and Renault. From 2009 to 2013, he was engaged in the creation and development of the G&MS Business & Investment Consulting Company, focused on the automotive industry.

### **Compensation of Directors and Officers**

As a matter of Italian law, the compensation of executive directors is determined by the board of directors, while the Company's shareholders generally determine the base compensation for all board members, including non-executive directors. Compensation of the Company's executive officers is determined by the Chief Executive Officer. A list of significant differences between the Group's corporate governance practices and those followed by U.S. companies listed on the New York Stock Exchange ( NYSE ) may be found at [www.natuzzi.com](http://www.natuzzi.com). See Item 16G. Corporate Governance on the Company Strategy for a description of these significant differences. None of our directors or senior executive officers is party to a contract with the Company that would entitle such persons to benefits upon the termination of service as a director or employment, as the case may be.

Aggregate compensation paid by the Group to the directors and officers was approximately 2.0 million in 2013. This figure represents only part of the salary of our Chief Operations Officer, who was hired in May 2013, and does not include any remuneration for our Chief Commercial Officer, who was hired in January 2014; therefore aggregate compensation may be higher in 2014. The overall remuneration paid to the Group's directors and officers was lower by approximately 0.3 million during 2013 than in 2012 due to the voluntary renunciation by part of the management team of its compensation.

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The compensation paid in 2013 to the members of the Board of Directors is set forth below individually:

| <b>Name</b>                                    | <b>Base Compensation</b> |
|--|--------------------------|
| Pasquale Natuzzi <sup>(1)</sup>                | 0                        |
| Antonia Isabella Perrone                       | 35,544                   |
| Anna Maria Natuzzi <sup>(1)(2)</sup>           | 0                        |
| Giuseppe Antonio D Angelo                      | 35,544                   |
| Maurizia Iachino Leto di Priolo <sup>(2)</sup> | 35,544                   |
| Giuseppe De Santis <sup>(1)(2)</sup>           | 0                        |
| Giuseppe Marino                                | 35,544                   |
| Andrea Martinelli <sup>(2)</sup>               | 35,544                   |

(1) For 2013, these directors renounced their compensation.

(2) These directors did not stand for re-election at the annual general meeting held on April 28, 2014 and were not re-elected to the board.

During 2013, consistent with decisions made in 2012, and due to the persistent negative performance of the Group, the Company decided to continue the suspension any incentive plans for executive managers and clerks within Company headquarters, with the exception of sales staff and sales managers. Incentive plans for those employees within industrial plants (blue- and white-collar workers) have not changed. In addition, a new incentive plan has been set up for sales staff within Italian stores that are directly operated by the Group and has been in effect since January 2014. The same incentive plan will be extended to the sale staffs operating within stores outside of Italy that are directly operated by the Group. During 2013, few people met the targets under the program and the overall amount paid was less than 0.1 million.

**Statutory Auditors**

The following table sets forth the names of the three members of the board of statutory auditors of the Company and the two alternate statutory auditors and their respective positions for the periods covered by this Annual Report. The current board of statutory auditors was elected for a three-year term on April 29, 2013, at the annual general shareholders meeting.

| <b>Name</b>          | <b>Position</b> |
|----------------------|-----------------|
| Carlo Gatto          | Chairman        |
| Cataldo Sferra       | Member          |
| Giuseppe Pio Macario | Member          |
| Francesco Venturelli | Alternate       |
| Costante Leone       | Alternate       |

During 2013, the statutory auditors of the Group received approximately 0.2 million in compensation in the aggregate for their services to the Company and its Italian subsidiaries.

According to Rule 10A-3 of the Securities Exchange Act of 1934, unless an exemption applies, companies whose securities are listed on U.S. national securities exchanges must establish an audit committee meeting specific

requirements. In particular, all members of this committee must be independent and the committee must adopt a written charter. The committee's prescribed responsibilities include (i) the appointment, compensation, retention and oversight of the external auditors; (ii) establishing procedures for the handling of whistle blower complaints; (iii) discussion of financial reporting and internal control issues and critical accounting policies (including through executive sessions with the external auditors); (iv) the approval of audit and non-audit services performed by the external auditors; and (v) the adoption of an annual performance evaluation. A company must also have an internal audit function, which may be out-sourced, as long as it is not out-sourced to the external auditor.

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The Company relies on an exemption from these audit committee requirements provided by Exchange Act Rule 10A-3(c)(3) for foreign private issuers with a board of statutory auditors established in accordance with local law or listing requirements and subject to independence requirements under local law or listing requirements. See Item 16D. Exemption from Listing Standards for Audit Committees for more information.

**External Auditors**

On April 29, 2013, at the annual general shareholders meeting, Reconta Ernst & Young S.p.A., with offices in Bari, Italy, was appointed as the Company's external auditor for the three-year period ending with the approval of 2015 financial statements.

**Employees**

The following tables set forth a breakdown of the Group's employees by qualification and location for the periods indicated:

| Qualification   | As of December 31, |              |              | Change<br>2013 / 2012 | Change<br>2012 / 2011 |
|-----------------|--------------------|--------------|--------------|-----------------------|-----------------------|
|                 | 2013               | 2012         | 2011         |                       |                       |
| Top managers    | 66                 | 66           | 62           | 0                     | 4                     |
| Middle managers | 166                | 170          | 127          | (4)                   | 43                    |
| Clerks          | 1,210              | 1,211        | 1,206        | (1)                   | 5                     |
| Laborers        | 4,935              | 5,295        | 5,270        | (360)                 | 25                    |
| <b>Total</b>    | <b>6,377</b>       | <b>6,742</b> | <b>6,665</b> | <b>(365)</b>          | <b>77</b>             |

| Location      | As of December 31, |              |              | Change<br>2013 / 2012 | Change<br>2012 / 2011 |
|---------------|--------------------|--------------|--------------|-----------------------|-----------------------|
|               | 2013               | 2012         | 2011         |                       |                       |
| Italy         | 3,134              | 3,177        | 3,233        | (43)                  | (56)                  |
| Outside Italy | 3,243              | 3,565        | 3,447        | (322)                 | 118                   |
| <b>Total</b>  | <b>6,377</b>       | <b>6,742</b> | <b>6,665</b> | <b>(365)</b>          | <b>77</b>             |

We believe in the importance of Corporate Social Responsibility and have generally enjoyed good relations with our employees. A significant number of our Italian and Chinese employees are members of trade unions, while our workers in Romania and Brazil are not members of trade unions.

Notwithstanding these generally good relations, in 2013 and during the first few weeks of 2014, we have experienced certain difficulties with our Italian laborers in connection with our reorganization efforts, as further discussed below. While our reorganization plans were under discussion, we experienced four days of strikes in June 2013 at our plant in Laterza (which produces upholstery), which had a negative impact on our other Italian operations due to lack of materials. When the reorganization plan and future layoffs were announced on July 1, 2013, we experienced another two days of general strikes in all our Italian operations beginning the following day, and from July through September our laborers engaged in a slowdown campaign, resulting in lower levels of productivity. In February 2014, we closed our Italian plants for two days while we announced the names of those employees that would be subject to termination at the conclusion of the CIGS program. Our laborers protested these announced layoffs by blocking any goods from entering or leaving our Italian plants for another three days, effectively stopping production during that time period.



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Italian law provides that, upon termination of employment for whatever reason, employees located in Italy are entitled to receive certain severance payments based on the length of employment. As of December 31, 2013, the Company had 24.8 million reserved for such termination indemnities, with such reserves being equal to the amounts, calculated on a percentage basis, required by Italian law.

On October 10, 2013, the Company entered into an agreement with local institutions, Italian trade unions, the Ministries of Economic Development and of Labor and Social Policy and the regions of Puglia and Basilicata governing the reorganization plan for the Group's Italian operations. The agreement enshrines the main goals included in the Italian reorganization plan announced in July 2013, and represents the starting point for a shared roadmap towards the recovery of the Group's competitiveness in Italy, based on a significant reduction in production costs and increases in productivity, investments and changes to the Company's workforce. See Item 10 Material Contracts.

The agreement entails the closure of two of the Company's manufacturing plants in Italy, increasing the efficiency of the production cycle, reviewing the Company's procurement and delivery processes to streamline logistics, and continuing to automate leather-cutting operations, expanding moving production lines and implementing other rationalization initiatives. In terms of the Company's workforce, the agreement envisages that 1,506 redundant employees will be subject to future layoffs.

Due to the complexity of the measures envisioned by the plan and in order to better manage workforce reductions, the Company and the trade unions obtained a one-year extension of the Company's participation in the CIGS, which was otherwise due to expire in October 2013, through October 15, 2014. Under the CIGS program, government funds cover the substantial majority of the salaries of redundant workers.

During the period covered by the CIGS program, expiring in October 2014, Natuzzi, the trade unions and other parties to the agreement have agreed on several initiatives to help manage the redundant workers and to promote the re-industrialisation of the upholstered furniture district in Puglia and Basilicata, including initiatives that would, under certain conditions, move some production back to Italy from the Group's Romanian plant, with employment and production to be undertaken by third parties. In addition, the Company anticipates making incentive payments to induce the voluntary resignation of up to 600 employees at the conclusion of the period covered by the CIGS program. As of the day of this Annual Report, a total of 372 employees have accepted these resignation incentives and have agreed to leave the Company. Their employment with the Company will officially be terminated upon the expiration of the CIGS program.

The Company, notwithstanding the global economic downturn and its own difficult financial situation, has decided to focus on the improvement of its human capital to increase productivity and competitiveness.

In light of this, several initiatives have been undertaken by the Human Resources & Organization department in order for the Group to recover its competitiveness, improve its customer service and enhance product quality. The Group's Human Resources Department and our board of directors have several initiatives under review that we anticipate may be adopted during 2014 to encourage employee performance.

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In addition, the implementation phase of the SAP Human Capital Management system was completed throughout the Group in early April 2014. This system is expected to improve the efficiency and effectiveness of our human resources management by allowing for central management of the Group's resources, the timely monitoring of performance and costs, a better and updated flow of communication and integrating the Group's processes. Once fully implemented, this system will contain and track personnel data, training plans, career paths, fields of expertise currently required (and expected to be required in the future), hiring plans, and other useful information. This human resources management system also allows for tracking of organizational data, performance, travel, reporting and budgeting.

We have continued to invest significantly in the development, updating and upgrading of initiatives aimed at re-training and re-qualifying certain members of the Group's workforce (including those workers that are participating in the CIGS program).

During 2013 we held 59 training courses involving 1,082 employees, including laborers, employees, executives and directors, for a total of 15,000 hours of training. During the 24-month CIGS restructuring program that ended in October 2013, the Company made an investment of 794,000 in training to support skills development and re-training of its employees. This training was focused on managerial, linguistic and specialization activities. The type of training provided is set forth below:

| <b>TRAINING TYPE</b>    | <b>%</b>    |
|-------------------------|-------------|
| Commercial              | 13%         |
| Company profile         | 1%          |
| Information technology  | 5%          |
| Linguistic              | 20%         |
| Managerial              | 37%         |
| Corporate regulations   | 4%          |
| Job-specific activities | 20%         |
| <b>TOTAL</b>            | <b>100%</b> |

A considerable portion of the training budget was dedicated to the retraining of employees affected by the layoff measures, as mandated by Italian laws on workforce reductions, and was undertaken by the Company pursuant to the CIGS agreement. In particular, 236 workers who were laid-off have been provided a total of 2,070 hours of training.

The average satisfaction rating for all our training courses was approximately 85%, an increase of three percentage point compared to the average rating measured in 2012, with percentages ranging from 98% for courses on information technology to 68% for courses on corporate regulations.

In 2013 a total of 196,641 was invested, of which 178,943 (91%) was covered by sources of financing arising from inter-professional funds or made available by public institutions. Consistent with the actions already implemented in the course of 2013, during 2014 the Company will continue to invest in training activities intended to update, retrain and upgrade the skills of its human resources. The main areas of educational action for 2014 are: lean manufacturing skills in all plants in Italy, health update, managerial skills, language skills, technical skills and regulatory obligations.





**Table of Contents****Share Ownership**

Mr. Pasquale Natuzzi, who founded the Company and is currently its Chief Executive Officer and Chairman of the Board of Directors, as of April 25, 2014, beneficially owns 30,217,521 Ordinary Shares, representing 55.1% of the Ordinary Shares outstanding (60.2% of the Ordinary Shares outstanding if the 5.1% of the Ordinary Shares owned by members of Mr. Natuzzi's immediate family (the Natuzzi Family) are aggregated).

As a result, Mr. Natuzzi controls Natuzzi S.p.A., including its management and the selection of the members of its board of director. Since December 16, 2003, Mr. Natuzzi has held his entire beneficial ownership of Natuzzi S.p.A. shares through INVEST 2003 S.r.l., an Italian holding company wholly-owned by Mr. Natuzzi and having its registered office at Via Gobetti 8, Taranto, Italy.

Starting on September 27, 2011 and through April 25, 2014, INVEST 2003 S.r.l. has purchased a total of 859,628 Natuzzi S.p.A. ADSs (representing approximately 1.6% of the Company's total shares outstanding), at an average price of U.S.\$ 2.37 per ADS. These purchases were made in accordance with a purchase plan undertaken pursuant to Rule 10b-18 (*Purchases of Certain Equity Securities by the Issuer and Others*) promulgated under the Securities Exchange Act of 1934 (the Rule 10b-18 Plan). On April 18, 2008, INVEST 2003 S.r.l. purchased 3,293,183 ADSs, each representing one Ordinary Share, at the price of U.S.\$ 3.61 per ADS. For more information, refer to Schedule 13D, filed with the SEC on April 24, 2008, and related Amendment No. 1 to Schedule 13D, filed with the SEC on April 8, 2013. For further discussion, see Note 20 to the Consolidated Financial Statements included in Item 18 of this Annual Report.

In relation to the Natuzzi Stock Incentive Plan 2004-2009 (see Item 10. Additional Information Authorization of Shares), the total number of new Natuzzi Ordinary Shares that were assigned without consideration to the beneficiary employees in 2006, 2007 and 2008 represents 0.3% of the current outstanding shares.

Each of the Company's other directors (with the exception of Ms. Anna Maria Natuzzi, who did not stand for re-election to the board of directors at the annual general meeting held on April 28, 2014) and officers owns less than 1% of the Company's Ordinary Shares and ADSs. None of the Company's directors or officers has stock options.

**ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS****Major Shareholders**

Mr. Pasquale Natuzzi, who founded the Company and is currently its Chief Executive Officer and Chairman of the Board of Directors, as of April 25, 2014, beneficially owns 30,217,521 (represented only by Ordinary Shares), representing 55.1% of the Ordinary Shares outstanding (60.2% of the Ordinary Shares outstanding if the 5.1% of the Ordinary Shares owned by the Natuzzi Family are aggregated). Since December 16, 2003, Mr. Natuzzi has held his entire beneficial ownership of Natuzzi S.p.A. shares through INVEST 2003 S.r.l., an Italian holding company wholly-owned by Mr. Natuzzi and having its registered office at Via Gobetti 8, Taranto, Italy.

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The following table sets forth information, as reflected in the records of the Company as of April 25, 2014, with respect to each person who owns 5% or more of the Company's Ordinary Shares or ADSs:

|   | Number of Shares<br>Owned | Percent<br>Owned |
|---|---------------------------|------------------|
| Pasquale Natuzzi <sup>(1)</sup>         | 30,217,521                | 55.1%            |
| Donald Smith & Co., Inc. <sup>(2)</sup> | 3,256,110                 | 5.9%             |
| Credit Suisse <sup>(3)</sup>            | 3,200,146                 | 5.8%             |
| Quaeroq CVBA <sup>(4)</sup>             | 2,760,400                 | 5.0%             |

- (1) Includes ADSs purchased on April 18, 2008 and purchases made from September 27, 2011 through April 25, 2014 under the Rule 10b-18 Plan. If Mr. Natuzzi's Ordinary Shares are aggregated with those held by members of the Natuzzi Family, the amount owned would be 33,017,521 and the percentage ownership of Ordinary Shares would be 60.2%.
- (2) According to the Schedule 13G filed with the SEC by Donald Smith & Co., Inc. on February 14, 2014.
- (3) According to Amendment No. 1 to Schedule 13G filed with the SEC by Credit Suisse on January 8, 2014.
- (4) According to the Schedule 13G filed with the SEC by Quaeroq CVBA on November 18, 2008.

As indicated in Item 6. Share Ownership, Mr. Natuzzi controls Natuzzi S.p.A., including its management and the selection of the members of its board of directors. Since December 16, 2003, Mr. Natuzzi has held his entire beneficial ownership of Natuzzi S.p.A. shares through INVEST 2003 S.r.l., an Italian holding company wholly-owned by Mr. Natuzzi and having its registered office at Via Gobetti 8, Taranto, Italy. During the period from September 27, 2011, through April 25, 2014, INVEST 2003 S.r.l. has purchased an additional 1.6% of the Company's Ordinary Shares (amounting to 859,628 shares) in a series of open market transactions made pursuant to the Rule 10b-18 Plan.

In addition, the Natuzzi Family has a right of first refusal to purchase all the rights, warrants or other instruments which The Bank of New York Mellon, as depository under the Deposit Agreement, determines may not lawfully or feasibly be made available to owners of ADSs in connection with each rights offering, if any, made to holders of Ordinary Shares. None of the shares held by the above shareholders have any special voting rights.

As of April 25, 2014, 54,853,045 Ordinary Shares were outstanding. As of the same date, there were 21,804,747 ADSs (equivalent to 21,804,747 Ordinary Shares) outstanding. The ADSs represented 39.8% of the total number of Natuzzi Ordinary Shares issued and outstanding.

Since certain Ordinary Shares and ADSs are held by brokers or other nominees, the number of direct record holders in the United States may not be fully indicative of the number of direct beneficial owners in the United States or of where the direct beneficial owners of such shares are resident.

### Related Party Transactions

Transactions with related parties amounted to \$5.3 million in 2013 sales and \$5.5 million as at December 31, 2013 in trade receivables and were conducted at arm's length. Other than the foregoing transactions, neither the Company nor any of its subsidiaries was a party to a transaction with a related party that was material to the Company or the related party, or any transaction that was unusual in its nature or conditions, involving goods, services, or tangible or intangible assets, nor is any such transaction presently proposed. During the same period, neither the Company nor any of its subsidiaries made any loans to or for the benefit of any related party. For purposes of the foregoing, related

party has the meaning ascribed to it in Item 7.B of Form 20-F.

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### **ITEM 8. FINANCIAL INFORMATION**

#### **Consolidated Financial Statements**

Please refer to Item 18. Financial Statements of this Annual Report.

#### **Export Sales**

Export sales from Italy totaled approximately 104.5 million in 2013, down 4% from 2012. That figure represents 25.9% of the Group's 2013 net leather and fabric-upholstered furniture sales.

#### **Legal and Governmental Proceedings**

The Group is involved in legal proceedings, including several minor claims and legal actions, arising in the ordinary course of business with suppliers and employees.

During 2011, the Group increased its provision to 1.4 million for the probable tax contingent liabilities related to income taxes of the Company and some foreign subsidiaries. Furthermore, in 2011, the Company set up a provision of 1.1 million for contingent liabilities related to several minor claims and legal actions arising in the ordinary course of business.

During 2012, the Group charged to other income (expense), net the amount of 0.1 million for the probable tax contingent liabilities related to income taxes and other taxes of the parent company and some foreign subsidiaries. In 2012 the remaining amount of 0.6 million of the provisions for contingent liabilities is related to several minor claims and legal actions arising in the ordinary course of business.

During 2013, the total amount of 1.4 million of provisions for contingent liabilities is related to several minor claims and legal actions arising in the ordinary course of business. In 2013, the Group has made no accrual to other income (expense), net the amount for the probable tax contingent liabilities related to income taxes and other taxes of the parent company and some foreign subsidiaries.

Apart from the proceedings described above, neither the Company nor any of its subsidiaries is a party to any legal or governmental proceeding that is pending or, to the Company's knowledge, threatened or contemplated against the Company or any such subsidiary that, if determined adversely to the Company or any such subsidiary, would have a materially adverse effect, either individually or in the aggregate, on the business, financial condition or results of the Group's operations.

#### **Dividends**

Considering that the Group reported a negative net result in 2013 and considering the capital requirements necessary to implement the restructuring of the operations and its planned retail and marketing activities, the Group decided not to distribute dividends in respect of the year ended on December 31, 2013. The Group has also not paid dividends in any of the prior three fiscal years.

The payment of future dividends will depend upon the Company's earnings and financial condition, capital requirements, governmental regulations and policies and other factors. Accordingly, there can be no assurance that dividends in future years will be paid at a rate similar to dividends paid in past years or at all.



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Dividends paid to owners of ADSs or Ordinary Shares who are United States residents qualifying under the Income Tax Convention will generally be subject to Italian withholding tax at a maximum rate of 15%, provided that certain certifications are given timely. Such withholding tax will be treated as a foreign income tax which U.S. owners may elect to deduct in computing their taxable income, or, subject to the limitations on foreign tax credits generally, credit against their United States federal income tax liability. See Item 10. Additional Information Taxation Taxation of Dividends.

**ITEM 9. THE OFFER AND LISTING****Trading Markets and Share Prices**

Natuzzi's Ordinary Shares are listed on the NYSE in the form of ADSs under the symbol NTZ. Neither the Company's Ordinary Shares nor its ADSs are listed on a securities exchange outside the United States. The Bank of New York Mellon is the Company's Depository for purposes of issuing the American Depositary Receipts evidencing ADSs.

Trading in the ADSs on the NYSE commenced on May 15, 1993. The following table sets forth, for the periods indicated, the high and low market prices on an intraday basis per ADS as reported by the NYSE.

|                | <b>New York Stock Exchange</b> |            |
|----------------|--------------------------------|------------|
|                | <b>Price per</b>               |            |
|                | <b>ADS (in US dollars)</b>     |            |
|                | <b>High</b>                    | <b>Low</b> |
| <b>2009</b>    | 3.71                           | 0.79       |
| <b>2010</b>    | 5.95                           | 2.64       |
| <b>2011</b>    | 4.83                           | 2.00       |
| <b>2012</b>    | 3.82                           | 1.77       |
| <b>2013</b>    | 2.60                           | 1.70       |
|                | <b>High</b>                    | <b>Low</b> |
| <b>2012</b>    |                                |            |
| First quarter  | 3.82                           | 2.29       |
| Second quarter | 3.36                           | 2.39       |
| Third quarter  | 2.80                           | 1.92       |
| Fourth quarter | 2.37                           | 1.77       |
|                | <b>High</b>                    | <b>Low</b> |
| <b>2013</b>    |                                |            |
| First quarter  | 2.40                           | 1.87       |
| Second quarter | 2.35                           | 1.92       |
| Third quarter  | 2.40                           | 1.70       |
| Fourth quarter | 2.60                           | 1.70       |
|                | <b>High</b>                    | <b>Low</b> |
| <b>2014</b>    |                                |            |
| First quarter  | 3.19                           | 2.35       |

|                               | <b>High</b> | <b>Low</b> |
|-------------------------------|-------------|------------|
| <b>Monthly data</b>           |             |            |
| October 2013                  | 2.35        | 1.70       |
| November 2013                 | 2.60        | 2.08       |
| December 2013                 | 2.60        | 2.16       |
| January 2014                  | 3.19        | 2.41       |
| February 2014                 | 2.80        | 2.35       |
| March 2014                    | 2.95        | 2.52       |
| April 2014 (through April 25) | 2.87        | 2.46       |

**Table of Contents****ITEM 10. ADDITIONAL INFORMATION****By-laws**

The following is a summary of certain information concerning the Company's shares and By-laws (*statuto*) and of Italian law applicable to Italian stock corporations whose shares are not listed on a regulated market in the European Union, as in effect at the date of this Annual Report. In particular, Italian issuers of shares that are not listed on a regulated market of the European Community are governed by the rules of the Italian civil code (the Civil Code). The summary contains all the information that the Company considers to be material regarding the shares, but does not purport to be complete and is qualified in its entirety by reference to the By-laws or Italian law, as the case may be.

**General** The issued share capital of the Company consists of 54,853,045 Ordinary Shares, with a par value of 1.00 per share. All the issued shares are fully paid, non-assessable and in registered form.

The Company is registered with the Companies Registry of Bari at No. 261878, with its registered office in Santeramo in Colle (Bari), Italy.

As set forth in Article 3 of the By-laws, the Company's corporate purpose is the production, marketing and sale of sofas, armchairs, furniture in general and raw materials used for their production. The Company is generally authorized to take any actions necessary or useful to achieve its corporate purpose.

**Authorization of Shares** At the extraordinary meeting of the Company's shareholders on July 23, 2004, shareholders authorized the Company's board of directors to carry out a free capital increase of up to 500,000, and a capital increase against payment of up to 3.0 million to be issued, in connection with the grant of stock options to employees of the Company and of other Group companies. On January 24, 2006 the Company's board of directors, in accordance with the Regulations of the Natuzzi Stock Incentive Plan 2004-2009 (which was approved by the board of directors in a meeting held on July 23, 2004), decided to issue without consideration 56,910 new Ordinary Shares in favor of the beneficiary employees. Consequently, the number of Ordinary Shares increased on the same date from 54,681,628 to 54,738,538. On January 23, 2007, the Company's board of directors, in accordance with the Regulations of the Natuzzi Stock Incentive Plan 2004-2009, decided to issue without consideration 85,689 new Ordinary Shares in favor of beneficiary employees. Consequently, the number of Ordinary Shares increased on the same date from 54,738,538 to 54,824,227. On January 24, 2008 the Company's board of directors, in accordance with the Regulations of the Natuzzi Stock Incentive Plan 2004-2009, decided to issue without consideration 28,818 new Ordinary Shares in favor of the beneficiary employees. Consequently, the number of Ordinary Shares increased on the same date from 54,824,227 to 54,853,045, the current number.

**Form and Transfer of Shares** The Company's Ordinary Shares are in certificated form and are freely transferable by endorsement of the share certificate by or on behalf of the registered holder, with such endorsement either authenticated by a notary in Italy or elsewhere or by a broker-dealer or a bank in Italy. The transferee must request that the Company enter his name in the register of shareholders in order to exercise his rights as a shareholder of the Company.



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**Dividend Rights** Payment by the Company of any annual dividend is proposed by the board of directors and is subject to the approval of the shareholders at the annual shareholders' meeting. Before dividends may be paid out of the Company's unconsolidated net income in any year, an amount at least equal to 5% of such net income must be allocated to the Company's legal reserve until such reserve is at least equal to one-fifth of the par value of the Company's issued share capital. If the Company's capital is reduced as a result of accumulated losses, dividends may not be paid until the capital is reconstituted or reduced by the amount of such losses. The Company may pay dividends out of available retained earnings from prior years, provided that, after such payment, the Company will have a legal reserve at least equal to the legally required minimum. No interim dividends may be approved or paid.

Dividends will be paid in the manner and on the date specified in the shareholders' resolution approving their payment (usually within 30 days of the annual general meeting). Dividends that are not collected within five years of the date on which they become payable are forfeited to the benefit of the Company. Holders of ADSs will be entitled to receive payments in respect of dividends on the underlying shares through The Bank of New York Mellon, as ADR depositary, in accordance with the deposit agreement relating to the ADRs.

**Voting Rights** Registered holders of the Company's Ordinary Shares are entitled to one vote per Ordinary Share.

As a registered shareholder, the Depositary (or its nominee) will be entitled to vote the Ordinary Shares underlying the ADSs. The Deposit Agreement requires the Depositary (or its nominee) to accept voting instructions from holders of ADSs and to execute such instructions to the extent permitted by law. Neither Italian law nor the Company's By-laws limit the right of non-resident or foreign owners to hold or vote shares of the Company.

**Board of directors** Under Italian law and pursuant to the Company's By-laws, the Company may be run by a sole director or by a board of directors, consisting of seven to eleven individuals. The Company is currently run by a board of directors composed of nine individuals (see Item 6. Directors, Senior Management and Employees). The board of directors is elected by the Assembly of Shareholders at a shareholders' meeting, for the period established at the time of election but in no case for longer than three fiscal years. A director, who may, but is not required to be a shareholder of the Company, may be reappointed for successive terms. The board of directors has the full power of ordinary and extraordinary management of the Company and in particular may perform all acts it deems advisable for the achievement of the Company's corporate purposes, except for the actions reserved by applicable law or the By-laws to a vote of the shareholders at an ordinary or extraordinary shareholders' meeting. See also Item 10. Additional Information Meetings of Shareholders.

The board of directors must appoint a chairman (*presidente*) and may appoint a vice-chairman. The chairman of the board of directors is the legal representative of the Company. The board of directors may delegate certain powers to one or more managing directors (*amministratori delegati*), determine the nature and scope of the delegated powers of each director and revoke such delegation at any time. The managing directors must report to the board of directors and board of statutory auditors at least every 180 days on the Company's business and the main transactions carried out by the Company or by its subsidiaries.

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The board of directors may not delegate certain responsibilities, including the preparation and approval of the draft financial statements, the approval of merger and de-merger plans to be presented to shareholders' meetings, increases in the amount of the Company's share capital or the issuance of convertible debentures (if any such power has been delegated to the board of directors by vote of the extraordinary shareholders' meeting) and the fulfillment of the formalities required when the Company's capital has to be reduced as a result of accumulated losses that reduce the Company's stated capital by more than one-third. See also Item 10. Additional Information Meetings of Shareholders .

The board of directors may also appoint a general manager (*direttore generale*), who reports directly to the board of directors and confer powers for single acts or categories of acts to employees of the Company or persons unaffiliated with the Company.

Meetings of the board of directors are called no less than five days in advance by registered letter, fax, telegram or e-mail by the chairman on his own initiative and must be called upon the request of any director. Meetings may be held in person, or by video-conference or tele-conference, in the location indicated in the notice convening the meeting, or in any other destination, each time that the chairman may consider necessary. The quorum for meetings of the board of directors is a majority of the directors in office. Resolutions are adopted by the vote of a majority of the directors present at the meeting. In case of a tie, the chairman has the deciding vote.

Directors having any interest in a proposed transaction must disclose their interest to the board and to the statutory auditors, even if such interest is not in conflict with the interest of the Company in the same transaction. The interested director is not required to abstain from voting on the resolution approving the transaction, but the resolution must state explicitly the reasons for, and the benefit to the Company of, the approved transaction. In the event that these provisions are not complied with, or that the transaction would not have been approved without the vote of the interested director, the resolution may be challenged by a director or by the board of statutory auditors if the approved transaction may be prejudicial to the Company. A managing director must solicit prior board approval of any proposed transaction in which he has any interest and that is within the scope of his powers. The interested director may be held liable for damages to the Company resulting from a resolution adopted in breach of the above rules. Finally, directors may be held liable for damages to the Company if they illicitly profit from insider information or corporate opportunities.

The board of directors may transfer the Company's registered office within Italy, set up and eliminate secondary offices and approve mergers by absorption into the Company of any subsidiary in which the Company holds at least 90% of the issued share capital. The board of directors may also approve the issuance of shares or convertible debentures and reductions of the Company's share capital in case of withdrawal of a shareholder if so authorized by the Company's by-laws.

Under Italian law and pursuant to the Company's By-laws, directors may be removed from office at any time by the vote of shareholders at an ordinary shareholders' meeting. However, if removed in circumstances where there was no just cause, such directors may have a claim for damages against the Company. Directors may resign at any time by written notice to the board of directors and to the chairman of the board of statutory auditors. The board of directors must appoint substitute directors to fill vacancies arising from removals or resignations, subject to the approval of the board of statutory auditors, to serve until the next ordinary shareholders' meeting. If at any time more than half of the members of the board of directors appointed by the Assembly of Shareholders resign, such resignation is ineffective until the majority of the new board of directors has been appointed. In such a case, the remaining members of the board of directors (or the board of statutory auditors if all the members of the board of directors have resigned or ceased to be directors) must promptly call an ordinary shareholders' meeting to appoint the new directors.



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Shareholders determine the remuneration of the directors at ordinary shareholders' meetings at which they are appointed. The board of directors, after consultation with the board of statutory auditors, may determine the remuneration of directors that perform management or other special services for the Company, such as the managing director, within a maximum amount established by the shareholders. Directors are entitled to reimbursement for expenses reasonably incurred in connection with their functions.

**Statutory Auditors** In addition to electing the board of directors, the Assembly of Shareholders, at ordinary shareholders' meetings of the Company, elects a board of statutory auditors (*collegio sindacale*), appoint its chairman and set the compensation of its members. The statutory auditors are elected for a term of three fiscal years, may be re-elected for successive terms and may be removed only for cause and with the approval of a competent court. Expiration of their office will have no effect until a new board is appointed. Membership of the board of statutory auditors is subject to certain good standing, independence and professional requirements, and shareholders must be informed as to the offices the proposed candidates hold in other companies prior to or at the time of their election. In particular, at least one standing and one alternate member must be a certified auditor.

The Company's By-laws provide that the board of statutory auditors shall consist of three statutory auditors and two alternate statutory auditors (who are automatically substituted for a statutory auditor who resigns or is otherwise unable to serve).

The Company's board of statutory auditors is required, among other things, to verify that the Company (i) complies with applicable laws and its By-laws, (ii) respects principles of good governance, and (iii) maintains adequate organizational structure and administrative and accounting systems. The Company's board of statutory auditors is required to meet at least once every ninety days. The board of statutory auditors reports to the annual shareholders meeting on the results of its activity and the results of the Company's operations. In addition, the statutory auditors of the Company must be present at meetings of the Company's board of directors and shareholders' meetings.

The statutory auditors may decide to call a meeting of the shareholders or the board of directors, ask the directors information about the management of the Company, carry out inspections and verifications at the Company and exchange information with the Company's external auditors. Additionally, the statutory auditors have the power to initiate a liability action against one or more directors after adopting a resolution with an affirmative vote by two thirds of the auditors in office. Any shareholder may submit a complaint to the board of statutory auditors regarding facts that such shareholder believes should be subject to scrutiny by the board of statutory auditors, which must take any complaint into account in its report to the shareholders' meeting. If shareholders collectively representing 5% of the Company's share capital submit such a complaint, the board of statutory auditors must promptly undertake an investigation and present its findings and any recommendations to a shareholders' meeting (which must be convened immediately if the complaint appears to have a reasonable basis and there is an urgent need to take action). The board of statutory auditors may report to a competent court serious breaches of directors' duties.

**External Auditor** The audit of the Company's accounts is entrusted, as per current legislation, to an independent audit firm whose appointment falls under the competency of the Shareholders' Meeting, upon the board of statutory auditors' opinion. In addition to the obligations set forth in national auditing regulations, Natuzzi's listing on the NYSE requires that the audit firm issues a report on the annual report on Form 20-F, in compliance with the auditing principles generally accepted in the United States. Moreover, the audit firm is required to issue an opinion on the efficacy of the internal control system applied to financial reporting. No changes were identified in the Company's internal control over financial reporting that occurred during the 2013 fiscal year that have materially affected or are reasonably likely to affect the Company's internal control over financial reporting.



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The external auditor or the firm of external auditors is appointed for a three-year term, may be elected for successive terms, and its compensation is determined by a vote at an ordinary shareholders' meeting, having heard the board of statutory auditors, and may be removed only for just cause by a vote of the shareholders' meeting and with the approval of a competent court.

On April 29, 2013, the Company's shareholders appointed Reconta Ernst & Young S.p.A., with registered offices at Via Po, 32, Rome, Italy, as its external auditor for a three-year term until the approval of the financial statements for 2015. For the entire duration of their office the external auditors or the firm of external auditors must meet certain requirements provided for by law.

**Meetings of Shareholders** Shareholders are entitled to attend and vote at ordinary and extraordinary shareholder meetings. Votes may be cast personally or by proxy. Shareholder meetings may be called by the Company's board of directors (or the board of statutory auditors) and must be called if requested by holders of at least 10% of the issued shares. If a shareholders' meeting is not called despite the request by shareholders and such refusal is unjustified, a competent court may call the meeting. Shareholders are not entitled to request that a meeting of shareholders be convened to vote on matters which, as a matter of law, shall be resolved on the basis of a proposal, plan or report by the Company's board of directors.

The Company may hold general meetings of shareholders at its registered office in Santeramo in Colle, or elsewhere within Italy or at locations outside Italy, following publication of notice of the meeting in any of the following Italian newspapers: *Il Sole 24 Ore*, *Corriere della Sera* or *La Repubblica* at least 15 days before the date fixed for the meeting.

The Assembly of Shareholders must be convened at least once a year. The Company's annual stand-alone financial statements are prepared by the board of directors and submitted for approval to the ordinary shareholders' meeting, which must be convened within 120 days after the end of the fiscal year to which such financial statements relate. This term may be extended by up to 180 days after the end of the fiscal year, as long as the Company continues to be bound by law to draw up consolidated financial statements or if particular circumstances concerning its structure or its purposes so require. At ordinary shareholders' meetings, shareholders also appoint the external auditors, approve the distribution of dividends, appoint the board of directors and statutory auditors, determine their remuneration and vote on any matter the resolution or authorization of which is entrusted to them by law.

Extraordinary shareholders' meetings may be called to vote on proposed amendments to the By-laws, issuance of convertible debentures, mergers and de-mergers, capital increases and reductions, when such resolutions may not be taken by the board of directors. Liquidation of the Company must be resolved by an extraordinary shareholders' meeting.

The notice of a shareholders' meeting may specify two or more meeting dates for an ordinary or extraordinary shareholders' meeting; such meeting dates are generally referred to as calls.

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The quorum for an ordinary meeting of shareholders is 50% of the Ordinary Shares, and resolutions are carried by the majority of Ordinary Shares present or represented. At an adjourned ordinary meeting, no quorum is required, and the resolutions are carried by the majority of Ordinary Shares present or represented. Certain matters, such as amendments to the By-laws, the issuance of shares, the issuance of convertible debentures and mergers and de-mergers may only be effected at an extraordinary meeting, at which special voting rules apply. Resolutions at an extraordinary meeting of the Company are carried, on first call, by a majority of the Ordinary Shares. An adjourned extraordinary meeting is validly held with a quorum of one-third of the issued shares and its resolutions are carried by a majority of at least two-thirds of the holders of shares present or represented at such meeting. In addition, certain matters (such as a change in purpose or corporate form of the company, demergers, mergers, the transfer of its registered office outside Italy, its liquidation prior to the term set forth in its By-laws, the extension of the term, the revocation of liquidation and the issuance of preferred shares) are approved by the holders of more than two-thirds of the shares present and represented at such meeting that must also represent more than one-third of the issued shares.

According to the By-laws, in order to attend any shareholders' meeting, shareholders, at least five days prior to the date fixed for the meeting, must deposit their share certificates at the offices of the Company or with such banks as may be specified in the notice of meeting, in exchange for an admission ticket. Owners of ADRs may make special arrangements with the Depositary for the beneficial owners of such ADRs to attend shareholders' meetings, but not to vote at or formally address such meetings. The procedures for making such arrangements will be specified in the notice of such meeting to be mailed by the Depositary to the owners of ADRs.

Shareholders may appoint proxies by delivering in writing an appropriate power of attorney to the Company. Directors, auditors and employees of the Company or of any of its subsidiaries may not be proxies and any one proxy cannot represent more than 20 shareholders.

**Preemptive Rights** Pursuant to Italian law, holders of Ordinary Shares or of debentures convertible into shares, if any exist, are entitled to subscribe for the issuance of shares, debentures convertible into shares and rights to subscribe for shares, in proportion to their holdings, unless such issues are for non-cash consideration or preemptive rights are waived or limited and such waiver or limitation is required in the interest of the Company. There can be no assurance that the holders of ADSs may be able to exercise fully any preemptive rights pertaining to Ordinary Shares.

**Preference Shares. Other Securities** The Company's By-laws allow the Company to issue preference shares with limited voting rights, to issue other classes of equity securities with different economic and voting rights, to issue so-called participation certificates with limited voting rights, as well as so-called tracking stock. The power to issue such financial instruments is attributed to the extraordinary meeting of shareholders.

The Company, by resolution of the board of directors, may issue debt securities non-convertible into shares, while it may issue debt securities convertible into shares through a resolution of an extraordinary shareholders' meeting.

**Segregation of Assets and Proceeds** The Company, by means of an extraordinary shareholders' meeting resolution, may approve the segregation of certain assets into one or more separate pools. Such pools of assets may have an aggregate value not exceeding 10% of the shareholders' equity of the company. Each pool of assets must be used exclusively for the carrying out of a specific business and may not be attached by the general creditors of the Company. Similarly, creditors with respect to such specific business may only attach those assets of the Company that are included in the corresponding pool. Tort creditors, on the other hand, may always attach any assets of the Company. The Company may issue securities carrying economic and administrative rights relating to a pool. In addition, financing agreements relating to the funding of a specific business may provide that the proceeds of such business be used exclusively to repay the financing. Such proceeds may be attached only by the financing party and such financing party would have no recourse against other assets of the Company.





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**Liquidation Rights** Pursuant to Italian law and subject to the satisfaction of the claims of all other creditors, shareholders are entitled to a distribution in liquidation that is equal to the nominal value of their shares (to the extent available out of the net assets of the Company). Holders of preferred shares, if any such shares are issued in the future by the Company, may be entitled to a priority right to any such distribution from liquidation up to their par value. Thereafter, all shareholders would rank equally in their claims to the distribution or surplus assets, if any. Ordinary Shares rank *pari passu* among themselves in liquidation.

**Purchase of Shares by the Company** The Company is permitted to purchase shares, subject to certain conditions and limitations provided for by Italian law. Shares may only be purchased out of profits available for dividends or out of distributable reserves, in each case as appearing on the latest shareholder-approved stand-alone financial statements. Further, the Company may only repurchase fully paid-in shares. Such purchases must be authorized by the Assembly of Shareholders at an ordinary shareholders meeting. The aggregate purchase price of such shares may not exceed the earnings reserve specifically approved by shareholders. Shares held in violation of the above conditions and limitations must be sold within one year of the date of purchase. Similar limitations apply with respect to purchases of the Company's shares by its subsidiaries.

A corresponding reserve equal to the purchase price of such shares must be created in the balance sheet, and such reserve is not available for distribution, unless such shares are sold or cancelled. Shares purchased and held by the Company may be resold only pursuant to a resolution adopted at an ordinary shareholders meeting. The voting rights attaching to the shares held by the Company or its subsidiaries cannot be exercised, but the shares are counted for quorum purposes in shareholders meetings. Dividends attaching to such shares will accrue to the benefit of other shareholders; pre-emptive rights attaching to such shares will accrue to the benefit of other shareholders, unless the shareholders meeting authorizes the Company to exercise, in whole or in part, the pre-emptive rights thereof.

In May 2009, the ordinary shareholders meeting of the Company approved a share buyback program as proposed by the board of directors. As of the date hereof, the share buyback program has not been implemented and, in accordance with its terms, the Company is no longer able to purchase its shares as part of the aforementioned share buyback program.

The Company does not own any of its ordinary shares.

**Notification of the Acquisition of Shares** In accordance with Italian antitrust laws, the Italian Antitrust Authority is required to prohibit the acquisition of control in a company which would thereby create or strengthen a dominant position in the domestic market or a significant part thereof and which would result in the elimination or substantial reduction, on a lasting basis, of competition, provided that certain turnover thresholds are exceeded. However, if the turnover of the acquiring party and the company to be acquired exceed certain other monetary thresholds, the antitrust review of the acquisition falls within the exclusive jurisdiction of the European Commission.

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**Minority Shareholders Rights. Withdrawal Rights** Shareholders' resolutions which are not adopted in conformity with applicable law or the Company's By-laws may be challenged (with certain limitations and exceptions) within ninety days by absent, dissenting or abstaining shareholders representing individually or in the aggregate at least 5% of Company's share capital (as well as by the board of directors or the board of statutory auditors). Shareholders not reaching this threshold or shareholders not entitled to vote at Company's meetings may only claim damages deriving from the resolution.

Dissenting or absent shareholders may require the Company to buy back their shares as a result of shareholders' resolutions approving, among other things, material modifications of the Company's corporate purpose or of the voting rights of its shares, the transformation of the Company from a stock corporation into a different legal entity, or the transfer of the Company's registered office outside Italy. The buy-back would occur at a price established by the board of directors, upon consultation with the board of statutory auditors and the Company's external auditor, having regard to the net assets value of the Company, its prospective earnings and the market value of its shares, if any. The Company's By-laws may set forth different criteria to determine the consideration to be paid to dissenting shareholders in such buy-backs.

Each shareholder may bring to the attention of the board of statutory auditors facts or actions which are deemed wrongful. If such shareholders represent more than 5% of the share capital of the Company, the board of statutory auditors must investigate without delay and report its findings and recommendations to the shareholders' meeting.

Shareholders representing more than 10% of the Company's share capital have the right to report to a competent court serious breaches of the duties of the directors, which may be prejudicial to the Company or to its subsidiaries. In addition, shareholders representing at least 20% of the Company's share capital may commence derivative suits before a competent court against its directors, statutory auditors and general managers.

The Company may waive or settle the suit unless shareholders holding at least 20% of the shares vote against such waiver or settlement. The Company will reimburse the legal costs of such action in the event that the claim of such shareholders is successful and the court does not award such costs against the relevant directors, statutory auditors or general managers.

Any dispute arising out of or in connection with the By-Laws that may arise between the Company and its shareholders, directors, or liquidators shall fall under the exclusive jurisdiction of the Tribunal of Bari (Italy).

**Liability for Mismanagement of Subsidiaries** Under Italian law, companies and other legal entities that, acting in their own interest or the interest of third parties, mismanage a company subject to their direction and coordination powers are liable to such company's shareholders and creditors for ensuing damages suffered by such shareholders. This liability is excluded if (i) the ensuing damage is fully eliminated, including through subsequent transactions, or (ii) the damage is effectively offset by the global benefits deriving in general to the company from the continuing exercise of such direction and coordination powers. Direction and coordination powers are presumed to exist, among other things, with respect to consolidated subsidiaries.

The Company is subject to the direction and coordination of INVEST 2003 S.r.l.

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**Material Contracts**

In the two years immediately preceding the filing of this Annual Report on Form 20-F, neither the Company nor any member of the Group has been a party to a material contract, other than contracts entered into in the ordinary course of business and the contract described immediately below.

**Italian Reorganization Agreement** On October 10, 2013, the Company entered into an agreement with local institutions, Italian trade unions, the Ministries of Economic Development and of Labor and Social Policy and the regions of Puglia and Basilicata governing the reorganization plan for the Group's Italian operations.

The Italian Reorganization Agreement governs certain actions that will be taken with the objective of restoring the competitiveness of the Group's Italian operations, including a significant reduction in production costs, increases in productivity, investments and changes in the Company's workforce composition. The agreement entails the closure of one of the company's manufacturing plants and one of its warehouses, both located in Italy (Ginosa and Matera La Martella, respectively), reviewing the company's procurement and delivery processes to streamline logistics, and continuing to automate leather-cutting operations, expanding moving production lines and implementing other rationalization initiatives.

The agreement also proposes an investment plan, which calls for investments by the Company over a five-year period totaling 242.5 million, aimed at further developing the Natuzzi Italia brand and safeguarding Italian production. Investments under the agreement will be made in marketing, communications and the expansion of distribution networks in emerging markets. Investments will also fund innovation in the company's products, logistics and production processes and staff training.

In terms of the company's workforce, the agreement envisages that the number of redundant employees subject to future layoffs will be reduced from 1,726 employees (foreseen in July 2013) to 1,506, reflecting a commitment to the potential, gradual reabsorption of up to 200 manufacturing employees for the production of *Re-vive* recliners and up to 20 corporate employees.

Due to the complexity of the measures envisioned by the plan and in order to better manage workforce reductions, the Company and the trade unions obtained a one-year extension through October 15, 2014, of the Company's participation in the CIGS program, pursuant to which government funds cover the substantial majority of the salaries of redundant workers.

During the period covered by the CIGS program, Natuzzi, the trade unions and other parties to the agreement have agreed on several initiatives to help manage the redundant workers and to promote the re-industrialisation of the upholstered furniture district in Puglia and Basilicata:

- 1) Only on the condition that the cost of production in Italy is demonstrably sustainable, competitive and in line with economic targets, part of the production of the *Leather Editions* brand for the European market would be transferred to Italy from the Group's Romanian factory. If these conditions are satisfied, this production would be entrusted to outside companies, independent of Natuzzi but linked to the company by specific commercial agreements.
  
- 2)

The second initiative focuses on allocating to companies outside the Group which can count on support for investment from the Ministry of Economic Development and the Puglia and Basilicata Regions both the production of furniture accessories that are currently manufactured outside the district and the new products forming part of a range-extension project.

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- 3) The Company anticipates making incentive payments to induce the voluntary resignation of up to 600 employees at the conclusion of the period covered by the CIGS program.

As part of the initiative to spur new business creation and create employment opportunities, the agreement also envisages the creation of a steering committee, consisting of representatives from the Company, trade unions, government, Regional and local authorities and employers' associations. This steering committee has the objective of monitoring the progress of the reorganization program and identifying any form of support for the implementation of the plan, such as the promotion of those business initiatives that have a positive social impact and other opportunities that may make the upholstered furniture district in the Puglia and Basilicata Regions attractive for growth and investment.

**Exchange Controls**

There are currently no exchange controls, as such, in Italy restricting rights deriving from the ownership of shares. Residents and non-residents of Italy may hold foreign currency and foreign securities of any kind, within and outside Italy. Non-residents may invest in Italian securities without restriction and may transfer to and from Italy cash, instruments of credit and securities, in both foreign currency and Euro, representing interest, dividends, other asset distributions and the proceeds of any dispositions.

Certain procedural requirements, however, are imposed by law. Regulations on the use of cash and bearer securities are contained in the legislative decree No.231 of November 21, 2007, as amended from time to time, which implemented in Italy the European directives on anti-money laundering No. 2005/60 and 2006/70. Such legislation requires that transfers of cash or bearer bank or postal passbooks or bearer instruments in Euro or in foreign currency, effected for whatsoever reason between different parties, shall be carried out by means of credit institutions and any other authorized intermediaries when the total amount of the value to be transferred is equal to or more than 1,000. Credit institutions and other intermediaries effecting such transactions on behalf of residents or non-residents of Italy are required to maintain records of such transactions for ten years, which may be inspected at any time by Italian tax and judicial authorities. Non-compliance with the reporting and record-keeping requirements may result in administrative fines or, in the case of false reporting and in certain cases of incomplete reporting, criminal penalties. The Bank of Italy is required to maintain reports for ten years and may use them, directly or through other government offices, to police money laundering, tax evasion and any other unlawful activity.

Individuals, non-profit entities and partnerships that are residents of Italy must disclose on their annual tax returns all investments and financial assets held outside Italy, as well as the total amount of transfers to, from, within and between countries other than Italy relating to such foreign investments or financial assets, even if at the end of the taxable period foreign investments or financial assets are no longer owned. Generally, no such tax disclosure is required if the total value of the foreign investments or financial assets at the end of the taxable period or the total amount of the transfers effected during the fiscal year does not exceed 10,000. In addition, no such tax disclosure is required in respect of securities deposited for management with qualified Italian financial intermediaries and in respect of contracts entered into through their intervention, provided that the items of income derived from such foreign financial assets are collected through the intervention of the same intermediaries. Corporate residents of Italy are exempt from these tax disclosure requirements with respect to their annual tax returns because this information is required to be disclosed in their financial statements.

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There can be no assurance that the current regulatory environment in or outside Italy will persist or that particular policies presently in effect will be maintained, although Italy is required to maintain certain regulations and policies by virtue of its membership of the EU and other international organizations and its adherence to various bilateral and multilateral international agreements.

**Taxation**

The following is a summary of certain U.S. federal and Italian tax matters. The summary contains a description of the principal U.S. federal and Italian tax consequences of the purchase, ownership and disposition of Ordinary Shares or ADSs by a holder who is a citizen or resident of the United States or a U.S. corporation or who otherwise will be subject to U.S. federal income tax on a net income basis in respect of the Ordinary Shares or ADSs. The summary is not a comprehensive description of all of the tax considerations that may be relevant to a decision to purchase or hold Ordinary Shares or ADSs. In particular, the summary deals only with beneficial owners who will hold Ordinary Shares or ADSs as capital assets and does not address the tax treatment of a beneficial owner who owns 10% or more of the voting shares of the Company or who may be subject to special tax rules, such as banks, tax-exempt entities, insurance companies, partners or partnerships therein, or dealers in securities or currencies, or persons that will hold Ordinary Shares or ADSs as a position in a straddle for tax purposes or as part of a constructive sale or a conversion transaction or other integrated investment comprised of Ordinary Shares or ADSs and one or more other investments. The summary does not discuss the treatment of Ordinary Shares or ADSs that are held in connection with a permanent establishment through which a non-resident beneficial owner carries on business or performs personal services in Italy.

The summary is based upon tax laws and practice of the United States and Italy in effect on the date of this Annual Report, which are subject to change.

Investors and prospective investors in Ordinary Shares or ADSs should consult their own advisors as to the U.S., Italian or other tax consequences of the purchase, beneficial ownership and disposition of Ordinary Shares or ADSs, including, in particular, the effect of any state or local tax laws.

For purposes of the summary, beneficial owners of Ordinary Shares or ADSs who are considered residents of the United States for purposes of the current income tax convention between the United States and Italy (the Income Tax Convention), and are not subject to an anti-treaty shopping provision that applies in limited circumstances, are referred to as U.S. owners. Beneficial owners who are citizens or residents of the United States, corporations organized under U.S. law, and U.S. partnerships, estates or trusts (to the extent their income is subject to U.S. tax either directly or in the hands of partners or beneficiaries) generally will be considered to be residents of the United States under the Income Tax Convention. Special rules apply to U.S. owners who are also residents of Italy, according to the Income Tax Convention.

For the purpose of the Income Tax Convention and the United States Internal Revenue Code of 1986, as amended, beneficial owners of ADRs evidencing ADSs will be treated as the beneficial owners of the Ordinary Shares represented by those ADSs.

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**i) Italian Tax Considerations** As a general rule, Italian laws provide for the withholding of income tax on dividends paid by Italian companies to shareholders who are not residents of Italy for tax purposes, currently levied at a 20% rate on dividends paid as of January 1, 2012. Italian laws provide a mechanism under which non-resident shareholders can claim a refund of, as of January 1, 2012, up to one-fourth of Italian withholding taxes on dividend income by establishing to the Italian tax authorities that the dividend income was subject to income tax in another jurisdiction in an amount at least equal to the total refund claimed. U.S. owners should consult their own tax advisers concerning the possible availability of this refund, which traditionally has been payable only after extensive delays. Alternatively, reduced rates (normally 15%) may apply to non-resident shareholders who are entitled to, and comply with procedures for claiming, benefits under an income tax convention.

Under the Income Tax Convention, dividends derived and beneficially owned by U.S. owners are subject to an Italian withholding tax at a reduced rate of 15%.

However, the amount initially made available to the Depository for payment to U.S. owners will reflect withholding at the 20% rate. U.S. owners who comply with the certification procedures described below may then claim an additional payment of 5% of the dividend (representing the difference between the 20% rate applicable as of January 1, 2012, and the 15% rate, and referred to herein as a treaty refund). The certification procedure will require U.S. owners (i) to obtain from the U.S. Internal Revenue Service (IRS) a form of certification required by the Italian tax authorities with respect to each dividend payment (IRS Form 6166), unless a previously filed certification will be effective on the dividend payment date (such certificates are effective until March 31 of the year following submission), (ii) to produce a statement whereby the U.S. owner represents to be a U.S. owner individual or corporation and does not maintain a permanent establishment in Italy, and (iii) to set forth other required information. IRS Form 6166 may be obtained by filing a request for certification on IRS Form 8802. (Additional information, including IRS Form 8802, can be obtained from the IRS website at [www.irs.gov](http://www.irs.gov). Information appearing on the IRS website is not incorporated by reference into this document.) The time for processing requests for certification by the IRS normally is 30 to 45 days. Accordingly, in order to be eligible for the procedure described below, U.S. owners should begin the process of obtaining certificates as soon as possible after receiving instructions from the Depository on how to claim a treaty refund.

The Depository's instructions will specify certain deadlines for delivering to the Depository the documentation required to obtain a treaty refund, including the certification that the U.S. owners must obtain from the IRS. In the case of ADSs held by U.S. owners through a broker or other financial intermediary, the required documentation should be delivered to such financial intermediary for transmission to the Depository. In all other cases, the U.S. owners should deliver the required documentation directly to the Depository. The Company and the Depository have agreed that if the required documentation is received by the Depository on or within 30 days after the dividend payment date and, in the reasonable judgment of the Company, such documentation satisfies the requirements for a refund by the Company of Italian withholding tax under the Convention and applicable law, the Company will within 45 days thereafter pay the treaty refund to the Depository for the benefit of the U.S. owners entitled thereto.

If the Depository does not receive a U.S. owner's required documentation within 30 days after the dividend payment date, such U.S. owner may for a short grace period (specified in the Depository's instructions) continue to claim a treaty refund by delivering the required documentation (either through the U.S. owner's financial intermediary or directly, as the case may be) to the Depository. However, after this grace period, the treaty refund must be claimed directly from the Italian tax authorities rather than through the Depository. Expenses and extensive delays have been encountered by U.S. owners seeking refunds from the Italian tax authorities.





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Distributions of profits in kind will be subject to withholding tax. In that case, prior to receiving the distribution, the holder will be required to provide the Company with the funds to pay the relevant withholding tax.

**ii) United States Tax Considerations** The gross amount of any dividends (that is, the amount before reduction for Italian withholding tax) paid to a U.S. owner generally will be subject to U.S. federal income taxation as foreign-source dividend income and will not be eligible for the dividends-received deduction allowed to domestic corporations. Dividends paid in Euro will be included in the income of such U.S. owners in a dollar amount calculated by reference to the exchange rate in effect on the day the dividends are received by the Depositary or its agent. If the Euro are converted into dollars on the day the Depositary or its agent receives them, U.S. owners generally should not be required to recognize foreign currency gain or loss in respect of the dividend income. U.S. owners who receive a treaty refund may be required to recognize foreign currency gain or loss to the extent the amount of the treaty refund (in dollars) received by the U.S. owner differs from the U.S. dollar equivalent of the Euro amount of the treaty refund on the date the dividends were received by the Depositary or its agent. Italian withholding tax at the 15% rate will be treated as a foreign income tax which U.S. owners may elect to deduct in computing their taxable income or, subject to the limitations on foreign tax credits generally, credit against their U.S. federal income tax liability. The rules governing the foreign tax credit are complex and U.S. owners are urged to consult their own tax advisers in this regard. Dividends will generally constitute foreign-source passive category income for U.S. tax purposes.

Subject to certain exceptions for short-term and hedged positions, the U.S. dollar amount of dividends received by an individual with respect to the Ordinary Shares or ADSs will be subject to taxation at reduced rates if the dividends are qualified dividends. Dividends paid on the Ordinary Shares or ADSs will be treated as qualified dividends if (i) the Company is eligible for the benefits of a comprehensive income tax treaty with the United States that the IRS has approved for the purposes of the qualified dividend rules and (ii) the Company was not, in the year prior to the year in which the dividend was paid, and is not, in the year in which the dividend is paid, a passive foreign investment company (PFIC). The Income Tax Convention has been approved for the purposes of the qualified dividend rules, and the Company believes it is eligible for the benefits of the Income Tax Convention. Based on the Company's audited financial statements and relevant market and shareholder data, the Company believes that it was not treated as a PFIC for U.S. federal income tax purposes with respect to its 2012 or 2013 taxable year. In addition, based on the Company's audited financial statements and its current expectations regarding the value and nature of its assets, the sources and nature of its income, and relevant market and shareholder data, the Company does not anticipate becoming a PFIC for its 2014 taxable year.

The U.S. Treasury has announced its intention to promulgate rules pursuant to which holders of ADSs or common stock and intermediaries through whom such securities are held will be permitted to rely on certifications from issuers to treat dividends as qualified for tax reporting purposes. Because such procedures have not yet been issued, it is not clear whether the Company will be able to comply with the procedures. Holders of Ordinary Shares and ADSs should consult their own tax advisers regarding the availability of the reduced dividend tax rate in the light of the considerations discussed above and their own particular circumstances.

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Foreign tax credits may not be allowed for withholding taxes imposed in respect of certain short-term or hedged positions in securities or in respect of arrangements in which a U.S. owner's expected economic profit is insubstantial. U.S. owners should consult their own advisers concerning the implications of these rules in light of their particular circumstances.

A beneficial owner of Ordinary Shares or ADSs who is, with respect to the United States, a foreign corporation or a nonresident alien individual, generally will not be subject to U.S. federal income tax on dividends received on Ordinary Shares or ADSs, unless such income is effectively connected with the conduct by the beneficial owner of a trade or business in the United States.

**Taxation of Capital Gains**

**i) Italian Tax Considerations** Under Italian law, capital gains tax ( CGT ) is generally levied on capital gains realized by non-residents from the disposal of shares in companies resident in Italy for tax purposes even if those shares are held outside of Italy. However, capital gains realized by non-resident holders on the sale of non-qualified shareholdings (as defined below) in companies listed on a stock exchange and resident in Italy for tax purposes (as is the Company's case) are not subject to CGT. In order to benefit from this exemption, such non-Italian-resident holders may need to file a certificate evidencing their residence outside of Italy for tax purposes.

A qualified shareholding consists of securities that entitle the holder to exercise more than 2% of the voting rights of a company with shares listed on a stock exchange in the ordinary meeting of the shareholders or represent more than 5% of the share capital of a company with shares listed on a stock exchange. A non-qualified shareholding is any shareholding that does not exceed either of these thresholds. The relevant percentage is calculated taking into account the shareholdings sold during the prior 12-month period.

Capital gains realized upon disposal of a qualified shareholding are partially included in the shareholders' taxable income, for an amount equal to 49.72% with respect to capital gains realized as of January 1, 2009. If a taxpayer realizes taxable capital gains in excess of 49.72% of capital losses of a similar nature incurred in the same tax year, such excess amount is included in his total taxable income. If 49.72% of such taxpayer's capital losses exceeds its taxable capital gains, then the excess amount can be carried forward and deducted from the taxable amount of similar capital gains realized by such person in the following tax years, up to the fourth, provided that it is reported in the tax report in the year of disposal.

The above is subject to any provisions of an income tax treaty entered into by the Republic of Italy, if the income tax treaty provisions are more favorable. The majority of double tax treaties entered into by Italy, including the Income Tax Convention, in accordance with the OECD Model tax convention, provide that capital gains realized from the disposition of Italian securities are subject to CGT only in the country of residence of the seller.

The Income Tax Convention between Italy and the U.S. provides that a U.S. owner is not subject to the Italian CGT on the disposal of shares, provided that the shares are not held through part of a permanent establishment of the U.S. owner in Italy.

**ii) United States Tax Considerations** Gain or loss realized by a U.S. owner on the sale or other disposition of Ordinary Shares or ADSs will be subject to U.S. federal income taxation as capital gain or loss in an amount equal to the difference between the U.S. owner's basis in the Ordinary Shares or the ADSs and the amount realized on the disposition (or its dollar equivalent, determined at the spot rate on the date of disposition, if the amount realized is denominated in a foreign currency). Any such gain or loss generally would be treated as arising from sources within the United States. Such gain or loss will generally be long-term capital gain or loss if the U.S. owner holds the

Ordinary Shares or ADSs for more than one year. The net amount of long-term capital gain recognized by a U.S. owner that is an individual holder generally is subject to taxation at a reduced rate. The ability to offset capital losses against ordinary income is subject to limitations. Deposits and withdrawals of Ordinary Shares by U.S. owners in exchange for ADSs will not result in the realization of gain or loss for U.S. federal income tax purposes.

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A beneficial owner of Ordinary Shares or ADSs who is, with respect to the United States, a foreign corporation or a nonresident alien individual will not be subject to U.S. federal income tax on gain realized on the sale of Ordinary Shares or ADSs, unless (i) such gain is effectively connected with the conduct by the beneficial owner of a trade or business in the United States or (ii), in the case of gain realized by an individual beneficial owner, the beneficial owner is present in the United States for 183 days or more in the taxable year of the sale and certain other conditions are met.

### **Taxation of Distributions from Capital Reserves**

**Italian Tax Considerations** Special rules apply to the distribution of certain capital reserves. Under certain circumstances, such a distribution may be considered as taxable income in the hands of the recipient depending on the existence of current profits or outstanding reserves at the time of distribution and the actual nature of the reserves distributed. The application of such rules may also have an impact on the tax basis in the Ordinary Shares or ADSs held and/or the characterization of any taxable income received and the tax regime applicable to it. Non-resident shareholders may be subject to withholding tax and CGT as a result of such rules. You should consult your tax adviser in connection with any distribution of capital reserves.

### **Other Italian Taxes**

**Estate and Inheritance Tax** A transfer of Ordinary Shares or ADSs by reason of death or gift is subject to an inheritance and gift tax levied on the value of the inheritance or gift, as follows:

Transfers to a spouse or direct descendants or ancestors up to 1,000,000 to each beneficiary are exempt from inheritance and gift tax. Transfers in excess of such threshold will be taxed at a 4% rate on the value of the Ordinary Shares or ADSs exceeding such threshold;

Transfers between relatives within the fourth degree other than siblings, and direct or indirect relatives-in-law within the third degree are taxed at a rate of 6% on the value of the Ordinary Shares or ADSs (where transfers between siblings up to a maximum value of 100,000 for each beneficiary are exempt from inheritance and gift tax); and

Transfers by reason of gift or death of Ordinary Shares or ADSs to persons other than those described above will be taxed at a rate of 8% on the value of the Ordinary Shares or ADSs.

If the beneficiary of any such transfer is a disabled individual, whose handicap is recognized pursuant to Law No. 104 of February 5, 1992, the tax is applied only on the value of the assets received in excess of 1,500,000 at the rates illustrated above, depending on the type of relationship existing between the deceased or donor and the beneficiary.

The tax regime described above will not prevent the application, if more favorable to the taxpayer, of any different provisions of a bilateral tax treaty, including the convention between Italy and the United States against double taxation with respect to taxes on estates and inheritances, pursuant to which non-Italian resident shareholders are generally entitled to a tax credit for any estate and inheritance taxes possibly applied in Italy.

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**Italian Financial Transaction Tax** In December 2012, Italy introduced a financial transaction tax (the IFTT), which, beginning March 1, 2013, is applicable, among other transactions, to all trades entailing the transfer of title of (i) shares or equity-like financial instruments issued by companies resident in Italy, such as the Ordinary Shares; and (ii) securities representing the shares and financial instruments under (i) above (including depositary receipts such as the ADSs), regardless of the residence of the issuer. The IFTT may also apply to the transfer of Ordinary Shares and ADSs by a U.S. resident.

The IFTT will apply at a rate of 0.2% for over-the-counter transactions, reduced to 0.1% for trades executed on a regulated market or multilateral trading facility. The New York Stock Exchange should qualify as a regulated market for such purposes.

The rules governing the IFTT are fairly complex and still subject to further clarification to be issued by the Italian tax authorities. As to its basic features, it should be noted that the IFTT (i) is levied on a tax base equal to (x) the market value (calculated by taking the net balance of daily trades on the relevant securities) or, in the absence of any such market value, (y) the consideration paid for each trade; and (ii) is borne by the purchaser but is collected by the financial intermediaries (including non-resident financial intermediaries) intervening in the relevant trades.

However, a number of exemptions apply, including with respect to trades of securities issued by companies having an average market capitalization lower than 500 million in the month of November of the year preceding the year in which the trade takes place. Companies, the securities of which are listed on a foreign regulated market, and which could benefit from this exemption, such as the Company, need a confirmation from the Italian Ministry of Economy and Finance: such companies must communicate their market capitalization for each tax year to the Ministry, which will then prepare a list of the companies in relation to which the exemption applies.

**EU Financial Transaction Tax** On February 14, 2013, the European Commission proposed the implementation of the EU FTT (see Item 3. Key Information Risk Factors) that may also apply to the transfer of Ordinary Shares and ADSs by a U.S. resident on or after January 1, 2014. Moreover, the implementation of the proposed EU FTT may also affect the IFTT, as described above.

**United States Information Reporting and Backup Withholding Requirements** In general, information reporting requirements will apply to payments by a paying agent within the United States to a non-corporate (or other non-exempt) U.S. owner of dividends in respect of the Company Shares or ADSs, or the proceeds received on the sale or other disposition of the Company Shares or ADSs. Backup withholding may apply to such amounts if the U.S. owner fails to provide an accurate taxpayer identification number to the paying agent on a properly completed IRS Form W-9 or otherwise comply with the applicable requirements of the backup withholding rules. Amounts withheld as backup withholding will be creditable against the U.S. owner's U.S. federal income tax liability, provided that the required information is timely furnished to the IRS.

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The Company is subject to the information reporting requirements of the Securities Exchange Act of 1934, as amended (the Exchange Act), applicable to foreign private issuers. In accordance therewith, the Company is required to file reports, including annual reports on Form 20-F, and other information with the U.S. Securities and Exchange Commission. These materials, including this Annual Report, are available for inspection and copying at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the Commission at 1-800-SEC-0330 for further information on the public reference room. As a foreign private issuer, we have been required to make filings with the SEC by electronic means since November 4, 2002. Any filings we make electronically will be available to the public over the Internet at the SEC's website at <http://www.sec.gov>. The Form 20-F and reports and other information filed by the Company with the Commission will also be available for inspection by ADS holders at the Corporate Trust Office of The Bank of New York Mellon at 101 Barclay Street, New York, New York 10286.

**ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The following discussion of the Group's risk management activities includes forward-looking statements that involve risks and uncertainties. Actual results could differ materially from those projected in the forward looking statements. See Forward Looking Information. A significant portion of the Group's net sales and its costs, are denominated in currencies other than the euro, in particular the U.S. dollar.

The Group is exposed to market risks principally from fluctuations in the exchange rates between the euro and other currencies, including in particular the U.S. dollar, and to a significantly lesser extent, from variations in interest rates.

**Exchange Rate Risks** The Group's foreign exchange rate risks in 2013 arose principally in connection with the Chinese yuan, U.S. dollars, British pounds, Canadian dollars, Australian dollars, Japanese yen, Swiss francs, Romanian Leu, Swedish kroner, Norwegian kroner and Danish kroner, as well as in connection with Euros for the Company's subsidiary located in Eastern Europe.

As of December 31, 2013 and 2012, the Group had outstanding trade receivables denominated in foreign currencies totaling 42.4 million and 56.5 million, respectively, of which 56.2% and 49.5%, respectively, were denominated in U.S. dollars. On those same dates, the Group had 19.4 million and 27.6 million, respectively, of trade payables denominated in foreign currencies, principally U.S. dollars. See Notes 6 and 14 to the Consolidated Financial Statements included in Item 18 of this Annual Report.

As of December 31, 2013, the Company was a party to a number of currency forward contracts (known in Italy as domestic currency swaps), all of which are designed to hedge future sales denominated in U.S. dollars and other currencies. As of the same date, no option contract was outstanding (as was the case as of December 31, 2012). The Group does not use such foreign exchange contracts for speculative trading purposes.

As of December 31, 2013, the notional amount in Euro terms of all of the outstanding currency forward contracts totaled 41.4 million. As of December 31, 2012, the notional amounts of all of the outstanding currency forward contracts totaled 47.4 million.

At the end of 2013, such currency forward contracts had notional amounts of 12.0 million, Canadian dollars 14.5 million, U.S.\$12.0 million, British pounds 5.0 million, Australian dollars 3.2 million, Japanese yen 185.0 million, Norwegian kroner 4.8 million and Swedish kroner 3.0 million. All of these forward contracts had various maturities extending through June 2014. See Note 27 to the Consolidated Financial Statements included in Item 18 of this

Annual Report.

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The table below summarizes (in thousands of euro equivalent) the contractual amounts of currency forward contracts (no options were outstanding) intended to hedge future cash flows from accounts receivable and sales orders as of December 31, 2013 and 2012:

| <b>Euro equivalent of contractual amounts of</b> | <b>December 31,</b> |               |
|--|---------------------|---------------|
| <b>currency forward contracts as of:</b>         | <b>2013</b>         | <b>2012</b>   |
| Euro*  | 12,037              | 9,479         |
| Canadian dollars                                 | 10,153              | 13,588        |
| U.S. dollars                                     | 8,817               | 10,100        |
| British pounds                                   | 5,984               | 7,231         |
| Australian dollars                               | 2,157               | 3,719         |
| Japanese yen                                     | 1,362               | 1,811         |
| Norwegian kroner                                 | 575                 | 1,071         |
| Swedish kroner                                   | 341                 | 387           |
| Swiss francs                                     | 0                   | 984           |
| <b>Total</b>                                     | <b>41,426</b>       | <b>47,387</b> |

\* Used by the Group's Romanian subsidiary to hedge its net collections denominated in Euro.

As of December 31, 2013, these forward contracts had a net unrealized gain of 0.5 million, compared to a net unrealized gain of 0.9 million as of December 31, 2012. The Group recorded this amount in other income (expense), net in its Consolidated Financial Statements. See Note 27 to the Consolidated Financial Statements included in Item 18 of this Annual Report.

The following table presents information regarding the contract amount in thousands of Euro equivalent and the estimated fair value of all of the Group's foreign exchange contracts: contracts with unrealized gains are presented as assets and contracts with unrealized losses are presented as liabilities.

|              | <b>December 31, 2013</b>   |                                      | <b>December 31, 2012</b>   |                                      |
|--------------|----------------------------|--------------------------------------|----------------------------|--------------------------------------|
|              | <b>Contract<br/>Amount</b> | <b>Unrealized<br/>gains (losses)</b> | <b>Contract<br/>Amount</b> | <b>Unrealized<br/>gains (losses)</b> |
| Assets       | 24,636                     | 570                                  | 39,684                     | 907                                  |
| Liabilities  | 16,790                     | (51)                                 | 7,702                      | 1                                    |
| <b>Total</b> | <b>41,426</b>              | <b>519</b>                           | <b>47,386</b>              | <b>908</b>                           |

The Group's foreign currency forward contracts as of December 31, 2013 had maturities of a maximum of six months. The potential loss in fair value of all of the Group's forward contracts outstanding as of December 31, 2013 that would have resulted from a hypothetical, instantaneous and unfavorable 10% change in currency exchange rates would have been approximately 4.0 million. This sensitivity analysis assumes an instantaneous and unfavorable 10% fluctuation in exchange rates affecting the foreign currencies of all of the Group's hedging contracts outstanding as of the end of



2013.

For the accounting of transactions entered into in an effort to reduce the Group's exchange rate risks, see Notes 3 and 27 to the Consolidated Financial Statements included in Item 18 of this Annual Report.

At December 31, 2013, the Group had approximately 51 million in cash and cash equivalents held in Chinese yuan (57 million as at December 31, 2012). Exchange rate fluctuations in respect of this amount could have significant positive or negative effects on our results of operations in future periods.

**Interest Rate Risks** To a significantly lesser extent, the Group is also exposed to interest rate risk. As of December 31, 2013, the Group had 32.5 million (equivalent to 7.7% of the Group's total assets as of the same date) in debt outstanding (bank overdrafts and long-term debt, including the current portion of such debt), which is for the most part subject to floating interest rates. See Notes 13 and 18 to the Consolidated Financial Statements included in Item 18 of this Annual Report.

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In the normal course of business, the Group also faces risks that are either non-financial or non-quantifiable. Such risks principally include country risk, credit risk and legal risk.

**ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES**

**ITEM 12A. DEBT SECURITIES**

Not applicable.

**ITEM 12B. WARRANTS AND RIGHTS**

Not applicable.

**ITEM 12C. OTHER SECURITIES**

Not applicable.

**ITEM 12D. AMERICAN DEPOSITARY SHARES**

**Fees paid by ADR holders** The Bank of New York Mellon, as the depositary of our ADSs (the Depositary), collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. The Depositary collects fees for making distributions to investors by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The Depositary may generally refuse to provide fee-attracting services until its fees for those services are paid.

**Persons depositing or withdrawing shares must pay:**

\$5.00 (or less) per 100 ADSs (or portion of 100 ADSs)

**For:**

Depositing or substituting the underlying shares

Selling or exercising rights

Cancellation of ADSs for the purpose of withdrawal, including if the deposit agreement terminates

Distribution of securities distributed to holders of deposited securities which are distributed by the Depositary to ADS registered holders

A fee for the distribution of proceeds of sales of securities or rights in an amount equal to the lesser of: (i) the fee for the issuance of ADSs referred to above which would have been charged as a result of the deposit by owners of securities (for purposes hereof treating all such securities as if they were shares) or shares received in exercise of rights distributed to them, respectively, but which securities or rights are instead sold by the Depositary and the net proceeds distributed and (ii) the amount of such proceeds

Registration or transfer fees

Transfer and registration of shares on our share register to or from the name of the Depositary or its agent when you deposit or withdraw shares

Expenses of the Depositary

Cable, telex and facsimile transmissions (when expressly provided in the deposit agreement)

Converting foreign currency to U.S. dollars

Taxes and other governmental charges the Depositary or the custodian have to pay on any ADS or share underlying an ADS, for example, stock transfer taxes, stamp duty or withholding taxes

As necessary

Any charges incurred by the Depositary or its agents for servicing the deposited securities

As necessary

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**Fees payable by the Depositary to the Company**

**i) Fees incurred in past annual period** From January 1, 2013 to December 31, 2013, the Depositary waived a total of \$2,122.82 in administrative fees for routine corporate actions including services relating to Natuzzi's annual general meeting of shareholders

**ii) Fees to be paid in the future** The Company does not have any agreements in place with the Depositary for the payment or reimbursement of fees or other direct or indirect payments by the Depositary to the Company in connection with its ADS program.

**PART II**

**ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES**

None.

**ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS**

None.

**ITEM 15. CONTROLS AND PROCEDURES**

**(a) Disclosure Controls and Procedures** The Company carried out an evaluation under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of December 31, 2013. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

Based on the Company's evaluation of its disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of December 31, 2013 to provide reasonable assurance that information required to be disclosed in the reports the Company files and submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's applicable rules and forms, and that it is accumulated and communicated to the Company's management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

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**(b) Management's Annual Report on Internal Control Over Financial Reporting** The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal controls over financial reporting may not prevent or detect misstatements. Even when determined to be effective, they can provide only reasonable assurance regarding the reliability of financial reporting and the preparation and presentation of financial statements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

To assess the effectiveness of the Company's internal control over financial reporting, the Company's management, including the Chief Executive Officer and the Chief Financial Officer, used the criteria described in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ).

The Company's management assessed the effectiveness of its internal control over financial reporting as of December 31, 2013. Based on such assessment, the Company's management has concluded that as of December 31, 2013, the Company's internal control over financial reporting was effective and that there were no material weaknesses in the Company's internal control over financial reporting.

The effectiveness of internal control over financial reporting as of December 31, 2013 has been audited by Reconta Ernst & Young S.p.A., an independent registered public accounting firm, as stated in their report on the Company's internal control over financial reporting, which follows below.

**(c) Attestation Report of the Registered Public Accounting Firm**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders of

Natuzzi S.p.A.

We have audited Natuzzi S.p.A. and Subsidiaries' internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) (the COSO criteria). Natuzzi S.p.A. and Subsidiaries management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.



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A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Natuzzi S.p.A. and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Natuzzi S.p.A. and Subsidiaries as of December 31, 2013 and 2012 and the related consolidated statement of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2013 and our report dated April 30, 2014 expressed an unqualified opinion thereon.

/s/ Reconta Ernst & Young S.p.A.

Bari, Italy

April 30, 2014

**Table of Contents****ITEM 16. [RESERVED]****ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT**

The Company has determined that, because of the existence and nature of its board of statutory auditors, it qualifies for an exemption provided by Exchange Act Rule 10A-3(c)(3) from many of the Rule 10A-3 audit committee requirements. The board of statutory auditors has determined that each of its members is an audit committee financial expert as defined in Item 16A of Form 20-F. For the names of the members of the board of statutory auditors, see Item 6. Directors, Senior Management and Employees Statutory Auditors and Item 16G. Corporate Governance Audit Committee and Internal Audit Function.

Each of the audit committee financial experts is independent under the NYSE Independence Standards that would apply to audit committee members in the absence of our reliance on the exemption in Rule 10A-3(c)(3).

**ITEM 16B. CODE OF ETHICS**

The Company has adopted a code of ethics, as defined in Item 16B of Form 20-F under the Exchange Act. This code of ethics applies, among others, to the Company's Chief Executive Officer and Chief Financial Officer. The Company's code of ethics is downloadable from its website at [www.natuzzi.com/codeofethics/](http://www.natuzzi.com/codeofethics/). If the Company amends the provisions of its code of ethics that apply to the Company's Chief Executive Officer and Chief Financial Officer, or if the Company grants any waiver of such provisions, it will disclose such amendment or waiver on its website at the same address.

**ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

Reconta Ernst & Young S.p.A. (Ernst & Young, hereafter) has served as Natuzzi S.p.A.'s principal independent public auditor for fiscal year 2013 and 2012 for which it audited the consolidated financial statements included in this Annual Report.

The following table sets forth the aggregate fees billed and billable to the Company by Ernst & Young in Italy and abroad during the fiscal years ended December 31, 2013 and 2012, for audit fees, audit related fees, tax fees and all other fees for audit.

|                    | <b>2013</b>                       | <b>2012</b> |
|--------------------|-----------------------------------|-------------|
|                    | (Expressed in thousands of euros) |             |
| Audit fees         | 600                               | 876         |
| Audit-related fees |                                   |             |
| Tax fees           | 3                                 | 3           |
| Other fees         |                                   |             |
| <b>Total fees</b>  | <b>603</b>                        | <b>879</b>  |

Audit fees in the above table are the aggregate fees billed and billable in connection with the audit of the Company's annual financial statements.

Tax fees consist of fees billed and billable in connection with the professional services rendered for tax compliance.





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The Company's board of statutory auditors expressly pre-approves on a case-by-case basis any engagement of our independent auditors for audit and non-audit services provided to our subsidiaries or to us. All services rendered by our independent auditors for audit and non-audit services were pre-approved by our board of statutory auditors in accordance with this policy.

**ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES.**

The Company is relying on the exemption from listing standards for audit committees provided by Exchange Act Rule 10A-3(c)(3). The basis for this reliance is that the Company's board of statutory auditors meets the following requirements set forth in Exchange Act Rule 10A-3(c)(3):

- 1) the board of statutory auditors is established and selected pursuant to Italian law expressly permitting such a board;
- 2) the board of statutory auditors is required under Italian law to be separate from the Company's board of directors;
- 3) the board of statutory auditors is not elected by management of the Company and no executive officer of the Company is a member of the board of statutory auditors;
- 4) Italian law provides for standards for the independence of the board of statutory auditors from the Company and its management;
- 5) the board of statutory auditors, in accordance with applicable Italian law and the Company's governing documents, is responsible, to the extent permitted by Italian law, for the appointment, retention and oversight of the work (including, to the extent permitted by law, the resolution of disagreements between management and the auditor regarding financial reporting) of any registered public accounting firm engaged for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the Company, and
- 6) to the extent permitted by Italian law, the audit committee requirements of paragraphs (b)(3), (b)(4) and (b)(5) of Rule 10A-3 apply to the board of statutory auditors.

The Company's reliance on Rule 10A-3(c)(3) does not, in its opinion, materially adversely affect the ability of its board of statutory auditors to act independently and to satisfy the other requirements of Rule 10A-3.

**ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS**

Starting on September 27, 2011 and through April 30, 2013, INVEST 2003 S.r.l., an Italian limited liability company wholly owned by Mr. Natuzzi, Chairman of the Board of Directors and CEO of the Company, has purchased a total of 859,628 Natuzzi S.p.A. ADSs, (representing approximately 1.6% of the Company's total shares outstanding), at the average price of 1.72 (U.S.\$ 2.37) per ADS, based on the April 18, 2014 exchange rate of US\$1.3816 per 1.00. Each of these purchases was made through open-market transactions in accordance with the Rule 10b-18 Plan, which is not subject to an expiration date or maximum cap. No purchases of the ADSs have been made by Mr. Natuzzi since

April 30, 2013. See Item 6. Directors, Senior Management and Employees Share Ownership.

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The following table summarizes the purchases of the Company's ADSs made by INVEST 2003 S.r.l., on a monthly basis, since January 1, 2013.

| <b>Trading month</b>                              |                    | <b>Total number of ADSs purchased</b> | <b>Weighted average price per ADS (in Euro <sup>(1)</sup>)</b> | <b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b> | <b>Maximum Number</b>  |
|---|--------------------|---------------------------------------|--|---|--|
|   |                    |                                       |  |   | <b>(or Appropriate U.S. Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs</b> |
| January 1   | January 31, 2013   | 49,264                                | 1.59   |   |  |
| February 1  | February 28, 2013  | 83,648                                | 1.62   |   |  |
| March 1   | March 31, 2013     | 17,157                                | 1.59   |   |  |
| April 1   | April 30, 2013     | 147,534                               | 1.51   |   |  |
| May 1   | May 31, 2013       |                                       |  |   |  |
| June 1  | June 30, 2013      |                                       |  |   |  |
| July 1  | July 31, 2013      |                                       |  |   |  |
| August 1  | August 31, 2013    |                                       |  |   |  |
| September 1                                       | September 30, 2013 |                                       |  |   |  |
| October 1   | October 31, 2013   |                                       |  |   |  |
| November 1  | November 30, 2013  |                                       |  |   |  |
| December 1  | December 31, 2013  |                                       |  |   |  |
| January 1   | January 31, 2014   |                                       |  |   |  |
| February 1  | February 29, 2014  |                                       |  |   |  |
| March 1   | March 31, 2014     |                                       |  |   |  |
| April 1   | April 25, 2014     |                                       |  |   |  |
| <b>Total ADSs purchased since January 1, 2013</b> |                    | <b>297,603</b>                        | <b>1.56</b>  |   |  |

(1) Euro equivalents of U.S. dollar prices, converted into euros based on the April 18, 2014 exchange rate of US\$1.3816 per 1.00.

From January 1, 2013 to December 31, 2013, no purchases were made by or on behalf of the Company or any other affiliated purchaser of the Company's Ordinary Shares or ADSs.

**ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT**

None.

**ITEM 16G. CORPORATE GOVERNANCE**

Under NYSE rules, we are permitted, as a listed foreign private issuer, to adhere to the corporate governance rules of our home country in lieu of certain NYSE corporate governance rules.

Corporate governance rules for Italian stock corporations (*società per azioni*) like the Company, whose shares are not listed on a regulated market in the European Union, are set forth in the Civil Code. As described in more detail below, the Italian corporate governance rules set forth in the Civil Code differ in a number of ways from those applicable to U.S. domestic companies under NYSE listing standards, as set forth in the NYSE Listed Company Manual.

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As a general rule, our company's main corporate bodies are governed by the Civil Code and are assigned specific powers and duties that are legally binding and cannot be derogated from. The Company follows the traditional Italian corporate governance system, with a board of directors (*consiglio di amministrazione*) and a separate board of statutory auditors (*collegio sindacale*) with supervisory functions. The two boards are separate and no individual may be a member of both boards. Both the members of the board of directors and the members of the board of statutory auditors owe duties of loyalty and care to the Company. As required by Italian law, an external auditor (*revisore contabile*) is in charge of auditing its financial statements. The members of the Company's board of directors and board of statutory auditors, as well as the external auditor, are directly and separately appointed by shareholder resolution at the general shareholders' meetings. This system differs from with the unitary system envisaged for U.S. domestic companies by the NYSE listing standards, which contemplate the board of directors serving as the sole governing body.

Below is a summary of the significant differences between Italian corporate governance rules and practices, as the Company has implemented them, and those applicable to U.S. issuers under NYSE listing standards, as set forth in the NYSE Listed Company Manual.

### **Independent Directors**

*NYSE Domestic Company Standards* The NYSE listing standards applicable to U.S. companies provide that independent directors must comprise a majority of the board. In order for a director to be considered independent, the board of directors must affirmatively determine that the director has no material direct or indirect relationship with the company. These relationships can include commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationship (among others).

More specifically, a director is not independent if such director or his/her immediate family members has certain specified relationships with the company, its parent, its consolidated subsidiaries, their internal or external auditors, or companies that have significant business relationships with the company, its parent or its consolidated subsidiaries. Ownership of a significant amount of stock is not a per se bar to independence. In addition, a three-year cooling off period following the termination of any relationship that compromised a director's independence must lapse before that director can again be considered independent.

*Our Practice* The presence of a prescribed number of independent directors on the Company's board is neither mandated by any Italian law applicable to the Company nor required by the Company's By-laws.

However, Italian law sets forth certain independence requirements applicable to the Company's statutory auditors. Statutory auditors' independence is assessed on the basis of the following rules: a person who (i) is a director, or the spouse or a close relative of a director, of the Company or any of its affiliates, or (ii) has an employment or a regular consulting or similar relationship with the Company or any of its affiliates, or (iii) has an economic relationship with the Company or any of its affiliates which might compromise his/her independence, cannot be appointed to the Company's board of statutory auditors. The law sets forth certain principles aimed at ensuring that any member of the board of statutory auditors who is a chartered public accountant (*iscritto nel registro dei revisori contabili*) be substantively independent from the company subject to audit and not be in any way involved in the company's decision-making process. The Civil Code mandates that at least one standing and one alternative member of the board of statutory auditors be a chartered public accountant. Each of the current members of the board of statutory auditors is a chartered public accountant.



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### **Executive Sessions**

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

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

### **Audit Committee and Internal Audit Function**

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

*Our Practice* Rule 10A-3 under the Exchange Act provides that foreign private issuers with a board of statutory auditors established in accordance with local law or listing requirements and meeting specified requirements with regard to independence and responsibilities (including the performance of most of the specific tasks assigned to audit committees by Rule 10A-3, to the extent permitted by local law) (the Statutory Auditor Requirements) are exempt from the audit committee requirements established by the rule. The Company is relying on this exemption on the basis of its separate board of statutory auditors, which is permitted by the Civil Code and which satisfies the Statutory Auditor Requirements. Notwithstanding that, our board of statutory auditors, consisting of independent and highly professional experts, comply with the requirements indicated at points (i), (iii) and (iv) of the preceding paragraph.

The Company also has an internal audit function, which has not been outsourced.

### **Compensation Committee**

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

*Our Practice* The Company has not established a compensation committee. Under Italian law, the compensation of executive directors is determined by the board of directors, having consulted with the Board of Statutory Auditors, while the Company's shareholders determine the base compensation of all the Board members, including non-executive directors. Compensation of the Company's executive officers is determined by the Chief Executive Officer. The Company does not produce a compensation report. However, the Company discloses aggregate compensation of all of its directors in its annual financial statements prepared in accordance with Italian GAAP and in



Item 6 of its Annual Report.

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**Nominating Committee**

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

*Our Practice* As allowed by Italian laws, the Company has not established a nominating committee (or equivalent) responsible for nominating its directors. Directors may be nominated by any of the Company's shareholders or the Company's board of directors. Mr. Natuzzi, by virtue of owning a majority of the outstanding shares of the Company, controls the Company, including its management and the selection of its board of directors.

**Corporate Governance and Code of Ethics**

*NYSE Domestic Company Standards* Under NYSE standards, a company must adopt governance guidelines and a code of business conduct and ethics for directors, officers and employees. A company must also publish these items on its website and provide printed copies on request. Section 406 of the Sarbanes-Oxley Act requires a company to disclose whether it has adopted a code of ethics for its principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, and if not, the reasons why it has not done so. The NYSE listing standards applicable to U.S. companies provide that codes of conduct and ethics should address, at a minimum, conflicts of interest; corporate opportunities; confidentiality; fair dealing; protection and use of company assets; legal compliance; and reporting of illegal and unethical behavior. Corporate governance guidelines must address, at a minimum, directors' qualifications, responsibilities and compensation; access to management and independent advisers; management succession; director orientation and continuing education; and annual performance evaluation of the board.

*Our Practice* In January 2011, the Company's board of directors approved the adoption of a compliance program to prevent certain criminal offenses, according to the Italian Decree 231/2001. The Company has adopted a code of ethics that applies to all employees of the Company, including the Company's Chief Executive Officer, Chief Financial Officer, and principal accounting officer. The Company believes that its code of ethics and the conduct and procedures adopted by the Company address the relevant issues contemplated by the NYSE standards applicable to U.S. companies noted above.

**Certifications as to Violations of NYSE Standards**

*NYSE Domestic Company Standards* Under NYSE listing standards, the CEO of a U.S. company listed on the NYSE must certify annually to the NYSE that he or she is not aware of any violation by the company of the NYSE corporate governance standards. The company must disclose this certification, as well as that the CEO/CFO certification required under Section 302 of the Sarbanes-Oxley Act of 2002, has been made in the company's annual report to shareholders (or, if no annual report to shareholders is prepared, its annual report). Each listed company on the NYSE, both domestic and foreign issuers, must submit an annual written affirmation to the NYSE regarding compliance with applicable NYSE corporate governance standards. In addition, each listed company on the NYSE, both domestic and foreign issuers, must submit interim affirmations to the NYSE upon the occurrence of specified events. A domestic issuer must file such an interim affirmation whenever the independent status of a director changes, a director is added or leaves the board, a change occurs to the composition of the audit, nominating/corporate governance, or compensation committee, or there is a change in the company's classification as a controlled company.

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The CEO of both domestic and foreign issuers listed on the NYSE must promptly notify the NYSE in writing if any executive officer becomes aware of any material non-compliance with the NYSE corporate governance standards.

*Our Practice* Under the NYSE rules, the Company's CEO is not required to certify annually to the NYSE whether he is aware of any violation by the Company of the NYSE corporate governance standards. However, the Company is required to submit an annual affirmation of compliance with applicable NYSE corporate governance standards to the NYSE within 30 days of the filing of its annual report on Form 20-F with the U.S. Securities and Exchange Commission. The Company is also required to submit to the NYSE an interim written affirmation any time it is no longer eligible to rely on, or chooses to no longer rely on, a previously applicable exemption provided by Rule 10A-3, or if a member of its audit committee ceases to be deemed independent or an audit committee member had been added.

Under NYSE rules, the Company's CEO must notify the NYSE in writing if any executive officer becomes aware of any material non-compliance by the Company with NYSE corporate governance standards.

**Shareholder Approval of Adoption and Modification of Equity Compensation Plans**

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

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

**ITEM 16H. MINE SAFETY DISCLOSURE.**

Not applicable.

**Table of Contents****PART III****ITEM 17. FINANCIAL STATEMENTS**

Our financial statements have been prepared in accordance with Item 18 hereof.

**ITEM 18. FINANCIAL STATEMENTS**

Our audited consolidated financial statements are included in this Annual Report beginning at page F-1.

| <b>Index to Consolidated Financial Statements</b>  | <b>Page</b> |
|--|-------------|
| <u>Reports of Independent Registered Public Accounting Firm</u>  | F-1         |
| <u>Consolidated Balance Sheets as of December 31, 2013 and 2012</u>  | F-2         |
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| <u>Consolidated Statements of Changes in Shareholders' Equity for the Years Ended December 31, 2013, 2012 and 2011</u> | F-4         |
| <u>Consolidated Statements of Cash Flows for the Years Ended December 31, 2013, 2012 and 2011</u>                      | F-5         |
| <u>Notes to the Consolidated Financial Statements</u>  | F-6         |

**ITEM 19. EXHIBITS**

- 1.1 English translation of the by-laws (Statuto) of the Company, as amended and restated as of January 24, 2008 (incorporated by reference to the Form 20-F filed by Natuzzi S.p.A. with the Securities Exchange Commission on June 30, 2008, file number 001-11854).
- 2.1 Deposit Agreement dated as of May 15, 1993, as amended and restated as of December 31, 2001, among the Company, The Bank of New York, as Depositary, and owners and beneficial owners of ADRs (incorporated by reference to the Form 20-F filed by Natuzzi S.p.A. with the Securities and Exchange Commission on July 1, 2002, file number 001-11854).
- 4.1 Agreement among the Ministry of Economic Development, Ministry of Labour and Social Policy, INVITALIA, the Region of Puglia, the Region of Basilicata, Natuzzi S.p.A., Confindustria and the Italian trade union and other entities named therein, dated as of October 10, 2013.
- 8.1 List of Significant Subsidiaries.
- 12.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 12.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 13.1 Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders of

Natuzzi S.p.A.

We have audited the accompanying consolidated balance sheets of Natuzzi S.p.A. and Subsidiaries as of December 31, 2013 and 2012 and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Natuzzi S.p.A. and Subsidiaries at December 31, 2013 and 2012, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with established accounting principles in the Republic of Italy.

Established accounting principles in the Republic of Italy vary in certain significant respects from generally accepted accounting principles in the United States of America. Information relating to the nature and effect of such differences is presented in note 29 to the consolidated financial statements.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Natuzzi S.p.A. and Subsidiaries' internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) and our report dated April 30, 2014 expressed an unqualified opinion thereon.

/s/ Reconta Ernst & Young S.p.A.

Bari, Italy

April 30, 2014

**Table of Contents****Natuzzi S.p.A. and Subsidiaries****Consolidated Balance Sheets****as of December 31, 2013 and 2012***(Expressed in thousands of euros)*

|   | Notes | Dec. 31, 2013  | Dec. 31, 2012  |
|---|-------|----------------|----------------|
| <b>ASSETS</b>                               |       |                |                |
| <b>Current assets:</b>                      |       |                |                |
| Cash and cash equivalents                   | 4     | 61,033         | 77,713         |
| Marketable securities                       | 5     | 4              | 4              |
| Trade receivables, net                      | 6     | 78,853         | 93,069         |
| Other receivables                           | 7     | 48,484         | 51,012         |
| Inventories                                 | 8     | 78,991         | 82,269         |
| Unrealized foreign exchange gain            | 27    | 592            | 907            |
| Prepaid expenses and accrued income         | 9     | 1,938          | 2,031          |
| Deferred income taxes                       | 16    | 288            | 525            |
| <b>Total current assets</b>                 |       | <b>270,183</b> | <b>307,530</b> |
| <b>Non current assets:</b>                  |       |                |                |
| Property plant and equipment                | 10    | 143,579        | 161,461        |
| Intangible asset, net                       | 11    | 5,558          | 4,782          |
| Goodwill                                    | 12    |                | 81             |
| Investment in affiliates                    | 3k)   | 1,429          | 1,429          |
| Other non current assets                    |       | 1,159          | 771            |
| <b>Total non current assets</b>             |       | <b>151,725</b> | <b>168,524</b> |
| <b>TOTAL ASSETS</b>                         |       | <b>421,908</b> | <b>476,054</b> |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>  |       |                |                |
| <b>Current liabilities:</b>                 |       |                |                |
| Bank Overdrafts                             | 13    | 25,020         | 26,948         |
| Current portion of long-term debt           | 18    | 3,342          | 3,503          |
| Accounts payable-trade                      | 14    | 67,393         | 63,328         |
| Accounts payable-other                      | 15    | 25,839         | 21,033         |
| Accounts payable-shareholders for dividends |       |                | 82             |
| Unrealized foreign exchange losses          | 27    | 193            | 1              |
| Income taxes                                | 16    | 7,126          | 9,199          |
| Deferred income taxes                       | 16    | 1,000          | 1,096          |
| Salaries, wages and related liabilities     | 17    | 8,325          | 7,967          |

|  |     |                |                |
|--|-----|----------------|----------------|
| Total current liabilities                                    |     | 138,238        | 133,157        |
| <b>Non current liabilities:</b>                              |     |                |                |
| Employees leaving entitlement                                | 3o) | 24,837         | 25,717         |
| Long-term debt   | 18  | 4,171          | 7,285          |
| Deferred income taxes  | 16  |                |                |
| Deferred income for capital grants                           | 3n) | 8,624          | 9,209          |
| Other liabilities  | 19  | 34,436         | 17,025         |
| Total non current liabilities                                |     | 72,068         | 59,236         |
| <b>Commitments and contingent liabilities</b>                | 21  |                |                |
| <b>Shareholders equity:</b>                                  | 20  |                |                |
| Share capital  |     | 54,853         | 54,853         |
| Reserves   |     | 42,780         | 42,780         |
| Additional paid-in capital                                   |     | 8,442          | 8,442          |
| Retained earnings  |     | 102,835        | 175,062        |
| Total equity attributable to Natuzzi S.p.A. and Subsidiaries |     | 208,910        | 281,137        |
| Non-controlling interest                                     |     | 2,692          | 2,524          |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>             |     | 211,602        | 283,661        |
|  |     | <b>421,908</b> | <b>476,054</b> |

See accompanying notes to the consolidated financial statements

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## Natuzzi S.p.A. and Subsidiaries

## Consolidated Statements of Operations

Years ended December 31, 2013, 2012 and 2011

*(Expressed in thousands of euros except per share data)*

|   |     | 2013              | 2012              | 2011              |
|---|-----|-------------------|-------------------|-------------------|
| Net sales   | 22  | 449,109           | 468,844           | 486,364           |
| Cost of sales   | 23  | (317,299)         | (313,847)         | (326,068)         |
| Gross profit  |     | 131,810           | 154,997           | 160,296           |
| Selling expenses  | 24  | (126,634)         | (132,417)         | (144,290)         |
| General and administrative expenses                               | 25  | (37,505)          | (39,862)          | (43,298)          |
| Operating income/(loss)   |     | (32,329)          | (17,282)          | (27,292)          |
| Other income/(expense), net                                       | 26  | (31,900)          | (4,577)           | 17,299            |
| Earning/(loss) before taxes and non-controlling interest          |     | (64,229)          | (21,859)          | (9,993)           |
| Income taxes  | 16  | (4,136)           | (4,171)           | (8,884)           |
| <b>Net income/(loss)</b>  |     | <b>(68,365)</b>   | <b>(26,030)</b>   | <b>(18,877)</b>   |
| Less: (Net income)/loss attributable to non-controlling interest  |     | (211)             | (74)              | (709)             |
| Net income/(loss) attributable to Natuzzi S.p.A. and Subsidiaries |     | (68,576)          | (26,104)          | (19,586)          |
| <i>Basic loss per share</i>                                       | 3z) | <i>(1.25)</i>     | <i>(0.48)</i>     | <i>(0.36)</i>     |
| <i>Diluted loss per share</i>                                     | 3z) | <i>(1.25)</i>     | <i>(0.48)</i>     | <i>(0.36)</i>     |
| <i>Average Ordinary Shares Outstanding</i>                        |     | <i>54,853,045</i> | <i>54,853,045</i> | <i>54,853,045</i> |
| <i>Average Ordinary Shares Outstanding assuming dilution</i>      |     | <i>54,853,045</i> | <i>54,853,045</i> | <i>54,853,045</i> |
| See accompanying notes to the consolidated financial statements   |     |                   |                   |                   |



Table of Contents**Natuzzi S.p.A. and Subsidiaries****Consolidated Statements of Changes in Shareholders Equity****Years ended December 31, 2013, 2012 and 2011**

(Expressed in thousands of euros except number of ordinary shares)

|  | Share<br>Capital<br>amount | Reserves      | Additional<br>paid in<br>capital | Retained<br>earnings | Equity<br>attributable to controlling<br>Natuzzi S.p.A. | Non-<br>interest | Total<br>Share<br>holders<br>equity |
|--|----------------------------|---------------|----------------------------------|----------------------|---|------------------|-------------------------------------|
| <b>Balances at December 31, 2010</b>                         | <b>54,853</b>              | <b>42,780</b> | <b>8,282</b>                     | <b>217,204</b>       | <b>323,119</b>  | <b>2,112</b>     | <b>325,231</b>                      |
| Exchange difference on<br>translation of financial statement |                            |               |                                  | 6,944                | 6,944   | 214              | 7,158                               |
| Net Income /(loss) of the year                               |                            |               |                                  | (19,586)             | (19,586)  | 709              | (18,877)                            |
| <b>Balances at December 31, 2011</b>                         | <b>54,853</b>              | <b>42,780</b> | <b>8,282</b>                     | <b>204,562</b>       | <b>310,477</b>  | <b>3,035</b>     | <b>313,512</b>                      |
| Italsofa Shanghai dividend<br>distribution                   |                            |               |                                  |                      |   | (186)            | (186)                               |
| IMPE acquisition minority<br>interest                        |                            |               | 160                              |                      | 160   | (360)            | (200)                               |
| Exchange difference on<br>translation of financial statement |                            |               |                                  | (3,396)              | (3,396)   | (39)             | (3,435)                             |
| Net Income /(loss) of the year                               |                            |               |                                  | (26,104)             | (26,104)  | 74               | (26,030)                            |
| <b>Balances at December 31, 2012</b>                         | <b>54,853</b>              | <b>42,780</b> | <b>8,442</b>                     | <b>175,062</b>       | <b>281,137</b>  | <b>2,524</b>     | <b>283,661</b>                      |
| Exchange difference on<br>translation of financial statement |                            |               |                                  | (3,651)              | (3,651)   | (43)             | (3,694)                             |
| Net Income /(loss) of the year                               |                            |               |                                  | (68,576)             | (68,576)  | 211              | (68,365)                            |
| <b>Balances at December 31, 2013</b>                         | <b>54,853</b>              | <b>42,780</b> | <b>8,442</b>                     | <b>102,835</b>       | <b>208,910</b>  | <b>2,692</b>     | <b>211,602</b>                      |

See accompanying notes to the consolidated financial statements

**Table of Contents****Natuzzi S.p.A. and Subsidiaries****Consolidated Statements of Cash Flows****Years ended December 31, 2013, 2012 and 2011**

(Expressed in thousands of euros)

|  | 2013           | 2012           | 2011            |
|--|----------------|----------------|-----------------|
| <b>Cash flows from operating activities:</b>                             |                |                |                 |
| Net earnings (loss)  | (68,365)       | (26,030)       | (18,877)        |
| Adj to reconcile net income (loss) to net cash provided by op.activities |                |                |                 |
| Depreciation and amortization  | 16,561         | 17,033         | 18,999          |
| Write off of Fixed Assets  | 359            | 339            | 311             |
| Impairment of long lived Assets  | 8,550          | 864            | 1,036           |
| One-time termination benefit   | 19,959         |                | 5,446           |
| Deferred income taxes  | 141            | (5,957)        | 6,205           |
| (Gain)/Loss on disposal of assets  | (61)           | 1,306          | (28,303)        |
| Unrealized foreign exchange (gain) and losses                            | 508            | (1,500)        | (296)           |
| Deferred income for capital grants                                       | (585)          | (606)          | (543)           |
| Change in assets and liabilities:  |                |                |                 |
| Receivables, net   | 14,216         | (130)          | 2,876           |
| Inventories  | 3,278          | 11,268         | (6,183)         |
| Prepaid expenses and accrued income                                      | 93             | 566            | (1,262)         |
| Accounts payable   | 4,065          | (215)          | (775)           |
| Income taxes   | (2,073)        | 7,864          | (1,615)         |
| Salaries, wages and related liabilities                                  | 358            | (73)           | (1,869)         |
| Other liabilities net  | 1,528          | (11,920)       | 6,563           |
| Employees leaving entitlement  | (880)          | (1,028)        | (1,671)         |
| Total adjustments  | 66,139         | 17,811         | (1,081)         |
| Net cash provided by (used in) operating activities                      | <b>(2,226)</b> | <b>(8,219)</b> | <b>(19,958)</b> |
| <b>Cash flows from investing activities:</b>                             |                |                |                 |
| Property, plant and equipment:   |                |                |                 |
| Additions  | (7,116)        | (7,513)        | (19,733)        |
| Disposals  | 212            | 1,737          | 2,415           |
| Chinese compensation   |                |                | 46,691          |
| Other assets   | (1,091)        | (310)          | (1,265)         |
| Dividends distribution   | (202)          | (186)          |                 |
| Minority interest acquisition  | (43)           | (200)          |                 |
| Net cash used in investing activities                                    | <b>(8,240)</b> | <b>(6,472)</b> | <b>28,108</b>   |
| <b>Cash flows from financing activities:</b>                             |                |                |                 |
| Long-term debt:  |                |                |                 |

|   |                |              |               |
|---|----------------|--------------|---------------|
| Proceeds  |                |              | 1,000         |
| Repayments  | (3,274)        | (3,753)      | (1,890)       |
| Short-term borrowings   | (1,932)        | 2,811        | 24,074        |
| <b>Net cash provided by (used in) financing activities</b>      | <b>(5,206)</b> | <b>(942)</b> | <b>23,184</b> |
| Effect of translation adjustments on cash                       | (1,008)        | (694)        | 1,612         |
| Increase (decrease ) in cash and cash equivalents               | (16,680)       | (16,327)     | 32,946        |
| Cash and cash equivalents, beginning of the year                | 77,713         | 94,040       | 61,094        |
| Cash and cash equivalents, end of the year                      | 61,033         | 77,713       | 94,040        |
| <b>Supplemental disclosure of cash flow information:</b>        |                |              |               |
| Cash paid during the year for interest                          | 929            | 662          | 631           |
| Cash paid during the year for income taxes                      | 7,213          | 2,516        | 3,084         |
| See accompanying notes to the consolidated financial statements |                |              |               |

**Table of Contents****Natuzzi S.p.A. and Subsidiaries**

Notes to consolidated financial statements

*(Expressed in thousands of euros except as otherwise indicated)***1. Description of business and Group composition**

The consolidated financial statements include the accounts of Natuzzi S.p.A. ( Natuzzi or the Company ) and of its subsidiaries (together with the Company, the Group ). The Group 's primary activity is the design, manufacture and marketing of contemporary and traditional leather and fabric upholstered furniture. The subsidiaries included in the consolidation at December 31, 2013, together with the related percentages of ownership, are as follows:

| <b>Name</b>                     | <b>Percentage of ownership</b> | <b>Registered office</b>  | <b>Activity</b> |
|---------------------------------|--------------------------------|---------------------------|-----------------|
| Italsofa Nordeste S/A           | 100.00                         | Salvador de Bahia, Brazil | (1)             |
| Italsofa Shanghai Ltd           | 96.50                          | Shanghai, China           | (1)             |
| Natuzzi China Ltd               | 100.00                         | Shanghai, China           | (1)             |
| Italsofa Romania                | 100.00                         | Baia Mare, Romania        | (1)             |
| Natco S.p.A.                    | 99.99                          | Santeramo in Colle, Italy | (2)             |
| I.M.P.E. S.p.A.                 | 100.00                         | Bari, Italy               | (3)             |
| Nacon S.p.A.                    | 100.00                         | Santeramo in Colle, Italy | (4)             |
| Lagene S.r.l.                   | 100.00                         | Santeramo in Colle, Italy | (4)             |
| Natuzzi Americas Inc.           | 100.00                         | High Point, NC, USA       | (4)             |
| Natuzzi Iberica S.A.            | 100.00                         | Madrid, Spain             | (4)             |
| Natuzzi Switzerland AG          | 100.00                         | Dietikon, Switzerland     | (4)             |
| Natuzzi Nordic                  | 100.00                         | Copenhagen, Denmark       | (4)             |
| Natuzzi Benelux S.A.            | 100.00                         | Hereentals, Belgium       | (4)             |
| Natuzzi Germany GmbH            | 100.00                         | Köln, Germany             | (4)             |
| Natuzzi Japan KK                | 100.00                         | Tokyo, Japan              | (4)             |
| Natuzzi Services Limited        | 100.00                         | London, UK                | (4)             |
| Natuzzi Trading Shanghai Ltd    | 100.00                         | Shanghai, China           | (4)             |
| Natuzzi Oceania PTI Ltd         | 100.00                         | Sydney, Australia         | (4)             |
| Natuzzi Russia OOO              | 100.00                         | Moscow, Russia            | (4)             |
| Natuzzi India Furniture PVT Ltd | 100.00                         | New Delhi, India          | (4)             |
| Italholding S.r.l.              | 100.00                         | Bari, Italy               | (5)             |
| Natuzzi Netherlands Holding     | 100.00                         | Amsterdam, Holland        | (5)             |
| Natuzzi Trade Service S.r.l.    | 100.00                         | Santeramo in Colle, Italy | (6)             |
| SALENA SRL                      | 49.00                          | Milan, Italy              | (7)             |

- (1) Manufacture and distribution
- (2) Intragroup leather dyeing and finishing
- (3) Production and distribution of polyurethane foam
- (4) Services and distribution

- (5) Investment holding
- (6) Transportation services
- (7) Dormant

During 2013, Natuzzi Sweden AB was liquidated. Also, the merger of Softaly Shanghai Ltd. with Natuzzi China Ltd. was finalized.

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**Natuzzi S.p.A. and Subsidiaries**

Notes to consolidated financial statements

*(Expressed in thousands of euros except as otherwise indicated)*

**2. Basis of preparation**

The financial statements utilized for the consolidation are the financial statements of each Group company at December 31, 2013, 2012 and 2011. The 2013, 2012 and 2011 financial statements have been adopted by the respective Boards of Directors of the relevant companies.

The financial statements of subsidiaries are adjusted, where necessary, to conform to Natuzzi's accounting principles and policies, which are consistent with Italian legal requirements governing financial statements considered in conjunction with established accounting principles promulgated by the Italian Accounting Profession (OIC).

Established accounting principles in the Republic of Italy vary in certain significant respects from generally accepted accounting principles in the United States of America. Information relating to the nature and effect of such differences is presented in note 29 to the consolidated financial statements.

**3. Summary of significant accounting policies**

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

**a) Principles of consolidation**

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

The assets and liabilities of subsidiaries are consolidated on a line-by-line basis and the carrying value of intercompany investments held is eliminated against the related shareholder's equity accounts. The non-controlling interests of consolidated subsidiaries are separately reported in the consolidated balance sheets and consolidated statements of operations. All intercompany balances and transactions are eliminated in consolidation.

**b) Foreign currency transactions**

Foreign currency transactions are recorded at the exchange rates applicable at the transaction dates. Assets and liabilities denominated in foreign currency are remeasured at year-end exchange rates. Foreign exchange gains and losses resulting from the remeasurement of these assets and liabilities are included in other income (expense), net, in the consolidated statements of operations.

**c) Forward and collars exchange contracts**

The Group enters into forward exchange contracts (known in Italian financial markets as domestic currency swaps) and, for a limited number of contracts, into so called zero cost collars exchange rate derivative instruments to manage its exposure to foreign currency risks. The Group does not enter into these contracts on a speculative basis, nor is hedge effectiveness constantly monitored. As a consequence of this, forward and collar exchange contracts are not used to hedge any on or off-balance sheet items. Therefore, at December 31, 2013, 2012 and 2011 all unrealized gains or losses on such contracts are recorded in other income (expense), net, in the consolidated statements of operations.

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**Natuzzi S.p.A. and Subsidiaries**

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*(Expressed in thousands of euros except as otherwise indicated)*

**d) Financial statements of foreign operations**

The financial statements of the foreign subsidiaries expressed in the foreign currency are translated directly into euro as follows: i) year-end exchange rate for assets, liabilities, and shareholders' equity and ii) average exchange rates during the year for revenues and expenses. The resulting exchange differences on translation are recorded as a direct adjustment to shareholders' equity.

**e) Cash and cash equivalents**

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

**f) Marketable debt securities**

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

Gains and losses realized on the sale of marketable debt securities were computed based on a weighted-average cost of the specific securities being sold. Realized gains and losses are charged to other income (expense), net.

**g) Accounts receivable and payable**

Receivables are stated at nominal value net of an allowance for doubtful accounts. Payables are stated at face value. The Group records revenues net of returns and discounts. The Group estimates sales returns and discounts and creates an allowance for them in the year of the related sales. The Group makes estimates in connection with such allowances based on its experience and historical trends in its large volumes of homogeneous transactions. However, actual costs for returns and discounts may differ significantly from these estimates if factors such as economic conditions, customer preferences or changes in product quality differ from the ones used by the Group in making these estimates.

The Group makes estimates and judgments in relation to the collectability of its accounts receivable and maintains an allowance for doubtful accounts based on losses it may experience as a result of failure by its customers to pay amounts owed. The Group estimates these losses using consistent methods that take into consideration, in particular, insurance coverage in place, the creditworthiness of its customers and general economic conditions. Changes to assumptions relating to these estimates could affect actual results. Actual results may differ significantly from the Group's estimates if factors such as general economic conditions and the creditworthiness of its customers are different from the Group's assumptions.





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**Natuzzi S.p.A. and Subsidiaries**

Notes to consolidated financial statements

*(Expressed in thousands of euros except as otherwise indicated)*

**h) Inventories**

Raw materials are stated at the lower of cost (determined under the specific cost method for leather hides and under the weighted-average method for other raw materials) and replacement cost.

Goods in process and finished goods are valued at the lower of production cost and net realizable value. Production cost includes direct production costs and production overhead costs. The production overhead costs are allocated to inventory based on the manufacturing facility's normal capacity.

The provision for slow moving and obsolete raw materials and finished goods is based on the estimated realizable value net of the costs of disposal.

**i) Property, plant and equipment**

Property, plant and equipment is stated at historical cost, except for certain buildings which were revalued in 1983, 1991 and 2000 according to Italian revaluation laws. Maintenance and repairs are expensed; significant improvements are capitalized and depreciated over the useful life of the related assets. The cost or valuation of fixed assets is depreciated on the straight-line method over the estimated useful lives of the assets (refer to note 10). The related depreciation expense is allocated to cost of goods sold, selling expenses and general and administrative expenses based on the usage of the assets.

**j) Intangible assets and Goodwill**

Set-up costs, advertising costs and goodwill are recorded with the consent of the board of statutory auditors, and are stated at cost, net of the amortization expense calculated on the straight-line method over a period of five years. Other intangible assets primarily include software and trademarks, and are stated at cost, net of the amortization expense calculated on the straight-line method over their estimated useful life.

The carrying amounts of these assets are reviewed to determine if they are in excess of their recoverable amount, based on discounted cash flows, at the consolidated balance sheet date. If the carrying amount exceeds the recoverable amount, the asset is written down to the recoverable amount.

**k) Investment in affiliates**

The affiliate enterprise is Salena S.r.l. in which the Company owns 49% and has a significant influence. This affiliate has interests in real estate. We account for ownership interest under the acquisition cost method since we have significant influence but we do not control.

**l) Impairment of long-lived assets and long-lived assets to be disposed of**

The Company reviews long-lived assets, including intangible assets with estimable useful lives, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset with its recoverable value, which is the higher of a) future undiscounted and discounted cash flows expected to be generated by the asset or b) estimated fair value less costs to sell. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the recoverable value of the assets. Assets not in use/to be disposed of are reported at the lower of their carrying amount and their fair value less costs to sell. Estimated fair value is generally determined through various valuation techniques including quoted market values and third-party independent appraisals, as considered necessary.

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**Natuzzi S.p.A. and Subsidiaries**

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*(Expressed in thousands of euros except as otherwise indicated)*

**m) Income taxes**

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

**n) Government grants**

Capital grants compensate the Group for the partial cost of an asset and are part of the Italian government's investment incentive program, under which the Group receives amounts generally equal to a percentage of the aggregate investment made by the Group in the construction of new manufacturing facilities, or in the improvement of existing facilities, in designated areas of the country.

Capital grants from government agencies are recorded when there is reasonable assurance that the grants will be received and that the Group will comply with the conditions applying to them.

Until December 31, 2000 capital grants were recorded, net of tax, within reserves in shareholders' equity. As from January 1, 2001 all new capital grants are recorded in the consolidated balance sheet initially as deferred income and subsequently recognized in the consolidated statement of operations as revenue on a systematic basis over the useful life of the related asset.

In addition when capital grants are received after the year in which the related assets are acquired, the depreciation of the capital grants is recognized as income as follows: (a) the depreciation of the grants related to the amortization of the assets recorded in statements of operations in the years prior to the date in which the grants are received, is recorded in other income (expense), net; (b) the depreciation of the grants related to the amortization of the assets recorded in statements of operations of the year, is recorded in net sales.

At December 31, 2013 and 2012 the deferred income for capital grants shown in the consolidated balance sheet amounts to 8,624 and 9,209, respectively.

The amortization of these grants recorded in net sales of the consolidated statement of operations for the years ended December 31, 2013, 2012 and 2011, amounts to 443, 606 and 543, respectively.

Cost reimbursement grants relating to research, training and other personnel costs are credited to income when there is a reasonable assurance of receipt from government agencies.



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**Natuzzi S.p.A. and Subsidiaries**

Notes to consolidated financial statements

*(Expressed in thousands of euros except as otherwise indicated)*

**o) Employees leaving entitlement**

Leaving entitlements represent amounts accrued for each Italian employee that are due and payable upon termination of employment, assuming immediate separation, determined in accordance with applicable Italian labour laws. The Group accrues the full amount of employees' vested benefit obligation as determined by such laws for leaving entitlements. At December 31, 2013 and 2012 employees' leaving entitlement shown in the consolidated balance sheets amounts to 24,837 and 25,717, respectively.

Under such Italian labor laws, upon termination of an employment relationship, the former employee has the right to receive termination benefits for each year of service equal to the employee's gross annual salary, divided by 13.5. The entitlement is increased each year by an amount corresponding to 75% of the rise in the cost of living index plus 1.5 points.

The expenses recorded for the leaving entitlement for the years ended on December 31, 2013, 2012 and 2011 were 6,162, 6,393 and 6,668, respectively.

**p) Revenue recognition**

The Company recognizes revenue on sales at the time products are shipped from the manufacturing facilities, and when the following criteria are met: persuasive evidence of an arrangement exists; the price to the buyer is fixed and determinable and collectability of the sales price is reasonably assured.

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

**q) Cost of sales, selling expenses, general and administrative expenses**

Cost of sales consist of the following expenses: the change in opening and closing inventories, purchases of raw materials, labor costs, third party manufacturing costs, depreciation and amortization expense of property, plant and equipment used in the production of finished goods, energy and water expenses (for instance light and power expenses), expenses for maintenance and repairs of production facilities, distribution network costs (including inbound freight charges, warehousing costs, internal transfer costs and other logistic costs involved in the production cycle), rentals and security costs for production facilities, small-tools replacement costs, insurance costs, and other minor expenses.

Selling expenses consist of the following expenses: shipping and handling costs incurred for transporting finished products to customers, advertising costs, labor costs for sales personnel, rental expense for stores, commissions to sales representatives and related costs, depreciation and amortization expense of property, plant and equipment and intangible assets that, based on their usage, are allocated to selling expense, sales catalogue and related expenses,

warranty costs, exhibition and trade-fair costs, advisory fees for sales and marketing of finished products, expenses for maintenance and repair of stores and other trade buildings, bad debt expense, insurance costs for trade receivables and other related costs, and other miscellaneous expenses.

General and administrative expenses consist of the following expenses: costs for administrative personnel, advisory fees for accounting and information-technology services, traveling expenses for management and other personnel, depreciation and amortization expenses related to property, plant and equipment and intangible assets that, based on their usage, are allocated to general and administrative expense, postage and telephone costs, stationery and other office-supplies costs, expenses for maintenance and repair of administrative facilities, statutory auditors and external auditors fees, and other miscellaneous expenses. As noted above, the costs of the Group's distributions network, which include inbound freight charges, warehousing costs, internal transfer costs and other logistic costs involved in the production cycle, are classified under the cost of sales line item.

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**Natuzzi S.p.A. and Subsidiaries**

Notes to consolidated financial statements

*(Expressed in thousands of euros except as otherwise indicated)*

**r) Shipping and handling costs**

Shipping and handling costs sustained to transport products to customers are expensed in the periods incurred and are included in selling expenses. Shipping and handling expenses recorded for the years ended December 31, 2013, 2012 and 2011 were 40,461, 42,577 and 40,554, respectively.

**s) Advertising costs**

Advertising costs (other than those capitalized as intangibles) are expensed in the periods incurred and are included in selling expenses. Advertising expenses recorded for the years ended December 31, 2013, 2012 and 2011 were 16,152, 19,527 and 24,332, respectively.

**t) Commission expense**

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

**u) Warranties**

Warranties are estimated and provided for in the year of sales. Such allowances are made based on historical trends. The Company has the ability to make a reasonable estimate of such allowances due to large volumes of homogeneous transactions and historical trends.

**v) Research and development costs**

Research and development costs are expensed in the period incurred. At December 31, 2013 and 2012 research and development expenses were 7,940 and 7,954 respectively.

**w) Contingencies**

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

**x) Use of estimates**

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



**y) Leases**

The Company has evaluated its existing lease contracts and concluded that all of its contracts are operating in nature. As such, lease expenses are recognized when incurred over the term of the lease.

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Notes to consolidated financial statements

*(Expressed in thousands of euros except as otherwise indicated)***z) Earnings (losses) per share**

Basic earnings (losses) per share is calculated by dividing net earnings (losses) attributable to ordinary shareholders by the weighted-average number of ordinary shares outstanding during the period. Diluted earnings (losses) per share include the effects of the possible issuance of ordinary shares under share grants and option plans in the determination of the weighted average number of ordinary shares outstanding during the period.

The following table provides the amounts used in the calculation of losses per share:

|   | 2013       | 2012       | 2011       |
|---|------------|------------|------------|
| Net loss attributable to ordinary shareholders  | (68,576)   | (26,104)   | (19,586)   |
| Weighted-average number of ordinary shares outstanding during the year                      | 54,853,045 | 54,853,045 | 54,853,045 |
| Increase resulting from assumed conversion of share grants and options                      |            |            |            |
| Weighted-average number of ordinary shares and potential shares outstanding during the year | 54,853,045 | 54,853,045 | 54,853,045 |

**4. Cash and cash equivalents**

Cash and cash equivalents are analyzed as follows:

|               | 2013   | 2012   |
|---------------|--------|--------|
| Cash on hand  | 180    | 163    |
| Bank accounts | 60,853 | 77,550 |
|               | 61,033 | 77,713 |

The following table shows the Group's cash and cash equivalents broken-down by country/region

|       | 2013   | 2012   |
|-------|--------|--------|
| China | 52,429 | 61,546 |

|               |        |        |
|---------------|--------|--------|
| Europe        | 7,961  | 15,234 |
| North America | 378    | 556    |
| South America | 105    | 200    |
| Other         | 160    | 177    |
|               | 61,033 | 77,713 |

The Company anticipates that its existing cash and cash equivalents resources, including availability under its letter of credit (see note 13) and cash flows from operations, will be adequate to satisfy its liquidity requirements and capital expenditures through calendar year 2014. If available liquidity is not sufficient to meet the Company's operating and debt service obligations as they come due, the management could pursue alternative financing arrangements or reduce expenditures as necessary to meet the Company's cash requirements throughout 2014.

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Notes to consolidated financial statements

*(Expressed in thousands of euros except as otherwise indicated)***5. Marketable debt securities**

Details regarding marketable debt securities are as follows:

|                         | 2013 | 2012 |
|-------------------------|------|------|
| Foreign corporate bonds | 4    | 4    |
|                         | 4    | 4    |

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

| 2013                    | Cost | Gross unrealized<br>Gains | (Losses) | Fair<br>value |
|-------------------------|------|---------------------------|----------|---------------|
| Foreign corporate bonds | 4    |                           |          | 4             |
| Total                   | 4    |                           |          | 4             |

| 2012                    | Cost | Gross unrealized<br>Gains | (Losses) | Fair<br>value |
|-------------------------|------|---------------------------|----------|---------------|
| Foreign corporate bonds | 4    |                           |          | 4             |
| Total                   | 4    |                           |          | 4             |

The contractual maturity of the Group's marketable debt securities at December 31, 2013 is on short term.

**6. Trade receivables, net**

Trade receivables are analyzed as follows:

|                          | 2013   | 2012   |
|--------------------------|--------|--------|
| North American customers | 32,100 | 37,288 |
| Other foreign customers  | 33,045 | 41,208 |

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|                                   |          |         |
|-----------------------------------|----------|---------|
| Domestic customers                | 24,951   | 24,421  |
| Trade bills receivable            |          |         |
| Total trade receivables           | 90,096   | 102,917 |
| (Allowance for doubtful accounts) | (11,243) | (9,848) |
| Total trade receivables, net      | 78,853   | 93,069  |

Trade receivables are due primarily from major retailers who sell directly to their customers. Trade receivables due from related parties amounted to 5,471 as at December 31, 2013 (4,283 in 2012). Sales to related parties amounted to 5,255 in 2013 (4,750 in 2012). Transactions with related parties were conducted at arm's length.

As of December 31, 2013, 2012 and 2011 and for each of the years in the three-year period ended December 31, 2013, the Company had customers who exceeded 5% of trade receivables and/or net sales as follows:

| Trade receivables | N° of customers | % of trade receivables |
|-------------------|-----------------|------------------------|
| 2013              | 2               | 15%                    |
| 2012              | 2               | 17%                    |
| 2011              | 2               | 15%                    |

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## Notes to consolidated financial statements

*(Expressed in thousands of euros except as otherwise indicated)*

| Net sales | N° of customers | % of net sales |
|-----------|-----------------|----------------|
| 2013      | 2               | 14%            |
| 2012      | 2               | 15%            |
| 2011      | 2               | 14%            |

In 2013, 2012 and 2011 one customer accounted for approximately 8%, 8% and 9% of the total net sales of the Group, respectively. This customer operates many furniture stores throughout the world.

The Company insures with a third party its collection risk in respect of a significant portion of accounts receivable outstanding balances, and estimates an allowance for doubtful accounts based on the insurance in place, the credit worthiness of its customers, as well as general economic conditions.

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

| Allowance for doubtful accounts                  | 2013    | 2012    | 2011   |
|--|---------|---------|--------|
| Balance, beginning of year                       | 9,848   | 10,647  | 9,373  |
| Charges-bad debt expense                         | 3,413   | 471     | 1,695  |
| (Reductions-write off of uncollectible accounts) | (2,018) | (1,270) | (421)  |
| Balance, end of year                             | 11,243  | 9,848   | 10,647 |

Trade receivables denominated in foreign currencies at December 31, 2013 and 2012 totaled 42,357 and 56,526, respectively. These receivables consist of the following:

| Trade receivables in foreign currencies | 2013   | 2012   |
|---|--------|--------|
| U.S. dollars                            | 23,821 | 28,004 |
| Canadian dollars                        | 9,461  | 15,497 |
| British pounds                          | 2,366  | 3,255  |
| Australian dollars                      | 1,847  | 3,237  |
| Other currencies                        | 4,862  | 6,533  |
| Total                                   | 42,357 | 56,526 |

**7. Other receivables**

Other receivables are analyzed as follows:

|  | 2013   | 2012   |
|--|--------|--------|
| Receivable from National Institute for Social Security | 16,473 | 16,940 |
| Government capital grants                              | 5,239  | 7,561  |
| VAT  | 4,484  | 8,016  |
| Receivable from tax authorities                        | 2,901  | 2,086  |
| Advances to suppliers                                  | 8,579  | 9,418  |
| Other  | 10,808 | 6,991  |
|  | 48,484 | 51,012 |

The Receivable from National Institute for Social Security represents the amounts anticipated by the Company on behalf of such governmental institute related to salaries for those employees subject to temporary work force reduction.

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## Notes to consolidated financial statements

*(Expressed in thousands of euros except as otherwise indicated)*

The receivable for Government capital grants represents amounts due from government agencies related to capital expenditures that have been incurred.

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

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

The Advances to suppliers represents principally advance payment for services and general expenses.

The Other caption primarily includes deposits and certain receivables related to green incentive for photovoltaic investment. The increase with respect to 2012 is related to the portion (4.6 million, collected in March 2014) of the compensation with the Shanghai Municipality deriving from the second supplementary agreement that was signed in July 2013 between the Company and the Shanghai Municipality, pursuant to which the Company obtained the reimbursement of taxes due on 2011 relocation compensation.

**8. Inventories**

Inventories are analyzed as follows:

|                                 | 2013   | 2012   |
|---------------------------------|--------|--------|
| Leather and other raw materials | 47,206 | 51,901 |
| Goods in process                | 8,931  | 8,541  |
| Finished products               | 22,854 | 21,827 |
|                                 | 78,991 | 82,269 |

As of December 31, 2013 and 2012 the provision for slow moving and obsolete raw materials and finished products included in inventories amounts to 6,572 and 6,252, respectively.

**9. Prepaid expenses and accrued income**

Prepaid expenses and accrued income are analyzed as follows:



|                | 2013  | 2012  |
|----------------|-------|-------|
| Accrued income | 4     | 25    |
| Prepayments    | 1,934 | 2,006 |
|                | 1,938 | 2,031 |

Prepayments mainly include the rent advance payment on factory buildings.

**10. Property, plant and equipment and accumulated depreciation**

Fixed assets are listed below together with accumulated depreciation.

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## Notes to consolidated financial statements

*(Expressed in thousands of euros except as otherwise indicated)*

|                                      | Cost or<br>valuation | Accumulated<br>depreciation | Net<br>Book<br>value | Annual rate<br>of<br>depreciation |     |
|--------------------------------------|----------------------|-----------------------------|----------------------|-----------------------------------|-----|
| 2013                                 |                      |                             |                      |                                   |     |
| Land and industrial buildings        | 166,056              | (65,797)                    | 100,259              | 0                                 | 10% |
| Machinery and equipment              | 123,781              | (100,414)                   | 23,367               | 10                                | 25% |
| Airplane                             | 24,075               | (17,331)                    | 6,744                |                                   | 3%  |
| Office furniture and equipment       | 23,155               | (21,402)                    | 1,753                | 10                                | 20% |
| Retail gallery and store furnishings | 32,068               | (30,336)                    | 1,732                | 25                                | 35% |
| Transportation equipment             | 4,266                | (3,873)                     | 393                  | 20                                | 25% |
| Leasehold improvements               | 17,648               | (9,853)                     | 7,795                | 10                                | 20% |
| Construction in progress             | 1,536                |                             | 1,536                |                                   |     |
| <b>Total</b>                         | <b>392,585</b>       | <b>(249,006)</b>            | <b>143,579</b>       |                                   |     |

|                                      | Cost or<br>valuation | Accumulated<br>depreciation | Net book<br>value | Annual rate of<br>depreciation |     |
|--------------------------------------|----------------------|-----------------------------|-------------------|--------------------------------|-----|
| 2012                                 |                      |                             |                   |                                |     |
| Land and industrial buildings        | 169,810              | (62,803)                    | 107,007           | 0                              | 10% |
| Machinery and equipment              | 123,262              | (98,867)                    | 24,395            | 10                             | 25% |
| Airplane                             | 24,075               | (10,834)                    | 13,241            |                                | 3%  |
| Office furniture and equipment       | 23,033               | (21,031)                    | 2,002             | 10                             | 20% |
| Retail gallery and store furnishings | 32,581               | (30,043)                    | 2,538             | 25                             | 35% |
| Transportation equipment             | 4,630                | (4,147)                     | 483               | 20                             | 25% |
| Leasehold improvements               | 17,831               | (7,406)                     | 10,425            | 10                             | 20% |
| Construction in progress             | 1,370                |                             | 1,370             |                                |     |
| <b>Total</b>                         | <b>396,592</b>       | <b>(235,131)</b>            | <b>161,461</b>    |                                |     |

The following table shows the Long lived assets down by country:

|                          | 2013   | 2012   |
|--------------------------|--------|--------|
| Italy                    | 88,737 | 98,365 |
| Romania                  | 18,450 | 19,386 |
| Brazil                   | 11,326 | 13,815 |
| United States of America | 12,805 | 13,889 |
| China                    | 11,195 | 12,589 |
| Spain                    |        | 797    |
| UK                       | 1,019  | 1,543  |

|                 |                |                |
|-----------------|----------------|----------------|
| Other countries | 47             | 1,077          |
| <b>Total</b>    | <b>143,579</b> | <b>161,461</b> |

In 2013 the Company performed an impairment review of its fixed assets and an impairment loss totaling 8,550 was recorded (450 as land and industrial buildings, 448 as machinery and equipment, 1,659 as retail gallery and store furnishing and 5,993 as airplane).

For assets in use, the Company determined the fair value using the Undiscounted and Discounted Cash Flow, at the lowest level for which identifiable cash flows are independent of other cash flows, and compared it with the carrying value of its fixed assets. Cash flow projections were derived from the Business Plan 2014-2016, as adopted by the Board of Directors on February 28, 2014.

For assets not in use/to be disposed of, the fair value was estimated through third-party independent external appraisals, and, for some specific assets (Airplane) through the most recent market value determined on the basis of a preliminary sale agreement stipulated in the first months of 2014. Following the main impairments performed by country.

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In **Brazil** the Company in order to improve its worldwide manufacturing efficiency, in 2008 decided to close and try to sell one of the two Brazilian manufacturing plants located in Pojuca State of Bahia, recording an impairment loss of 2,911. As a result of this decision, as of December 31, 2009 the Company prepared the impairment test, based on a third-party independent appraisal, and determined that the carrying value of this manufacturing plant (net of the 2008 impairment loss already recorded), was less than the fair value less cost to sell. As a consequence, no additional impairment loss was recorded in the 2009 consolidated statement of operations.

During 2010, the Company formally confirmed the decision to sell this manufacturing plant with a Board of Directors resolution. The plant was classified as property, plant and equipment since the sale was deemed unlikely to happen in the short term. As of December 31, 2010, the Company performed the annual impairment analysis with a new third-party independent appraisal and determined that its carrying value was less than the fair value less cost to sell. As consequence, no additional impairment loss was recorded in the 2010 consolidated statement of operations.

During 2011, the Company, was not able to sell this plant and, at the end of 2011, engaged a third-party independent consulting firm to review the fair market value of the Pojuca plant. With this new external appraisal, the management performed the annual impairment analysis and determined that its carrying value as of December 31, 2011 exceeded its fair value. Therefore, as of December 31, 2011 the carrying value of Pojuca plant was reduced to its fair value. This resulted in an impairment loss of 1,036, that was recorded, under the line other income/(expense) net of the consolidated statement of operations for the year ended December 31, 2011(see note 26). As of December 31, 2011 the carrying value, net of the 2008 and 2011 impairment loss, was 5,891.

During 2012 the company reevaluated its earlier decision to sell the plant, given its growth plans in Brazil. As of December 31, 2012, the Company performed the annual impairment analysis with a new third-party independent appraisal and determined that its carrying value was less than the fair value less cost to sell. As consequence, no additional impairment loss was recorded in the 2012 consolidated statement of operations. As of December 31, 2012 the carrying value, net of the 2008 and 2011 impairment loss, was 5,891.

As of December 31, 2013, new external appraisals were requested for the review of the fair market value of Pojuca plant (not in use) and Simoes Filho plant (currently in use). The appraisals determined that the carrying values of these plants (net of the impairment losses already recorded for the Pojuca plant) were less than the fair value less cost to sell for each of the plant considered. As a consequence, no additional impairment loss has been recorded in 2013 consolidated statement of operations. As of December 31, 2013 the carrying value of the plant not in use (Pojuca), net of the 2008 and 2011 impairment loss, is 4,936.

In **Italy**, the Company in 2008 decided to close and market for sale six industrial buildings mainly utilized as warehouses and located in the cities of Altamura and Matera nearby the Group's headquarters in Santeramo in Colle. As a result of this decision the Company performed an impairment analysis and recorded an impairment loss of 1,792.

During 2009 the Company sold one of the above industrial buildings (not impaired in 2008).



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During 2011 one industrial building was reactivated as a consequence of demand from the made in Italy production and, at year-end, the Company performed a new impairment analysis with a third-party independent appraisal that resulted in no additional impairment losses. As of December 31, 2011 the carrying value, net of the 2008 impairment loss, of the four remaining industrial buildings is 5,109.

During 2012 one of those buildings was sold for cash consideration of 1,500, close to its carrying value and, at year-end, the Company performed the annual analysis on the remaining three buildings not in use, that resulted in no additional impairment losses. As of December 31, 2012 the carrying value, net of the 2008 impairment loss, of the three remaining industrial buildings not in use was 3,842.

As of December 31, 2013, as a consequence of the reorganization process of the Group that resulted in the agreement entered into with government Ministries, regions and trade unions on October 10, 2013, two plants (Ginosa and Matera La Martella) were idled and considered not to be used in the near term (2014). As a consequence, at year-end, after recording the depreciation charge for the year, the Company performed an impairment analysis estimating the fair value of all industrial buildings not in use on the basis of observable market transactions involving sales of comparable buildings and third party independent appraisals. Based on these third-party independent appraisals, the Company recorded an impairment loss of 404.

As of December 31, 2013, the carrying value of the buildings not in use, net of cumulated impairment losses is 17,717.

Also, during 2013 an impairment test was performed on assets pertaining to the Italian retail business unit, in consideration of the history of losses over the past few years. The recoverable amount has been determined as value in use, using the Discounted Cash Flow method, derived from the Business Plan 2014-2016, as adopted by the Board of Directors on February 28, 2014. The impairment test resulted in the recording of an impairment loss of 698 for long-lived assets connected to the retail business unit. Also, as of December 31, 2013, an impairment loss of 5,993 has been recorded for a specific asset (Airplane), as a result of a preliminary sale agreement signed by the Company in March 2014, in order to align the carrying value of the Airplane to the market value.

In **Spain**, in 2012 the Company performed an impairment review of the retail long-lived assets and an impairment loss of 864 was recorded. The Company determined the fair value of the assets using the Discounted Cash Flow, at the lowest level for which identifiable cash flows are independent of other cash flows, and compared it with the carrying value of its fixed assets. An impairment loss arose due, in particular, to the decline in cash flow projections related to the uncertain prospects for full economic recovery in Spain, since private consumption was negatively impacted by a general weakness in the job market, high levels of public indebtedness, and a decreasing level of savings among families.

As of December 31, 2013, an additional impairment test has been performed for the retail long-lived assets (equipment and retail gallery and store furnishing) as a consequence of the reported losses of stores and galleries over the past few years. The recoverable amount has been determined as value in use, using the Discounted Cash Flow

method, derived from the Business Plan 2014-2016, as adopted by the Board of Directors on February 28, 2014. The impairment test resulted in the recording of an impairment loss of 482. As a consequence of the impairment losses recorded and some write-offs of assets related to closed stores (113), the carrying value of long-lived assets as of December 31, 2013 is nil.

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In **Other European countries** (mainly Germany), during 2013 an impairment test has been performed for the retail long-lived assets due to the negative track record of economic results, and impairment loss of 782 has been recorded. Also in this case, the recoverable amount has been determined as value in use, using the Discounted Cash Flow method, derived from the Business Plan 2014-2016, as adopted by the Board of Directors on February 28, 2014.

In addition, in UK assets write-off were recorded for some stores that were closed during 2013. The total asset write-off was 246.

In the other countries (China, Romania, United States of America), no impairment indicators arose in the current year, thanks to the positive track record of operating results.

**11. Intangible assets**

Intangible assets consist of the following, together with accumulated amortization:

|                               | Gross carrying amount | Accumulated amortization | Net book value |
|-------------------------------|-----------------------|--------------------------|----------------|
| 2013                          |                       |                          |                |
| Software                      | 25,503                | (22,115)                 | 3,388          |
| Trademarks, patents and other | 14,490                | (12,320)                 | 2,170          |
| <b>Total</b>                  | <b>39,993</b>         | <b>(34,435)</b>          | <b>5,558</b>   |
| 2012                          |                       |                          |                |
| Software                      | 23,279                | (19,499)                 | 3,780          |
| Trademarks, patents and other | 12,725                | (11,723)                 | 1,002          |
| <b>Total</b>                  | <b>36,004</b>         | <b>(31,222)</b>          | <b>4,782</b>   |

During 2013, the Company included in Trademarks, patents and other the advertisement costs related to the launch of its new armchair, Re-vive, for an amount of 1,225. Under US GAAP this cost will be completely expensed with an adjustment to the net result and equity of the same amount. See note 29.

Amortization expense recorded for these assets was 3,212, 2,683 and 3,714 for the years ended December 31, 2013, 2012 and 2011, respectively. Estimated amortization expense for the next five years is 1,456 in 2014, 440 in 2015, 378 in 2016 and 73 in 2017.



**12. Goodwill**

At December 31, 2013 and 2012 the net book value of goodwill may be analyzed as follows:

|                               | 2013    | 2012    |
|-------------------------------|---------|---------|
| Gross amount                  | 9,136   | 9,136   |
| Less accumulated amortization | (9,136) | (9,055) |
| Total, net                    |         | 81      |

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The changes in the carrying amount of goodwill for the year ended December 31, 2013, 2012 and 2011 are as follows:

|                              | 2013 | 2012  | 2011  |
|------------------------------|------|-------|-------|
| Balance, beginning of year   | 81   | 261   | 711   |
| Increase for new acquisition |      |       |       |
| Reductions for amortization  | (81) | (180) | (450) |
| Balance, end of year         |      | 81    | 261   |

During 2013, the depreciation process of Goodwill, related to a small operating unit named Italian retail owned stores, was completed and, as a consequence, its net book value is nil and aligned with the US GAAP where the original carrying value was already written-off. See Note 29.

**13. Bank overdrafts**

Bank overdrafts consist of the following:

|                 | 2013   | 2012   |
|-----------------|--------|--------|
| Bank overdrafts | 25,020 | 26,948 |

Bank overdrafts are payable on demand. The weighted average interest rates on the above overdrafts at December 31, 2013 and 2012 are as follows:

|                 | 2013  | 2012  |
|-----------------|-------|-------|
| Bank overdrafts | 3.89% | 2.16% |

Letters of credit available to the Group amounted to 47,026 and 48,258 at December 31, 2013 and 2012, respectively. The unused portion of these facilities, for which no commitment fees are due, amounted to 1,028 and 1,093 at December 31, 2013 and 2012, respectively.

**14. Accounts payable-trade**

Accounts payable-trade totaling 67,393 and 63,328 at December 31, 2013 and 2012, respectively, represent principally amounts payable for purchases of goods and services in Italy and abroad, and include 19,392 and 27,564 at December 31, 2013 and 2012, respectively, denominated in foreign currencies.

**15. Accounts payable-other**

Accounts payable-other are analyzed as follows:

|   | 2013          | 2012          |
|---|---------------|---------------|
| Provision for warranties                      | 6,335         | 5,804         |
| Advances from customers                       | 4,776         | 4,356         |
| Cooperative advertising and quantity discount | 3,956         | 4,347         |
| Withholding taxes on payroll and on others    | 2,329         | 2,091         |
| Other accounts payable                        | 8,443         | 4,435         |
| <b>Total</b>                                  | <b>25,839</b> | <b>21,033</b> |

Other accounts payable represents principally VAT payable.

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The following table provides the movements in the Provision for warranties :

|                            | 2013    | 2012    | 2011    |
|----------------------------|---------|---------|---------|
| Balance, beginning of year | 5,804   | 7,180   | 8,661   |
| Charges to profit and loss | 2,492   | 1,000   | 1,355   |
| Reductions for utilization | (1,961) | (2,376) | (2,836) |
| Balance, end of year       | 6,335   | 5,804   | 7,180   |

**16. Taxes on income**

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

|                     | 2013   | 2012   | 2011   |
|---------------------|--------|--------|--------|
| IRES (state tax)    | 27.50% | 27.50% | 27.50% |
| IRAP (regional tax) | 4.82%  | 4.82%  | 4.82%  |

IRES is a state tax and is calculated on the taxable income determined on the income before taxes modified to reflect all temporary and permanent differences regulated by the tax law. The enacted IRES tax rate for 2013, 2012 and 2011 is 27.50% of taxable income.

IRAP is a regional tax and each Italian region has the power to increase the current rate of 3.90% by a maximum of 0.92%. In general, the taxable base of IRAP is a form of gross profit determined as the difference between gross revenues (excluding interest and dividend income) and direct production costs (excluding labour costs, interest expense and other financial costs). The enacted IRAP tax rate due in Puglia region for 2013, 2012 and 2011 is 4.82% (3.90% plus 0.92%).

Total income taxes for the years ended December 31, 2013, 2012 and 2011 are allocated as follows:

|            | 2013    | 2012     | 2011    |
|------------|---------|----------|---------|
| Current:   |         |          |         |
| - Domestic | (1,212) | (1,856)  | (1,842) |
| - Foreign  | (2,835) | (8,309)  | (836)   |
| Total (a)  | (4,047) | (10,165) | (2,678) |

|             |         |         |         |
|-------------|---------|---------|---------|
| Deferred:   |         |         |         |
| - Domestic  |         | (1,000) |         |
| - Foreign   | (89)    | 6,994   | (6,206) |
| Total (b)   | (89)    | 5,994   | (6,206) |
| Total (a+b) | (4,136) | (4,171) | (8,884) |

Certain foreign subsidiaries enjoy significant tax benefits, such as corporate income tax exemptions or reductions of the corporate income tax rates effectively applicable. The tax reconciliation table reported below shows the effect of such tax exempt income on the Group's 2013, 2012 and 2011 income tax charge.

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Consolidated Net income/(loss) before income taxes and non-controlling interest of the consolidated statement of operations for the year ended December 31, 2013, 2012 and 2011, is analyzed as follows:

|             | 2013     | 2012     | 2011     |
|-------------|----------|----------|----------|
| Domestic    | (60,085) | (11,144) | (22,553) |
| (a) Foreign | (4,144)  | (10,715) | 12,560   |
| (b) Total   | (64,229) | (21,859) | (9,993)  |

The effective income taxes differ from the expected income tax expense (computed by applying the IRES state tax, which is 27.5% for 2013, 2012 and 2011, to income before income taxes and non-controlling interest) as follows:

|   | 2013     | 2012    | 2011     |
|---|----------|---------|----------|
| Expected tax benefit at nominal tax rates   | 17,663   | 6,011   | 2,748    |
| Effects of:   |          |         |          |
| -Tax exempt income  | 1,450    | 1,109   | 1,505    |
| -Aggregate effect of different tax rates in foreign jurisdictions                     | 1,311    | 965     | 1,429    |
| - Italian regional tax  | (1,212)  | (1,854) | (1,796)  |
| - Expiration and write off tax loss carry-forwards                                    | (3,101)  |         | (10,086) |
| - Non-deductible expenses   | (3,250)  | (993)   | (1,940)  |
| - Provisions for contingent liabilities   |          |         |          |
| - Depreciation and impairment of goodwill   | (5)      | (5)     | (5)      |
| - Effect of net change in valuation allowance established against deferred tax assets | (16,992) | (8,679) | (1,549)  |
| - Tax effect of unremitted earnings   |          | (725)   | 810      |
| Actual tax charge   | (4,136)  | (4,171) | (8,884)  |

The effective income tax rates for the years ended December 31, 2013, 2012 and 2011 were 6.44%, 19.08% and 88.9%, respectively.

The related Income tax debt recorded for the years ended December 31, 2013 and 2012 is 7,126 and 9,199, respectively.



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The tax effects of temporary differences that give rise to deferred tax assets and deferred tax liabilities at December 31, 2013 and 2012 are presented below:

|   | 2013           | 2012           |
|---|----------------|----------------|
| <b><u>Deferred tax assets:</u></b>              |                |                |
| Tax loss carry-forwards                         | 75,839         | 67,099         |
| Provision for warranties                        | 1,976          | 1,787          |
| Allowance for doubtful accounts                 | 3,890          | 3,411          |
| Unrealized net losses on foreign exchange       | 1,152          | 347            |
| Impairment of long-lived assets                 | 4,554          | 2,231          |
| One-time termination benefits                   | 6,805          | 1,693          |
| Inventory obsolescence                          | 1,648          | 1,268          |
| Goodwill and intangible assets                  | 1,503          | 1,608          |
| Intercompany profit on inventory                | 1,176          | 1,166          |
| Provision for contingent liabilities            | 1,893          | 2,523          |
| Provision for sales representatives             | 339            | 408            |
| <b>Total gross deferred tax assets</b>          | <b>100,775</b> | <b>83,541</b>  |
| Less valuation allowance                        | (98,772)       | (81,780)       |
| <b>Net deferred tax assets (a)</b>              | <b>2,003</b>   | <b>1,761</b>   |
| <b><u>Deferred tax liabilities:</u></b>         |                |                |
| Unrealized net gains on foreign exchange        | (1,008)        | (529)          |
| Unremitted earnings of subsidiaries             | (137)          | (137)          |
| With tax on unremitted earnings of subsidiaries | (1,000)        | (1,000)        |
| Government Grants                               | (570)          | (570)          |
| Other temporary differences                     | 0              | (96)           |
| <b>Total deferred tax liabilities (b)</b>       | <b>(2,715)</b> | <b>(2,332)</b> |
| <b>Net deferred tax assets (a + b)</b>          | <b>(712)</b>   | <b>(571)</b>   |

A valuation allowance has been established for most of the deductible tax temporary differences and tax loss carry-forwards.

Net deferred tax assets not provided for are mainly related to provisions for contingent liabilities and unrealized net losses on foreign exchange recorded by Natuzzi China Ltd and Italsofa Romania, for which a valuation allowance has not been recorded in consideration of the positive economic result of the subsidiaries.



The valuation allowance for deferred tax assets as of December 31, 2013 and 2012 was 98,772 and 81,780, respectively. The net change in the total valuation allowance for the years ended December 31, 2013 and 2012 was an increase of 16,992 and 8,679, respectively. In assessing the reliability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible and the tax loss carry-forwards are utilized.

Starting from 2012, in Italy, a new tax rule has been adopted for tax losses carry forwards. From 2012 all net losses carried forward no longer expire, with the only limitation being that such loss carryforwards can be utilized to off-set a maximum of 80% of the taxable income in each following year. The new tax rule is applicable also to net losses recorded in previous periods.

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Given the cumulative loss position of the Company and of most of the Italian and foreign subsidiaries as of December 31, 2013 and 2012, and despite the new tax rule described above, management has considered the scheduled reversal of deferred tax liabilities and tax planning strategies, in making their assessment. The management after a reasonable analysis as of December 31, 2013 and 2012 has not identified any relevant tax planning strategies prudent and feasible available to reduce the valuation allowance. Therefore, at December 31, 2013 and 2012 the realization of the deferred tax assets is primarily based on the scheduled reversal of deferred tax liabilities, except in certain historically profitable jurisdictions.

Based upon this analysis, management believes it is not more likely than not that Natuzzi Group will realize the benefits of these deductible differences and net operating losses carry-forwards, net of the existing valuation allowance at December 31, 2013 and 2012.

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

|  |         |             |              |
|--|---------|-------------|--------------|
| (c) <u>2013</u>                                  | Current | Non current | Total        |
| Gross deferred tax assets                        | 4,249   | 96,526      | 100,775      |
| (d) Less Valuation allowance                     | (2,246) | (96,526)    | (98,772)     |
| (e) Deferred tax assets                          | 2,003   |             | 2,003        |
| Deferred tax liabilities compensated             | (1,715) |             | (1,715)      |
| Net deferred tax assets                          | 288     |             | 288          |
| Deferred tax liabilities                         | (1,000) |             | (1,000)      |
| <b>(f) Net deferred tax assets (liabilities)</b> |         |             | <b>(712)</b> |
| 2012   | Current | Non current | Total        |
| Gross deferred tax assets                        | 3,306   | 80,235      | 83,541       |
| Less Valuation allowance                         | (1,545) | (80,235)    | (81,780)     |
| Deferred tax assets                              | 1,761   |             | 1,761        |
| Deferred tax liabilities compensated             | (1,236) |             | (1,236)      |
| Net deferred tax assets                          | 525     |             | 525          |
| Deferred tax liabilities                         | (1,096) |             | (1,096)      |

**Net deferred tax assets (liabilities) (571)**

As of December 31, 2013, taxes that are due on the distribution of the portion of shareholders' equity equal to unremitted earnings of some of the subsidiaries is 137 and the 10% of the withholding tax has also been posted considering that these unremitted earnings will be distributed as dividends. The Group has provided for such taxes as the likelihood of distribution is probable.

As of December 31, 2013 the tax losses carried-forward of the Group total 264,181 and expire as follows:

|               |                |
|---------------|----------------|
| 2014          | 2,043          |
| 2015          | 2,301          |
| 2016          | 2,237          |
| 2017          | 3,801          |
| 2018          | 1,363          |
| Thereafter    | 49,072         |
| No expiration | 203,364        |
| <b>Total</b>  | <b>264,181</b> |

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*(Expressed in thousands of euros except as otherwise indicated)***17. Salaries, wages and related liabilities**

Salaries, wages and related liabilities are analyzed as follows:

|                               | 2013  | 2012  |
|-------------------------------|-------|-------|
| Salaries and wages            | 1,344 | 1,632 |
| Social security contributions | 3,462 | 3,384 |
| Vacation accrual              | 3,519 | 2,951 |
| Total                         | 8,325 | 7,967 |

**18. Long-term debt**

Long-term debt at December 31, 2013 and 2012 consists of the following:

|   | 2013    | 2012    |
|---|---------|---------|
| 0.25% long-term debt payable in semi-annual installments with final payment due July 2013     |         | 300     |
| 2.25% long-term debt payable in annual equal installments with final payment due May 30, 2015 | 597     | 885     |
| 3-month Euribor (360) plus a 1.0% spread long-term debt with final payment due August 2015    | 4,356   | 6,974   |
| 0.74% long-term debt payable in annual installments with final payment due April 2018         | 2,560   | 2,629   |
| Total long-term debt  | 7,513   | 10,788  |
| Less: (current installments)  | (3,342) | (3,503) |
| Long-term debt, excluding current installments  | 4,171   | 7,285   |

The most significant Long term debt of a nominal amount of 10,000 was obtained in 2010 with installments payable on a quarterly basis and with final payments due August 2015. This long term floating-rate debt provides variable installments depending on the 3-month Euribor (360) plus a 1.0% spread. Out of the total amount, the Company received 9,000 in 2010 and 1,000 in 2011. During 2012 and 2013 the Company punctually reimbursed all the installment of the aforementioned long term loans.

Loan maturities after 2013 are summarized below:

|            |       |
|------------|-------|
| 2015       | 2,623 |
| 2016       | 512   |
| 2017       | 516   |
| 2018       | 520   |
| Thereafter |       |
| Total      | 4,171 |

At December 31, 2013 and 2012 there are no covenants on the above long-term debt. In addition, at December 31, 2013 and 2012 there is no long-term debt denominated in foreign currencies.

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Interest expense related to long-term debt for the years ended December 31, 2013, 2012 and 2011 was 111, 209 and 295 respectively. Interest expense is paid with the related installment (quarterly, semi-annual or annual).

**19. Other liabilities**

Other liabilities consist of:

|  | 2013   | 2012   |
|--|--------|--------|
| Provision for tax and legal proceedings  | 7,315  | 8,293  |
| One-time termination benefits            | 24,730 | 6,135  |
| Termination indemnities for sales agents | 1,095  | 1,300  |
| Other provisions                         | 1,296  | 1,297  |
|  | 34,436 | 17,025 |

The Group is involved in a number of certain and probable claims (including tax claims) and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters, after the provision accrued, will not have a material adverse effect on the Group's consolidated financial position or results of operations. The changes in the balance of Provision for tax and legal proceedings for the year ended December 31, 2013, 2012 and 2011 are as follows:

|   | 2013    | 2012    | 2011    |
|---|---------|---------|---------|
| Provision for tax and legal proceedings |         |         |         |
| Balance, beginning of year              | 8,293   | 12,237  | 14,244  |
| -Increase for new provision             | 1,433   | 740     | 2,492   |
| -(Reductions)                           | (2,411) | (4,684) | (4,499) |
| Balance, end of year                    | 7,315   | 8,293   | 12,237  |

The One-time termination benefits include the amounts to be paid on the separation date of certain workers and have been determined by the Company based on the current applicable Italian law and regulations for involuntarily termination of employees. In particular, in September 2011 the Company and the Trade Unions submitted a request to the Italian Ministry of Labor to access for 24 months (starting from October 16, 2011) to the unemployment benefits (Italian law July, 23 1991 n. 223 e D.M. August 20, 2002 n. 31444) granted by a special Social Security procedure called CIGS *Cassa Integrazione Guadagni Straordinaria*. The average number of positions involved in the CIGS program within the Group's Italian facilities for the 2011-2013 period was 1,273, employed in the Italian headquarters and production sites. In October 2011 the Italian Ministry of Labor accepted the above request, and admitted the

Company to a 24 month layoff period, in order to support the reorganization process of the Company that assumed 1,060 redundant employees at the end of the lay-off period (October 15, 2013). Based on the above signed agreement, the Company, at December 31, 2011 increased the One-time termination benefits reserve to 6,703 with an addition accrual of 5,446 (for the 1,060 employees to be dismissed) recorded as a non-operating expense, under the line other income/(expense) net of the consolidated statement of operations for the year ended December 31, 2011. During 2012, the Company paid one-time termination benefits of 568 to the workers terminated pursuant to individual agreements reached during the year. As of December 31, 2012, the provision therefore decreased to 6,135.

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Before the end of the first lay-off period (October 15, 2013), an agreement was signed between the Company and the Trade Unions by which the Company obtained the extension by one year (October 15, 2014) of the special Social Security procedure called CIGS *Cassa Integrazione Guadagni Straordinaria*, and the number of redundant workers has been estimated at 1,506, with the possibility for maximum 600 workers to adhere to an incentive payments program ending in May 2014. Based on the agreement dated October 10, 2013, the Company, at December 31, 2013 increased the One-time termination benefits reserve to 24,730 with an addition accrual of 19,959 recorded as a non-operating expense, under the line other income/(expense) net of the consolidated statement of operations for the year ended December 31, 2013 (see note 26). The provision, calculated by the Company together with its labor consultants, considered (i) the cost of future layoffs, to be paid for those workers not adhering to the incentive payments program (ii) the best estimation of incentive payments to be paid in 2014 (iii) the advance notice remuneration owed to redundant workers in case of termination.

|                              |         |       |       |
|------------------------------|---------|-------|-------|
| One time termination benefit | 2013    | 2012  | 2011  |
| Balance, beginning of year   | 6,135   | 6,703 | 2,046 |
| -Increase for new provision  | 19,959  |       | 5,446 |
| -(Reductions)                | (1,364) | (568) | (789) |
| Balance, end of year         | 24,730  | 6,135 | 6,703 |

During 2013, 2012 and 2011, the Company paid one-time termination benefits of 1,364, 568 and 789 respectively, to the workers terminated pursuant to individual agreements reached during each year.

**20. Shareholders equity**

The share capital is owned, as of December 31, as follows:

|                         |       |       |
|-------------------------|-------|-------|
|                         | 2013  | 2012  |
| Mr. Pasquale Natuzzi*   | 55.1% | 54.5% |
| Mrs. Anna Maria Natuzzi | 2.6%  | 2.6%  |
| Mrs. Annunziata Natuzzi | 2.5%  | 2.5%  |
| Other investors         | 39.8% | 40.4% |
|                         | 100%  | 100%  |



\* *through Invest 2003 S.r.l.*

An analysis of the Reserves is as follows:

|   | 2013          | 2012          |
|---|---------------|---------------|
| Legal reserve                             | 11,199        | 11,199        |
| Monetary revaluation reserve              | 1,344         | 1,344         |
| Government capital grants reserve         | 29,749        | 29,749        |
| Majority shareholder capital contribution | 488           | 488           |
| <b>Total</b>                              | <b>42,780</b> | <b>42,780</b> |

The number of ordinary shares issued at December 31, 2013 and 2012 is 54,853,045. The par value of one ordinary share is euro 1.

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Italian law requires that 5% of net income of the parent company and each of its consolidated Italian subsidiaries be retained as a legal reserve, until this reserve is equal to 20% of the issued share capital of each respective company. The legal reserve may be utilized to cover losses; any portion which exceeds 20% of the issued share capital is distributable as dividends. The combined legal reserves totaled 11,199 at December 31, 2013 and 2012, respectively.

During 2008 the majority shareholder made a contribution of 488 recorded by the Company under shareholder's equity in the line item reserves.

No taxes would be payable on the distribution of the government capital grants reserve.

The cumulative translation adjustment included in retained earnings of shareholders' equity related to translation of the Group's foreign assets and liabilities at December 31, 2013 was a debit of 7,418 (credit of 3,875 at December 31, 2012).

**Non-controlling interest** Non-controlling interest shown in the accompanying consolidated balance sheet at December 31, 2013 is 2,692 (2,524 at December 31, 2012). The variation includes the effect of the exchange difference on group's foreign financial statements.

**21. Commitments and contingent liabilities**

Several companies of the Group lease manufacturing facilities and stores under non-cancellable lease agreements with expiry dates through 2023. Rental expense recorded for the years ended December 31, 2013, 2012 and 2011 was 17,602, 17,931 and 18,710, respectively. As of December 31, 2013, the minimum annual rental commitments are as follows:

|       |        |
|-------|--------|
| 2014  | 15,446 |
| 2015  | 15,228 |
| 2016  | 15,428 |
| 2017  | 15,737 |
| 2018  | 16,240 |
| Total | 78,079 |

Certain banks have provided guarantees at December 31, 2013 to secure payments to third parties amounting to 898 (893 at December 31, 2012). These guarantees are unsecured and have various maturities extending through December 31, 2016.

In October 2013, a new agreement was signed between the Company, the Trade Unions and relevant authorities, by which the Company obtained the extension by one year (October 15, 2014) of the special Social Security procedure called CIGS *Cassa Integrazione Guadagni Straordinaria*, and the number of redundant workers has been re-determined as 1,506, with the possibility for maximum 600 workers to adhere to an incentive payments program by the end of May 2014. If at the end of the layoff period (October 15, 2014) the CIGS *Cassa Integrazione Guadagni Straordinaria* program is not extended by the Italian Ministry of Labor, the Company will provide the redundant employees with notice of formal termination.

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*(Expressed in thousands of euros except as otherwise indicated)***22. Segmental and geographical information**

The Group operates in a single industry segment, that is, the design, manufacture and marketing of contemporary and traditional leather and fabric upholstered furniture. It offers a wide range of upholstered furniture for sale, manufactured in production facilities located in Italy and abroad (Romania, Brazil and China).

Net sales of upholstered furniture analyzed by coverings are as follows:

| <b>Sales of upholstered furniture</b> | 2013           | 2012           | 2011           |
|---------------------------------------|----------------|----------------|----------------|
| Upholstered furniture Leather         | 382,237        | 389,778        | 403,032        |
| Upholstered furniture Fabric          | 20,621         | 19,627         | 22,243         |
| <b>Subtotal</b>                       | <b>402,858</b> | <b>409,405</b> | <b>425,275</b> |
| Other sales                           | 46,251         | 59,439         | 61,089         |
| <b>Total</b>                          | <b>449,109</b> | <b>468,844</b> | <b>486,364</b> |

Within leather and fabric upholstered furniture, the Company offers furniture in the following categories: stationary furniture (sofas, loveseats and armchairs), sectional furniture, motion furniture, sofa beds and occasional chairs, including recliners and massage chairs.

The following tables provide information upon the net sales of upholstered furniture and of long-lived assets by geographical location. Net sales are attributed to countries based on the location of customers.

| <b>Sales of upholstered furniture</b> | 2013    | 2012    | 2011   |
|---------------------------------------|---------|---------|--------|
| United States of America              | 102,525 | 108,137 | 94,192 |
| Italy                                 | 31,022  | 34,121  | 46,151 |
| England                               | 30,667  | 32,261  | 32,384 |
| Canada                                | 40,189  | 45,024  | 35,580 |
| France                                | 20,085  | 19,195  | 21,049 |
| Spain                                 | 12,292  | 13,587  | 21,556 |
| Belgium                               | 11,645  | 14,185  | 19,412 |
| Germany                               | 16,247  | 16,984  | 20,719 |
| Brazil                                | 8,548   | 6,571   | 3,569  |
| Australia                             | 10,469  | 12,758  | 12,282 |

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|  |         |         |         |
|--|---------|---------|---------|
| China                                  | 18,330  | 9,491   | 10,484  |
| Other countries (none greater than 2%) | 100,839 | 97,091  | 107,897 |
| Total                                  | 402,858 | 409,405 | 425,275 |

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*(Expressed in thousands of euros except as otherwise indicated)*

In addition, the Group also sells minor volumes of excess polyurethane foam, leather by-products and certain pieces of furniture (coffee tables, lamps and rugs) which, for 2013, 2012 and 2011 totaled 46,251, 59,580 and 61,089, respectively.

**23. Cost of sales**

Cost of sales is analyzed as follows:

|                           | 2013           | 2012           | 2011           |
|---------------------------|----------------|----------------|----------------|
| Opening inventories       | 82,269         | 93,537         | 87,356         |
| Purchases                 | 195,302        | 186,579        | 211,403        |
| Labor                     | 78,695         | 75,699         | 79,148         |
| Third party manufacturers | 11,129         | 11,212         | 10,305         |
| Other manufacturing costs | 28,895         | 29,089         | 31,393         |
| Closing inventories       | (78,991)       | (82,269)       | (93,537)       |
| <b>Total</b>              | <b>317,299</b> | <b>313,847</b> | <b>326,068</b> |

The line item "Other manufacturing costs" includes the depreciation expenses of property plant equipment used in the production of finished goods. This depreciation expense amounted to 10,283, 9,505 and 9,472 for the years ended December 31, 2013, 2012 and 2011, respectively.

**24. Selling expenses**

Selling expenses is analyzed as follows:

|                 | 2013   | 2012   | 2011   |
|-----------------|--------|--------|--------|
| Salaries        | 20,588 | 21,526 | 26,950 |
| Fairs           | 3,699  | 3,339  | 2,984  |
| Commissions     | 9,002  | 9,697  | 9,107  |
| Freight         | 38,470 | 40,293 | 39,434 |
| Promotion       | 1,129  | 1,690  | 1,863  |
| Advertising     | 16,152 | 19,527 | 24,333 |
| Depreciations   | 2,761  | 4,057  | 5,367  |
| Product repairs | 3,922  | 4,594  | 4,046  |
| Samples         | 1,039  | 900    | 1,419  |

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|                                 |         |         |         |
|---------------------------------|---------|---------|---------|
| Credit insurance cost           | 613     | 527     | 611     |
| Bad debts                       | 3,546   | 471     | 1,695   |
| Other commercial insurance cost | 539     | 548     | 580     |
| Other Freight costs             | 7,155   | 7,323   | 6,924   |
| Rent                            | 13,648  | 13,008  | 13,908  |
| Consultancy                     | 404     | 707     | 765     |
| Utilities                       | 2,178   | 2,278   | 2,583   |
| Other                           | 1,789   | 1,932   | 1,721   |
| Total                           | 126,634 | 132,417 | 144,290 |

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*(Expressed in thousands of euros except as otherwise indicated)***25. General and administrative expenses**

General and administrative expenses is analyzed as follows:

|                                    | 2013   | 2012   | 2011   |
|------------------------------------|--------|--------|--------|
| Salaries                           | 18,535 | 17,998 | 17,013 |
| Consultancy                        | 3,677  | 4,127  | 4,380  |
| Electronic data processing         | 124    | 196    | 300    |
| Mail & Phone                       | 1,000  | 1,085  | 1,382  |
| Other                              | 1,996  | 2,109  | 1,877  |
| Printing & Stationery              | 572    | 643    | 791    |
| Depreciations                      | 3,518  | 3,470  | 4,160  |
| Travel expenses                    | 3,945  | 5,148  | 7,004  |
| Cars cost                          | 1,171  | 1,214  | 1,459  |
| Directors and auditors fees        | 592    | 982    | 1,368  |
| Non deductibles and indirect taxes | 2,375  | 2,890  | 3,564  |
|                                    | 37,505 | 39,862 | 43,298 |

**26. Other income /(expense), net**

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

|  | 2013     | 2012    | 2011    |
|--|----------|---------|---------|
| Interest income  | 1,348    | 1,561   | 1,373   |
| (Interest expense and bank commissions)                                      | (1,895)  | (1,719) | (1,860) |
| Interest income/(expense), net   | (547)    | (158)   | (487)   |
| Gains (losses) on foreign exchange, net                                      | (3,305)  | (3,396) | 1,042   |
| Unrealized exchange gain (losses) on<br>exchange derivative instruments, net | 519      | 908     | (594)   |
| Other, net   | (28,567) | (1,931) | 17,338  |
| Total  | (31,900) | (4,577) | 17,299  |



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

|   | 2013    | 2012    | 2011    |
|---|---------|---------|---------|
| Net realized gains (losses) on<br>exchange derivative instruments   | 2,150   | (1,101) | 1,933   |
| Net realized gains (losses) on<br>accounts receivable and payable   | (2,574) | 2,309   | (1,247) |
| Net unrealized gains (losses) on<br>accounts receivable and payable | (2,881) | (4,604) | 356     |
| Total   | (3,305) | (3,396) | 1,042   |

Other, net are related to the following:

|  | 2013     | 2012    | 2011     |
|--|----------|---------|----------|
| Provisions for contingent liabilities  | (1,433)  | (740)   | (2,492)  |
| Impairment losses of long-lived assets | (8,550)  | (864)   | (1,036)  |
| One-time termination benefits          | (19,959) |         | (5,446)  |
| Chinese relocation compensation        | 8,738    |         | 46,691   |
| Expenses for the Chinese relocation    | (857)    |         | (21,631) |
| Write-off of fixed assets              | (359)    | (339)   | (311)    |
| Other, net                             | (6,147)  | 12      | 1,563    |
| Total                                  | (28,567) | (1,931) | 17,338   |

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**Provisions for contingent liabilities** The Company has charged to other income (expense), net in 2013, 2012 and 2011 the amount of 1,433, 740 and 2,492, respectively, for the estimated probable liabilities related to some claims (including tax claims) and legal actions in which it is involved.

During 2013 the Group has made no additional accruals related to tax contingent liabilities. The amount of the accrual for contingent liabilities, totaling 1,433, is related to several minor claims and legal actions arising in the ordinary course of business mainly referred to the parent Company.

During 2012 the Group has charged to other income (expense), net the amount of 114 for the probable tax contingent liabilities related to income taxes and other taxes of the parent company and some foreign subsidiaries. The remaining amount of 626 of the provisions for contingent liabilities is related to several minor claims and legal actions arising in the ordinary course of business.

During 2011 the Group charged to other income (expense), net the amount of 1,358 for the probable tax contingent liabilities related to income taxes and other taxes of the parent company and some foreign subsidiaries. The remaining amount of 1,134 of the provisions for contingent liabilities is related to several minor claims and legal actions arising in the ordinary course of business.

**Impairment losses of long-lived assets** In 2013 the Company performed an impairment review of its production and retail long-lived assets and an impairment loss totaling 8,550 was recorded (2,153 as retail assets, 404 as long-lived assets not in use in Italy, and 5,993 as the Airplane).

In 2012 the Company performed an impairment review of its long-lived assets related to retail stores in Spain and an impairment loss of 864 was recorded. The Company determined the fair value of the reporting unit and compared it with the carrying value of its fixed assets.

In 2011 the Company performed the annual impairment analysis of some Brazilian plants with a third-party independent appraisal and this resulted in an impairment loss of 1,036 recorded under the line other income (expense), net of the consolidated statement of operations for the year ended December 31, 2011.

**One-time termination benefits** In September 2011, the Company and the Trade Unions submitted a request to the Italian Ministry of Labor to access for 24 months (starting from October 16, 2011) to the unemployment benefits (Italian law July, 23 1991 n. 223 e D.M. August 20, 2002 n. 31444) granted by special Social Security procedure called CIGS *Cassa Integrazione Guadagni Straordinaria*. Based on the above signed agreement, the Company, at December 31, 2011 accrued 5,446 to the One-time termination benefits reserve (for the 1,060 employees to be dismissed) recorded as a non-operating expense, under the line other income/(expense) net of the consolidated statement of operations for the year ended December 31, 2011. No additional accruals were made for the year ended December 31, 2012.

Before the end of the first layoff period (October 15, 2013), a new agreement was signed between the Company, government ministries, regions and the trade unions, by which the Company obtained the extension by one year (October 15, 2014) of the special Social Security procedure called *CIGS Cassa Integrazione Guadagni Straordinaria* , and the number of redundant workers has been estimated in 1,506, with the possibility for maximum 600 workers to adhere to an incentive payments program ending in May 2014. Based on the above signed agreement dated October 10, 2013, the Company, at December 31, 2013 increased the One-time termination benefits reserve to 24,730 with an addition accrual of 19,959 recorded as a non-operating expense, under the line other income/(expense) net of the consolidated statement of operations for the year ended December 31, 2013. The provision, calculated by the Company together with its labor consultants, considered (i) the cost of future layoffs, to be paid for those workers not adhering to the incentive payments program (ii) the best estimation of incentive payments to be paid in 2014 (iii) the advance notice remuneration owed to redundant workers in case of termination (see note 19).

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**Chinese relocation compensation** On January 26, 2011 Italsofa Shanghai Ltd (a Chinese subsidiary) signed an agreement with the Shanghai Municipality and Shanghai n.12 Metro Line Development Co. Ltd to abandon its industrial site and relocate to another industrial site. In April 2011, this agreement was executed and Italsofa Shanghai relocated its manufacturing process to a new industrial site. As a consequence of the signed agreement Italsofa Shanghai collected a relocation compensation amount of 46,691 (equal to RMB 420 million), which was recorded as non-operating income, under the line other income/(expense) net of the consolidated statement of operations for the year ended December 31, 2011. During 2013, a second supplementary agreement was signed between the Company and the Shanghai Municipality, by which the Company obtained the reimbursement of taxes due on the relocation compensation, totaling 8,738 (equal to RMB 71.4 million). The extraordinary income of 8,738 was recorded as non-operating income under the line other income/(expense) net of the consolidated statement of operations for the year ended December 31, 2013.

**Expenses for the Chinese relocation** As a consequence of the above relocation, all fixed assets owned by Italsofa Shanghai that were not transferred to the new industrial site (the industrial building and some machines and equipment) were written-off recording a loss of 18,388 (equivalent to RMB 165 million). In addition the Chinese subsidiary recorded other extraordinary expenses for employees compensation and fees of 3,243 (equivalent to RMB 28 million). The consolidated statement of operations for the year ended December 31, 2011 includes under the line other income/(expense) net the cumulative expenses for the Chinese relocation of 21,631. During 2013, additional consulting expenses were incurred, connected to the second supplementary agreement, totaling 857, which were recorded as non-operating expenses under the line other income/(expense) net of the consolidated statement of operations for the year ended December 31, 2013.

**Write off of fixed assets** The write off of fixed assets includes the net book value of those fixed assets that refer mainly to damaged items and that were no longer in conformity with the production quality standards, together with assets pertaining to stores that were closed. As of December 31, 2013, 2012 and 2011 the write offs of fixed assets amount to 359, 339 and 311, respectively.

**Other, net** Other, net include as of December 31, 2013, 2,278 of partial write-off of some government grants receivables following a revision of the original grant decree, and 1,693 of extraordinary costs related to the restructuring of the Group. As of December 31, 2012 and 2011, the caption included minor items.

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*(Expressed in thousands of euros except as otherwise indicated)***27. Financial instruments and risk management**

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

The Group is exposed to credit risk in the event that the counterparties to the domestic currency swaps and zero cost collars fail to perform according to the terms of the contracts. The contract amounts of the domestic currency swaps and zero cost collars described below do not represent amounts exchanged by the parties and, thus, are not a measure of the exposure of the Group through its use of those financial instruments. The amounts exchanged are calculated on the basis of the contract amounts and the terms of the financial instruments, which relate primarily to exchange rates. The immediate credit risk of the Group's domestic currency swaps is represented by the unrealized gains or losses on the contracts. Management of the Group enters into contracts with creditworthy counter-parties and believes the risk of material loss from such credit risk to be remote. The table below summarizes in euro equivalent the contractual amounts of forward exchange contracts and zero cost collars used to hedge principally future cash flows from accounts receivable and sales orders at December 31, 2013 and 2012:

|                    | 2013          | 2012          |
|--------------------|---------------|---------------|
| U.S. dollars       | 8,817         | 10,101        |
| Euro               | 12,037        | 9,479         |
| Canadian dollars   | 10,153        | 13,588        |
| British pounds     | 5,984         | 7,231         |
| Australian dollars | 2,157         | 3,719         |
| Norwegian kroner   | 575           | 1,071         |
| Swedish kroner     | 341           | 387           |
| Japanese yen       | 1,362         | 1,811         |
| <b>Total</b>       | <b>41,426</b> | <b>47,386</b> |

The following table presents information regarding the contract amount in euro equivalent amounts and the estimated fair value of all of the Group's forward exchange and zero cost collar contracts. Contracts with net unrealized gains are presented as assets and contracts with net unrealized losses are presented as liabilities.

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|              | 2013            |                           | 2012            |                           |
|--------------|-----------------|---------------------------|-----------------|---------------------------|
|              | Contract amount | Unrealized gains (losses) | Contract amount | Unrealized gains (losses) |
| Assets       | 24,636          | 570                       | 39,684          | 907                       |
| Liabilities  | 16,790          | (51)                      | 7,702           | 1                         |
| <b>Total</b> | <b>41,426</b>   | <b>519</b>                | <b>47,386</b>   | <b>908</b>                |

At December 31, 2013, 2012 and 2011, the exchange derivative instruments contracts had a net unrealized income (expense), of 519, (908) and (594), respectively. These amounts are recorded in other income (expense), net in the consolidated statements of operations (see note 26).

Unrealized gains (losses) on forward exchange contracts are determined by using quoted prices in active markets for similar forward exchange contracts.

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The fair value of zero cost collars is determined using pricing models developed based on the exchange rates in active markets.

Refer to note 3 (c) for the Group's accounting policy on forward exchange contracts and zero cost collars.

**28. Fair value of financial instruments**

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

|                              | 2013              |               | 2012              |               |
|------------------------------|-------------------|---------------|-------------------|---------------|
|                              | Carrying<br>value | Fair<br>value | Carrying<br>value | Fair<br>value |
| <b>Assets:</b>               |                   |               |                   |               |
| -Marketable debts securities | 4                 | 4             | 4                 | 4             |
| <b>Liabilities:</b>          |                   |               |                   |               |
| -Long-term debt              | 7,646             | 6,759         | 10,788            | 10,169        |

Cash and cash equivalents, receivables, payables and bank overdraft approximate fair value because of the short maturity of these instruments.

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

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

**29. Application of generally accepted accounting principles in the United States of America**

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

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

**Reconciliation of net loss:**

|  | 2013          | 2012          | 2011          |
|--|---------------|---------------|---------------|
| Net loss attributable to Natuzzi S.p.A. and subsidiaries in conformity with Italian GAAP | (68,576)      | (26,104)      | (19,586)      |
| Adjustments to reported income:  |               |               |               |
| (a) Revaluation of property, plant and equipment   | 28            | 28            | 28            |
| (b) Government grants  | 532           | 619           | 626           |
| (c) Revenue recognition  | 282           |               | 2,599         |
| (d) Goodwill and intangible assets   | 81            | (1,056)       | (5,756)       |
| (e) Translation of foreign financial statements  | 1,862         | 2,677         | 4,565         |
| (f) One-time termination benefits  | 7,987         | (568)         | 4,657         |
| (h) Write-off advertisement and advisory costs   | (1,833)       |               |               |
| (i) Long lived assets - Depreciation   | (1,643)       |               |               |
| Tax effect of US GAAP adjustments  | (753)         | (5,123)       | (201)         |
| Net loss attributable to Natuzzi S.p.A. and subsidiaries in conformity with US GAAP      | (62,034)      | (29,527)      | (13,068)      |
| <i>Basic loss per share in conformity with US GAAP</i>                                   | <i>(1.13)</i> | <i>(0.54)</i> | <i>(0.24)</i> |
| <i>Diluted loss per share in conformity with US GAAP</i>                                 | <i>(1.13)</i> | <i>(0.54)</i> | <i>(0.24)</i> |

**Reconciliation of equity attributable to Natuzzi S.p.A. and Subsidiaries:**

|  | 2013    | 2012    |
|--|---------|---------|
| Equity attributable to Natuzzi S.p.A. and Subsidiaries in conformity with Italian GAAP | 208,910 | 281,137 |
| (a) Revaluation of property, plant and equipment                                       | (396)   | (424)   |
| (b) Government grants  | (9,010) | (9,543) |
| (c) Revenue recognition  | (3,276) | (3,558) |
| (d) Goodwill and intangible assets   |         | (81)    |
| (e) Translation of foreign financial statements  | 15,982  | 10,469  |
| (f) One-time termination benefits  | 14,120  | 6,135   |



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|   |         |         |
|---|---------|---------|
| (g) Long-lived assets impairment  | 388     | 388     |
| (h) Write-off advertisement costs   | (1,833) |         |
| (i) Long lived assets Depreciation  | (1,643) |         |
| Tax effect of US GAAP adjustments   | (6,171) | (5,418) |
| Equity attributable to Natuzzi S.p.A. and Subsidiaries in conformity with US GAAP | 217,071 | 279,105 |

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The condensed consolidated balance sheets as at December 31, 2013 and 2012, and the condensed consolidated statements of operations for the years ended December 31, 2013, 2012 and 2011, which include all the US GAAP differences commented below are as follows:

**Condensed Consolidated Balance Sheets as at December 31, 2013 and 2012**

|  | Dec. 31, 2013  | Dec. 31, 2012  |
|--|----------------|----------------|
| <b>ASSETS</b>  |                |                |
| Current assets   | 264,700        | 301,772        |
| Non current assets                                     | 164,221        | 178,871        |
| <b>TOTAL ASSETS</b>                                    | <b>428,921</b> | <b>480,643</b> |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>             |                |                |
| Current liabilities                                    | 136,963        | 132,810        |
| Non current liabilities                                | 72,195         | 66,204         |
| Equity attributable to Natuzzi S.p.A. and Subsidiaries | 217,071        | 279,105        |
| Non-controlling interest                               | 2,692          | 2,524          |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>       | <b>428,921</b> | <b>480,643</b> |

**Condensed Consolidated Statements of Operations Years Ended December 31, 2013, 2012 and 2011**

|                                     | 2013           | 2012           | 2011           |
|-------------------------------------|----------------|----------------|----------------|
| Net sales                           | 445,183        | 459,271        | 488,321        |
| Cost of sales                       | (333,600)      | (318,148)      | (333,771)      |
| <b>Gross profit</b>                 | <b>111,583</b> | <b>141,123</b> | <b>154,550</b> |
| Selling expenses                    | (109,883)      | (122,963)      | (143,180)      |
| General and administrative expenses | (57,464)       | (37,623)       | (42,468)       |
| Operating income/(loss)             | (55,764)       | (19,463)       | (31,928)       |
| Other income /(expenses), net       | (1,178)        | (666)          | 28,529         |

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|  |          |          |          |
|--|----------|----------|----------|
| Net income/(loss) before income taxes                            | (56,942) | (20,129) | (3,399)  |
| Income taxes   | (4,881)  | (9,324)  | (8,960)  |
| Net income /(loss)   | (61,823) | (29,453) | (12,359) |
| Less: (Net income)/loss attributable to non-controlling interest | (211)    | (74)     | (709)    |
| Net income /(loss) attributable to                               |          |          |          |
| Natuzzi S.p.A. and subsidiaries                                  | (62,034) | (29,527) | (13,068) |

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*(Expressed in thousands of euros except as otherwise indicated)*

The tables below set forth the reconciliation of net sales and operating income (loss) from Italian GAAP to US GAAP for the years ended December 31, 2013, 2012 and 2011:

**Reconciliation of net sales from Italian GAAP to US GAAP**

|  | 2013    | 2012    | 2011    |
|--|---------|---------|---------|
| Net sales in conformity with Italian GAAP              | 449,109 | 468,844 | 486,364 |
| (b) Government grants (reclassification)               | (461)   | (470)   | (542)   |
| (c) Revenue recognition (adjustment)                   | (1,300) | (600)   | 7,000   |
| (j) Cost paid to resellers (reclassification)          | (2,165) | (5,323) | (4,501) |
| (m) Contingent liabilities reversal (reclassification) |         | (3,180) |         |
| Net sales in conformity with US GAAP                   | 445,183 | 459,271 | 488,321 |

**Reconciliation of operating loss from Italian GAAP to US GAAP**

|  | 2013     | 2012     | 2011     |
|--|----------|----------|----------|
| Operating income/(loss) in conformity with Italian GAAP      | (32,329) | (17,282) | (27,292) |
| (a) Revaluation prop, plant and equ. (adjustment)            | 28       | 28       | 28       |
| (b) Government grants (adjustment)                           | 532      | 619      | 626      |
| (c) Revenue recognition (adjustment)                         | 281      |          | 2,599    |
| (d) Goodwill and intangible assets amortization (adjustment) | 81       | (116)    | 156      |
| (d) Goodwill and Intangible assets impairment (adjustment)   |          | (941)    | (5,910)  |
| (f) One-time termination benefits (reclassification)         | (19,959) |          |          |
| (f) One-time termination benefits (adjustment)               | 7,987    | (568)    | (789)    |
| (g) Long-lived assets (reclassification)                     | (8,550)  | (864)    | (1,036)  |
| (h) Write-off advertisement and advisory costs               | (1,833)  |          |          |
| (i) Long lived assets Depreciation                           | (1,643)  |          |          |
| (k) Write-off of fixed assets (reclassification)             | (359)    | (339)    | (311)    |

|  |          |          |          |
|--|----------|----------|----------|
| Operating income/(loss) in conformity with US GAAP | (55,764) | (19,463) | (31,928) |
|--|----------|----------|----------|

The differences which have a material effect on net loss and/or shareholders' equity are disclosed as follows:

**(a)** Certain property, plant and equipment has been revalued in accordance with Italian laws. The revalued amounts are depreciated for Italian GAAP purposes. US GAAP does not allow for such revaluations, and depreciation is based on historical costs. The revaluation primarily relates to industrial buildings. The adjustment to net loss and shareholders' equity represents the reversal of excess depreciation recorded under Italian GAAP on revalued assets.

**(b)** Under Italian GAAP until December 31, 2000 government grants related to capital expenditures were recorded, net of tax, within reserves in shareholders' equity. Subsequent to that date such grants have been recorded as deferred income and recognized in the consolidated statement of operations as revenue or other income, as appropriate under Italian GAAP (see note 3 n)), on a systematic basis over the useful life of the asset.

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Under US GAAP, such grants, when received, are classified either as a reduction of the cost of the related fixed asset or as a deferred credit and amortized over the estimated remaining useful lives of the assets. The amortization is treated as a reduction of depreciation expense and classified in the consolidated statement of operations according to the nature of the asset to which the grant relates.

The adjustments to net loss represent mainly the annual amortization of the pre December 31, 2000 capital grants based on the estimated useful life of the related fixed assets. The adjustments to shareholders' equity are to reverse the amounts of capital grants credited directly to equity for Italian GAAP purposes, net of the amounts of amortization of such grants for US GAAP purposes.

Amortization of deferred income related to grants recognized as revenues under Italian GAAP of 462, 470 and 542 for the years ended December 31, 2013, 2012 and 2011 respectively would be reclassified to depreciation expense and recorded in cost of goods sold under US GAAP, in the period such amounts are recognized.

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

US GAAP requires that revenue should not be recognized until it is realized or realizable and earned, which is generally at the time delivery to the customer occurs. Accordingly, the Italian GAAP for revenue recognition differs from US GAAP.

The principal effects of this variance on the accompanying consolidated balance sheets as of December 31, 2013 and 2012 and related consolidated statements of operations for each of the years in the three-year period ended December 31, 2013 are indicated below:

|   | 2013<br>Effects<br>Increase | 2012<br>Effects<br>Increase |
|---|-----------------------------|-----------------------------|
| Effect of revenue recognition adjustment on | (Decrease)                  | (Decrease)                  |
| Trade receivables, net                      | (18,400)                    | (17,100)                    |
| Inventories                                 | 12,917                      | 11,440                      |
| <b>Total effect on current assets (a)</b>   | <b>(5,483)</b>              | <b>(5,660)</b>              |

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|   |         |         |
|---|---------|---------|
| Accounts payable-trade                    | (2,208) | (2,103) |
| Income taxes                              |         |         |
| Total effect on current liabilities (b)   | (2,208) | (2,103) |
| Total effect on shareholders equity (a-b) | (3,276) | (3,558) |

| Effect of revenue recognition adjustment on | 2013    | 2012  | 2011  |
|---|---------|-------|-------|
| Net sales                                   | (1,300) | (600) | 7,000 |
| Gross profit                                | 178     | (222) | 3,492 |
| Operating income/(loss)                     | 281     |       | 2,599 |
| Net Income/(loss)                           | 281     |       | 2,599 |

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(d) Under Italian GAAP, the Company amortizes the goodwill arising from business acquisitions on a straight-line basis over a period of five years. In addition, under Italian GAAP, the Company has allocated certain intangible assets, having definite lives and arising from a business acquisition and asset acquisition under the caption goodwill.

Under US GAAP, in accordance with Accounting Standards Certification (ASC) 350, *Intangible, Goodwill and Other*, the Company do not amortize goodwill. The Company annually assesses goodwill impairment at the end of its fiscal year by applying a fair value test. In the first step of testing for goodwill impairment, the Company estimates the fair value of each reporting unit, which we have determined to be the geographic operating segments and compare the fair value with the carrying value of the net assets assigned to each reporting unit. The above U.S. and Italian GAAP goodwill is entirely related to a small reporting unit named Italian retail owned stores. If the fair value is less than its carrying value, then a second step would be performed to determine the fair value of the goodwill. In this second step, the fair value of goodwill is determined by deducting the fair value of a reporting unit's identifiable assets and liabilities from the fair value of the reporting unit as a whole, as if that reporting unit had just been acquired and the purchase price were being initially allocated. If the fair value of the goodwill is less than its carrying value for a reporting unit, an impairment charge would be recorded.

The changes in the carrying amount of goodwill, intangible assets and US deferred taxes arising from business and asset acquisitions are as follows:

|                          | Goodwill |         | Intangibles |         | US Deferred Taxes |            |
|--------------------------|----------|---------|-------------|---------|-------------------|------------|
|                          | US       | Italian | US          | Italian | Goodwill          | Intangible |
| Balance at Dec. 31, 2010 | 6,205    | 711     | 1,237       |         | (274)             | (390)      |
| Impairment               | (5,910)  |         |             |         | 274               |            |
| Amortization             |          | (450)   | (296)       |         |                   | 95         |
| Balance at Dec. 31, 2011 | 295      | 261     | 941         |         |                   | (295)      |
| Impairment               | (295)    |         | (645)       |         |                   | 202        |
| Amortization             |          | (180)   | (296)       |         |                   | 93         |
| Balance at Dec. 31, 2012 |          | 81      |             |         |                   |            |
| Impairment               |          |         |             |         |                   |            |
| Amortization             |          | (81)    |             |         |                   |            |
| Balance at Dec. 31, 2013 |          |         |             |         |                   |            |



In 2011, the Company performed its annual impairment test, which resulted in the impairment charge of 5,910. As part of its 2011 close process, Natuzzi revised its sales growth projections for the Italian retail owned stores as the recovery in the Italian retail furniture market failed to materialize with the strength anticipated, following the crisis started in prior years. In addition the domestic and Eurozone credit crisis experienced in 2011 negatively impacted the Company's results and management's expectations for the economic recovery in Italy where private consumption remains weak. In addition, in 2011, the Italian Government passed significant tax, social security, and other extraordinary measures in order to meet the European Commission and European Financial Stability Facility requirements. Such measures were recognized by the international community as a positive step in the right direction, but also resulted in a negative impact in the medium to short-term growth expectation of consumer demand and the overall market recovery.

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As a result of the factors described above and the resulting revisions in the expected level of sales of finished products through its Italian retail owned stores, as well as the related operating income, the Company concluded that the carrying value of the goodwill related to such operating unit as of December 31, 2011 was less than the fair value of the reporting unit based on the step one impairment test required by ASC 350. The Company performed the required step two of the impairment test by comparing the implied fair value of goodwill to its carrying amount. The fair value of the reporting unit as of December 31, 2011 was determined based on a discounted cash flow analysis, which requires significant assumptions and estimates about the future operations of the reporting unit. Significant judgments inherent in this analysis include the determination of appropriate discount rates, the amount and timing of expected future cash flows and growth rates. The cash flows employed in our 2011 discounted cash flow analyses were based on 2012-2014 year financial forecasts developed internally by management. The key inputs that were used in performing the impairment tests related to the estimated long term growth rate of 0.5% (1% in 2010), the weighted average cost of capital equal to 9.67% (9.91% in 2010), and an estimated average growth rate in sales of 2.5% (6% in 2010) for the subsequent years.

In 2012 Natuzzi performed its annual impairment test of goodwill and an impairment loss of 295 was recorded. The Company determined the fair value of the reporting unit on a discounted cash flow basis. An impairment loss arose due, in particular, to the continued decline in cash flow projections related to the uncertain prospects for full economic recovery in Italy, since private consumption was negatively impacted by a general weakness in the job market, high levels of public indebtedness, and a decreasing level of savings among families. As a result of the impairment test, the implied fair value of goodwill was zero and therefore, the Company recorded an impairment charge of 645 for the residual amount of the intangibles with a cumulative impairment loss of 941. The key inputs that were used in performing the impairment tests related to the estimated long term growth rate of 0.5% (the same in 2011), the weighted average cost of capital equal to 12.47% (9.67% in 2011), and an estimated average growth rate in sales of 5% (2.5% in 2012) for the subsequent years.

Under Italian GAAP the impairment losses of 941 for 2012 and of 5,910 for 2011, respectively, were classified under the line other income /(expense), net in the consolidated statement of operations. Under US GAAP these impairment losses have been classified as cost of sales and are included as part of operating loss.

In 2013, the original carrying value of the goodwill under Italian GAAP (81) and US GAAP (nil) have resulted aligned as a consequence of the amortization process, completed at year-end, where for both GAAP the carrying value of goodwill is nil.

(e) Under Italian GAAP as of December 31, 2013, 2012 and 2011, the financial statements of the foreign subsidiaries expressed in a foreign currency are translated directly into euro as follows: (i) year-end exchange rate for assets, liabilities, share capital and retained earnings and (ii) average exchange rates during the year for revenues and expenses. The resulting exchange differences on translation are recorded as a direct adjustment to shareholders' equity (see note 3 d)).



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Under US GAAP as of December 31, 2013, 2012 and 2011 Natuzzi's foreign subsidiaries financial statements have been translated on the basis of the guidance included in ASC No. 830-20, *Foreign Currency Transactions* (Formerly FASB Statement No. 52). Under US GAAP, foreign subsidiaries are considered to be an integral part of Natuzzi due to various factors including significant intercompany transactions, financing, and cash flow indicators. Therefore, the functional currency for these foreign subsidiaries is the functional currency of the parent, namely the euro. As a result all monetary assets and liabilities are remeasured, at the end of each reporting period, using euro and the resulting gain or loss is recognized in the consolidated statements of operations. For all non monetary assets and liabilities, share capital and retained earnings historical exchange rates are used. The average exchange rates during the year are used for revenues and expenses, except for those revenues and expenses related to assets and liabilities translated at historical exchange rates. The resulting exchange differences on translation are recognized in the statements of operations.

At December 31, 2013, 2012 and 2011 the US GAAP difference arises due to the requirement to use the local currency as the functional currency under Italian GAAP as compared to US GAAP, which requires that the functional currency be determined based on certain indicators which may, or may not result in the local currency being determined to be the functional currency. Consequently, the Company recorded in the US GAAP reconciliation (a) income of 1,862 for 2013, 2,677 for 2012 and of 4,565 for 2011, respectively; and (b) an increase in shareholders equity of 15,982 and 10,469 for 2013 and 2012, respectively.

(f) Under Italian GAAP, the Company during 2008 recognized the cost of one-time termination benefits of 4,605 related to the employees to be terminated on a involuntary basis as indicated in the plan of termination.

During 2011, the Company recognized additional cost of one-time termination benefits of 5,446 related to the employees to be terminated on an involuntary basis at the end of 24 months special Social Security procedure called *CIGS Cassa Integrazione Guadagni Straordinaria*, starting from October 16, 2011 to October 15, 2012 (see note 26).

During 2012, no additional accrual was made and the Company paid 568 of one-time termination benefits to the workers terminated pursuant to individual agreement.

During 2013, following the new agreement signed with the Trade Unions in October 2013, under Italian GAAP the Company accrued 19,959 to the provision for one-time termination benefits. Also, during the year, the Company paid termination benefits for individual agreements reached for 1,364.

In accordance with Italian GAAP this cost has been recognized in 2013, 2011 and 2008 as in such years the Company has formally decided to adopt the termination plan (approval by the Board of Directors and agreements signed with the Trade Unions) and is able to reasonably estimate the related one-time termination benefits, since, under Italian GAAP for the recognition of the cost for the termination benefits related to the terminated workers the communication or announcement to third parties of the plan of termination of workers is not relevant.

ASC No. 420, *Exit or Disposal Obligations*, paragraph 8 states that the liability for the one-time termination benefits provided to current employees that are involuntarily terminated under the terms of a benefit arrangement that, in substance, is not an ongoing benefit arrangement or an individual deferred compensation contract is measured and recognized if a one-time arrangement exist at the date the plan of termination meets all the following criteria and has been communicated to the employees: (a) management, having the authority to approve the action, commits to a plan of termination; (b) the plan identifies the number of employees to be terminated, their job classifications or functions and their locations, and the expected completion date; (c) the plan establishes the terms of the benefit arrangement, including the benefits that employees will receive upon termination (including but not limited to cash payments), in sufficient detail to enable employees to determine the type and amount of benefits they will receive if they are involuntarily terminated; (d) actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

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Therefore, on the basis of the above discussion, the Italian GAAP recognition in the consolidated statement of operations of the one-time termination benefits related to the employees to be terminated involuntarily differs from US GAAP.

Under US GAAP, considering the guidance of ASC 420, the one-time termination benefits has to be recorded in the consolidated statement of operations when the termination plan is communicated to the employees and meets all the criteria indicated in ASC 420.

Therefore, under US GAAP, as of December 31, 2011 the cost of the one-time termination benefits of 5,446 less amounts paid during the year of 789 has been reversed out of the consolidated statement of operations for the year then ended, considering no notification was made to terminated employees.

During 2012, the Company paid one-time termination benefits of 568 to the workers terminated pursuant to individual agreements that were reached. The residual difference of equity under US GAAP of 6,135 is attributable to the 1,060 workers that the Company decided to terminate on an involuntary basis (see note 19), but where all the criteria in ASC 420 have not been met.

During 2013, further to the agreement signed with the Trade Unions in October 2013, that increased to 1,506 the number of redundant workers, according to US GAAP the Company: (i) reclassified the accrual of the year of 19,959 made to the provision for one-time termination benefits that was classified under the line other income /(expense), net in the consolidated statement of operations prepared according to Italian GAAP to cost of sales, included therefore as part of operating loss (ii); as a consequence of some agreements reached with individual workers (372) during the year, reversed 7,987 out of the consolidated statement of operations, connected to the portion of workers for whom no notification/agreements were reached in 2013. The residual difference of equity under US GAAP of 14,120 is attributable to the 1,134 workers that represent the remaining redundant workers and for which the criteria in ASC 420 have not yet been met.

(g) The Company in order to improve its worldwide manufacturing efficiency, in 2008 decided to close and try to sell one of its two Brazilian manufacturing plants located in Pojuca State of Bahia, recording an impairment loss. Under US GAAP the impairment loss has been measured by the amount by which the carrying value exceeds its fair value less cost to sell of 388. The difference between Italian GAAP and US GAAP related to costs to sell was reported in the US GAAP reconciliation for the year ended December 31, 2008 and continues to be reflected as an adjustment in the equity reconciliation as of December 31, 2013 and 2012.

During 2013, 2012 and 2011 the Company performed an impairment review of its fixed assets and an impairment loss of 8,550, 864 and 1,036 were recorded. Under Italian GAAP the impairment losses were classified under the line other income /(expense), net in the consolidated statement of operations for the year ended December 31, 2013 and December 31, 2012. Under US GAAP these impairment losses would be classified as cost of sales and would be included as part of operating loss.



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**(h)** In 2013, the Group has capitalized advertising costs incurred for the advertising campaign launched to promote the new Re-vive armchair totaling 1,224, and advisory costs related to the implementation of the new moving line production system in the Italian plants, totaling 609. Advertising costs, according to Italian GAAP, are capitalizable if they are connected to the necessary commercial phase of launch of a new and innovative product and they are functional and essential to the success of the related project. In accordance with Italian GAAP, advertising costs have been amortized over a five year period.

Under US GAAP (ASC 340-20), advertising costs are usually expensed as incurred, except for some direct-response advertising costs, which are to be reported as an asset and amortized over the future benefit period. For costs to qualify as direct-response advertising, a direct link between specific sales to customers and specific advertising expenditures has to be demonstrated, so that it is reasonable to conclude that the advertising will result in probable future benefits.

The advertising campaign launched by the Company to introduce the new Re-vive armchair has not been qualified as direct-response advertising, since the promotional activities performed did not have the aim to reach targeted consumers and the effect of this campaign in terms of direct responses from selected customers cannot therefore be measured and/or easily verifiable. Accordingly, under US GAAP, these costs have been expensed.

Advisory costs related to the implementation of the new moving line production system are classifiable, according to Italian GAAP, to research and development costs, which capitalization is permitted provided that: (i) the product or process is clearly defined and costs are separately identified and measured reliably (ii) the technical feasibility of the product and/or process can be demonstrated, and the Company owns or can obtain the financial resources needed to realize the product/process (iii) revenues that are forecasted to be realized from the intended product/process are sufficient at least to recover the incurred costs, after deducting production costs, selling expenses and any additional development costs.

According to US GAAP, these advisory costs can be considered as start-up costs. ASC 720-15 defines start-up costs as one-time activities related to any of the following: a) opening a new facility; b) introducing a new product or service; c) conducting business in a new territory; d) conducting business with an entirely new class of customers (for example, a manufacturer who does all of its business with retailers attempts to sell merchandise directly to the public) or beneficiary; e) initiating a new process in an existing facility; f) commencing some new operation. ASC 720-15 requires the costs of start-up activities to be expensed as incurred, therefore advisory costs related to the implementation of the new moving line production system have been expenses for US GAAP purposes.

As of December 31, 2013, therefore, under US GAAP, a total write-off of 1,833 has been recorded with reference to the above advertisement and advisory costs.

**(i)** During 2010, the Company formally decided to sell one of the two Brazilian manufacturing plants located in Pojuca, with a Board of Directors resolution. The plant was classified as property, plant and equipment since not all criteria to record it as held for sale had been met. According to Italian GAAP, from 2011 depreciation on this plant has



been suspended, and the plant has been stated at the lower between the cost, net of cumulated depreciation, and the fair value, determined through third-party independent appraisals.

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According to US GAAP, considering that the sale was not foreseeable in near term, and there is no evidence that the sale process has been started, depreciation has not been interrupted. Therefore, under US GAAP, the depreciation has been maintained using the currency historical exchange rates of the assets, as required by ASC 830-20. Considering the impairment loss posted in 2011, and the different foreign currency translation process of the 2012 financial statements, the cumulated depreciation costs did not impact the net result and net equity in the previous years.

As of December 31, 2013, the recalculation of the depreciation process for the Brazilian plant not in use resulted in a depreciation impact of 1,643, net of the accumulated impairment losses, that impacted the net equity and net result, classified as part of operating loss in the consolidated statement of operations. As of December 31, 2013, the carrying value of the Pojuca plant, according to US GAAP, net of the 2008 and 2011 impairment loss, is 1.4 million, to be absorbed, in consideration of the expected depreciation charge, in the upcoming three years (ending in 2016).

Further, there is no difference between Italian GAAP and US GAAP regarding the classification of the manufacturing facility of Brazil and industrial building of Italy in the consolidated balance sheets as of December 31, 2013, 2012 and 2011 as under both GAAP these assets are classified under the line property, plant and equipment (see note 10).

**(j)** Under Italian GAAP certain costs paid to resellers are reflected as part of selling expenses. Under US GAAP, in accordance with ASC No. 605-50 (Revenue Recognition – Customer Payments and Incentive) (Formerly EITF 01-09), these costs should be recorded as a reduction of net sales. Such expenses include advertising contributions paid to resellers which amounted at December 31, 2013, 2012 and 2011 to 2,165, 5,323 and 4,501, respectively.

**(k)** During 2013, 2012 and 2011 the Company under Italian GAAP has recognized the write-off of tangible assets of 359, 339 and 311, respectively, as part of non-operating loss under the line other income/(expense), net. Under US GAAP such write-off charge has been classified as part of operating loss.

**(l)** Under Italian GAAP, the Company includes its warranty cost as a component of selling expenses in the consolidated statement of operations. Under US GAAP, warranty costs would be included as a component of cost of sales. For the years ended December 31, 2013, 2012 and 2011 warranty cost amounting to 6,414, 4,593 and 4,046, respectively, would be reclassified from selling expenses to cost of sales under US GAAP.

**(m)** During 2012, certain legal and tax claims pertaining to the Company's Brazilian subsidiary, Italsofa Nordeste S.A., were reversed due to a favorable decision by the relevant court and due to the expiration of the relevant statute of limitations, respectively. Based on this favorable decision, the Company, with assistance from its advisors, has evaluated the likelihood of loss arising from these claims as remote and, therefore, the Company reversed the accrual made in previous years.

Under Italian GAAP the Company classified this reversal under the line net sales (other revenues) for 3,180. Under US GAAP this reversal would be reclassified from net sales to general and administrative expenses as part of the operating result. During 2013 and 2011 there were no item to be reversed



**Table of Contents****Natuzzi S.p.A. and Subsidiaries**

## Notes to consolidated financial statements

*(Expressed in thousands of euros except as otherwise indicated)*

**(n)** Under Italian GAAP the Company records a tax contingent liability (income tax exposure) when it is probable that the liability has been incurred and the amount of the loss can be reasonably estimated.

The Company adopted the provisions of ASC No. 740-10, Income Taxes Overall, on January 1, 2007. ASC 740 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a threshold of more-likely-than-not for recognition of tax benefits and liabilities on uncertain tax position taken or expected to be taken in a tax return. ASC 740 also provides related guidance on measurement, derecognition, classification, interest and penalties, and disclosure. As a result of the implementation of ASC 740 as of January 1, 2007, the Company did not recognize any increase or decrease in the liability for unrecognized tax benefits, in respect of the Italian GAAP.

There are no differences between the amounts recognized by the Company under ASC 740 and the amounts recognized under Italian GAAP.

The following table provides the movements in the liability for unrecognized tax benefits for the years ended December 31, 2013 and 2012:

|  | 2013 | 2012  |
|--|------|-------|
| Balance, beginning of the year                               | 541  | 1,072 |
| Additions based on tax positions related to the current year | 63   |       |
| Additions for tax positions of prior years                   |      | 31    |
| Foreign exchange   | (75) | (42)  |
| Reductions due to statute of limitations expiration          | (73) |       |
| Settlements  | (3)  | (520) |
| Balance, end of year   | 453  | 541   |

The Company recognized interest and penalties, accrued in relation to the uncertainties in income taxes disclosed above, in other income (expense), net. During the years ended December 31, 2013, 2012 and 2011, the Company recognized approximately 51, 2 and (929) in interest and penalties, respectively. The total provision for the payment of interest and penalties as at December 31, 2013 and 2012 amounted to approximately 508 and 608, respectively (net of foreign currency exchange rate losses of the period and release of liabilities due to the expiration of the tax audit terms).

Under Italian GAAP the Company includes the provisions for income tax contingent liabilities under the line other liabilities of the non current part of the balance sheet. For the years ended December 31, 2013 and 2012 the above provisions for income tax contingent liabilities amount to 961 and 1,149, respectively.

The Company operates in many foreign jurisdictions. With no material exceptions, the Company is no longer subject to examination by tax authorities for years prior to 2009.

According to Italian GAAP the Company has accrued a provision of 1,000 for the withholding tax due to undistributed earnings as the likelihood of distribution is more likely than not in the near term.

Under US GAAP the provision for the withholding tax has been accrued for all the unremitted earnings of subsidiaries for which a withholding tax is applicable in case of a dividend distribution. As of December 31, 2013 and 2012 the provision amounted to 7,170 and 6,417.

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**Natuzzi S.p.A. and Subsidiaries**

Notes to consolidated financial statements

*(Expressed in thousands of euros except as otherwise indicated)*

(o) The consolidated statements of cash flows for the years ended December 31, 2013, 2012 and 2011 prepared by the Company under Italian GAAP is in conformity with US GAAP ASC No. 230, *Statement of Cash Flow* (Formerly FASB Statement No. 95).

**Comprehensive Income** Comprehensive income/(loss) generally encompasses all changes in shareholders' equity (except those arising from transactions with owners). The Company's comprehensive income (loss) under U.S. GAAP does not differ from its U.S. GAAP net income (loss) indicated in Note 29.

**Recently issued Accounting Pronouncements** Recently issued but not yet adopted U.S. Accounting pronouncements relevant for the Company are as follows:

In July 2013, the Financial Accounting Standards Board, or the FASB, issued Accounting Standards Update, or ASU, No. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*, or ASU No. 2013-11, which concludes that, under certain circumstances, unrecognized tax benefits should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. ASU No. 2013-11 will be effective for us beginning January 1, 2014. We do not anticipate that the adoption of this standard will have a material impact on our financial position.

In March 2013, the FASB issued ASU No. 2013-05, *Parent's Accounting for the Cumulative Translation Adjustment upon De-recognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity*, or ASU No. 2013-05. The objective of ASU No. 2013-05 is to resolve the diversity in practice regarding the release into net income of the cumulative translation adjustment upon de-recognition of a subsidiary or group of assets within a foreign entity. ASU No. 2013-05 will be effective for us beginning January 1, 2014. We do not anticipate that the adoption of this standard will have an impact on our results of operations or financial position.

**30. Subsequent events**

No significant event has occurred after year end.

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**SIGNATURE**

The registrant, Natuzzi S.p.A., hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

**NATUZZI S.p.A.**

By /s/ Pasquale Natuzzi  
Name: Pasquale Natuzzi  
Title: Chief Executive Officer

Date: April 30, 2014

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**Exhibit Index**

- 1.1 English translation of the by-laws (Statuto) of the Company, as amended and restated as of January 24, 2008 (incorporated by reference to the Form 20-F filed by Natuzzi S.p.A. with the Securities and Exchange Commission on June 30, 2008, file number 001-11854).
- 2.1 Deposit Agreement dated as of May 15, 1993, as amended and restated as of December 31, 2001, among the Company, The Bank of New York, as Depositary, and owners and beneficial owners of ADRs (incorporated by reference to the Form 20-F filed by Natuzzi S.p.A. with the Securities and Exchange Commission on July 1, 2002, file number 001-11854).
- 4.1 Agreement among the Ministry of Economic Development, Ministry of Labour and Social Policy, INVITALIA, the Region of Puglia, the Region of Basilicata, Natuzzi S.p.A., Confindustria and the Italian trade union and other entities named therein, dated as of October 10, 2013.
- 8.1 List of Significant Subsidiaries.
- 12.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 12.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 13.1 Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.