

NATUZZI S P A  
Form 20-F  
April 30, 2012

**Natuzzi S.p.A**

Annual Report on Form 20-F

2011

**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, 2011

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)

Mrs. Silvia Di Rosa

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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>
American Depositary Shares, each representing one Ordinary Share	New York Stock Exchange New York Stock Exchange
Ordinary Shares, with a par value of 1.00 each	(for listing purposes only)

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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, 2011 **54,853,045 Ordinary Shares**

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, references to        or 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, 2011 of U.S.\$ 1.2973. 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, Company, Group, we, us, and our, unless otherwise indicated or as the context may otherwise require, mean Natuzzi and its consolidated subsidiaries.

**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, 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.

**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,					
	2011	2011	2010	2009	2008	2007
	(millions of					
	dollars,					
	except per					
	Ordinary		(millions of euro,			
	Share) <sup>(1)</sup>		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	\$ 595.5	425.3	460.5	450.6	587.8	563.5
Other(2)	85.4	61.0	58.1	64.8	78.2	70.9
Total net sales	680.9	486.3	518.6	515.4	666.0	634.4
Cost of sales	(456.6)	(326.1)	(321.5)	(329.8)	(478.8)	(460.6)
Gross profit	224.3	160.2	197.1	185.6	187.2	173.8
Selling expenses	(202.0)	(144.3)	(154.3)	(149.6)	(172.3)	(173.9)
General and administrative expenses	(60.6)	(43.3)	(42.4)	(46.6)	(49.9)	(49.0)
Operating income (loss)	(38.4)	(27.4)	0.4	(10.6)	(35.0)	(49.1)
<i>Operating income (loss) per Ordinary Share</i>	(0.70)	(0.50)	0.01	(0.19)	(0.64)	(0.90)
Other income (expense), Net (3) (4) (5)	24.2	17.3	(4.4)	3.1	(25.8)	(2.6)
Income (loss) before taxes and minority interests	(14.1)	(10.1)	(4.0)	(7.5)	(60.8)	(51.7)
Income taxes	(12.5)	(8.9)	(7.0)	(9.8)	(1.5)	(11.4)
Income (loss) before non-controlling interests	(26.6)	(19.0)	(11.0)	(17.3)	(62.3)	(63.1)
Non-controlling interest	1.0	0.7	0.1	0.4	(0.4)	(0.5)
Net income (loss)	(27.6)	(19.7)	(11.1)	(17.7)	(61.9)	(62.6)
<i>Net income (loss) per Ordinary Share</i>	(0.50)	(0.36)	(0.20)	(0.32)	(1.13)	(1.14)
<i>Dividends declared per share</i>						
<i>Amounts in accordance with U.S. GAAP:</i>						
Net sales	\$ 683.7	488.3	510.8	506.0	670.1	635.9
Operating income (loss)	(36.4)	(26.0)	0.4	(14.2)	(40.0)	(46.4)
<i>Operating income (loss) per Ordinary Share</i>	(0.66)	(0.47)	0.01	(0.26)	(0.73)	(0.85)
Net income (loss)	(18.3)	(13.1)	(8.9)	(25.9)	(55.7)	(60.0)
<i>Net income (loss) per Ordinary Share (basic and diluted)</i>	(0.33)	(0.24)	(0.16)	(0.47)	(1.02)	(1.09)
<i>Weighted average number of Ordinary Shares Outstanding</i>	54,853,045	54,853,045	54,853,045	54,853,045	54,850,643	54,817,086
<b>Balance Sheet Data :</b>						
<i>Amounts in accordance with Italian GAAP</i>						
:						
Current assets	\$ 426.0	328.4	298.6	301.9	318.5	364.1
Total assets	662.9	511.0	503.9	508.6	543.8	617.5
Current liabilities	159.4	122.9	107.8	116.8	136.3	146.0
Long-term debt	14.0	10.8	13.6	5.9	3.3	2.1
Non-controlling interest	3.9	3.0	2.1	1.9	0.8	0.1
Shareholders' equity attributable to Natuzzi S.p.A. and Subsidiaries (6)	402.8	310.5	323.2	325.0	345.2	411.6
Net Asset	406.7	313.5	325.3	326.9	346.0	411.7
<i>Amounts in accordance with U.S. GAAP:</i>						
Total assets	\$ 662.9	511.0	508.5	521.1	560.5	627.5
Shareholders' equity attributable to Natuzzi S.p.A. and Subsidiaries	400.3	308.6	321.7	327.6	353.3	408.5



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Net Asset	404.2	311.6	323.8	329.5	354.1	408.6
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- 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 2011 of U.S.\$ 1.4002 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.\$ 1.2973 per 1 euro as of December 31, 2011. 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.
- 3) Other income (expense), net is principally affected by gains and losses, as well as interest income and expenses, resulting from measures adopted by the Group in an effort to reduce its exposure to exchange rate risks. See Item 5. Operating and Financial Review and Prospects Results of Operations 2011 Compared to 2010, Item 11. Quantitative and Qualitative Disclosures about Market Risk and Notes 3, 26 and 27 to the Consolidated Financial Statements included in Item 18 of this annual report.
- 4) Other income (expense), net in 2008 was negatively affected by the impairment losses of long-lived assets, a one-time employee termination benefit and the provision for contingent liabilities.
- 5) 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.
- 6) Share capital as of December 31, 2011, 2010, 2009, 2008 and 2007 amounted to 54.9 million, 54.9 million, 54.9 million, 54.9 million and 54.8 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.

Year:	Average <sup>(1)</sup>	At Period End
2007	1.3797	1.4603
2008	1.4695	1.3919
2009	1.3955	1.4332
2010	1.3216	1.3269
2011	1.4002	1.2973
<b>Month ending on:</b>	<b>High</b>	<b>Low</b>
31-Oct-2011	1.4172	1.3281
30-Nov-2011	1.3803	1.3244
31-Dec-2011	1.3487	1.2926
31-Jan-2012	1.3192	1.2682
29-Feb-2012	1.3463	1.3087
30-Mar-2012	1.3336	1.3025

- (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 March 30, 2012 was U.S.\$ 1.3334 to 1 euro.

### 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 2011 ( 19.6 million), 2010 ( 11.1 million), 2009 ( 17.7 million), 2008 ( 61.9 million) and 2007 ( 62.6 million), while it reported an operating loss of 27.3 million in 2011 and an operating income of 0.4 million in 2010 after three years of operating losses ( 10.6 million in 2009, 35.0 million in 2008 and 49.1 million in 2007). In addition, the Group's net sales declined from 634.4 million in 2007 to 486.4 million in 2011. 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 2011 to a difficult macroeconomic environment affecting the furniture industry as a whole (particularly in mature markets such as Europe and the United States), including the European sovereign debt crisis and the consequent decline in consumer confidence, continued high levels in raw material prices, price competition from low-cost manufacturers and unfavorable currency conditions. See Item 5. Operating and Financial Review and Prospects. Operational challenges also contributed the Group's losses over the past year. In particular, the relocation of our previous Chinese plant to a new Chinese plant during the first half of 2011 resulted in labor strikes, interruptions in the Group's production cycle, additional costs and delays in order scheduling. 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. In the Euro-zone, as a consequence of weakening world economic growth and the sovereign debt crisis affecting Greece, Portugal, Spain, Italy and Ireland, the economic situation worsened in the latter part of 2011.

Prospects for full economic recovery, therefore, still remain uncertain, especially in the so-called western economies, where private consumption is negatively impacted by a general weakness in the job market, continuing vulnerability in the real-estate sector, a decreasing level of savings among families, high levels of public indebtedness in most developed countries, whose creditworthiness has been recently downgraded or put under review by major rating agencies, austerity measures designed to reduce public expenditures and decreased consumer credit and spending. Furthermore, the repercussions of the sovereign debt crisis in Europe are not easy to quantify: the persistent funding difficulties of Europe's banking industry could diminish its ability to lend to the real economy, setting in motion a negative spiral of declining production, a weakening financial sector and sovereign debt risks. Lastly, social and political tensions in the Middle East and Northern Africa have added a further level of uncertainty on the supply-side, and, consequently, on the purchasing power of private consumers.

These persistently negative 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, 2011, we had € 24.1 million of bank overdrafts outstanding. In addition, while we had € 94.0 million of cash and cash equivalents at December 31, 2011, a portion of this amount is 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.

**The Group's operations have benefited in 2011 and in previous years from a temporary work force reduction program that, if not continued, 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, in September 2011 the Company renewed the agreement with the Italian trade unions pursuant to which it was entitled to benefit from the *Cassa Integrazione Guadagni Straordinaria* (or CIGS), an Italian temporary lay-off program, for a two-year period that will expire in October 2013. There is no guarantee that the Group will be able to renew this lay-off program upon the expiration of its two-year term and, if such lay-off program is not renewed, the future performance of the Group may be impacted. For more information see Item 6. Directors, Senior Management and Employees .

**A failure to offer a wide range of products at different price-points could result in a decrease in our future earnings** The Group has been trying for the past few years to widen its price-point offerings in order to attract a wider base of consumers. The potential inability of the Group in achieving this goal may negatively affect the Group's ability to generate future earnings.

**Our growth strategy includes, in part, the development of new stores each year. If we and our dealers are not able to open new stores or effectively manage the growth of these stores, our ability to grow and our profitability could be adversely affected** 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 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 experienced in some of our markets, such as the United States and, particularly, Europe.

In 2011, the Group derived 33.7% of its leather and fabric-upholstered furniture net sales from the Americas, 51.8% from Europe and 14.5% from the rest of the world. A prolonged economic slowdown in the United States and Europe may have a material adverse effect on the Group's results of operations.

**The Group operates principally in a niche area of the furniture market** The Group is a leading player in the production of leather-upholstered furniture, with 94.8% of net sales of upholstered furniture in 2011 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 not decrease.

**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, some 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 will 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 2011, a significant portion of the Group's net sales, but only approximately 40% 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.

**The price of the Group's principal raw materials is difficult to predict** Leather is used in approximately 87.4% of the Group's upholstered furniture production, and the acquisition of cattle hides represents approximately 20.0% 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.

**Introduction of a new integrated management system** In 2011, the Group adopted a new Enterprise Resource Planning system entitled SAP for its operations worldwide with the aim of enabling management to achieve better control over the Company through:

improved quality, reliability and timeliness of information;

improved integration and visibility of information stemming from different management functions and countries; and

optimization and global management of corporate processes.

The adoption of the new SAP system poses several challenges relating to, among other things, training of personnel, communication of new rules and procedures, changes in corporate culture, migration of data and the potential instability of the new system. The implementation of the SAP system has also involved a change in the management culture of the Company to create a more productive working environment and to better prepare for the transition to the new technological platform. To the extent the Group is unable to successfully manage the integration of the new SAP systems, as well as the challenges associated therewith, it may experience adverse consequences, including financial ones.

**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 has been granted tax benefits and export incentives by the relevant governmental authorities in those countries. During the course of 2011, part of these tax benefits and export incentives were reduced or expired. There can be no assurance that the Group will continue to be eligible for such tax benefits or export incentives for its current or 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 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, 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 March 30, 2012, 29,534,627 Ordinary Shares, representing 53.8% of the Ordinary Shares outstanding (59.0% 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.

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.

**Our auditors, like other independent registered public accounting firms operating in Italy, are not 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 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.

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 auditors' 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 Group is primarily engaged in the design, manufacturing and marketing of contemporary and traditional leather and fabric-upholstered furniture, principally sofas, loveseats, armchairs, sectional furniture, motion furniture and sofa beds, living room furnishings and accessories.

The Group is one of the world's leading companies for the production of leather-upholstered furniture and believes that it has a leading share of the market for leather-upholstered furniture in the United States and Europe based on research conducted by CSIL, a well-known, unaffiliated and reputable Italian market research firm, with reference to market information for the market for leather-upholstered furniture in the United States and Europe, respectively (Sources: CSIL, *The European market for upholstered furniture*, September 2011; CSIL, *Upholstered furniture: world market outlook 2012*, July 2011). Our distribution network covers approximately 100 countries.

The Group sells its Natuzzi branded furniture principally through franchised *Divani & Divani by Natuzzi* and *Natuzzi* furniture stores. As of March 30, 2012, the Group sells its furniture through 105 *Divani & Divani by Natuzzi* and 188 *Natuzzi* stores, of which 49 are directly owned by the Group, and through 16 concessions in the United Kingdom. The concessions are store-in-store concept managed directly by a subsidiary of the Company located in the United Kingdom. As of March 30, 2012, there were 372 Natuzzi galleries worldwide (store-in-store concept managed by independent partners). In 2012, the Group intends to restructure and re-launch the Natuzzi brand, consolidating its product portfolio.

In the last quarter of 2005 and the beginning of 2006, the Group moved some of the production of its most popular Natuzzi models in the United States under a collection named *Natuzzi Editions* to its manufacturing facilities outside of Italy in order to increase profitability by avoiding increased production costs at its Italian plants due to the weak U.S. dollar. This move included limited models and covers made of leather and microfibers, but did not include any Total Look furnishings. The *Natuzzi Editions* collection was mainly distributed through wholesale customers.

Based on the success and sales volumes generated by the *Natuzzi Editions* collection, the Group decided to promote this collection as a distinct brand under the *Natuzzi Editions* label in the Americas region and under the *Editions* label in Europe and our Rest of the World region, with limited numbers of models and covers exclusively for wholesale distribution, thus targeting the medium/medium-low segment of the market.



The Group strategically decided to leverage the Natuzzi name in the Americas region, and therefore maintained the brand as *Natuzzi Editions* due to its name recognition in the marketplace and in order to assure prior customers of the Group's continuing strength and presence in that region. In Europe and the Rest of the World, the brand was launched as *Editions* in order to avoid conflicting with the Group's well-established network of stores and galleries that were already operating under the Natuzzi name.

The *Editions* brand was officially presented in January 2010 during a well-known worldwide trade fair in Cologne, Germany, as a new trademark intended for the traditional wholesale market. Both the *Natuzzi Editions* and the *Editions* collections were targeted specifically to large customers and were intended to help the Group recover market share.

Throughout 2011, customer response demonstrated that the *Editions/Natuzzi Editions* brand positioned itself in the medium end of the market, hence targeting independent retailers. During the third quarter of 2011, the Group reworked the *Editions/Natuzzi Editions* brand's motto to be *Leather and Craftsmanship* and launched its new logo for the brand in Europe and Asia: *Leather Editions*. In the Americas, the brand continues to be *Natuzzi Editions*.

In 2012, the Group intends to protect current market share developed with the *Natuzzi Editions/Leather Editions* brand and expand further through a gallery program.

In addition to the repositioning of *Natuzzi Editions/Leather Editions* for the medium end of the market, the Group launched a fourth brand, *Softaly*, in the first quarter of 2011, targeting key-accounts with the mission of offering good prices, quality and customized service. With the repositioning of the *Natuzzi Editions/Leather Editions* brand, the Group believed it was fitting to launch a fourth brand, dedicated solely to key-accounts, that would still permit the Group to better control the supply chain from the purchasing of raw materials to delivery.

The *Softaly* brand is focused only on offering exclusive products to key-accounts and following their requested customizations. Such customized products can be listed, among others, as private label or even unbranded. The selection of key-account customers is based on the forecasted volume that such customers can generate on a regular basis. The *Softaly* brand is currently marketed in Europe, Brazil, North America and in the Asia-Pacific region through a few customers.

The Group, since 2007, has refreshed and updated the image of the *Italsofa* brand, and operates, as of March 30, 2012, a total of 19 *Italsofa* stores (one of which is directly owned by the Group), with the objective of positioning *Italsofa* as a higher market alternative to very low-cost Chinese competitors. From the beginning of 2011 until March 30, 2012 the Group also opened four *Italsofa* stores in Europe, the Middle East and Asia. In 2012, the Group intends to continue developing the *Italsofa* retail channel in Europe and the Middle East. In addition, the Group has decided to allocate marketing investments for both communications and for the *Italsofa* display system to support this new retail channel.

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* (stock company) organized under the laws of the Republic of Italy and was established 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, 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.

### Organizational Structure

Natuzzi S.p.A. is the parent company of the Natuzzi Group. As of March 30, 2012, the Company's principal operating subsidiaries were:

Name	Percentage of ownership	Registered office	Activity
Italsofa Nordeste S/A	100.00	Salvador de Bahia, Brazil	(1)
Italsofa Shanghai Ltd	96.50	Shanghai, China	(1)
Softaly Shanghai Ltd	100.00	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.	90.84	Santeramo in Colle, 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 Sweden AB	100.00	Stockholm, Sweden	(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)
La Galleria Limited	100.00	London, UK	(7)
Natuzzi United Kingdom Limited	100.00	London, UK	(7)
Kingdom of Leather Limited	100.00	London, UK	(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 2011 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 by the persistent effects of the global economic downturn, largely as a result of lower home values, high levels of unemployment and personal debt, sovereign debt-related issues within the European Monetary Union in particular, and a generalized reduced access to consumer credit.

In an effort to address these challenges and to restore the positive performance of the Group, the Board of Directors in February 2012 approved the 2012 Budget, which took into account the prevailing financial and economic uncertainty.

The Group updates annually, for internal guidance purposes only, a long-term business plan (L-T Plan), which sets forth the macro targets of turnover and profitability of the Group over the next few years. This L-T Plan mainly focuses on the recovery of sales in major markets (namely, North America and Europe), as well as the development of fast growing markets such as China, Brazil, Russia and India. The L-T Plan also accounts for different sources of efficiencies, namely a rationalization of its distribution channel, generalized savings in operations at the manufacturing, headquarters and commercial subsidiaries levels, and a global revision in processes to reduce complexity. If the Group is unable to fully implement the strategies that are contained in the L-T Plan or if such strategies do not achieve their intended effects, the Group may continue to suffer losses. See Item 3. Key Information Risk Factors for discussions of the risks and uncertainties that may impact the Group's results and plans.

In order to accomplish its primary objectives, the L-T Plan employs a growth strategy based on:

increasing competitiveness among industry players;

improving service to clients;

improving product quality;

striving for product, process and material innovation to reduce complexity;

creating more efficiency in the manufacturing and procurement process by revising product cost structures and focusing more on the R&D and engineering process;

focus on fast growing markets such as China, Brazil, Russia and India;

recovering market share in mature markets thanks to:

- a) the development of the B2B trademark *Edition*, launched in 2010;
- b) the Key-Account program intended to help the Group recover market share among large customers in historical markets such as North America and Europe;
- c) a rationalization of the existing distribution channel while increasing the number of points-of-sale on worldwide basis;
- d) a new commercial organization with focus on differentiation by brands, regions and distribution channels; and
- e) strong reduction in waste and redundancies in Group processes, with a focus on increasing integration within the Group by completing the SAP rollout.

The Group's primary objective is to expand and strengthen its presence in the global upholstered furniture market in terms of sales and production, while at the same time increasing the Group's profit and efficiency. To achieve these objectives, the Group's principal strategic objectives include:

**The Brand Portfolio Strategy of the Group** The Group competes in all price segments of the leather upholstered furniture market with a complementary range of furnishings and accessories to deliver the total living concept. The Group has divided its extensive product range into four different business propositions each with specific brand name, identity, target and positioning: a) *Natuzzi*; b) *Italsofa*; c) *Natuzzi Editions* (only for the North American market) and *Leather Editions* (Rest of the World); d) *Softaly*. This differentiated brand portfolio is designed to address all market segments to increase sales and profitability.

**a) The *Natuzzi* brand** is the most established consumer brand within the Group's portfolio. It is sold through single brand stores, concessions and galleries delivering sofas that are designed and made in Italy, priced at the middle to high-end, with unique and customized materials, workmanship and finishes, thanks to the Natuzzi heritage of fine craftsmanship in the leather sofas segment. The positioning of the *Natuzzi* brand is one that delivers the total Italian living concept by extending its line to complementary decorative products and furnishings for the

living room. The benefit consists in helping consumers make their home a harmonious, beautiful environment. Through the style and quality of its products and the merchandizing techniques in its stores, the Group aims to make this brand aspirational yet affordable. From the identification of consumer preferences and market trends to the delivery of the living room in the consumer's home, Natuzzi directly controls the production and distribution value chain, with the aim of ensuring ultimate quality at competitive prices. All models are designed in the Group's Style Center in Italy and are primarily manufactured at the Group's Italian factories.

**b) *Italsofa*** targets the medium- to medium-low segment of the market. The Group aims to position this brand by offering Italian style products at the best value. The brand includes a wide range of sofas and armchairs, with a particular emphasis on fabrics and a more restricted range of leather coverings, all available in different colors, to address young consumers in particular. Products are designed and engineered in Italy, but manufactured at the Group's factories outside of Italy, to provide the best possible value in the market. Products under this brand are mainly distributed through the wholesale channel supported by tailor-made display systems in galleries and complemented by in-store communications and advertising tools for independent, qualified retailers recognized as design product specialists. Development through single-brand stores is planned in a few selected markets (Brazil, India, China, Israel).

**c.1) The *Leather Editions*** collection includes products with a wide range of upholstery positioned in the medium- to low-segments of the market, leveraging on the know-how and the high credibility of Natuzzi in the leather upholstery business. *Leather Editions* products are manufactured at the Group's foreign plants (Romania, China and Brazil) and sold through the wholesale channel, with specific display systems within galleries and merchandising materials designed to emphasize the core values of *Leather & Craftsmanship*. Its product offering is developed according to regional market needs and linked with specific plants to serve regional customers.

**c.2) *Natuzzi Editions*** While the European and the Rest of the World markets are served through the *Leather Editions* brand, in the North American market *Leather Editions* is sold under the *Natuzzi Editions* brand name. In this market the Natuzzi Group has historically held a notable market share thanks to its strong reputation among wholesalers and the Natuzzi Editions name.

**d) *Softaly*** At the beginning of 2011 the Group introduced a key-account program to compete in low segments of the market. The objective of the key-account program is to recover business from large distributors and develop additional volumes. The Natuzzi Group aims to replicate the best practices applied in connection with the most demanding customer in terms of quality, service and price. Each account will be 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 material, components and coverings, resulting in a focused collection with few models, versions and coverings;

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

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

Precise market segmentation, clear, simple 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.

**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 Natuzzi galleries worldwide. See Item 4. Information on the Company Markets.

In 2011, according to a survey ( *World Luxury Tracking* ) by Lagardère Global Advertising in cooperation with an independent market-research company, IPSOS, 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 8,800 luxury consumers from seven countries (Italy, France, Germany, Spain, UK, the United States and Japan).

Such recognition of the Natuzzi brand among luxury consumers from developed countries is the result of investments the Company has made over the past decade on 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 March 30, 2012, the Group sells its furniture through 105 *Divani & Divani by Natuzzi* and 188 *Natuzzi* stores, of which 49 are directly owned by the Group, and through 16 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 March 30, 2012, there were 372 Natuzzi galleries worldwide (store-in-store concept managed by independent partners).

Apart from the *Natuzzi* stores and *Divani & Divani by Natuzzi* network, *Italsofa* operates 19 stores and 123 galleries, whilst *Natuzzi Editions/Leather Editions* galleries totaled 205 as of March 30, 2012.

The Group's penetration into the Indian market continued in 2011 bringing the total number of the Group's points-of-sale to six as of March 30, 2012, of which five are *Natuzzi* stores and one is an *Italsofa* store. Fourteen *Natuzzi* stores were also opened in China during 2011, bringing the total number of points-of-sale in China to 36 (of which 4 are *Italsofa* stores).

In 2011, the Group also organized the annual Retail Congress in Italy, inviting all of its worldwide partners to visit the Group's headquarters for product selection and collection renewal, and to participate in strategy sessions aimed at developing marketing and advertising plans for the upcoming year.

The Group's future retail strategy will be focused on improving same-store sales, making the existing network more efficient, and continuing expansion where the business model is properly executed and shows greatest potential. The willingness to support all of our partners and our joint efforts in continuously looking for new retail solutions are clearly visible at the Group's headquarters, where three new showrooms have been built (one for each brand, *Natuzzi*, *Italsofa* and *Natuzzi Editions/Leather Editions*) in order to properly test the effectiveness of the Group's retail concept as well as to host all of the visitors during the Retail Congress in an energizing setting.

The expansion of products that the Group offers for the high-end segment has required an adjustment to the presentation of such 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 the Italian manufacturing company in the furniture and home decoration industry most capable of offering consumers carefully developed, coordinated living rooms at competitive prices through its Total Look offer. The Total Look offer is conceived in accordance with the latest trends in design, materials and colors, and includes high quality sofas, furnishings and accessories, all of which are developed in-house and presented in harmonic 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.

In 2011, the Group introduced a new innovative material in production under the *Softaly* brand specifically for the North American and the Brazilian markets: Next Leather®. This material is made of genuine leather left-overs, pressed together and adhered to the fabric core. The backside is then bonded with bits and pieces of leather. This type of material can also be referred to as reconstituted leather. Next Leather® is a bonded leather that contains a minimum of 17 percent leather in the product. The above-noted construction meets the United States Federal Trade Commission's definition of bonded leather. The introduction of this material has enabled the Group to enter a new market with very competitive price points. The Group currently produces models composed of a mix of leather and Next Leather® for the North American market and 100% Next Leather® for the Brazilian market.

In order to add to its already vast offerings in upholstered furniture, the Group has begun to invest in its furnishings and accessories offerings.

Beginning in 2006, the Group has further widened its collection of accessories by introducing wall units, dining tables and chairs, in order to complete its living room environment offering. 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. In 2011, the Group also launched a furnishings collection composed of tables and rugs under its Italsofa brand. The Group has invested in Natuzzi Style Center in Santeramo in Colle, Italy, to serve as a creative hub for the Group's design activities.

### **Manufacturing**

Our manufacturing facilities are located in Italy, China, Romania and Brazil.

As of March 30, 2012, in addition to the headquarters site, the Group operated six production facilities and three warehouses (one for leather, one for finished goods and one for accessories) in Italy. Four of the facilities are engaged in upholstery cutting and sewing and assembly of finished and semi-finished products, and employed, as of December 31, 2011, 2,019 workers, 31% of whom are not directly involved in production. Seven of these nine facilities are located either in, or within a 25-mile radius of, Santeramo, where the Group's headquarters are located. Assembly operations at the Group's production facilities also include leather cutting and sewing and attaching foam and covering to frames.

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

In July 2006, the Group initiated an industrial restructuring program to improve the flow of production logistics and simplify job assignments in order to increase productivity while improving product quality.

In June 2010, the Group initiated a Lean Production process review that is aimed at improving product quality while regaining competitiveness. In December 2010, new prototypes of the more efficient product line were created. The industrialization of the prototyped product lines was defined in May 2011, and in December 2011 three new production lines were already completed in a new dedicated plant (located in Iesce, Matera, Italy). These new production lines produce approximately 60% of the Italian production of motion products. We also moved the manufacturing of wooden frames that was originally executed in the production site located in Santeramo in Colle (Ba), Italy, to the Iesce, Matera, Italy, plant, thus further optimizing both productivity and logistics costs through a direct, *in-loco* integration of sofa assembly.



These new Lean Production lines were also implemented in the Company's manufacturing subsidiary located in Romania (4 lines), thus contributing to a marked increase in the productivity level as well as a reduction in industrial costs in this plant. The Group is planning to extend these new production lines on a world-wide basis, through their implementation during the course of 2012 in the Group's manufacturing sites located in China and Brazil, while the existing production lines continue to be developed.

Operations at all of the Group's facilities are normally conducted Monday through Friday with two maximum eight-hour shifts per day.

Two of the Group's production facilities are involved in the processing of leather hides to be used as upholstery. One of the facilities is a leather dyeing and finishing plant located near Udine. The Udine facility receives both raw and tanned cattle hides, sends raw cattle hides to subcontractors for tanning, and then dyes and finishes the hides. The other facility, located near Vicenza, is a warehouse that receives semi-finished hides and sends them to various subcontractors for processing, drying and finishing, and then arranges for the finished leather to be shipped to the Group's assembly facilities. 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, nine grades of leather in approximately 15 finishes and 118 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-branded leather products, while split leather is used, in addition to top grain leather, in the manufacture of some Natuzzi-branded products and most Natuzzi Editions/Leather Editions and Italsofa products). The hides are then colored with dyes and treated with fat liquors 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.

One of the Group's production facilities, which is located near Naples and employed 56 workers as of December 31, 2011, is engaged in the production of flexible polyurethane foam and, because the facility's production capacity is in excess of the Group's needs, also sells foam to third parties.

As a result of intensive R&D 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.

The Group manufactures the *Italsofa* and the *Natuzzi Editions/Leather Editions* collections mainly outside of Italy. If orders exceed production capacity at the foreign plants, *Italsofa* products and *Natuzzi Editions/Leather Editions* products are also manufactured in the Company's Italian plants.

The Group owns the land and buildings for its principal assembly facilities located in Santeramo in Colle, Matera, its leather dyeing and finishing facility located near Udine, its foam-production facility located near Naples, and its facilities located in Ginosa, Laterza, Brazil and Romania.

The 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 have now been concluded. 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 is 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.

The Group identified a new production plant of 88,000 square meters, which was made ready 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.

Furthermore, in order to minimize the imbalances on production capacity caused by the relocation, a new plant of 15,000 square meters was leased, starting in July 2010. This smaller plant is located 1 kilometer from the new production plant of 88,000 square meters and focuses on sofa sewing and assembly processes. The Group expects that it will not renew the agreement for the leased plant by April 2012, since by that time the new production plant is supposed to be fully operational.

The Group owns two plants in Brazil that, in the past, have been used for the production of furnishings for the Americas region. Due to the appreciation over the past few years of the Brazilian Real versus the U.S. dollar in particular, which has reduced the competitiveness of these two plants, the Group decided to temporarily close one plant and reduce the production capacity of the other down to a level that remains sufficient to serve only the Brazilian market.

However, 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.

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, as well as developing the current distribution channel of *Italsofa* and *Natuzzi Editions/Leather Editions* points-of-sale.

The land and buildings of the remaining production facilities are leased from lessors with whom the Group enjoys long-term relationships. Although the lease terms vary in length, under Italian law the leases for the Group's Italian plants must have a minimum term of six years. The lease agreements provide for rents that generally increase each year in line with inflation. Management believes that the prospects are good for renewing the leases on acceptable terms when they expire. The Group owns substantially all of the equipment used in its facilities.

Starting in July 2010, the Company ceased all supplying relationships with sub-contractors near Santeramo in Colle and internalized their portion of production with the aim of better ensuring high quality standards and customer service.

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

The Group purchases hides from slaughterhouses and tanneries located mainly in Italy, Brazil, Germany, Colombia, other countries in South America, Scandinavian countries, and Eastern Europe. The hides purchased by the Group are divided into several categories, with hides in the lowest categories being purchased mainly in Brazil. The hides in the middle categories are purchased mainly in Italy and certain other parts of Europe and hides in the highest categories are purchased in Germany and Scandinavian countries. 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 inspected overseas by technicians of the Group, delivered to an Italian port and then sent by the Group to the Udine facility and subcontractors. 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 the first half of 2011, the prices for hides increased. During the second half of 2011 the prices remained substantially stable, with a slow decrease in prices in the last months of 2011. Due to the volatile nature of the hides market, there can be no assurances that any current trend in prices will continue. See Item 3. Key Information Risk Factors The price of the Group's principal raw material 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 in the highest price categories, while the most inexpensive of some microfibers are in the lowest price categories. Fabrics are purchased exclusively in Italy from about a dozen suppliers which provide the product at the finished stage. Microfibers are purchased in Italy, South Korea and Taiwan through some suppliers who provide them at the finished stage. Microfibers purchased from the Group's Italian supplier are in some cases imported by the supplier at the greige or semi-finished stage and then finished (dyed and bonded) in Italy. Fabrics and microfibers are generally purchased from the suppliers pursuant to orders given every week specifying the quantity (in linear meters) and the delivery date. The price is determined before the fabrics or microfiber is introduced into the collection.

Fabrics and microfibers purchased from the Italian suppliers are delivered directly by the suppliers to the Group's facility in Laterza, while those purchased outside of Italy are delivered to an Italian port and then sent to the Laterza facility. Microfibers and fabrics included into *Italsofa* and *Natuzzi Editions/Leather Editions* are delivered directly by the suppliers to Chinese, Romanian and Brazilian ports and then sent to the Group's Shanghai, Baia Mare and Salvador de Bahia facilities. The Group is able to purchase such products at reasonable prices as a result of the volume of its orders. 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. 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. During 2011, the market prices for fabrics and microfibers were influenced by the strong rising trend of raw materials. Some of these raw materials (like cotton) rose to historically high price levels. 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 Korea, 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 increased in the last past few months. The Group obtains wood and wood products for its wooden frames from suppliers in Italy and Eastern Europe. Through its plant located in Romania, the Group has begun engaging directly in the cutting and transportation of wood from Romanian forests.

With regard to the Group's collection of home furnishing accessories (tables, lamps, carpets, home accessories in different materials), most of the suppliers are located in Italy and other European countries, while some hand-made products (such as carpets) are made in India.

### 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 now 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 (with the support of the Information Systems department) has created a new portal that allows the Logistics Department and other departments (such as Customer Service and Sales) to monitor the movement of goods through the supply-chain.

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

- 1) the development of a logistic-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 through 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 new forecast methodology, developed in cooperation with a consulting firm. This methodology 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 new methodology is currently being developed together with the Group's Information Systems Department, in order to create a new intranet portal, called Worldwide Demand Planning tool. This tool was launched in March 2011 for sales coming from the North American and Asia Pacific markets, under the supervision of a forecast manager and, starting 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 so as to improve the lead time from materials supply to sales delivery. Special production programs – those requiring lead times shorter than three weeks – are only available to a restricted group of customers, for a limited group of collections and product combinations.

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** With the aim of decreasing costs and safeguarding product quality, the Group attains optimum load levels for shipping by using software developed through a research partnership with the University of Bari and the University of Copenhagen, completed in June 2006.

This software manages customers' orders to be shipped by sea with the goal of maximizing the number of orders shipped in full containers. If a customer's order does not make optimal use of container space, revisions to the order quantities are suggested. This activity, which was previously a prerogative of the Group's headquarters, has been almost completely transferred to Natuzzi Americas in High Point, North Carolina. Now, this software is also undergoing testing by customers.

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 and route optimization for customers' orders in defined areas. This software was developed by the Group jointly with Polytechnic of Bari and the University of Lecce.

**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 2011, the Group shipped 8,299 containers to overseas countries and approximately 4,358 full load mega-trailer trucks to European destinations. To improve service levels, a method of Supplier Vendor Rating is under development to measure performance of carriers and distributors providing direct service. This rating system has first been extended to transport by land, and, later, also to transport by sea.

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

The Group is committed to the conception, prototyping (for sofas and furnishings), production (for sofas only) and commercialization of a wide range of upholstered furniture, both in leather and in fabric, as well as furnishings and accessories. The Group also collaborates with acclaimed third-party designers and engineers for the conception and prototyping of certain products in order to enhance brand visibility, especially with respect to the Natuzzi brand.

New models are the result of a constant information flow that stems from the market (whose preferences are analyzed, filtered and translated by the product managers into a brief, including specific styles, functions and price points), and is communicated to the group of designers who, through constant work with the team from the prototypes department, sketches the creation of new products in accordance with the guidelines received. The diversity of customer tastes and preferences and the natural inclination of the Group to offer new solutions results in the development of products that are increasingly personalized.

More than 150 highly-qualified people work in these activities, and typically about 70 new sofa models are generally introduced each year. The Group conducts its research and development efforts and activities from its headquarters in Santeramo in Colle, Italy, in accordance with stringent 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. The Group's plant in Laterza and the Santeramo headquarters have also received an ISO 9001 certification for their roles in the design and production of furnishings and accessories.

The product development process is also based on specific needs of particular clients (key accounts / mass dealers) who are capable of generating a critical mass of sales that enable the product to achieve the right market penetration. The Group's product range falls within six broad categories of furniture: stationary furniture (sofas, loveseats and armchairs); sectional furniture; motion furniture; sofa beds; and occasional chairs (including recliners and body massage chairs); sliding furniture, a new category that the Group launched in 2011 which differentiates itself from stationary or motion furniture, with seats that slide forward, allowing the consumer to adjust seat length.

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 Group's offering is divided into four different brands and collections that satisfy different market needs:

- a) **Natuzzi**: an inspirational, middle- to high-end consumer brand, vigorously promoted worldwide as "Made in Italy";
- b) **Italsofa**: a consumer brand that aspires to provide customers with tasteful designs at affordable prices;
- c) **Natuzzi Editions/Leather Editions**: a trademark that leverages on the Group's strength in leather and craftsmanship offering products at the medium- to low-end of the market; and
- d) **Softaly**: a brand that aims to offer the best price at the low-end of the market that satisfies the needs of key accounts under private label.

The Natuzzi collection, positioned in the medium-high market, focuses on making Italian quality and style accessible through coordinated and innovative living rooms. This collection stands out for high quality in the choice of materials and finishes, as well as the creativity and details of its designs. As of March 30, 2012, this line of products offered 133 models. Regarding the range of coverings offered, the Natuzzi retail collection has 14 leather articles in 75 colors and 21 fabric articles in 83 colors. In 2011, coffee tables matching the new wall unit furniture were introduced to the Natuzzi collection with vibrant and fresh colors, available in both opaque and shiny lacquer as well as dining tables and chairs designed by *Claudio Bellini*. During the last quarter of 2011, the Group widened its *Natuzzi* collection with products designed in accordance with the Transitional style (a blend of modern and classical styles), targeting mainly the North American market, which were commercialized beginning in the first quarter of 2012. The collection also includes a selection of additional furniture (wall units, tables, lamps, carpets), accessories (pots and candles), and furniture for the dining room (tables, chairs, lamps) to offer complete furnishings with the aim of enabling the Group to become a real Lifestyle Company.

The *Italsofa* collection, which is characterized by a young and vibrant style, in 2011 reinforced its style makeover to differentiate itself from Chinese competitors and the collection was divided into two macro groups: Retail and Wholesale. The Group launched a transformation of the *Italsofa* brand from a wholesale to a retail brand and thus introduced affordable design products. As of March 30, 2012, the *Italsofa* collection consisted of 60 models including exclusive models to key accounts. Regarding the range of coverings offered, the *Italsofa* retail collection has 3 leather products in 24 colors and 5 fabric products in 22 colors.

The Natuzzi Editions/Leather Editions collection, as of March 30, 2012, consisted of 160 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* offers 13 products in leather available in 65 colors and two products in fabric with 9 colors.

The *Softaly* collection, as of March 30, 2012, is composed of 63 models including exclusive models for key accounts. Apart from the new covering, Next Leather<sup>®</sup>, the *Softaly* brand utilizes the existing covers in production.

The Group's overall sales are also partly the outcome of unbranded production, developed on the basis of specific provision agreements for important key accounts and mass-dealer clients like Macy's, and Rooms To Go.

**Innovation** remains a strategic activity for the Group. An important step in such direction is the 3P Project (Production, Preparation and Process). The 3P Project aims at reaching different goals, such as the reduction in complexity of products, improvement in production efficiency and increase in standardization and cost reduction, through the adoption of an innovative methodology that is specific for the industrialization processes. Such methodology has already been successfully implemented worldwide by different companies that apply the principles of Lean Enterprise and waste-hunting. The 3P Project was put into practice during the first week of July 2011 in one of the Group's plants, Iesce 1, located in Matera (Italy), in cooperation with a consulting company.

Twenty-five professionals of the Company, including managers and employees from the Research & Development (R&D, hereafter), Operations and Human Resources departments, were involved in the 3P Project. During the five days spent in the plant, these people started to set the basis for conceiving a completely new way of designing product.

The objective of the 3P Project was to reduce, through its complete re-engineering, the number of components in one of our armchair models, and consequently reduce its overall production cost. The Company, through the 3P Project, was able to achieve a 46% reduction in the number of components and a 13% reduction in the production costs of that model.

Therefore, considering the encouraging results achieved with the 3P Project, it was recently decided to extend such methodology to some models/versions of the *Softaly* collection as well, through the implementation of the Lean Product Development project, with the aims of reducing waste, focusing on value-added activity, reducing product complexity and increasing efficiency in the production phase, as well as component standardization.

Innovation, quality, cost control and a high level of customer service are at the basis of growth as a strategic priority. Within R&D are major, specific competences. By integrating all company skills, no matter the department they report to, the Group strives to maximize results, thus creating a true empowerment of resource.

In this perspective, the Group believes that the Lean Product Development program is an innovative approach to new product development: it focuses on know-how and technical features that must characterize an area where the ability to innovate is a key factor.

The recently launched Lean Product Development program aims at reaching the above-mentioned ambitious goals, through training sessions, workshops and activities in the field.

Research and development expenses were 7.3 million in 2011, 7.0 million in 2010, and 5.3 million in 2009.



### Advertising

The Group's Communications System was developed to regulate all methods used in each market to advertise the 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.

Advertising in store 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.

### Retail Development

The Retail Department team continues to develop useful sales tools for the market, including manuals and guidelines to be followed when it comes to managing a store and/or a gallery (Store Operations Manual, Visual Merchandising Manual, etc.) designed to enhance the performance of the store (for more information, see Item 4. Information on the Company Strategy).

### Markets

The Group markets its products internationally as well as in Italy. Outside Italy, the Group sells its leather 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* furniture stores. Since 2001, the Group has also sold its furniture through directly owned *Natuzzi* stores and *Divani & Divani by Natuzzi* stores. Starting in the second half of 2007, the Group has sold its promotional line in China through *Italsofa* stores, of which there were 19 worldwide as of March 30, 2012.

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:

#### 1) Leather and Fabric Upholstered Furniture, Net Sales (in millions of euro)

	2011		2010		2009	
<b>Americas<sup>(1)</sup></b>	<b>143.5</b>	<b>33.7%</b>	<b>164.2</b>	<b>35.7%</b>	<b>139.8</b>	<b>31.0%</b>
Natuzzi brand	16.2	3.8%	15.5	3.4%	15.3	3.4%
Other <sup>(2)</sup>	127.3	29.9%	148.7	32.3%	124.5	27.6%
<b>Europe</b>	<b>220.3</b>	<b>51.8%</b>	<b>238.1</b>	<b>51.7%</b>	<b>263.7</b>	<b>58.5%</b>
Natuzzi brand	131.9	31.0%	145.0	31.5%	159.9	35.5%
Other <sup>(2)</sup>	88.4	20.8%	93.1	20.2%	103.8	23.0%
<b>Rest of the world</b>	<b>61.5</b>	<b>14.5%</b>	<b>58.2</b>	<b>12.6%</b>	<b>47.0</b>	<b>10.4%</b>
Natuzzi brand	33.3	7.8%	31.6	6.8%	27.8	6.2%
Other <sup>(2)</sup>	28.2	6.6%	26.6	5.8%	19.2	4.3%
<b>Total</b>	<b>425.3</b>	<b>100.0%</b>	<b>460.5</b>	<b>100.0%</b>	<b>450.6</b>	<b>100.0%</b>

<sup>(1)</sup> Outside the United States, the Group also sells its products to customers in Canada and Central and South America (collectively, the Americas).

<sup>(2)</sup> Starting in 2010, the Other item includes net sales from the *Natuzzi Editions/Leather Editions* and *Italsofa* brands, as well as the *Unbranded* products. Therefore, net sales for the year 2009 have been classified accordingly.

**2) Leather and Fabric Upholstered Furniture, Net Sales (in seats) <sup>(3)</sup>**

	2011		2010		2009	
<b>Americas<sup>(1)</sup></b>	<b>776,171</b>	<b>43.4%</b>	<b>886,471</b>	<b>45.4%</b>	<b>785,156</b>	<b>40.8%</b>
Natuzzi brand	45,777	2.6%	40,112	2.1%	43,520	2.3%
Other <sup>(2)</sup>	730,394	40.9%	846,359	43.3%	741,636	38.6%
<b>Europe</b>	<b>780,791</b>	<b>43.7%</b>	<b>847,451</b>	<b>43.4%</b>	<b>943,103</b>	<b>49.0%</b>
Natuzzi brand	331,983	18.6%	370,626	19.0%	414,876	21.6%
Other <sup>(2)</sup>	448,808	25.1%	476,826	24.4%	528,227	27.5%
<b>Rest of the world</b>	<b>230,858</b>	<b>12.9%</b>	<b>220,670</b>	<b>11.3%</b>	<b>194,961</b>	<b>10.1%</b>
Natuzzi brand	78,787	4.4%	73,050	3.7%	70,855	3.7%
Other <sup>(2)</sup>	152,071	8.5%	147,620	7.6%	124,106	6.5%
<b>Total</b>	<b>1,787,819</b>	<b>100.0%</b>	<b>1,954,592</b>	<b>100.0%</b>	<b>1,923,220</b>	<b>100.0%</b>

(1) Outside the United States, the Group also sells its products to customers in Canada and Central and South America (collectively, the Americas ).

(2) Starting in 2010, the Other item includes unit data from the Natuzzi Editions/Leather Editions and Italsofa brands, as well as the Unbranded products. Therefore, the number of units sold for the year and 2009 have been classified accordingly.

(3) Includes seats produced at Group-owned facilities and, until June 2010, also by subcontractors. Seats are a unit measurement. A sofa consists of three seats; an armchair of one.

**1. United States and the Americas.**

In 2011, net sales of leather and fabric-upholstered furniture in the United States and the Americas were 143.5 million, 12.6% less than the 164.2 million reported in 2010, and the number of seats sold decreased by 12.4%, from 886,471 in 2010 to 776,171 in 2011.

The Group's principal customers are major retailers. The Group advertises its products to retailers and, recently, to consumers in the United States and Canada 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 still 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 March 30, 2012, the High Point North Carolina operation had 58 employees, 30 independent sales representatives and seven sub-representatives for the United States and Canada. They are regionally supervised by four Vice Presidents.

As mentioned above, beginning on July 1, 2010, the invoicing for the Group's Latin American operations has been managed by the parent company, Natuzzi S.p.A. Until the end of the first half of 2011, the representative office in São Paulo, Brazil, was taking care of trademarks and products promotion activities for all markets south of the US-Mexico border. During the second half of 2011, this responsibility moved back to Natuzzi Americas. The São Paulo office, since June 2011, has handled only the Brazilian Market. At March 30, 2012, the commercial office had nine representatives.

A directly owned store operates in New York City under the brand *Natuzzi*. In addition to this store, as of March 30, 2012, there were also eight *Natuzzi* single-brand stores operating in the Americas that are owned by local dealers (one each in the United States, Canada, Panama, Brazil and Venezuela, and three in Mexico). Furthermore, as of the same date, there were four *Italsofa* single-brand stores in Brazil and one in Venezuela.

## **2. Europe.**

During 2011, the Group continued to consolidate its position in Europe by investing in stores and galleries. Net sales of leather and fabric-upholstered furniture in Europe (including Italy) decreased by 7.5% in 2011 to 220.3 million (from 238.1 million in 2010), with the number of seats sold decreasing by 7.9%, from 847,451 in 2010 to 780,791 in 2011.

**2a) Italy.** Since 1990, the Group has sold its upholstered products within Italy principally through the *Divani & Divani* franchised network of furniture stores (now *Divani & Divani by Natuzzi*). As of March 30, 2012 there were 92 *Divani & Divani by Natuzzi* stores and two *Natuzzi* stores located in Italy. The Group directly owns 20 of these stores, including the two stores operating under the *Natuzzi* name.

**2b) Outside Italy.** The Group expands into the European markets mainly through single-brand stores (local dealers, franchisees or directly operated stores). As of March 30, 2012, 112 single-brand stores were operating in Europe: under the *Divani & Divani by Natuzzi* franchise brand, 11 were located in Portugal and two in Greece; one *Italsofa* store was located in Spain; and the remaining 98 were under the *Natuzzi* name (22 in France, 16 in Spain, 11 in Holland, eight each in the United Kingdom and Russia, six in Switzerland, three each in the Czech Republic, Poland and Cyprus, two each in Malta, the Ukraine, Slovenia and Croatia, and one each in Germany, Latvia, Belgium, Denmark, Hungary, Serbia, Bosnia-Herzegovina, Armenia, Greece and Estonia). Of these stores, 28 were directly owned by the Group as of March 30, 2012 and all were operated under the *Natuzzi* name: 16 in Spain, six in Switzerland, five in the United Kingdom, and one in Denmark. Apart from the *Natuzzi* stores, the Group also operates 16 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.

## **3. Rest of the World.**

**3a) Middle East & Africa.** In 2011, net sales of leather and fabric-upholstered furniture in the Middle East & Africa increased to 15.3 million from 15.1 million in 2010, and the number of seats sold decreased from 58,416 in 2010 to 56,434 in 2011.

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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 2010 and 2011 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.

2010 Country	Natuzzi brand		Other *		Total 2010	
	Net Sales	%	Net Sales	%	Net Sales	%
IRAN	56.6	0.03%	183.5	0.07%	240.1	0.05%
SUDAN	0.0	0.00%	0.0	0.00%	0.0	0.00%
SYRIA	57.6	0.03%	63.7	0.02%	121.3	0.03%
All Other Countries	192,031.8	99.94%	268,136.3	99.91%	460,168.2	99.92%
<b>Total upholstery net Sales</b>	<b>192,146.0</b>	<b>100.00%</b>	<b>268,383.5</b>	<b>100.00%</b>	<b>460,529.6</b>	<b>100.00%</b>

2011 Country	Natuzzi brand		Other *		Total 2011	
	Net Sales	%	Net Sales	%	Net Sales	%
IRAN	161.2	0.09%	432.5	0.17%	593.7	0.14%
SUDAN	0.0	0.00%	0.0	0.00%	0.0	0.00%
SYRIA	20.0	0.01%	64.1	0.03%	84.1	0.02%
All Other Countries	176,858.3	99.90%	247,739.2	99.80%	424,597.4	99.84%
<b>Total upholstery net Sales</b>	<b>177,039.4</b>	<b>100.00%</b>	<b>248,235.8</b>	<b>100.00%</b>	<b>425,275.2</b>	<b>100.00%</b>

\* Including *Italsofa* and *Natuzzi Editions/Editions* brands, as well as *Unbranded* products.

Considering that the combined sales for Iran and Syria have never exceeded one-fifth of one-percent of Natuzzi total upholstery net sales, 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 has any plans 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 and Syrian dealers that were not controlled by, owned or otherwise related to the governments of Iran or Syria.

As of March 30, 2012, the Group had a total of 16 *Natuzzi* 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 Egypt, Kuwait, Lebanon and Qatar.

In addition, seven single-brand stores were operating under the brand *Italsofa* in Israel and one in Turkey.

**3b) Asia-Oceania.** In 2011, net sales of leather and fabric-upholstered furniture in the Asia-Oceania region increased to 46.2 million (up from 43.1 million in 2010), and the number of seats sold increased 7.5%, from 162,255 in 2010 to 174,424 in 2011.

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 March 30, 2012, 63 single-brand *Natuzzi* stores were operating in the Asia-Oceania market: 32 in China, 13 in Australia, five each in India and Taiwan, two in Singapore, and one each in the Philippines, New Zealand, Thailand, Malaysia, South Korea and Indonesia. The Group also maintains 17 galleries in the Asia-Oceania region with locations in Japan, New Zealand, Thailand and Indonesia, including a gallery presence in Australia, specifically at seven David Jones department stores.

As of March 30, 2012, there were four *Italsofa* single-branded stores in China and one in India. 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.

**India.** The Group is 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. As of March 30, 2012, the Group operates five *Natuzzi* stores and one *Italsofa* store in the Indian market.

**Expansion into New Markets** The Group first targeted the United States market in 1983 and subsequently began diversifying its geographic markets, particularly in the highly fragmented European markets (outside of Italy). Although the Group is currently a leader in the leather-upholstered furniture segment in the United States and Europe, it is now focusing its attention on BRIC countries (Brazil, Russia, India and China) and other developing markets. Sources: CSIL, *Upholstered Furniture: World Market Outlook 2011*, August 2010. The Group intends to continue its growth in these markets.

**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 almost 89% of this amount; less than 9% of the Group's sales are commonly made to customers on a cash against documents and cash on delivery basis; and lastly, about 9% 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. In particular, a substantial portion of the Group's earnings before taxes and non-controlling interests from 1994 to 2003 was derived from Group companies to some extent from such tax exemptions. These tax exemptions expired between 1996 and 2003. The last tax exemption was related to the subsidiary *Style & Comfort S.r.l.* and expired on December 27, 2003.

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 in the form of capital grants for 145.5 million. 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 to the Italian Ministry of Industrial Activities for the revision of the original Program Agreement 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 from the Italian Government the final approval of the Program Agreement 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 is 9.1 million. However, in 2010, the Ministry of Industrial Activities determined an overall net receivable of only 7.1 million. In fact, the Ministry of Industrial Activities claims that interest in arrears of 1.8 million has 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 is attributable to fees owed to Committee appointed by the Ministry. Hence, the Company has allocated in its balance sheet, as a precautionary measure, an overall devaluation for such receivable of 3.7 million, as the result of the 1.7 million reduction in the final amount of capital grants not approved (reduced from 35.0 million to 33.3 million), the claimed interest in arrears ( 1.8 million), and the fees due to the Ministry Committee ( 0.2 million).

On April 27, 2004, the Technical-Scientific Committee of the Italian Ministry of Education, University and Research approved a four-year research project presented by the Company in February 2002 related to improvement and development in leather manufacturing and processing. The Committee has approved a maximum capital grant of 2.4 million and a 10-year subsidized loan for a maximum amount of 3.0 million at a subsidized interest rate of 0.5% to be used in connection with industrial research expenses and prototype developments (as published on August 20, 2004, in the Italian Official Gazette (*Gazzetta Ufficiale della Repubblica Italiana*) n° 195). Industrial research and prototype developments, planned as part of the project, are already underway thanks to the collaborative efforts of specialized in-house personnel and university researchers from the University of Lecce and the Polytechnic University of Bari. In 2007 and 2008, the Company provided the aforementioned Committee with the complete list of expenses to be acknowledged under such project and that had been incurred between 2002 through 2007. As a result of these costs, the Italian Government in June 2008 provided a 2.0 million subsidized loan and a 1.5 million operating subsidy to the Company and in February 2010 also provided a 0.6 million subsidized loan and a 0.6 million operating subsidy. In 2010, the committee appointed by the Ministry of Education University and Research prepared the final technical report according to which all of the costs incurred were acknowledged. Therefore, in 2010, the Ministry provided a 0.4 million subsidized loan and a 0.3 million operating subsidy to the Company. All of the receivables under this project have been collected by the Company.

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 acknowledges 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 acknowledged under such 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. In 2010, the Ministry Committee has completed the acknowledgement of all of the costs incurred by the Company under the aforementioned project and, therefore, is expected to issue the final decree necessary for the disbursement of the subsidies still owed to the Company.

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.

In November 2008, the Puglia regional authorities launched an incentive program in order to support companies located in the Puglia regional district that intend to invest in new production process changes, production diversification and industrial research. In January 2009, the Company submitted its proposal, entitled UThinkLean. The UThinkLean program envisions a total investment of 11.3 million, up to 3.7 million of which may be contributed as a grant by the Puglia regional authorities. However, in April 2011, the Company was informed by the Puglia regional authorities that this program was not approved for a grant.

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 MIUR (*The Italian Ministry of Education, University and Research*) a project proposal entitled Future Factory, which hopes to be financed using P.O.N. (*Piano Operativo Nazionale National Operating Plan*) 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 MIUR informed the Company that it was included on a short list of companies being considered for the grant. However, there can be no guarantee that the Company will receive any such grant from the Italian Government.

In December 2010, Italsofa Romania, an operating subsidiary wholly owned by the Company, took part in a European consortium (Augmented Reality Technologies in FACTories ARTiFACT) of partners who excel in their respective fields of knowledge. The main objective of the project is to enhance the competitiveness of European companies and to optimize production efficiency in order to provide workers on the shop-floor level with context-based information. In addition, the industrial partners and scientific research institutes involved in the project are able to challenge international competitors. The ARTiFACT consortium consists of 14 European partners. The total investments included in the ARTiFACT project amount to 5.6 million, and the overall capital grant is 3.8 million, of which 0.2 million is earmarked for Italsofa Romania.

Certain of the Group's foreign subsidiaries, including Natuzzi China Ltd and Italsofa Nordeste S.A. enjoy significant tax benefits, such as corporate income tax exemptions or reductions of the applicable corporate income tax rates.

#### **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*, *Italsofa*, *Leather Editions*, *Natuzzi Editions* and *Softaly* 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.

#### **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.

#### Description of Properties

The location, approximate size and function of the principal physical properties used by the Group as of December 31, 2011 are set forth below:

Country	Location	Size (approximate square meters)	Function	Production Capacity per day	Unit of Measure
Italy	Santeramo in Colle (BA)	29,000	Headquarters, prototyping, showroom (Owned)	N.A.	N.A.
Italy	Santeramo in Colle, Iesce (BA)	28,000	Sewing and product assembly (Owned)	1,400	Seats
Italy	Matera La Martella	38,000	General warehouse of sofas and accessory furnishing (Owned)	N.A.	N.A.
Italy	Ginosa (TA)	16,000	Sewing and product assembly (Owned)	900	Seats
Italy	Matera Iesce	10,000	Motion product assembly, manufacturing of wooden frames (Owned)	200	Seats
Italy	Laterza (TA)	11,000	Leather cutting (Owned)	7,500	Square Meters
Italy	Laterza (TA)	13,000	Fabric and lining cutting, leather warehouse (Owned)	6,000	Linear Meters
Italy	Laterza (TA)	20,000	Accessory Furnishing Packaging and Warehouse (Owned)	N.A.	N.A.
Italy	Qualiano (NA)	12,000	Polyurethane foam production (Owned)	87	Tons
Italy	Pozzuolo del Friuli (UD)	21,000	Leather dyeing and finishing (Owned)	14,000	Square Meters
U.S.A.	High Point North Carolina	10,000	Office and showroom for Natuzzi Americas (Owned)	N.A.	N.A.
Romania	Baia Mare	75,600	Leather cutting, sewing and product assembly, manufacturing of wooden frames, polyurethane foam shaping, fiberfill production and wood and wooden product manufacturing (Owned)	2,900	Seats
China	Shanghai	88,000	Leather cutting, sewing and product assembly, manufacturing of wooden frames, polyurethane foam shaping,	3,000	Seats

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			fiberfill production (Leased)			
China	Shanghai		15,000	Sewing and product assembly (Leased)	700	Seats
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. The Group's production facilities are operated utilizing close to 70.0% of their production capacity. Operations at all of the Group's production facilities are normally conducted Monday through Friday with two eight-hour shifts per day. Up until July 2010, the Group utilized subcontractors to meet demand variability.

### Capital Expenditures

The following table sets forth the Group's capital expenditures for each year for the three-year period ended December 31, 2011:

	Year ending December 31, (millions of Euro)		
	2011	2010	2009
Land and plants	0.9	0.2	0.3
Equipment	18.8	13.8	1.6
Intangible assets	1.3	3.1	6.7
Total	21.0	17.1	8.6

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 2011, capital expenditures were primarily made to make improvements at the Group's existing facilities and in particular in order to adequate the new Chinese facility in leasing for the implementation of the production process, to implement a photovoltaic plant in all our Italian production sites, to increase productivity of the facility located in Baia Mare, (Romania), and to implement the SAP system.

The Group expects that capital expenditures in 2012 will be approximately 14 million, which is expected to be financed with cash flow from operations. The Group plans to direct such capital expenditures mainly to open new stores and galleries, towards the continued implementation of SAP and to achieve productivity improvements in existing plants. The Group expects almost all of the new store and gallery openings to be in the Asia region.

#### 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.

**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 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 recovery value, 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).

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 of these recovery values are reasonable; however, changes in estimates of such recovery values could affect the relevant valuations. The cash flows employed in our 2011 undiscounted and discounted cash flow analyses for impairment analysis of long lived assets in use were based on 2012-2014 year financial forecasts developed internally by management.

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 2011 (2010 only undiscounted cash flow) impairment tests for the long-lived assets are as follow:

Long lived assets (in use) located in	Cash flows	Year Ended Dec. 31, 2011		
		g	WACC	Sales CAGR 2012-14
Italy	Undiscounted	n/a	n/a	n/a
Brazil	Third-party independent appraisal	n/a	n/a	n/a
America	Undiscounted	n/a	n/a	n/a
Spain	Discounted	0.5%	9.75%	11.5%
U.K.	Undiscounted	n/a	n/a	n/a

n/a Not Applicable;

g estimated long term growth rate;

WACC Weighted Average Cost of Capital;

Sales CAGR Sales Cumulative Average Growth Rate

The fair value analysis of each long-lived asset not in use is determined by means of third party independent appraisal.

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, 2011, 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.

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, 2011, please see Note 29(d) of the Consolidated Financial Statements included in item 18 of this annual report.

The fair value as of December 31, 2011 was determined based on Discounted Cash analyses, which require 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 for the Italian retail owned stores. The credit crisis experienced in Italy during 2011, negatively impacted the Company's results and management's expectations for the Italian market 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. The key inputs used in performing the impairment test of Italian retail owned stores relate to an estimated long term growth rate of 0.5% (1% in 2010), a weighted average cost of capital equal to 9.67% (9.91% in 2010), and an estimated average growth rate in sales of 4.2% (6% in 2010) for the subsequent years.

The lower growth rates used in the 2011 analysis reflect the difficult economic outlook in the key markets in which we operate. See Trend Information below. 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.

Furthermore, the Company would like to highlight that the net book value of goodwill (net of impairment charge) as of December 31, 2011 under Italian GAAP and U.S. GAAP was 0.06% and 0.05% of total assets, respectively (see notes 11 and 29(d) of the Consolidated Financial Statements included in item 18 of this annual report).

**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