



SÀFILO GROUP

Annual Report Year 2003

April 29th, 2004

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FORWARD-LOOKING STATEMENTS

This Annual Report includes forward-looking statements. All statements other than statements of historical fact included in this Annual Report regarding our business, financial condition, results of operations and certain of our plans, objectives, assumptions, projections, expectations or beliefs with respect to these items and statements regarding other future events or prospects, are forward-looking statements. These statements include, without limitation, those concerning: our strategy and our ability to achieve it; expectations regarding sales, profitability and growth; plans for the launch of new products; our possible or assumed future results of operations; research and development, capital expenditure and investment plans; adequacy of capital; and financing plans. The words "aim", "may", "will", "expect", "anticipate", "believe", "future", "continue", "help", "estimate", "plan", "intend", "should", "shall" or the negative or other variations thereof as well as other statements regarding matters that are not historical fact, are or may constitute forward-looking statements. In addition, this Annual Report includes forward-looking statements relating to our potential exposure to various types of market risks, such as foreign exchange rate risk, interest rate risks and other risks related to financial assets and liabilities. We have based these forward-looking statements on our management's current view with respect to future events and financial performance. These views reflect the best judgment of our management but involve a number of risks and uncertainties which could cause actual results to differ materially from those predicted in our forward-looking statements and from past results, performance or achievements. Although we believe that the estimates reflected in the forward-looking statements are reasonable, such estimates may prove to be incorrect. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements. These factors include, among other things:

- risks associated with our significant debt and our ability to meet our obligations;
- factors affecting our ability to design, develop and introduce successful new products;
- factors affecting our ability to compete effectively in the eyewear market, including new products and distribution strategies of our competitors;
- uncertainties associated with changing consumer preferences;
- factors affecting our ability to negotiate, maintain and renew license arrangements on satisfactory terms with leading designers;
- uncertainties associated with general economic conditions;
- governmental factors, including the costs of compliance with regulations and the impact of regulatory changes;
- factors affecting our ability to obtain or maintain intellectual property protection for our products;
- human resource factors, including our ability to retain our senior management and other key personnel and employee costs;
- risks related to our manufacturing and distribution operations and our arrangements with third-party manufacturers;
- the impact of currency exchange rate and interest rate fluctuations; and
- other risks, uncertainties and factors inherent in our business.

These risks are not exhaustive. For further discussion of these factors and other risks, see "Risk Factors", "Business" and "Operating and Financial Review and Prospects".

We do not intend to update or revise any forward-looking statements whether as a result of new information, future events or otherwise. All subsequent written or oral forward-looking statements attributable to us or persons acting on our behalf, are expressly qualified in their entirety by the cautionary statements contained throughout this Annual Report. As a result of these risks, uncertainties and assumptions, you should not place undue reliance on these forward-looking statements as a prediction of actual results or otherwise.

PRESENTATION OF FINANCIAL AND OTHER DATA

The consolidated financial statements of Safilo S.p.A. contained in this annual report are derived from the financial statements that were prepared for Italian legal and statutory purposes in accordance with the law governing the preparation of financial statements in Italy, as interpreted by, and integrated with, the accounting principles established by the *Consiglio Nazionale dei Dottori Commercialisti e dei Ragionieri*, the Italian accounting profession. The balance sheet and the statement of operations have been reclassified in accordance with the Statement of the *Consiglio Nazionale dei Dottori Commercialisti e dei Ragionieri* ("Italian Accounting Principles"). There are significant differences between Italian Accounting Principles and International Financial Reporting Standards ("IFRS", or formerly "IAS") and between Italian Accounting Principles and accounting principles generally accepted in the United States ("U.S. GAAP").

The financial information included in this Annual Report is not intended to comply with SEC reporting requirements. Compliance with such requirements would require the presentation of U.S. GAAP financial information and the modification or exclusion of certain financial measures and the presentation of certain other information not included herein or the exclusion of certain information presented herein.

Currency

Unless otherwise indicated, references in this annual report to "euro" or "€" are to the single currency of the participating Member States in the Third Stage of European Economic and Monetary Union pursuant to the Treaty Establishing the European Community, as amended from time to time; and references to "dollars" or "\$" are to the lawful currency of the United States of America.

We prepare our consolidated financial statements in euro. Unless otherwise indicated, all 2000 amounts have been translated into euro from Italian Lire at an exchange rate of €1.00 = ITL 1,936.27.

Rounding

Some numbers in this annual report, including percentage amounts, have been rounded; accordingly, numerical figures shown as totals in certain tables may not be an arithmetic aggregation of the figures which precede them.

Definitions

In this Annual Report, unless the context otherwise requires, references to the "Company", "Safilo", the "Group", "we", "us" and "our" are to Safilo S.p.A. and its consolidated subsidiaries, unless otherwise indicated.

EXCHANGE RATES

The following chart shows for the period from January 1, 1999, through March 31, 2004, the average, high and low noon buying rates in the City of New York for cable transfers of euro as certified for customs purposes by the Federal Bank of New York expressed as dollars per €1.00 (the "noon buying rate"). The noon buying rate on March 31, 2004, was US\$ 1.23 per euro. The euro did not exist as a currency prior to January 1, 1999.

	Low	High	Average⁽¹⁾	Period End
	<i>(dollars per euro)</i>			
Year				
1999	1.01	1.18	1.06	1.01
2000	0.83	1.03	0.92	0.94
2001	0.84	0.95	0.90	0.89
2002	0.86	1.05	0.95	1.05
2003	1.05	1.26	1.14	1.26
Month				
October 2003	1.16	1.18	1.17	1.16
November 2003	1.20	1.17	1.20	1.14
December 2003	1.26	1.23	1.29	1.20
January 2004	1.24	1.29	1.26	1.25
February 2004	1.24	1.29	1.26	1.24
March 2004	1.21	1.24	1.23	1.23

(1) The average of the noon buying rates in the City of New York for cable transfers of euro as certified for customs purposes by the Federal Reserve Bank of New York on the last day of each month.

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

3.A. Selected financial data

The following table includes our selected historical consolidated financial data for the periods indicated. The selected historical consolidated financial data included below as at and for the years ended December 31, 2001, 2002 and 2003 have been derived from our audited consolidated financial statements included elsewhere in this annual report. The selected historical consolidated financial data included below as at and for the year ended December 31, 1999 have been derived from the audited consolidated financial statements of Fimit S.p.A., a predecessor of Safilo S.p.A., which are not included in this annual report.

Our consolidated financial statements are presented in euros and are prepared in accordance with Italian Accounting Principles, which differ in certain significant respects from U.S. GAAP and IFRS.

You should read this selected historical consolidated financial data in conjunction with "Operating and Financial Review and Prospects", and our audited consolidated financial statements and the related notes included elsewhere in this annual report.

	Year ended December 31,				
	1999	2000	2001	2002	2003
Statement of Operations Data:					
Net sales.....	509.9	685.6	845.0	894.1	900.1
Cost of sales.....	(223.4)	(297.6)	(352.2)	(347.9)	(375.3)
Gross profit	286.5	388.0	492.8	546.2	524.8
Gross margin (1)	56.2%	56.6%	58.3%	61.1%	58.3%
Selling and marketing expenses.....	(161.9)	(220.4)	(272.5)	(283.9)	(300.7)
General and administrative expenses.....	(60.1)	(80.6)	(96.7)	(119.1)	(124.4)
Other income (expenses), net	(0.4)	(0.4)	(0.2)	--	--
Operating income (loss).....	64.9	86.6	123.4	143.2	99.7
Operating margin (2).	12.7%	12.6%	14.6%	16.0%	11.2%
Interest income (expense) and other financial charges.....	(9.5)	(11.5)	(34.3)	(70.9)	(68.1)
Extraordinary income (expense), net	2.5	0.2	1.4	0.9	(7.1)
Amortization of goodwill (3).....	(3.1)	(3.7)	(43.0)	(23.9)	(23.3)
Income (loss) before taxes.....	54.8	71.6	47.5	49.3	1.2
Tax expense.....	(17.7)	(21.9)	(36.4)	(35.6)	(8.5)
Net Income/(loss) before minority shareholders.....	37.1	49.7	11.1	13.7	(7.3)
Income attributable to minority shareholders	(16.6)	(22.1)	(3.8)	(3.4)	(3.6)
Net Income/(loss)	20.5	27.6	7.3	10.3	(10.9)

	As of December 31,			
	2000	2001	2002	2003
Cash Flow Data:				
Net cash provided by operating activities.....	52.4	49.3	112.6	23.9
Net cash used in investment activities	(48.0)	(575.1)	(216.7)	(80.4)
Net cash used in financing activities.....	(28.0)	523.8	197.0	22.2

	As of December 31,				
	1999	2000	2001	2002	2003
Balance Sheet Data:					
Cash and bank balances.....	20.9	14.8	30.9	51.4	38.7
Property, plant and equipment, net	101.6	134.0	151.5	176.9	184.1
Net working capital (4).....	173.0	208.1	261.1	189.1	225.0
Total assets.	452.2	577.5	1,053.9	1,224.5	1,230.0
Total debt (5).....	160.9	158.8	704.2	851.3	835.8
Net debt (6).....	140.0	144.0	673.3	799.8	797.1
Total shareholders' equity	164.2	221.9	129.2	90.7	98.6

	Year ended December 31,				
	1999	2000	2001	2002	2003
Other Data:					
Capital expenditure, net (7)	23.1	45.9	45.0	58.4	45.5
Depreciation and amortization of other intangibles (8)	21.6	27.5	30.7	32.7	31.8
EBITDA (9)	86.4	114.1	154.0	175.8	131.6

- (1) We define gross margin as gross profit as a percentage of net sales.
- (2) We define operating margin as operating profit as a percentage of net sales.
- (3) During year ended December 31, 2002, the company changed the estimated useful life of goodwill from 10 years to 20 years; this decreased goodwill amortization by €19.1 million in 2002, compared to 2001.
- (4) We define net working capital as total current assets (excluding cash) less total current liabilities (excluding bank loans, short-term debt, current portion of long-term borrowings and other borrowing). Net working capital was reduced in 2002 and 2003 by the sale of trade receivables by Safilo under the securitisation bridge facility started in December 2002.
- (5) We define total debt as short-term loans and medium/long-term loans.
- (6) We define net debt as total debt, net of cash and cash equivalents.
- (7) Capital expenditure, net includes investments in tangible fixed assets, net of disposals.
- (8) Depreciation and amortization of other intangibles (excluding goodwill amortization) is included with cost of sales and selling, general and administrative expenses in the consolidated financial statements of the Company.
- (9) We define EBITDA as operating income/(loss) plus depreciation and amortization of other intangibles. EBITDA is not a measurement of performance under Italian Accounting Principles, and you should not consider EBITDA as an alternative to (a) operating income or net income (as determined in accordance with generally accepted accounting principles), or as a measure of our operating performance, (b) cash flow operating, investing or financing activities (as determined in accordance with generally accepted accounting principles), or as measure of our ability to meet cash needs, or (c) any other measures of performance under generally accepted accounting principles. EBITDA may not be indicative of our historical operating results, nor is it meant to be predictive of our future results. We believe EBITDA is a measure commonly reported and widely used by investors in comparing performance on a consistent basis without regard to depreciation and amortization, which can vary significantly depending upon accounting methods (particularly when acquisitions have occurred) or non-operating factors. Accordingly, EBITDA has been disclosed in this annual report to permit a more complete and comprehensive analysis of our operating performance relative to other companies and of our ability to service our debt. Because companies do not calculate EBITDA identically, our presentation of EBITDA may not be comparable to similarly titled measurements used by other companies.

3.B. Capitalization and indebtedness

Not applicable

3.C. User of the offer and use of proceeds

Not applicable.

3.D. Risk factors

Risks Relating to Our Business

Our fashion eyewear business is sensitive to economic conditions and changing consumer preferences.

The fashion eyewear industry is cyclical. Downturns in general economic conditions or uncertainties regarding future economic prospects, which affect consumer disposable income, have historically adversely affected consumer spending habits in our principal markets. Therefore, economic downturns or uncertainties could have an adverse effect on our business, results of operations and financial condition. In particular, if an economic downturn is more severe or longer in duration than expected, our business, results of operations and financial condition could be impaired.

The fashion eyewear industry is also subject to rapidly changing consumer preferences. While eyewear has achieved a significant degree of acceptance as a fashion accessory, and the fashion eyewear industry has grown significantly in recent years, this growth may not continue and consumer preferences could change in a manner which will adversely affect the fashion eyewear industry as a whole and our business in particular. Changes in fashion preferences could also affect the popularity and, therefore, the value of the fashion brand licenses granted to us by designers. The prescription frames and sunglasses markets in which we compete could be affected by these changes in fashion trends and consumer preferences. Our historical success is attributable, in part, to our ability to introduce eyewear products which are perceived to represent an improvement over products otherwise available in the market. Our future success will also depend on our continued ability to develop and introduce such products in accordance with consumers' shifting preferences. Any event or circumstance resulting in reduced market acceptance of one or more of these designers could reduce our sales and the value of our inventory of models based on that design. Unanticipated shifts in consumer preferences may result in excess or obsolete inventory and underutilized manufacturing capacity. In addition, our success depends, in part, on our ability to anticipate and react to changing fashion trends in a timely manner. Any sustained failure to identify and respond to such trends would adversely affect our business, results of operations and financial condition.

Our business is increasingly dependent on our ability to negotiate, maintain and renew license agreements on satisfactory terms with leading fashion brand owners.

We have entered into license agreements that enable us to manufacture and distribute prescription frames and sunglasses under brands owned by third parties. During 2003, 77% of our total net sales were attributable to sales of licensed brands. We believe that our ability to negotiate, maintain and renew license agreements on satisfactory terms with leading designers in the fashion and luxury goods industries is essential to maintaining a successful brand portfolio and, therefore, material to the success of our business. Accordingly, if we are unable to maintain and renew license arrangements with our current licensors or comparable replacements or if we are unable to negotiate new license agreements with other leading designers, our growth prospects and financial results could be materially and adversely affected.

In addition, our licensors typically have final approval over all eyewear bearing their proprietary marks, and the eyewear must meet their design specifications and quality standards. Consequently, licensors may, in the exercise of their approval rights, delay the distribution of eyewear bearing their proprietary marks. Accordingly, there may be delays resulting from disagreements with, or an inability to obtain approvals from, our licensors. These delays could materially and adversely affect our business and results.

Many of our licenses, including some of our key licenses, contain provisions that permit a licensor to terminate the license in the event that there is a change of control of the Company, if we outsource production without the consent of the licensor, if we sell models that are not approved by the licensor, if we do not reach minimum revenue targets, or if we sell products through distribution outlets that have not been approved by the licensor.

Our results of operations could be adversely affected by a disruption of operations at our manufacturing facilities or our distribution centers or by problems with our third-party manufacturers.

We own and operate manufacturing facilities in Italy, Slovenia and Austria, and oversee production through facilities in the United States in which we produce *Smith* sport goggles. Our primary distribution facility, located in Padua, Italy, is highly automated and we rely on this facility to provide rapid delivery of products to our European and global customers. We also maintain a smaller distribution facility in the United States (New Jersey). All of these facilities are subject to operational risks, including:

- equipment failure;
- failure to comply with applicable regulations and standards and to maintain necessary permits and approvals;
- material supply disruptions;
- labor force shortages or work stoppages;
- events impeding or increasing the cost of transporting our products;
- natural disasters; and
- terrorist attacks.

Any significant disruption in operations at our manufacturing facilities or our distribution facilities resulting from these or other events may, to the extent not covered by our business interruption insurance, adversely affect our results of operations.

In addition to our owned manufacturing facilities, we increasingly are using third-party manufacturers and suppliers, mainly located in Asia but also in Italy and the United States, to produce certain of our products. The use of third-party manufacturers entails a number of additional risks, including the risk of termination and less control over the quality of manufactured products. Any delays or disruptions in the products furnished by third-party manufacturers, or disruption or termination of our present arrangements with third-party manufacturers without suitable alternative arrangements in place, could have an adverse effect on our business, results of operations and financial condition.

Because our assets, liabilities, sales and costs are denominated in multiple currencies, we are vulnerable to exchange rate fluctuations.

Our reporting currency is the euro and we conduct and will continue to conduct transactions in currencies other than the euro. As a result, we are vulnerable to foreign exchange rate fluctuations because:

- we incur some of our manufacturing costs in euro and generate a substantial portion of our revenues in other currencies, particularly the U.S. dollar; therefore, a strengthening of the euro relative to such other currencies in which we receive revenues could negatively impact our operating margins, which could adversely affect our business and results of operations; and
- a portion of our assets, liabilities, revenues and costs are denominated in various currencies other than euro; as a result, our operating results, which are reported in euro, are affected by currency exchange rate fluctuations.

Future movements of the exchange rate of the euro against the U.S. dollar and other currencies may negatively impact our reported results. For example, the depreciation of the U.S. dollar against the euro over the past years has adversely affected our results of operations, particularly in the North America and Far East regions. Fluctuations could also significantly affect the comparability of performance between financial periods.

The markets in which we compete are highly competitive, and a failure to maintain an extensive distribution network could harm our business.

The prescription frames and sunglasses markets in which we operate are highly competitive. We believe that, in addition to successfully introducing new products, responding to changes in the market environment and maintaining superior production capabilities, our ability to remain competitive is dependent on our maintaining an extensive distribution network. One of the key objectives of our business strategy is to strengthen our existing distribution network by establishing sales and marketing subsidiaries in additional attractive geographic markets. This effort will require additional expenditures and may not be successful. If we are unable to strengthen and to maintain our distribution network, our business, results of operations and financial condition could be adversely affected.

Our business is subject to risks relating to international sales and exposure to changing local conditions.

We currently have direct operations in over 20 countries and our products are sold in over 120 countries. We are therefore subject to various risks inherent in conducting business internationally, including exposure to local economic, political and civil conditions; export and import restrictions; currency exchange rate fluctuations and currency controls; changes in government regulations, including those relating to payments for prescription eyewear; withholding and other taxes on remittances and other payments by subsidiaries; investment restrictions or requirements; and local content laws requiring that certain products contain a specified minimum percentage of domestically-produced components. Our exposure to these and other risks and their potential impact on us vary from country to country and are unpredictable, but may have a significant effect on our business, results of operations, financial condition and prospects.

We may be unable to protect our proprietary rights, which would adversely affect our business and financial results.

We rely on trade secret, unfair competition, trade name, service mark, trademark, copyright and patent laws to protect our rights to certain aspects of our products, including product designs, proprietary manufacturing processes and technologies, product research and concepts and recognized trademarks, all of which we believe are important to the success of our products and our competitive position. However, pending patent and trademark applications may not generate registered patents and trademarks, and any patent or trademark registration that is granted may be ineffective in preventing competition and could be held invalid if subsequently challenged. In

addition, the actions we take to protect our proprietary rights may be inadequate to prevent imitation of our products. Our proprietary information could become known to competitors, and we may not be able to meaningfully protect our rights to proprietary information. Furthermore, other companies may independently develop substantially equivalent or better products that do not infringe on our intellectual property rights or could assert rights in, and ownership of, our proprietary rights. Moreover, the laws of certain countries do not protect proprietary rights to the same extent as the laws of the European Union and the United States.

If the level of potentially infringing activities by others were to increase substantially, we might have to significantly increase the resources we devote to protecting our rights. Additionally, an adverse determination in any dispute involving our proprietary rights could require us to grant licenses to, or obtain licenses from, third parties, or prevent us from manufacturing or selling our products or could subject us to substantial liability. Any of these possibilities could have a material adverse effect on our business, results of operations, financial condition and prospects.

Our business could be adversely affected by legal proceedings to which we are, or may become a party.

In the ordinary course of our business, we may become involved in various other claims, lawsuits, and governmental and administrative proceedings, some of which may be significant. Adverse judgments or determinations in one or more of these potential proceedings could have a material adverse effect on our business, results of operations and financial condition.

Maintaining and achieving compliance with governmental regulations requires us to incur costs and may limit our operations or otherwise negatively impact our business.

Our operations are subject to various laws and regulations by governmental authorities in the United States and other jurisdictions in which we conduct business. Governmental regulations, whether in the European Union, the United States or other jurisdictions, have historically been subject to change. Violations of these laws and regulations, including those relating to the environment and other matters, could result in significant fines, or civil or criminal sanctions. We also could incur cleanup costs in the event that significant contamination is discovered at any of our facilities, or at any off-site location for which we may be responsible. In addition, new laws and regulations, or changes in how existing requirements are enforced, could require us to incur additional costs, subject us to unexpected liabilities, limit our operations or negatively impact our business.

We depend on the services of our senior management and other key personnel, and if we are not able to retain our senior personnel or retain suitable replacements, our business could be negatively impacted.

We are currently managed by a relatively small number of senior executive officers and employees, many of whom have many years of experience with us and in the eyewear industry and would be difficult to replace. Our senior managers, including our chairman, chief executive officers and regional managing directors, and our senior product design, sales, marketing and production staff have extensive knowledge of our business, industry, licensors and customers. Any loss or interruption of the services of our key senior personnel, or our inability to recruit sufficient qualified personnel, could adversely affect our ability to maintain the loyalty of key customers and licensors, to continue to develop important product improvements, to design, manufacture, distribute and market our products and to implement our strategy. This could adversely affect our business, results of operations and financial condition.

We believe that our continued growth and success largely depends on our ability to retain skilled, qualified and experienced managerial, design, research and development, sales, marketing and production personnel and to train our staff to produce and to sell successfully the broad range of products that we offer. If we are unable to attract, retain and motivate highly skilled, qualified and experienced personnel we could lose licensors, customers and suffer reduced profitability. Even if we are successful in attracting and retaining such personnel, competition for such employees may significantly increase our compensation costs and adversely affect our operating results.

We are controlled by our principal shareholders, and their interests may conflict with your interests.

Companies controlled by Vittorio Tabacchi and funds advised by CSFB Private Equity collectively own actually 100% of the capital shares of our parent company, Safilo Holding. In addition, all but one of the directors of Safilo and Safilo Holding are designees of Vittorio Tabacchi and CSFB Private Equity. As a consequence, they have and will continue to have, directly or indirectly, the power, among other things, to affect our legal and capital structure and our day-to-day operations, as well as the ability to elect and change our management and to approve any other changes to our operations or strategic direction. The interests of these shareholders, in certain circumstances, may conflict with your interests as holders of the notes. For example, our principal shareholders could vote to declare dividends or to cause us to incur indebtedness, in each case as permitted under the indenture, causing capital outflows or increasing our debt service obligations, all of which could hinder our ability to meet our obligations under the notes.

Risks Relating to Our Structure, the Notes and the Guarantees and Our Other Indebtedness

Our high leverage and debt service obligations could adversely affect our business.

We are highly leveraged and have significant debt service obligations. As of December 31, 2003, we had approximately €36 million of consolidated debt. We also have availability under our revolving credit facility and our newly established capex facility. We anticipate that our high leverage will continue for the foreseeable future. Our high leverage could have important consequences, including, but not limited to:

- making it more difficult for us to satisfy our debt obligations, including the notes;
- increasing our vulnerability to a downturn in our business or economic and industry conditions;
- limiting our ability to obtain additional financing to fund future working capital, capital expenditures, business opportunities and other corporate requirements;
- requiring the dedication of a substantial portion of our cash flow from operations to the payment of principal of, and interest on, our indebtedness, which means that this cash flow will not be available to fund our operations, product research and development efforts, capital expenditures or other corporate purposes; and
- limiting our flexibility in planning for, or reacting to, changes in our business, the competitive environment and the industry.

We may incur substantial additional debt in the future which could be senior to the notes or could mature prior to the notes. The terms of the indenture governing the notes and the senior credit facilities restrict us from incurring additional debt, but do not prohibit us from doing so. The incurrence of additional debt would increase the leverage-related risks described in this annual report.

We are subject to significant restrictive debt covenants, which limit our operating flexibility.

Our senior credit facilities and the indenture governing the notes contain covenants which impose significant restrictions on the way we and our subsidiaries can operate, including restrictions on the ability of the Company and its subsidiaries to:

- incur additional indebtedness or guarantee indebtedness of others;
- make certain loans or investments or enter into joint ventures;

- dispose of assets or create liens on our properties;
- make acquisitions;
- engage in certain transactions with affiliates;
- issue or sell share capital;
- reorganize or enter into mergers; or
- substantially change the nature of our business.

These covenants could limit our ability to finance our future operations and capital needs and our ability to pursue acquisitions and other business activities that may be in our interest.

Our senior credit facilities also require us to maintain specified ratios and satisfy specified financial tests. Our ability to meet these financial ratios and tests may be affected by events beyond our control and, as a result, we cannot assure you that we will be able to meet these ratios and tests. In the event of a default under our senior credit facilities, the lenders could terminate their commitments and declare all amounts owed to them, to be due and payable. Borrowings under other debt instruments that contain cross-acceleration or cross-default provisions may as a result also be accelerated and become due and payable. We may be unable to pay these debts in such circumstances.

ITEM 4. Information of the company

4.A. History and development of the company

The legal and commercial name of the Company is Safilo – SOCIETÀ AZIONARIA FABBRICA ITALIANA LAVORAZIONE OCCHIALI – S.p.A. The Company is incorporated as a joint stock company under the laws of Italy and is registered with the Companies' Registry of Belluno under the number 03625410281. The duration of the Company extends until December 31, 2100. The registered office of Safilo S.p.A. is at Piazza Tiziano 8, Pieve di Cadore (BL), Italy, and the Company has a branch office at Settima Strada 15, 35129 Padua (PD) – Italy. The telephone number for the Company is +39 049 6985111.

Safilo S.p.A. was founded in 1934 when Guglielmo Tabacchi (father of our current Chairman, Vittorio Tabacchi) assumed control of a lens and frame factory established in 1878 in northeast Italy, a region where many leading companies in the eyewear industry are located. Safilo initially produced frames and lenses in a single factory using artisan methods, basic raw materials and considerable manual work. Today, Safilo is an international group, a world leader in the design, production and distribution of optical frames and fashion and sport sunglasses.

Safilo's frames are produced at a rate of over thirteen million pieces a year, in the Group's factories, five of which located in Italy. The finishing process of metal, acetate and injection-moulded frames are done in the original and now historic factory at Pieve di Cadore. At Santa Maria di Sala, near Venice, frames are produced in acetate by working sheets. This plant is also home to the Research Division, which studies and designs new products and the machines to produce them, and develops technical innovations for the production process. There are two facilities in the Friuli Venezia Giulia region: one, in Precenicco, carries out the surface treatment, painting and colouring of Optyl and injection-moulded frames. The other one, in Martignacco, specializes in the production of metal components created by cutting edge technology that is subsequently applied to all of Safilo's glasses. Two other factories are in Traun (Austria) and in Ormoz (Slovenia). The site in Ormoz produces injection-molded ski goggles and Optyl frames comprised of a unique thermosetting resin that is protected by international patent. In addition, our Smith design team in the United States purchases raw materials for the production of Smith sunglasses and sport goggles and supervises the production of the goggles at a third party's facility in Utah. Our Italian subsidiary Lenti S.r.l. produces some of our lens requirements.

For over twenty years, our organic growth has been complemented by a limited number of highly selective product line acquisitions and the expansion of our distribution network into attractive markets. In 1984, with the acquisition of Optifashion, which had license agreements with *Ferrari* and *Ferré*, we entered the then embryonic fashion eyewear market.

In 1986, we purchased the 50% that we did not already own of American Starline Optical Corp., a large U.S. eyewear trading company that had a license agreement with Polo Ralph Lauren. Since the late 1980s, we have targeted the luxury eyewear market by entering into other brand licensing agreements with well known fashion houses, including: *Gucci* (1988), *Pierre Cardin* (1991), *Burberry* (1994), *Diesel* (1994), *Christian Dior* (through the 1996 acquisition of licensee Carrera Optyl), *Max Mara* (1997), *Valentino* and *Oliver by Valentino* (1998), *Nine West* (1998), *Fossil* (2000), *Yves Saint Laurent* (2001), *Kate Spade* (2002), *Bottega Veneta* (2002), *Stella McCartney* (2002), *Liz Claiborne* (2002), *Giorgio Armani* (2003) and *Emporio Armani* (2003).

In 1977, we opened our offices in Padua in northeast Italy, the current location of our headquarters and our recently established primary distribution facility.

In 1996, we acquired Carrera GmbH, a producer of optical products and sport eyewear. Through this acquisition, the Safilo Group acquired two new factories: one in Traun, Austria, and another in Ormoz, Slovenia, which was recently expanded. In the same year, we acquired the U.S. company Smith Sport Optics Inc. and added sport goggles targeted at the U.S. market to our product lines.

In July 2003, as part of the Outlook Eyewear acquisition, we acquired a 60,000 square foot leased distribution facility in Denver, Colorado. This distribution facility provides us with additional capacity to meet increased unit volume demands and provides customer service benefits derived from having distribution capability in the Western United States, as well as New Jersey, and from having an additional customer call center.

In recent years we have focused on establishing distribution subsidiaries to control the distribution of our products in our largest national markets, and we now distribute our products in 26 of our largest markets through subsidiaries.

4.B. Business overview

We believe that we are the world's second largest wholesale eyewear producer and that we are the worldwide leader in the premium eyewear market segments in terms of net sales and units sold. The premium eyewear market segments are comprised of eyewear with retail price points above €100 in Europe and the United States. Sales of our prescription frames and sunglasses positioned in the premium market segments represented an estimated 48% of our total net sales of €900.1 million in 2003. With a new exclusive worldwide license to produce *Giorgio Armani* and *Emporio Armani* eyewear, we believe we are the world's largest eyewear producer in terms of net sales and will improve our leadership position in the premium eyewear market segments. We are also one of the world's top three producers and distributors of sport goggles.

We design, manufacture and distribute high-quality eyewear products, including prescription frames, sunglasses frames and lenses, sport goggles and other accessories. In 2003, we distributed 26.3 million units of prescription frames, sunglasses and sport goggles. Our net sales are balanced by product category, geographic region, demographic group and our broad and diverse portfolio of owned and licensed brands. Our primary focus is on prescription frames and sunglasses with retail prices above €40 in the mid-range, high-end and premium eyewear market segments. We distribute our eyewear products to eyewear retailers, and our principal customers include optometrists, ophthalmologists, opticians, retail distribution chains, department store chains and specialty stores. Sales of prescription frames accounted for 49% of our total net sales in 2003, sales of sunglasses accounted for 47%, and sales of sport goggles and other products accounted for 4%.

The following table sets forth information regarding our sales in prescription frames, sunglasses, sport goggles and other, for the periods indicated.

	Year ended December 31,				
<i>(in millions Euro)</i>	1999	2000	2001	2002	2003
Prescription frames	293.7	347.3	396.7	425.2	443.5
Sunglasses	189.0	302.7	410.5	435.6	423.6
Sport goggles and other	27.2	35.6	37.8	33.3	33.0
Total	509.9	685.6	845.0	894.1	900.1

We believe that our prescription frames, sunglasses and brands are recognized worldwide for their high quality design and distinctiveness. We produce and distribute eyewear products under our owned brands as well as under license agreements for leading luxury and designer brands. Our license agreements typically are exclusive

and have terms of five to eight years, and our relationships with some of our key licensors date back to the late 1980s. Our owned brands include *Safilo*, *Oxydo*, *Carrera*, *Smith* and *Blue Bay*. Our licensed brands include *Bottega Veneta*, *Burberry*, *Diesel*, *Dior*, *Emporio Armani*, *Fossil*, *Giorgio Armani*, *Gucci*, *Kate Spade*, *Liz Claiborne*, *Max Mara*, *Nine West*, *Oliver*, *Pierre Cardin*, *Polo Ralph Lauren*, *Saks Fifth Avenue*, *Stella McCartney*, *Valentino*, and *Yves Saint Laurent*. We have demonstrated an excellent track record in renewing existing licenses and in winning new high profile licenses, as shown by the February 2003 award of an exclusive eight-year worldwide license by the Armani Group for *Giorgio Armani* and *Emporio Armani* brands. We continually update our eyewear collections in response to changing consumer preferences, technological advances and market trends. Currently, we offer more than 2,000 models of prescription frames and more than 1,000 models of sunglasses, and we introduce more than 1,900 new models of prescription frames and sunglasses each year.

We have been highly successful in positioning our brands in the eyewear market. We seek to position each individual brand and the Safilo portfolio of licensed and owned brands, as a whole, in a commercially optimal manner by targeting specific groups of end customers based on the unique characteristics of each brand. Our distribution network gives us global reach and direct control of eyewear distribution in the retail outlets that meet the optimal brand placement requirements. Our strategic choice to selectively control where our products are sold and their placement in retail outlets is highly appealing to licensors of leading brands and distinguishes us from our major competitors, some of whom either lack such ability or are vertically integrated into retail channels. We believe that our requirement to approve where our products may be sold and thus protect the brand image has been an important factor in a number of our recent successes in obtaining new licenses, including the February 2003 award of a worldwide exclusive license by the Armani Group for *Giorgio Armani* and *Emporio Armani* brands.

In 2003, we operated seven principal manufacturing plants, with five located in northeast Italy, one in Austria and one in Slovenia. In late 2003, we decided to close our production facilities in Austria and transfer such production volumes to our factories in Italy. The factory was closed because of high production costs in Austria, to allow for greater production flexibility in Italy and to integrate with our existing production facilities in Italy. Our plants manufactured approximately 13.5 million eyewear units in 2003 compared to approximately 13.9 million units in 2002 and 15.7 million units in 2001 (including *Smith* sport goggles). In Sun Valley, Idaho, we design and oversee the production of our *Smith* sport goggles through third-party facilities in Utah. In order to maintain production flexibility, realize cost efficiencies and address the special design specifications of our Asian optical customers, we outsource the production of some of our prescription frames and sunglasses to selected manufacturers in Far East and Italy. We distributed approximately 13.4 million units of outsourced products of the 26.3 million total units distributed by us in 2003.

For the year ended December 31, 2003, we generated net sales of €90.1 million as compared to net sales of €94.1 million and €45.0 million in 2002 and 2001, respectively. For the year ended December 31, 2003, we generated EBITDA of €131.6 million as compared to €75.8 million and €54.0 million in 2002 and 2001, respectively.

Seasonality

Our revenues are partially influenced by seasonality, as we experience our highest level of demand during the second quarter due to sales of sunglasses leading up to the summer months, and we experience our lowest level of sales demand in the third quarter because, traditionally, the majority of shops are closed for some portion of the summer season.

Liz Claiborne and Outlook Distribution Facility

In December 2002, we entered into a license agreement for *Liz Claiborne* branded prescription frames and sunglasses. With the *Liz Claiborne* brand now in our portfolio, we expect to penetrate the lower part of the large mid-range market segment in the United States. In order to meet the volume demands of this brand, we have acquired, in July 2003, the assets and liabilities of Outlook Eyewear. Outlook Eyewear, based in Colorado, is a company with its own product development, marketing, sales and distribution capabilities that previously

held the *Liz Claiborne* license. As a result of this agreement, we have added all *Liz Claiborne* licensed eyewear brands to our portfolio, including *Liz Claiborne*, *LizSport*, *Claiborne*, *Liz Claiborne Readers*, *Crazy Horse*, *First Issue* and *Villager*. The *J. Lo* by Jennifer Lopez and *B.U.M. Equipment* sunwear brands were also acquired through the transaction. All the new brands acquired through Outlook will be distributed only in the United States and Canada.

Competitive Strengths

We believe that the following factors give us competitive advantages in the global eyewear industry:

Superior Product Quality and Innovation

Our products are renowned for their superior quality and innovative features by both optical retailers and end customers. We believe that high product quality is a key competitive factor that enables us to successfully position our products in the mid-range to premium eyewear market segments. In addition, we believe that our emphasis on quality has been an important factor in establishing and retaining our leading portfolio of brands. The value we have traditionally placed on product craftsmanship distinguishes us from our mass-production oriented competitors with our licensors and customers. All of our products are developed and designed internally by our design group, which comprises more than 100 highly qualified employees, which we believe to be the largest design team in the eyewear industry. We have a strategic focus on quality and on providing innovative technical solutions for our end customer's optical needs, such as non-allergenic frames, lens coatings and special lenses. One of our key objectives is to resolve optical defects and to meet the fitting, comfort and aesthetic requirements of end customers.

Global Market Leadership

We believe that we are the world's second largest eyewear producer and the worldwide market leader in the premium eyewear market segments and that we hold either the first or second position in over 20 of our largest geographic markets. We also believe that when we fully implement our recently won Armani license to produce *Giorgio Armani* and *Emporio Armani* eyewear that we may become the world's largest wholesale eyewear producer in terms of net sales.

Our leadership in the premium eyewear market segments can be attributed to our strategy to focus on these segments since the late 1980s. We leveraged our reputation for high quality products to become the producer of choice for luxury and designer brands in the premium eyewear market segments. We achieved and maintain our position through our ability to win new licenses and to retain existing licensing relationships with key international luxury and designer brands.

Our global market leadership makes us a preferred supplier for a key group of our clients, the optical retailers, for which our brands constitute a "must have" given the importance of providing a full range of top brands to meet consumer demands. In addition, our market leadership together with our superior product quality and innovation capabilities make us a preferred partner for luxury and designer houses.

Balanced Sales Mix

Our net sales are balanced by product category, geographic region, demographic group and our diversified portfolio of 36 owned and licensed brands. We generate a stable revenue stream from sales of prescription frames, which have represented about half of our total net sales and sales volume in recent years. Our prescription frame customer base primarily consists of an established network of independent optical industry professionals and a stable core of net sales of prescription frames that exhibit some medical product type characteristics. On a geographic basis, our net sales in the North America region (36% of total net sales in 2003) are approximately equivalent to our revenues in Italy and Europe (50% in 2003). Within the United States, our largest single market,

our sales are divided between prescription frames (49% of net sales in 2003) and sunglasses (47% in 2003), by geographic region and by distribution channels. Within Europe, besides our home market of Italy, we have significant sales in the key markets of France, Spain, Germany and the United Kingdom. This geographic balance partly insulates us from a downturn in any particular region. Similarly, our diversified portfolio of 36 brands mitigates against fashion risk. In addition, we believe that the long-term nature of our license agreements provides additional stability to our sales. Finally, our brands are positioned at distinct price points in the mid-range, high-end and premium eyewear segments, and targeted at discrete groups of consumers.

Superior Client Service

We believe that we are a recognized leader in providing superior service to our clients. We support our customers through our large and experienced sales force, modern call centers for telephone orders, strong advertising and promotional support at the point of sale and an extensive and distribution network capable of rapid delivery. We have established a dedicated pan-European organization, GCE (*Grandi Clienti Europa*), based in Padua, to improve the quality and promptness of our services to our largest European retail chain customers. We support our brands and our customers through extensive advertising and promotional activities, including point of sale displays and media campaigns. Our sales force of approximately 1,300 exclusive sales representatives is largely commissioned-based and dedicated to meeting the needs of our customers. This sales force is complemented by call centers located in Europe and the United States. Unlike our principal competitors, our sales representatives call on their clients, regardless of their size, on multiple occasions every year.

Experienced Management Team

We believe that our management team has an excellent track record in the eyewear industry and is highly regarded in terms of industry knowledge and strategic outlook. Our management team is led by Vittorio Tabacchi, our Chairman, and by Giannino Lorenzon and Roberto Vedovotto, our Co-Chief Executive Officers. A significant component of the compensation of our management team is based on the operating performance of the business. Certain of our directors, senior management and other key employees have been granted options under Safilo Holding's share option plan.

Partnership with CSFB Private Equity

CSFB Private Equity acquired an indirect minority interest in Safilo in December 2002 through the purchase of shares of our parent company, Safilo Holding S.p.A., from companies controlled by Vittorio Tabacchi and is represented on Safilo's board of directors. CSFB Private Equity is one of the world's largest private equity firms with over €26 billion of assets under management. CSFB Private Equity invests across a broad range of industries and has significant experience in Europe.

Business strategy

We seek to strengthen our current position in the global eyewear market and enhance our financial profitability. As part of our strategy, we intend to:

- *Continue to strengthen our portfolio of brands.* We intend to continue to strengthen our portfolio of both owned and licensed brands. We believe that we are well-positioned to take advantage of the historically consistent revenues generated from sales of prescription frames to an established customer base while continuing to exploit the attractive sales growth opportunities available in the premium sunglasses market segments.
 - *Owned brands.* Our strategy with respect to our owned brands is to position each brand to meet a specific customer need, such as increasing the focus on the sport segment for our *Carrera* and *Smith* brands through the establishment of dedicated sales teams or such as promoting through

optical retail channels our established *Safilo* brands as specializing in addressing particular eyewear problems of our end customers.

- *Licensed Brands.* Our strategy is to position and differentiate our licensed brands by targeting various end customers, including differentiating between income levels, ages, gender and activities pursued by our end customers, whether professional or leisure in nature. We may selectively strengthen our portfolio by winning new licenses for brands with international recognition, excellent reputations for quality and proven historic growth. The award of the exclusive eight-year license to Safilo by the Armani Group for the *Giorgio Armani* and *Emporio Armani* brands demonstrates our ability to achieve this objective. We also intend to strengthen our portfolio by continuing to identify local brands that enable us to increase our penetration in regional and national markets. In addition, we strengthen our portfolio of licensed brands by adding brands that will complement and enhance our existing portfolio.

- *Strengthen our distribution network.* In order to improve our customer service, protect the brand image and value of our licensed brands and increase profitability, we intend to strengthen our distribution network. This will be achieved through establishing company controlled distribution subsidiaries in markets where it is cost-effective to do so and increasing our control over third-party distributors and agents in other markets. Currently, we distribute our products through company controlled distribution subsidiaries in 26 of our largest markets worldwide, and we are in the process of expanding this network in potential high-growth markets. We recently established new distribution subsidiaries in China. As part of this strategy, we may also acquire the interests of local joint venture partners or minority investors in order to achieve total control of the distribution business.
In geographic markets where it is not yet attractive to establish our own distribution network, we intend to strengthen our control over our third-party distributors and agents. Besides achieving greater efficiency, we believe that increased control over third-party distributors and agents will contribute to the protection of the brand image and value of our licensed brands. We intend to utilize only one exclusive third-party distributor or agent in these markets. Additionally, unlike our major competitors, we intend to maintain our core identity as an eyewear producer that distributes its products through wholesale channels. We believe that large-scale vertical integration into retail distribution could jeopardize current relationships with some of our key customers.

- *Continue to focus on product design.* We believe that we are the industry leader in product design and technological innovation. Our emphasis on and approach to product design distinguishes us from our competitors and makes us an attractive licensing partner for leading luxury and design houses. Over a decade ago, we identified product design as a strategic objective of the Safilo Group and since then our design group has grown from two senior designers and six model designers to a total group of more than 100, including 12 senior designers and 34 model designers. Our competitors generally use external designers for their eyewear. We believe that we have an unrivalled capability to influence, if not lead, fashion trends in the eyewear industry. Product design influences nearly every aspect of our business, including production, marketing and sales.

- *Improve cash flow generation.* We are planning to improve cash flow generation by optimizing our working capital. We are working to change the terms of payment extended to our customers in order to reduce the amount of time to collect our receivables, which will result in increased cash generation. The plan is initially being presented to customers in Europe, and in particular Italy, where the average market payment period is larger than the average of the Group. The initiative also seeks to reduce the number and amount of overdue payments. To support the initiative, bonus levels for commercial managers are now linked to their results in this area.

We are also trying to optimize the level of stock of our products. We are further investing in our new distribution center in Padua to improve the level of service extended to our customers while at the same time efficiently monitoring all distribution and inventory costs.

- *Focus on flexible production.* We are committed to improving our operating efficiency through flexible production. For example, we aim to optimize the allocation of production requirements between our own production facilities and third-party manufacturers in order to attain maximum flexibility and cost-effectiveness without threatening intellectual property protection or product quality. Increasingly we are outsourcing more production of finished products, and we also increasingly use subcontractors to supply parts, finish assembly or produce our products. We link management and employee remuneration to improvements in production efficiency and closely monitor our product efficiency targets.

Products and brands

We design, manufacture and distribute high-quality eyewear in three product categories: prescription frames, sunglasses and sport goggles. Our product portfolio is comprised of:

- our owned brands of prescription eyewear, sunglasses and sport goggles; and
- our licensed brands of prescription eyewear and sunglasses.

Our prescription eyewear and sunglasses products are positioned throughout the mid-range, high-end, premium and luxury eyewear market segments. Our *Smith* and *Carrera* sport goggles are positioned in the mid-range of the sport goggles segment.

We manufacture and assemble approximately half of our prescription eyewear and sunglasses products at our seven facilities in Europe. We outsource the production of the other half to third party manufacturers in Italy, Japan and Asia. Most of our *Carrera* products are produced at our facilities in Europe and our *Smith* sport goggles are produced in the United States by a third party under our supervision.

In February 2003, we entered into a license agreement with the Armani Group whereby we have the exclusive worldwide right to design, manufacture and distribute prescription frames and sunglasses bearing the *Giorgio Armani* and *Emporio Armani* brands. Previously, *Giorgio Armani* and *Emporio Armani* prescription eyewear and sunglasses were designed, produced, distributed and sold by one of our principal competitors.

Giorgio Armani and *Emporio Armani* have historically been among the top selling eyewear brands in the world, and we believe that the Armani license represents a highly complementary fit with our existing brand portfolio, enhancing our position as one of the leading producers of eyewear globally. We began distribution of the *Giorgio Armani* and *Emporio Armani* brands in Europe during April 2003 and subsequently in the United States and Far East during the third and fourth quarters of 2003. The *Giorgio Armani* and *Emporio Armani* lines are expected to continue growing throughout 2004 and reach 100% of their own additional revenue target in 2005.

As part of our ongoing close collaboration with the Gucci Group, in November 2002 we entered into new license arrangements for the *Bottega Veneta* and *Stella McCartney* branded eyewear collections. In keeping with the attributes of unsurpassed quality, outstanding craftsmanship, fashion and exclusive materials, the first *Bottega Veneta* eyewear collection was introduced in March 2003.

Stella McCartney sunglasses, designed in close collaboration with Stella McCartney, the successful designer, are positioned in the luxury market segment, and their design and marketing emphasize the cutting-edge image that characterizes the *Stella McCartney* brand. The collection is distributed exclusively through selected luxury retail chains.

Owned Brands

Our portfolio of Safilo-owned brands includes *Safilo*, *Oxydo*, *Blue Bay*, *Carrera*, and *Smith*. Each of these brands and their brand extensions is positioned to address a specific eyewear market segment. Our owned brands also benefit from our long-standing emphasis on product research and development by incorporating the latest in

eyeframe technology and materials and lens coatings. In addition to our organic product development efforts over the years, we broadened our owned brand portfolio in the area of sports goggles and sport glasses in the United States and Europe through our acquisitions of the *Smith* and *Carrera* brands in 1996. We are one of the three top producers and distributors of sport goggles.

Safilo is a mid-range to premium-priced prescription eyewear brand. We consider *Safilo* to be a cornerstone brand because of the large number and wide range of end-customers to which the brand is targeted. *Safilo* prescription eyewear is sold worldwide and we produce and distribute specific products for different markets such as the United States, Germany and the Far East. In the United States, we believe the *Safilo* brand is the number one selling brand of prescription frames based on unit sales. The *Safilo* brand is also targeted to a wide range of end customers, as we produce models for children, adult men and women, and more mature customers across a wide price range. In 2002, we launched *Safilo Design* as a high-end brand extension as part of our strategy to have *Safilo* brand products that cover the range of price points between mid-range and premium-priced eyewear. We expect to continue to further develop the *Safilo* brand and increase the number of models aimed at younger customers.

Oxydo is a specialized mid-range to high-end prescription frames and sunglasses brand. The *Oxydo* brand is targeted at younger end customers more than our *Safilo* brand and relies more heavily on following the latest trends and fashions with respect to shapes and colors than does our *Safilo* brand. We will continue to further develop the brand by building on this brand differentiation as compared with our *Safilo* brand. In 2000, we consolidated *Safilo* brand sunglasses under the *Oxydo* brand, supporting it with a brand building campaign that included sponsoring the *Oxydo* motorcycle world championship team. Sponsorships allow us to better target the younger end customer and to more distinctly position *Oxydo* as a sportier, cutting-edge brand. Although *Oxydo* products are principally sold in Europe, we began distributing *Oxydo* in the United States in 2003.

Carrera is a specialized sports eyewear and goggle brand. *Carrera* is one of the most well-known sports brands in the world and is a market leader in Europe. In Austria alone, *Carrera* represents approximately 40% of the sports eyewear market. *Carrera* branded products are characterized by having highly technical features, including lenses, that enable *Carrera* products to be positioned as fashionable eyewear that meets the demands of active and sport-minded end customers who desire comfort and durability. Consequently, the *Carrera* brand is targeted to highly active individuals who pursue outdoor and highly physical recreational activities.

Smith is one of the most popular U.S. sport goggle brands, and it is also sold in over 50 other countries. We acquired the *Smith* brand in 1996. In addition to the primary product, sport goggles, we have also introduced a line of *Smith* brand sport sunglasses. *Smith* sunglasses are targeted to American men who would not be inclined to purchase luxury or designer sunglasses, including extreme sport participants. Designed for active and competitive sports, *Smith* sport goggles and sport sunglasses come in a range of bright colors. *Smith* products are distinguished because of the distortion free tapered lens technology and the versatility of the Slider series with its patented interchangeable lens system.

Blue Bay is a mid-range priced prescription frames and sunglasses brand. *Blue Bay* products are primarily sold in Europe, with Italy, Spain, France and Germany being the most important markets, and *Blue Bay* is mainly targeted to younger end customers, including children, and those who prefer un-branded eyewear products. *Blue Bay* products are characterized by up-to-date, classical styling that is not aggressive. We produce specific *Blue Bay* products for the German market, and we will continue to assess specific market demands and respond accordingly. As part of our efforts to continue to successfully grow the *Blue Bay* brand, we will undertake increased promotional and marketing activities for the brand in 2003 and 2004.

Licensed Brands

Our portfolio of licensed sunglasses and prescription frames, comprised of brands from many of the leading luxury and designer houses in the world, is one of the broadest and most diverse portfolios in the eyewear industry. Each of our licensed brands is designed, positioned and marketed so as to reflect the attributes of the brand and to address a specific eyewear market segment. Our portfolio consists of both global brands, such as *Giorgio*

Armani, Gucci, Dior, Polo Ralph Lauren and *Yves Saint Laurent*, and brands positioned to address specific segments of the U.S. market, such as *Kate Spade, Fossil, Nine West, Saks Fifth Avenue* and *Liz Claiborne*.

Our licensed brand eyewear products are positioned from the mid-range through the luxury eyewear market segments.

Our portfolio of licensed luxury and designer brands includes *Giorgio Armani, Bottega Veneta, Burberry, Diesel, Dior, Emporio Armani, Fossil, Gucci, Kate Spade, Liz Claiborne, Max Mara, Nine West, Oliver, Pierre Cardin, Polo Ralph Lauren, Saks Fifth Avenue, Stella McCartney, Valentino*, and *Yves Saint Laurent*. During 2003, we entered into an agreement for the *Giorgio Armani* and *Emporio Armani* licenses

Bottega Veneta. We introduced the first collection in February 2003 and launched the collection internationally in March 2003, consisting of 10 models of sunglasses that will be updated twice per year. The *Bottega Veneta* collection is unisex in style and is targeted to a well-defined niche clientele of men and women aged 30 to 50. Designed in conjunction with *Bottega Veneta's* renowned creative director Tomas Maier, the eyewear collection is characterized by outstanding craftsmanship, fashion and exclusive materials such as titanium combined with acetate. All sunglasses are presented in a dark brown leather case having a distinctive braided pattern.

Burberry. The collections are targeted to men and women aged 25 to 45 and are characterized by the incorporation of the distinctive and well-recognized *Burberry* check pattern that is designed to complement other *Burberry* products and accessories. At the beginning of 2002, we worked closely with the licensor to successfully re-launch the brand by targeting a younger end customer, and we will continue to closely collaborate with *Burberry's* creative team to update the brand image. We also intend to build on the strength of the *Burberry* brand by seeking to continue to increase its net sales outside of the United Kingdom, the brand's traditional stronghold.

Diesel. The collections are sold primarily in Europe and are targeted to younger men and women aged 13 to 35. Characterized by aggressive, countertrend styling, the image of the brand and the style of each collection is closely linked to other *Diesel* brand products and accessories. We will further develop the brand by launching *DSL 55*, a line of eyewear products targeted to a "street ware" market composed of young, urban consumers.

Dior. The collections are sold worldwide (with particular strength in Italy, France, the United States and Japan) and are targeted to men and women aged 20 to 50. Characterized by the most up-to-date design elements and cutting edge fashion, *Dior* products are unique, distinctive and exclusive in their shapes and colors, and it is the only brand in our portfolio in which we present a "limited edition" model each year. Although, the collections have primarily been targeted to cosmopolitan and affluent women, we recently launched *Dior Homme*, which is characterized by considerable technological innovations that are modern and elegant, including models in black acetate in a range of frames designed to complement a masculine wardrobe. We intend to continue to build on the growing strength of the *Dior* brand and to increase the selection of prescription frames targeted to younger, but fashion conscious, consumers.

Emporio Armani. The first collection was launched in May 2003 and scheduled releases followed soon after, with extra styles and colours both for sunglasses and frames. By mid-2004, the roll out of the full collection will be completed in all of the different segments. The *Emporio Armani* collections are intended to be more informal than the *Giorgio Armani* collections and are targeted to younger men and women aged 18 to 25 who are students or young professionals. The collections are distinguished by a wide range of shapes and colours that make it one of the most young, exciting and vibrant collections in the market.

Fossil. The *Fossil* collections are unisex in style and consist of 40 models of prescription frames, and the collection is updated three times per year. Characterized by extensive use of titanium, the collections are designed to complement the successful styling of *Fossil* brand watches.

Giorgio Armani. We launched a first collection – comprising more than 120 SKUs – in May 2003; we completed the range in June and we updated it in August and October to make one of the most respected collections in the high-end eyewear market. *Giorgio Armani* products are sold worldwide and are targeted to men aged 30 to 54 and women aged 30 to 44, in each case who are professionals and who seek a product unique in terms of design and content originality. Materials used for the *Giorgio Armani* collection will include titanium, genium, and very light steel and acetate.

Gucci. The collections are sold worldwide and are targeted to men and women aged 20 to 50. Characterized by the widespread use of the distinctive and highly recognized "G" logo, the collections consist of models composed of distinctive and beautiful materials that strive to create and be at the forefront of fashion styling. We work closely with Gucci's creative director, Tom Ford, under whose direction the brand has experienced tremendous success over the past several years, particularly with respect to its sunglasses range. We will continue to work to strengthen the brand by designing and incorporating exclusive combinations of colors and materials for use in *Gucci* branded products.

Kate Spade. Under the *Kate Spade* brand, we produce high-end prescription frames and sunglasses sold only in the United States. The brand was founded by Kate Spade, a highly successful designer of leather goods. The collections are characterized by vivid, colorful designs with elegant, fashionable and colorful details.

Liz Claiborne. Under the *Liz Claiborne* brand, we produce mid-range to high-end prescription frames sold only in the United States. The collections are characterized by high quality components and design at an attractive price.

Max Mara. Launched in 1998, the *Max Mara* collections are characterized by a distinctive elegant and refined identity that reflects the integral characteristics of the image projected in other *Max Mara* products and accessories. We will continue to work closely with the licensor to harmonize the *Max Mara* eyewear collections with its other products and accessories, particularly the warm tones that characterize the *Max Mara* clothes line.

Nine West. Under the *Nine West* brand, we produce mid-range and high-end prescription frames sold only in the United States. The collections are characterized by the use of a wide assortment of metals and plastics in an array of fashion colors.

Oliver. Launched in 1998 along with *Valentino* after winning the license from a competitor, the *Oliver* collections are unisex in style. The collections are targeted to younger men and women aged 18 to 30, and sales are particularly strong in France, Germany and Italy. Designed closely with its related luxury brand, *Valentino*, the *Oliver* eyewear collections are more informal in design and offer an increased color selection as compared to *Valentino* to better appeal to its younger end customer. To further develop the brand, we will begin to introduce advertising and promotional materials focused on *Oliver* to individual retail outlets.

Pierre Cardin. Under the *Pierre Cardin* brand, we produce mid-range prescription frames and sunglasses. Launched in 1991, the current *Pierre Cardin* collections have a very broad range as there are models targeted to children aged 5 to 10, younger men and women, and men and women aged 30 to 60. *Pierre Cardin* products are characterized by simple shapes combined with innovative designs. To further develop the brand, we will expand the number of prescription frame models from 60 to 80 and offer a greater number of model sizes.

Polo Ralph Lauren. Under the *Polo Ralph Lauren* brand, we produce mid-range to luxury prescription frames and sunglasses. Launched in 1988, the current *Polo Ralph Lauren* collections consist of several lines, each with a different price point, *Polo Ralph Lauren* and *Ralph Lauren*, *Polo Sport*, *Ralph*, and *Polo Jeans*. The collections are sold worldwide with the strongest sales coming from the United States; however, increased recent attention to the needs and tastes of European end customers have led to higher sales of *Polo Ralph Lauren* products in this region. With design characteristics ranging from cutting edge fashion, discreet informality, and sport mixed with fashion, the collections with their different lines have a very broad range of appeal and target men and women

aged 20 to 50. To further develop the brand, we will build on our recent success developing and growing the younger and sport product lines by further expanding the luxury lines of the *Polo Ralph Lauren* brand.

Saks Fifth Avenue. Under the *Saks Fifth Avenue* brand, we produce mid-range to high-end prescription frames and sunglasses sold only in the United States. Launched in 2002 in close collaboration with the well-known department store that bears the brand's name, the *Saks Fifth Avenue* collections targeted to women over 35 years of age. The collections are characterized by simple elegance and understated designs with sophisticated details and blended colour.

Stella McCartney. Under the *Stella McCartney* brand, we produce luxury sunglasses. Launched globally in 2003 in close collaboration with Stella McCartney, the successful designer and daughter of Paul McCartney, the collection is unisex in style and is targeted to men and women aged 25 to 45. Characterized by its use of a broad range of colours and shapes, the collection is designed to emphasize the cutting-edge image for which *Stella McCartney* branded products are known.

Valentino. Under the *Valentino* brand, we produce high-end to luxury prescription frames and sunglasses. Launched in 1998 along with *Oliver* after winning the license from a competitor and sold worldwide, the brand is particularly strong in Italy and Spain. The collections are targeted to men and women aged 30 to 50, but women account for about 80% of the brand's sales. Characterized by chic, sophisticated styling, *Valentino* eyewear products are set apart with special details such as a silver "V" insert on the temple. We will further develop the brand in close collaboration with Valentino as the licensor is currently engaged in a re-launch of the brand's image coupled with a broad advertising campaign. We will also design new *Valentino* products to target a younger, high fashion conscious customer.

Yves Saint Laurent. Under the *Yves Saint Laurent* brand, we produce high-end and luxury prescription frames and sunglasses. Launched worldwide in 2002 after winning the license from a competitor and sold worldwide, the brand is particularly strong in Italy and France. The collections are targeted to men and women aged 20 to 40 who are looking for extremely exclusive products. Characterized by sophisticated designs, *Yves Saint Laurent* eyewear products utilize high quality materials such as *Optyl* plastics and titanium in a variety of shapes and designs, including both updated classic designs from the 1960's and 1970's and modern, rectangular shapes. To further develop the brand, we will develop and offer sophisticated colors and acetates that will be exclusive to the *Yves Saint Laurent* collection.

We focus on top brands with international recognition and proven expansion strategies capable of conducting autonomous brand building campaigns which indirectly benefit the eyewear product. Generally, we do not consider obtaining licenses for smaller brands with only regional recognition. However, in recognition of the size and particular importance of the U.S. market, we have accepted U.S.-only licenses. These include *Kate Spade*, *Fossil*, *Nine West*, *Saks Fifth Avenue* and *Liz Claiborne* which target an end customer demand for alternatives to mainstream brands such as *Giorgio Armani*, *Gucci*, *Dior*, *Polo Ralph Lauren* and *Yves Saint Laurent*. The composition of the brand portfolio also follows an end customer segmentation strategy in order to build the best possible proposition for optical retailers. For example, our products have a varying price range. *Gucci* and *Dior* are directed towards customers seeking higher end exclusive products, and brands like *Polo Ralph Lauren* and *Emporio Armani* are directed towards other affluent customers with different design preferences. Similarly, in order to draw upon differing age groups, *Diesel* and *Kate Spade* target younger customers while *Valentino* and *Dior* target more mature customers.

Distribution and Customers

Our products are sold in 120 countries and are supplied to approximately 130,000 points of sale worldwide. We distribute our products directly in 26 of our largest geographic markets (91% of net sales in 2003) through company controlled distribution subsidiaries and a sales force of approximately 1,300 sales representatives, who, depending on the country, may be employees of the subsidiary (approximately 30%) or independent sales agents (approximately 70%). Regardless of whether our sales force members are employees or independent agents,

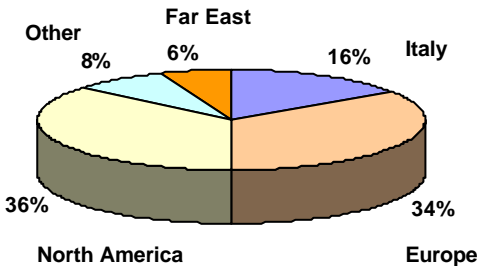
they exclusively distribute Safilo owned or licensed eyewear. All our sales agents are exclusive to Safilo and may not sell any other products. The agents sell one or more of our licensed or owned brands and do not sell our entire line of products. In order to maintain control of where our products are available, an agent may not sell our products to a customer without our final approval.

In other markets, we distribute our products through an established network of third-party distributors and pursuant to exclusive distribution arrangements in all but a few of our smallest markets. Our largest geographic markets in terms of net sales are the United States, Italy, France, Spain, Germany, the United Kingdom and Japan, which together accounted for 73% of our net sales in 2003.

In the over 100 countries where we do not have distribution subsidiaries, we sell our eyewear products through third-party distributors in all but the smallest markets. These distributors have the exclusive right to sell certain of our product lines in designated territories with the exception of our smallest markets. A third-party distributor may sell one or more of our product lines within its territory, depending on the terms of the relevant distribution arrangement. We maintain close contact with our third-party distributors in order to monitor sales in the relevant markets. Almost all orders for eyewear are given to us by the distributor, and, depending on the market, we generally ship the ordered goods to the distributor, who then delivers them to the retailer.

Our distribution network gives us global reach and direct control of eyewear distribution in the retail outlets that meet the requirements of where the brands are best placed. For luxury and premium brands, it is important to have selective distribution in order not to dilute brand awareness. We have been highly successful in being able to correctly position our different brand names in the eyewear market, by targeting specific groups of customers based on the unique characteristics of each brand, and in particular, being able to preserve the highest brand awareness of the various luxury names. We are also very focused on maintaining the highest quality in our brand portfolio in order to avoid the presence of conflicting brand names. We maintain close contact with our third-party distributors in order to monitor sales and to control the quality of the points of sale that display products. We typically enter into distribution agreements with such third-party distributors that establish minimum annual purchases and impose territorial limitations. In addition, to the extent permitted by law, we allow for distribution only through specifically authorized retail channels and qualified sales agents. We ensure that each third-party distributor employs dedicated sales agents for our products. The activities of these agents are similar to those of agents employed by our own distribution subsidiaries. They only sell our licensed or owned brands, but in some cases a larger number of brands due to the smaller size of the market.

Our net sales sold by region in 2003 were detailed as indicated in the following graph:



Europe

Our European regional headquarters is located in Padua, Italy. Our sales in Europe represented 50% of our total 2003 net sales. Our net sales in Europe (including Italy) were €450.8 million in 2003, selling 11.0 million units, compared to €12.8 million in 2002, selling 10.5 million units, representing a 9.2% increase in net sales. Net

sales of prescription frames accounted for 47%, net sales of sunglasses accounted for 51% and net sales of goggles and other accessories accounted for less than 2% of our total net sales in Europe in 2003.

North America

Our North American regional headquarters is located in New Jersey. Our sales from North America represented 36% of our total net sales in 2003. Our net sales for North America were €23.2 million in 2003 from sales of 11.6 million units compared to €53.5 million in 2002 from sales of 9.4 million units, which represents a 8.5% decrease in net sales. Net sales of prescription frames accounted for 56%, net sales of sunglasses accounted for 38% and net sales of goggles and other accessories accounted for 6% of our total net sales in North America in 2003.

Solstice. At the end of December 2003, we had a total of 36 Solstice chain stores. We expect to continue to expand this project on a highly selective basis in leading high-end retail locations in the United States. We believe that the Solstice project will raise the visibility of our luxury and fashion brands with affluent, fashion conscious customers. The program is limited to a few stores in selected large metropolitan areas specializing in the retail niche of luxury eyewear rather than a significant retail network.

Far East

Our Far East headquarters is located in Hong Kong where the managing director and business unit head oversees the Far East region. We currently distribute our products in the Far East market through distribution subsidiaries in Australia, Hong Kong, Japan, Malaysia and Singapore and exclusive third-party distributors in other key markets. All of our agents in the Far East are employees of our distribution subsidiaries. In the markets where we work with exclusive third-party distributors, there are only one or two such distributors operating in those markets. With the exception of Australia and Japan, and to a lesser extent Hong Kong and Malaysia, our customer market is highly fragmented, and we sell mainly to independent stores that have at most three or four locations.

Marketing and sales

We develop and implement a strategy for the marketing of each of the brands in our portfolio. Our objective is to achieve the optimal positioning of the individual brand and the Safilo portfolio of licensed and owned brands as a whole. The marketing approach for a brand is different for sunglasses, prescription frames and sports products, including sport sunglasses, goggles and helmets. The marketing approach for sunglasses is largely driven by fashion trends, with an emphasis on achieving the right marketing mix for the sunglasses brand. For prescription eyewear, the marketing emphasis is on the primary customer-optical professionals. The marketing efforts will include special pricing plans and providing high-quality customer service in order to motivate the optical professional to recommend our brands to customers.

Marketing Organization

We have separate product marketing teams for the North American, European and Far Eastern regions, the activities of which are coordinated by the European marketing team. Each product marketing team is responsible for marketing all of our products in its particular region. In addition, we have specialized marketing teams for our *Carrera* and *Smith* products. Our three primary marketing teams meet regularly in order to manage and coordinate the overall brand image and brand value for each of our licensed and owned brands.

Advertising and Promotion; Sponsorships

The advertising and promotion activities engaged in and the expenditures made to support a brand are determined by the desired brand positioning. An appropriate marketing mix of marketing activities, including media advertising, PR activities, product placements and point of sale promotional activities, must be determined for each brand. Marketing campaigns and the media plan for a brand are determined on a coordinated, company-

wide basis. Our marketing teams work closely with licensors and our product design group in developing point of purchase displays and advertising materials and planning promotional activities to ensure that the integrity of the brand image is maintained.

About two-thirds of our advertising and promotion expenditures are for media activities, including sponsorships of public events, and the remainder is for point of sale activities. Our total advertising and promotion expenses were €80.7 million in 2003 and €73.3 million and €67.4 million in 2002 and 2001, respectively.

We employ a number of methods to highlight the visibility of our licensed brands and owned brands in line with the image of the brand. For all of our brands, we focus our marketing efforts on the point of sale. We provide our retail customers with posters, specialized window displays and other marketing materials to advertise our products.

We support our licensed brands with advertising in the media. We primarily use print media, such as magazine advertisements, and in certain markets, billboards. Under a number of our license agreements, we are required to make contributions to the licensor's advertising and promotion activities for its brand.

We support our owned brands with sponsorships. We have entered into arrangements with a number of individual and teams sponsors for various sports ranging from soccer to skiing to motorcycle racing.

Production

Our products are produced both in our own facilities and by third-party manufacturers. We outsource the manufacture of some of our products primarily to facilities in the Far East and also to smaller producers in Japan and Italy. Our more detailed and specialized products are generally produced at our European facilities. Based on the demand for these products, we may outsource the production of other products. This ability to outsource production to third-party manufacturers in the Far East allows us to significantly reduce our cost of production and have greater production flexibility.

Safilo Owned Facilities

Our manufacturing operations are carried out primarily through Safilo S.p.A. and our Austrian and Slovenian subsidiaries, Carrera Optyl GmbH and Carrera Optyl D.o.o. We manufacture our products through seven owned facilities in Europe, five of which are located in Italy, one in Austria and one in Slovenia. In addition, our *Smith* design team in the United States purchases raw materials for the production of *Smith* sunglasses and sport goggles and supervises the production of the goggles at a third-party facility in Utah. Our Italian subsidiary Lenti S.r.l. produces some of our lens requirements. We are transferring the production from the Austria facility to Italian factories. The bases of this decision are the reduction of high cost of production, the improvement in flexibility and increased integration with our existing production facilities.

Manufacturing Process

We produce both metal and plastic frames. In addition to our frame manufacturing capacity, we also produce crystal lenses exclusively for our sunglasses collections and ski goggles.

Our manufacturing process consists of three phases. First, the frame structure is fabricated using models or moldings based on the prototype developed by our design team. Second, the frames are painted or treated with different finishes or coatings. Third, the products are assembled and finished with the appropriate accessories. The assembly process is the most labor- and time- intensive phase of our production cycle. Lenses for sunglasses are cut during this assembly phase. Because eyewear manufacturing is a labor intensive process, particularly the assembly and finishing phase, it allows limited automation in key phases of the production cycle. This reduces significantly most of the potential manufacturing constraints to the growth of the business, although limiting the operating leverage of our operations.

Our seven owned production facilities are specialized for different types of processes and products. However, the final assembling and finishing phases of the production cycle can be reallocated among the facilities, providing flexibility to adjust to changes in consumer preferences. Set forth below is certain information regarding our production facilities as of December 31, 2003.

<u>Plant Location</u>	<u>Production</u>	<u>Employees</u>
Martignacco (Italy).....	Components and Accessories	735
Longarone (Italy).....	Steel/Metal eyewear	1,133
Calalzo di Cadore (Italy).....	Metal and Plastic Frames Finishing	297
Santa Maria di Sala (Italy)	Plastic eyewear	673
Precentico (Italy).....	Metal and Plastic Frames Finishing Painting	269
Ormoz (Slovenia).....	<i>Optyl</i> Injection Frames and Ski Goggles	1,377
Traun (Austria).....	Metal eyewear	470

Our plants are presently operating with some excess capacity. We expect that we will require additional production capacity in the next several years to support the forecasted increase of sales .

Third-Party Manufacturing

The excess capacity at our own facilities, our use of our third-party manufacturers to produce completed products for resale and our use of third-party subcontractors to provide semi-finished products provide us with a significant degree of flexibility in production. We choose to outsource production of our products based on the demands at our owned facilities and to achieve cost savings when we produce products in the Far East. We have third party manufacturers with whom we regularly outsource production, 30 in Italy and 6 in the Far East, in particular. We outsource to the Italian manufacturers when the volume of products is smaller and the products are more intricate or require more creative production techniques, and we outsource to the Far East manufacturers when the volume of products is larger. We expect our use of outsourcing to increase in the future. This approach reduces the capital invested by us in manufacturing and provides flexibility to meet peaks in demand, while allowing us to focus our production expertise on premium and luxury eyewear. Our production flexibility is constrained by the requirements of certain of our licensors that their eyewear be produced in our European facilities.

Quality Control

High quality products are a key element of our success and strategy. As a result of our emphasis on quality, only a small amount of our products are returned due to quality issues. We have a dedicated team to focus on quality improvement at all our stages of production and distribution. In addition, we have employees responsible for quality monitoring and improvement in each of our production facilities and distribution centers. Throughout the stages of our manufacturing process and distribution, we sample our products for defects and irregularities. For products manufactured by third-parties in the Far East, we inspect them before they are shipped from the Far East, as well as upon receipt at the distribution centers.

During 2003, Safilo Management System, already certified ISO 9002, was assessed by an accredited third-party, Det Norske Veritas (DNV), in order to determine ongoing compliance with the ISO 9000 series standards and to ensure that continuous improvements are taking place. This assessment has followed also the criteria of International Quality Rating System (IQRS) and the result has been the achievement, in December 2003, of ISO 9001:2000 certification. Now all the staff is working to obtain improvements following the ranking system stated by IQRS.

Capital Expenditures

Our total capital expenditures in tangible assets were €45.5 million for 2003, €58.4 million and €45.0 million for 2002 and 2001, respectively.

The majority of the Group's capital expenditures in 2003 were dedicated to the modernization of existing production facilities for the purpose of increasing production capacity and improving product quality. A large portion of capital expenditures were invested into specific equipment for particular eyewear models that are frequently re-designed and produced internally. The type of capital construction required is rarely made into large, expensive facilities.

In recent years, the construction of a new central distribution warehouse in Europe that will be completed in 2004 has resulted in a significant increase in capital expenditures.

Raw materials

Our principal raw materials and parts purchased for our manufacturing process include lenses, acetate, cases and precious metals such as gold and palladium. For each main category of raw materials and parts, we prefer to have a small number of suppliers that can guarantee us a certain level of desired quality. Due to our growing need for a reliable source of high quality lenses for sunglasses, in recent years we have made investments in an Italian high quality sunglasses lens manufacturer, Lenti S.r.l., of which we now own 54%.

We generally do not have long-term contracts with our suppliers. Most of the prices for our raw materials have been relatively stable, except for raw materials that are invoiced in US dollars. We are not dependent on any suppliers given that they could be replaced easily. This is because the materials used for our products are fungible in nature. In the event that one of our suppliers or raw materials or parts could not meet our production needs, we believe we could find alternate supplies for identical or similar goods.

Product Design

We believe that we are the industry leader in product design and technological innovation. Our emphasis on and approach to product design distinguishes us from our competitors and makes us an attractive licensing partner for leading luxury and design houses. Over a decade ago, we identified product design as a strategic objective of the Safilo Group, and since then our design group has grown from two senior designers and six model designers to a total group of more than 100, including 12 senior designers and 34 model designers.

Model designers are highly-skilled artisans that design prototypes from sketches prepared by other designers. Technical designers are responsible for fabricating the eyewear figures. Industrial designers are located at our production facilities and prepare the eyewear product for production. Our design group uses computer-aided design/computer-aided manufacturing technology, known as CAD/CAM. CAD/CAM technology permits designers to easily manipulate and evaluate the designs. This process is integrated with our manufacturing facilities, which aids in the production of the models.

Our design group is centered in our Design Center in Padua, and we have technical designers located at our seven production facilities. We also have design teams in the United States and in the Far East in order to design products that better suit local market needs and fitting requirements.

Our design team serves both our own and licensed brands. Each of our design group members is dedicated to a specific brand. We work closely with each of our licensors to develop the themes and fashion concepts that reflect the attributes of the licensor's brand and its appropriate market segment positioning. Licensors must approve of all designs and models sold under their brand.

Within Safilo, our design group, marketing group and the technological solutions team collaborate to develop new styles based on consumer preferences, fashion trends and technological possibilities. Our design team

also plays a central role in developing the appropriate marketing strategy for eyewear products, including product advertising and point of purchase materials and displays.

There is a constant requirement to introduce new models, update existing models and to revitalize successful brands. The life cycle of eyewear in the mid-range to luxury eyewear market segment is short. The life cycle of sunglasses is about one year and prescription frames two years, and models are updated every three months. Existing models are updated using new colour schemes and palettes. Each year we introduce approximately 1,900 new models of prescription frames and sunglasses and one new model of sport goggles. There are approximately 2,500 models of our eyewear on the market at any given time. Our sport goggle models generally remain on the market for three to five years, and are updated annually. The ability to constantly renew our product offerings has enabled us to meet consumer demand in each market segment in which our brands are targeted.

Competition

The worldwide market for high quality prescription frames and sunglasses is highly competitive and fragmented. Our principal competitors on a worldwide basis are the Luxottica Group S.p.A., De Rigo S.p.A. and Oakley, Inc., and to a lesser extent, Marchon Eyewear Inc. and Marcolin S.p.A. We also face competition from numerous national, regional and local companies in the markets where we distribute our products.

We believe that important competitive factors in the prescription frames and sunglasses markets include product quality and innovation, scope of product portfolio, brand name recognition, relationships with licensors, customer service and a strong distribution network. Some of our key global competitors, including Luxottica and De Rigo, have acquired or established their own significant retail distribution networks for their eyewear products. We do not intend to do so, and will continue to rely upon what we believe are our key competitive strengths. Our Solstice stores will be a small, limited initiative of small stores in certain metropolitan areas. They will only sell luxury products and are not intending to compete with our competitors' vast retail networks.

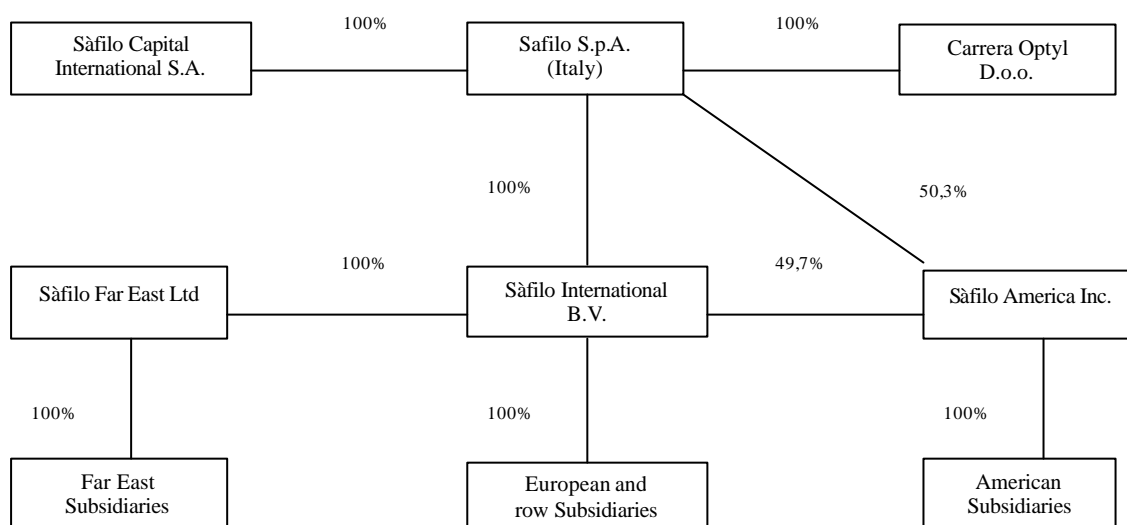
Regulatory matters

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

4.C. Organisational structure

Safilo S.p.A. is an Italian operating company, and our operations are carried out primarily through wholly owned subsidiaries. We have three manufacturing subsidiaries, and our marketing and distribution subsidiaries distribute directly in 26 countries. In addition, we have invested in a small number of companies, such as Elegance International Holdings, which owns factories that produce some of our products in Hong Kong. Generally, for our majority-owned subsidiaries we have the right to appoint a majority of the board of directors and have the ability to purchase the minority shareholder's shares in their entirety.

The following diagram shows an overview of our corporate structure as of December 31, 2003.



Set forth below is certain information regarding our subsidiaries.

<u>Location—Entity</u>	<u>Ownership %</u>
<i>Italian entities</i>	
Oxsol S.r.l.—Pieve di Cadore, Belluno.....	100.00
Lenti S.r.l.—Bergamo	54.00
Smith Sport Optics S.r.l.—Florence	100.00
<i>Foreign entities</i>	
Sàfilo International B.V.—Rotterdam, The Netherlands.....	100.00
Safint B.V.—Rotterdam, The Netherlands	100.00
Sàfilo Capital International S.A.—Luxembourg	100.00
Sàfilo Benelux S.A.—Zaventem, Belgium.....	100.00
Sàfilo Espana S.A.—Madrid, Spain	100.00
Sàfilo France S.a.r.l.—Paris, France.....	100.00
Sàfilo GmbH—Cologne, Germany	100.00
Sàfilo Nordic AB—Taby, Sweden	100.00
Sàfilo Far East Ltd.—Hong Kong.....	100.00

Safint Optical Investment Ltd.—Hong Kong.....	51.00
Sàfilo Hong Kong Ltd.—Hong Kong.....	51.00
Sàfilo Singapore Pte. Ltd.—Singapore.....	100.00
Sàfilo Optical Sdn. Bhd—Kuala Lumpur, Malaysia.....	100.00
Safilo Trading (Shenzhen) Co. Ltd. — China.....	51.00
Sàfilo Hellas Ottica S.A.—Athens, Greece.....	51.00
Sàfilo Nederland B.V. —Bilthoven, The Netherlands.....	100.00
Sàfilo South Africa PTY Ltd.—Bryanston, South Africa.....	100.00
Sàfilo Austria GmbH—Traun, Austria.....	100.00
Carrera Optyl GmbH—Traun, Austria.....	100.00
Carrera Optyl d.o.o.—Ormoz, Slovenia.....	100.00
Carrera Optyl Marketing GmbH—Traun, Austria.....	100.00
Sàfilo Japan Co Ltd—Tokyo, Japan.....	100.00
Sàfilo do Brasil Ltda—San Paulo, Brasil.....	100.00
Sàfilo Portugal Lda.—Lisbon, Portugal.....	100.00
Sàfilo Switzerland AG.—Liestal, Switzerland.....	77.00
Sàfilo India PVT Ltd. — Mumbai, India.....	75.00
Safint Australia Pty Ltd—Sydney, Australia.....	100.00
Sàfilo Australia Partnership—Sydney, Australia.....	51.00
Safint Optical UK Ltd.—United Kingdom.....	100.00
Sàfilo UK Ltd.—North Workshire, United Kingdom.....	100.00
Sàfilo America Inc.—Delaware, USA.....	100.00
Sàfilo USA Inc.—New Jersey, USA.....	100.00
FTL Corp.—Delaware, USA.....	100.00
Sàfilo Realty Corp.—Delaware, USA.....	100.00
Smith Sport Optics Inc.—Idaho, USA.....	100.00
Solstice Marketing Corp.— New Jersey, USA.....	100.00
2844-2580 Quebec Inc.—Montreal, Canada.....	100.00
Sàfilo Canada Inc.—Montreal, Canada.....	100.00
Canam Sport Eyewear Inc.—Montreal, Canada.....	100.00

4.D. Property, plants and equipment

Our major production facilities are in part owned and in part leased. In addition, we lease administrative and distribution office space in various locations in which we operate.

Information regarding the general location, use and approximate size of our principal owned facilities are set out in the following table:

<u>Location</u>	<u>Use</u>	<u>Approximate size (square meters)</u>
Padua, Italy.....	Corporate Headquarters and Distribution Facility	27,000
Martignacco, Italy.....	Components Manufacturing Facility	12,000
Longarone, Italy.....	Steel/Metal Eyewear Manufacturing Facility	26,000
Pieve di Cadore, Italy.....	Metal and Plastic Frames Finishing Facility	6,000
Santa Maria di Sala, Italy.....	Plastic Frames Manufacturing Facility	17,000
Precenico, Italy.....	Metal and Plastic Frames Painting Facility	5,000
Ormoz, Slovenia.....	Plastic and Injection Frames and Ski Goggles	16,000

	Manufacturing Facility	
Traun, Austria.....	Metal Eyewear Manufacturing Facility	23,000
Sun Valley, Idaho, United States	Administration and Distribution	2,000
Madrid, Spain	Commercial subsidiary	1,000

Environmental Regulation

Our facilities and operations are subject to environmental and occupational health and safety laws and regulations in each of the jurisdictions in which we operate. These laws govern, among other things, discharges of pollutants into the air, water and land, the use, storage and disposal of hazardous substances and wastes, and the cleanup of contaminated properties.

We believe that we are in material compliance with environmental laws and permits applicable to our business. However, from time to time we incur costs to maintain or achieve compliance with such requirements. Past environmental and safety costs have not significantly affected our operations, and future environmental costs are not expected to be material.

ITEM 5. Operating and Financial Review and Prospects

The discussion and analysis below provides information that we believe is relevant to an assessment and understanding of our consolidated financial position and results of operations. This discussion and analysis should be read in conjunction with the consolidated financial statements and related notes that appear elsewhere in this document.

The following discussion and analysis contains statements reflecting our views about our future performance and are considered “forward-looking statements”. These views may involve risks and uncertainties that are difficult to predict and may cause our actual results to differ materially from the results discussed in such forward-looking statements. Readers should consider that various factors including changes in general economic conditions, nature of competition, developments in distribution, industry trends, influence of currency fluctuations and inflation, and other factors discussed below, may affect our projected performance.

The following discussion and analysis is based on historical financial statements for the years ended December 31, 2003, 2002 and 2001 which were prepared in accordance with Italian Accounting Principles. These accounting principles differ in certain significant respects from U.S. GAAP and IFRS.

Overview

Safilo S.p.A. is the parent company of the Safilo Group, a leader in the production and sale of prescription frames, sunglasses, and fashion and sport eyewear. Our products are sold in approximately 120 countries and supplied to approximately 130,000 points of sale worldwide through our global distribution network. We compete in the prescription frames, sunglasses and sport goggles markets, which accounted for 49%, 47% and 4%, respectively, of our net sales in 2003. We also sell a limited line of complementary accessories, including ski helmets. We produce and distribute eyewear products under our owned brands, as well as under typically long-term license agreements for luxury, premium and high-end brands.

Our net sales are balanced by product category, geographic region and our broad portfolio of owned and licensed brands. We generate a consistent revenue stream from sales of prescription frames, which have represented about half of our total net sales and sales volume in recent years. Our prescription frame customer base primarily consists of a long-established network of independent optical industry professionals.

On a geographic basis, our net sales in the North American region have historically approximately equalled our revenues in Italy and Europe. Within the large United States market, our sales are balanced between prescription frames and sunglasses, by geographic region and by distribution channels. Within Europe, besides our home market of Italy, we have significant sales in the key markets of France, Spain, Germany and the United Kingdom.

While sales of licensed brands have grown more rapidly in recent years than sales of our own brands, we have a large and diverse portfolio of licensed brands positioned throughout the mid-range to luxury eyewear market segments. We have license relationships with a diverse group of fashion and design houses. Our license arrangements typically are exclusive and have terms of five to eight years, and our relationships with some of our key licensors date back to the late 1980s.

Geographic Distribution

Our net sales and units sold by region in 2003 were as follows:

Net Sales and Units Sold by Region 2003 (sales in millions and units in thousands)

Region	Total		Prescription Frames			Sunglasses		Goggles/Other Accessories	
	Net Sales	Units	% Net Sales	Net Sales	Units	Net Sales	Units	Net Sales	Units
	North America	€23.2	11,627	35.9%	€79.6	4,665	€22.2	5,315	€1.4
Europe (excluding Italy).....	310.4	7,791	34.5%	150.7	3,745	151.7	3,529	8.0	517
Italy	140.4	3,245	15.6%	60.4	1,658	79.2	1,547	0.8	40
Far East.....	52.0	1,073	5.8%	24.9	479	25.1	502	2.0	92
Other ⁽¹⁾	74.1	2,585	8.2%	27.9	1,118	45.4	1,372	0.8	95
Total	€900.1	26,321	100%	€443.5	11,665	€423.6	12,265	€33.0	2,391

(1) Other includes net sales in Australia (€13.7million) and global duty free sales (€16.6 million).

Because of the nature of the production process, the type and class of our final customers, the distribution method applied and the events that influence the customer's decision to buy our products, we believe that we operate in one industry segment, manufacturing and wholesale distribution, as defined under International Accounting Standard 14 "Segment Reporting". Our net sales consist of direct sales of finished products manufactured or purchased on a finished basis by us to opticians and other independent commercial retailers or retail distribution chains through our directly-owned and operated distribution subsidiaries or through third-party distributors in countries where we do not have our own distribution subsidiary or directly to the end customer, primarily through our Solstice speciality store business.

Sales by Product Category

We design, manufacture and distribute high-quality eyewear products, including prescription frames, sunglasses frames and lenses, sport goggles and other accessories.

In 2003, net sales of prescription frames totaled €443.5 million, representing 49% of our total net sales, net sales of sunglasses totaled €23.6 million, representing 47% of our total net sales, and net sales of sport goggles and other accessories totaled €3.0 million, representing 4% of our total net sales. Net sales of prescription frames as a share of our total net sales has steadily increased in recent years. Prescription frames represented 47% of our net sales in 2001, 48% in 2002 and 49% in 2003.

In 2003, we sold approximately 26.3 million units of prescription frames, sunglasses, goggles and other accessories compared to 23.2 million and 21.8 million in 2002 and 2001, respectively. The increase in number of units sold during 2003 was primarily related to our acquisition of the Outlook Eyewear business in 2003.

Foreign Exchange Effects

Because we have a significant amount of capital employed in, and a significant portion of our net sales is derived from, operations outside of Europe, primarily in North America and the Far East, our results of operations, reported in euros, can be affected by movements in foreign exchange rates between the euro and various other currencies, primarily the U.S. dollar and to a lesser extent, the U.K. pound sterling and the

Japanese yen. In 2003, 40% of our consolidated net sales were settled in U.S. dollars or related currencies, including most of our net sales in our markets in North America and the Far East. Moreover, the cost of a significant portion of the finished goods we obtain from third-party producers are settled in U.S. dollars, and nearly all of the costs associated with our operations in the North America region are U.S. dollar costs. As described under "Item 5.A Operating Results", the depreciation of the U.S. dollar against the euro adversely impacted our results of operations in 2003.

In order to prepare our consolidated financial statements, we must convert assets, liabilities, income and expenses that are accounted for in other currencies into euro. Consequently, even if the value of these items remains unchanged in the original currency, changes in foreign currency exchange rates will cause changes in the value of such items in our consolidated financial statements.

The table below sets forth the average value of the euro against the U.S. dollar during 2001, 2002 and 2003.

Average Noon Buying Rates					
<i>(dollars per euro)</i>					
<u>2001</u>	<u>2002</u>	<u>% Change from 2001</u>	<u>2003</u>	<u>% Change from 2002</u>	
0.8956	0.9454	5.6%	1.1313	19.7%	

We periodically enter into foreign currency contracts to hedge commitments, transactions or foreign income. See notes 3 and 29 to our consolidated financial statements.

Inflation

Inflation has not had a material effect on our operating results in recent years.

Critical Accounting Policies

The Company's discussion and analysis of its financial condition and results of operations are based upon the consolidated financial statements, which have been prepared in accordance with Italian accounting principles ("Italian GAAP").

The following sections discuss accounting policies applied in preparing the financial statements that management believes are most dependent on the application of estimates and assumptions. These estimates and assumptions are based on historical results and trends as well as our forecasts as to how these might change in the future, and actual results may differ significantly from such estimates. Management, on an ongoing basis, reviews estimates and assumptions, and if management determines, as a result of its consideration of facts and circumstances, that modifications in assumptions and estimates are appropriate, results of operations and financial position as reported in the Consolidated Financial Statements may change significantly. Some of the most significant accounting policies that might materially impact our results are discussed below.

Revenue Recognition

We recognize revenue from the sales of goods at the time product ownership passes to our customers, which is generally when goods are shipped to the customer. We record sales of products net of discounts, rebates, returns and VAT. If sales include the right of the dealer to return unsold products (generally these terms are available in the United States only), we recognize the sale upon shipment to the customer net of a provision that represents our best estimate of products that will be returned that we will not be able to resell. This provision is estimated based upon historical trends and specific knowledge concerning our customers, and we have not

experienced any historical material product return percentage that has exceeded our expectations. We measure revenue at the fair value of the consideration received or receivable. When we cannot reliably measure the fair value of consideration received or receivable, we measure the fair value of the products sold. Other than in the Far East, we generally extend credit to our customers and generally do not require collateral or credit support. Payment terms are generally determined based on the location of and our relationship with the customer.

Allowance for Doubtful Accounts

We make ongoing estimates relating to the collectibility of our accounts receivable and maintain a reserve for estimated losses resulting from the inability of our customers to make required payments. In determining the amount of the reserve, we consider our historical level of credit losses and make judgments about the creditworthiness of significant customers based on credit evaluations and specific circumstances related to any customer. Since we cannot predict future changes in the financial stability of our customers, however, actual future losses from uncollectible accounts may differ from our estimates. If the financial condition of our customers were to deteriorate, resulting in their inability to make payments, a larger reserve might be required. In the event we determined that a smaller or larger reserve was appropriate, we would record a credit or a charge to selling and administrative expense in the period in which we made such a determination.

Inventories

Inventories are stated at the lower of purchase or production cost (on weighted average cost basis), including all product-related and transport costs or the current estimated market value of the inventory, which is based on assumptions about future demand and market conditions. We also continually review our inventory quantities on hand and record provisions for excess and obsolete inventory based primarily on our estimated forecast of product demand and production requirements. If actual market conditions are less favorable than those projected by management, adjustments may be required.

Impairment of property, plant and equipment

Property, plant and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amounts of such assets exceed the fair value of the assets. Considerable judgment is required to estimate the fair value of the impaired asset.

Deferred income taxes

The Company is required to estimate its income taxes in each of the jurisdictions in which it operates. This process involves the jurisdiction-by-jurisdiction estimation of actual current tax exposure and the assessment of the temporary differences resulting from differing treatment of items, such as accruals and amortization, among others, for tax and financial reporting purposes. These differences result in deferred tax assets and liabilities, which are included in the Company's consolidated balance sheet.

The recognition of deferred tax assets is dependent on management's assumptions that future earnings will be sufficient to realize deferred tax benefits. Considerable judgment is required to project such future earnings.

Financial Instruments and Hedging

We use derivative products to manage exposure to fluctuations in both foreign currency and interest rates. To hedge against exposure to changes in foreign currency exchange rates on assets and liabilities denominated in currencies other than euro, we mainly enter into foreign currency forward contracts, and we mainly enter into currency swaps to manage exposure to foreign currency exchange rates related to our interest obligations. Discounts or premiums on forward contracts (the difference between the current spot exchange rate and the forward exchange rate at the inception of the contract) are amortized over the contract lives using the straight line method. Changes in the fair value of the underlying derivative contract are generally not accounted

for in the statement of operations until the underlying contract has expired. The notional amount of the contracts open at the end of the fiscal year are disclosed. The assessment of the fair value of a derivative contract requires the use of quoted market prices, banker price quotations, price quotations for similar instruments traded in different markets and, where applicable, pricing models. Pricing models and their underlying assumptions impact the amount and timing of unrealized gains and losses recognized, and the use of different assumptions could produce different financial results.

For interest rate swaps, the differential to be paid or received is accrued as adjustments to interest income or expense over the life of the agreement. Upon early termination of an interest rate swap, gains or losses are deferred and amortized as adjustments to interest expense of the related debt over the remaining period covered by the terminated swap.

We periodically enter into foreign currency contracts to hedge commitments, transactions or foreign income. For foreign currency contracts acquired for the purpose of hedging identified commitments, the gain or loss is generally deferred and included in the basis of the transaction underlying the commitment. If the underlying transaction is not completed during the period, however, the fair value of the derivative contract is disclosed.

Gains or losses on derivative contracts are recognized under cost of sales and thereby offset the related gains or losses on hedged transactions.

5.A. Operating results

Year Ended December 31, 2003, Compared to Year Ended December 31, 2002

The following table sets out certain information with respect to our net results:

	Year ended December 31,			
	2002		2003	
	€	% of Net sales	€	% of Net sales
<i>(in millions, except percentages)</i>				
Consolidated Statement of Operations Data:				
Net sales	894.1	100.0%	900.1	100.0%
Cost of sales	(347.9)	38.9%	(375.3)	41.7%
Gross profit	546.2	61.1%	524.8	58.3%
Selling and marketing expenses	(283.9)	31.7%	(300.7)	33.4%
General and administrative expenses	(119.1)	13.3%	(124.4)	13.8%
Other income/(expense)	—	—	—	—
Operating income/(loss)	143.2	16.0%	99.7	11.2%
Interest income/(expense) and other financial charges	(70.9)	7.9%	(68.1)	7.6%
Extraordinary income/(expense)	0.9	0.1%	(7.1)	0.8%
Amortization of goodwill	(23.9)	2.7%	(23.3)	2.6%
Income/(loss) before taxation	49.3	5.5%	1.2	0.1%
Tax expense	(35.6)	4.0%	(8.5)	0.9%
Net income/(loss) before minority shareholders	13.7	1.5%	(7.3)	0.8%
Income attributable to minority shareholders	(3.4)	0.4%	(3.6)	0.4%
Net income	10.3	1.2%	(10.9)	1.2%

The following tables set out certain information with respect to our net sales:

	Year ended December 31,				
	2002		2003		% Change
	€	% of Total	€	% of Total	
<i>(in millions, except percentages)</i>					
Net Sales:					
Prescription frames	425.2	47.6%	443.5	49.3%	4.3%
Sunglasses	435.6	48.7%	423.6	47.1%	(2.7)%
Sport goggles	30.1	3.4%	29.9	3.3%	(0.7)%
Other	3.2	0.4%	3.1	0.3%	(3.1)%
Total	894.1	100.0%	900.1	100.0%	0.7%

	Year ended December 31,				% Change
	2002	2003	2002	2003	
	€	% of Total	€	% of Total	
<i>(in millions, except percentages)</i>					
Net Sales:					
North America	353.5	39.5%	323.2	35.9%	(8.6)%
Italy	145.7	16.3%	140.4	15.6%	(3.6)%
Europe (excluding Italy)	267.1	29.9%	310.4	34.5%	16.2%
Far East	57.1	6.4%	52.0	5.8%	(8.9)%
Other	70.7	7.9%	74.1	8.2%	4.8%
Total	894.1	100.0%	900.1	100.0%	0.7%

Net sales.

Our consolidated net sales increased 0.7% (including negative currency effects) from €894.1 million in 2002 to €900.1 million in 2003. This increase can be analyzed with respect to the following components:

Type of product analysis

- in terms of volume, we sold 26.3 million units in 2003 compared to 23.2 million in 2002, representing a 13.3% increase attributable to the promotion of the newly acquired *Giorgio Armani* and *Emporio Armani* brands and the Outlook business acquired in 2003. This increase has been seen in both prescription frame and sunglasses sector, although the sales of sunglasses increased at a greater rate than sales of prescription frames. As at December 31, 2003 prescription frame and sunglasses sales have increased in volume terms by 9.5% and 17.6% respectively compared to 2002;
- the average revenue per frame decreased 11.1% from €38.50 in 2002 to €34.20 in 2003, due to the Outlook business acquired in 2003, which operates in a market with high volumes and lower sales prices per unit;
- net sales of prescription frames increased 4.3%, despite negative currency effects in 2003, from €425.2 million in 2002 on sales of 10.6 million units to €443.5 million in 2003 on sales of 11.7 million units, and as a percentage of our consolidated net sales, net sales of prescription frames increased slightly from 47.6% in 2002 to 49.3% in 2003;
- net sales of sunglasses decreased 2.7% (in consequence of negative currency effects in 2003) from €435.6 million in 2002 on sales of 10.4 million units to €423.6 million in 2003 on sales of 12.3 million units, and as a percentage of our consolidated net sales, net sales of sunglasses decreased slightly from 48.7% in 2002 to 47.1% in 2003. Sunglasses sales have been negatively impacted by an unprecedented combination of events including a downturn in the market attributable to the Iraq war and SARS as well as poor weather in the U.S. during the industry's peak selling season.

Geographical analysis

North America. Sales in North America decreased in 2003 by 8.6% compared to 2002. The U.S. dollar's decline in relation to the euro has reduced sales by 19% when expressed in euros. Dollar sales in the United States (accounting for 97% North America sales) have remained stable in 2003 compared to the same period in 2002. The brands which have reported the strongest growth are *Burberry* and *Kate Spade*. Significant, but more modest, growth was experienced by both *Valentino* and *Yves Saint Laurent*.

Italy. Net sales in Italy decreased by 3.6% in 2003 as compared to 2002. This decrease in net sales relates mainly to the downturn in the sunglasses sector of the market, while the prescription eyeglass sector experienced an increase in sales. The eyewear market in Italy was negatively impacted more significantly than the overall decrease in global consumption experienced in 2003. However, it needs to be considered that the domestic eyewear market in Italy has achieved a substantial rate of growth during the last few years and is forecasted to increase again in the medium term.

Rest of Europe. Our sales in Europe increased in comparison to the previous year. Sales increased by 16.2% from €267.1 million in 2002 to €310.4 million in 2003. In volume terms, the number of pieces sold increased by 10.9%, from 7.0 million in 2002 to 7.8 million in 2003. The brands that have experienced the greatest sales increases are *Burberry*, *Dior*, *Oxydo*, *Polo* and *Yves Saint Laurent*, while sales of the *Giorgio Armani* and *Emporio Armani* brands also contributed strongly to the positive development of the market. The increased sales have principally been seen in France, Spain, Germany and United Kingdom.

Far East. The Far East continues to suffer from the impact of SARS. Sales in the Far East decreased by 8.9% in 2003 compared with 2002 mainly due to the effect of foreign currency conversion that has negatively impacted the sales by 14%. Volumes increased 1.0% 2003 compared to the previous year. The *Burberry* and *Dior* brands have performed well throughout the period.

Cost of goods sold.

- Cost of goods sold increased 7.9% from €347.9 million in 2002 to €375.3 million in 2003, and our gross margin, as a percentage of net sales, decreased to 58.3% in 2003 compared to 61.1% in 2002. The main factors causing our gross margin to decrease during 2003 are as follows: (i) the devaluation of the U.S. dollar against the euro, as approximately 40% of our consolidated net sales are denominated in U.S. dollars while our entire internal production costs are denominated in euro, the negative impact of which was partially offset by our foreign exchange hedging contracts in place during 2003; (ii) higher levels of fixed costs per unit experienced in 2003 due to a lower level of production as compared to that which was originally forecast; and (iii) an increase in obsolete inventory costs.

Starting from the second half of 2003, a cost reduction program was put in place in an effort to increase profitability in future periods.

Selling and marketing expenses.

Selling and marketing expenses increased 5.9% from €283.8 million in 2002 to €300.7 million in 2003, representing an increase as a percentage of net sales from 31.7% in 2002 to 33.4% in 2003.

Selling costs were increased in 2003 due to (i) the hiring of sales personnel, for our Solstice operations, the sales force for which grew from 102 persons at December 31, 2002 to 202 persons at December 31, 2003 as a result of the opening of 21 stores in the course of 2003, and to (ii) the acquisition of our new distribution center in North America (Outlook Eyewear), which led to the hiring of a further 60 employees.

Advertising and promotion expenses increased by 10.1% in 2003, as a result of our increased use of sponsorship of public events as a means of brand promotion and increased costs associated with launching the new

brands, *Giorgio Armani* and *Emporio Armani*. These costs are driven by licensor contracts, which in terms of costs are linked to the prior year's revenues for those brands.

Royalty expense increased due to the relative growth in sales of licensed products during 2003 as compared to sales of brands owned by the Group.

General and administrative expenses.

General and administrative expenses increased 4.4% from €19.1 million in 2002 to €24.4 million in 2003, representing an increase in percentage of net sales from 13.3% in 2002 to 13.8% in 2003. General and administrative expenses were negatively impacted in 2003 by a 15.9% increase in staff salaries and related costs which is due to the increased number of employees, primarily at the Padua headquarters. The number of employees increased from 593 to 637 between December 31, 2002 and December 31, 2003.

Interest income/(expense) and other financial charges.

Interest expense and other financial charges decreased 3.9% from €70.9 million in 2002 to €68.1 million in 2003. Interest expense was negatively impacted by an increase in average interest rates for debt outstanding during 2003, which effect was more than compensated by gains on currency exchange rates (which effect excludes gains on currency swap contracts that are included in "Costs of sales").

Amortization of goodwill.

Amortization of goodwill decreased 2.5% from €3.9 million in 2002 to €3.3 million in 2003 relating to the gradual decline of the goodwill amortization base resulting from normal amortization over the asset's estimated useful life.

Extraordinary income/(expense).

Extraordinary income/(expenses) decreased from €0.9 million in 2002 to €7.1 million in 2003. This decrease was mainly due to €8.2 million in fixed asset impairments and €5.5 million in involuntary employee termination costs, which were incurred in connection with the closure of the Company's production facility in Traun. Such closure costs were partially offset by the cumulative effect of the Group's initial application of the equity method of accounting for the Group's associate company Elegance International Holding Ltd.

Tax expense.

Tax expense decreased 76.1% from €35.6 million in 2002 to €8.5 million in 2003. The effective tax rate on income before taxation, depreciation and amortization decreased from 30.8% in 2002 to 13.6% in 2003 primarily as a result of the decrease in taxable base due to a change in non-deductible costs. The Group has €1.8 million of tax loss carryforwards as of December 31, 2003.

The difference in tax expense as a percentage of income before taxation depends on the different geographic mix of pre-tax income and also depends on the effect of non-deductible expenses (i.e. goodwill).

Year Ended December 31, 2002, Compared to Year Ended December 31, 2001

The following table sets out certain information with respect to our net results:

	Year ended December 31,			
	2001		2002	
	€	% of Net sales	€	% of Net sales
	<i>(in millions, except percentages)</i>			
Consolidated Statement of Operations Data:				
Net sales	845.0	100.0%	894.1	100.0%
Cost of sales	(352.2)	41.7%	(347.9)	38.9%
Gross profit	492.8	58.3%	546.2	61.1%
Selling and marketing expenses	(272.5)	32.2%	(283.9)	31.7%
General and administrative expenses	(96.7)	11.4%	(119.1)	13.3%
Other income/(expense)	(0.2)	0.0%	—	—
Operating income/(loss)	123.4	14.6%	143.2	16.0%
Interest income/(expense) and other financial charges	(34.3)	4.1%	(70.9)	7.9%
Extraordinary income/(expense)	1.4	0.2%	0.9	0.1%
Amortization of goodwill	(43.0)	5.1%	(23.9)	2.7%
Income/(loss) before taxation	47.5	5.6%	49.3	5.5%
Tax expense	(36.4)	4.3%	(35.6)	4.0%
Net income/(loss) before minority shareholders	11.1	1.3%	13.7	1.5%
Income attributable to minority shareholders	(3.8)	0.4%	(3.4)	0.4%
Net income	7.3	0.9%	10.3	1.2%

The following tables set out certain information with respect to our net sales:

	Year ended December 31,				
	2001		2002		% Change
	€	% of Total	€	% of Total	
	<i>(in millions, except percentages)</i>				
Net Sales:					
Prescription frames	396.7	46.9%	425.2	47.6%	7.2%
Sunglasses	410.5	48.6%	435.6	48.7%	6.1%
Sport goggles	34.6	4.1%	30.1	3.4%	(13.0)%
Other	3.2	0.4%	3.2	0.4%	0.0%
Total	845.0	100.0%	894.1	100.0%	5.8%

	Year ended December 31,				% Change
	2001		2002		
	€	% of Total	€	% of Total	
<i>(in millions, except percentages)</i>					
Net Sales:					
North America	345.4	40.9%	353.5	39.5%	2.3%
Italy	159.4	18.9%	145.7	16.3%	(8.6)%
Europe (excluding Italy)	209.4	24.8%	267.1	29.9%	27.6%
Far East	56.7	6.7%	57.1	6.4%	0.7%
Other	74.1	8.8%	70.7	7.9%	(4.6)%
Total	845.0	100.0%	894.1	100.0%	5.8%

Net sales.

Our consolidated net sales increased 5.8% (including negative currency effects) from €845.0 million in 2001 to €894.1 million in 2002. This increase can be analyzed with respect to the following components:

Type of product analysis

- in terms of volume, we sold 23.2 million units in 2002 compared to 21.8 million in 2001, representing a 6.5% increase primarily due to an increase in some of our branded products;
- the average revenue per frame decreased 0.7% from €38.80 in 2001 to €38.50 in 2002, which resulted from a larger increase in sales volumes of brands having a lower price per frame relative to our higher priced brands;
- net sales of prescription frames increased 7.2% (despite generally negative currency effects in 2002) from €396.7 million in 2001 on sales of 9.6 million units to €425.2 million in 2002 on sales of 10.6 million units, and as a percentage of our consolidated net sales, net sales of prescription frames increased slightly from 46.9% in 2001 to 47.6% in 2002;
- net sales of sunglasses increased 6.1% (despite generally negative currency effects in 2002) from €10.5 million in 2001 on sales of 9.8 million units to €35.6 million in 2002 on sales of 10.4 million units, and as a percentage of our consolidated net sales, net sales of sunglasses increased slightly from 48.6% in 2001 to 48.7% in 2002; and
- worldwide, we experienced particularly strong sales growth in some of our branded products; however, most of our brands, while continuing to grow, exhibited a slower growth rate than has been experienced in prior years and some brand sales have been flat.

Geographical analysis

North America. In North America, our net sales increased 2.3% (after adverse currency effects) from €345.4 million in 2001 to €353.5 million in 2002. In the United States, the net sales increased 0.8% (after significant adverse currency effects) from €15.6 million in 2001 to €18.0 million in 2002 on strong sales of sunglasses. In terms of volume, we sold 8.8 million units in 2002 compared to 8.2 million in 2001, representing a 7.3% increase. We experienced particularly strong sales growth in *Dior, Valentino, Burberry* and *Nine West*

branded products and successfully launched new brands such as *Saks Fifth Avenue*, but we experienced weakness in sales of our *Smith* brand resulting from a change in ownership of a significant customer.

Italy. In Italy, net sales decreased 8.6% from €159.4 million in 2001 to €145.7 million in 2002. This decrease resulted primarily from poor economic conditions in Italy, which has had a particularly negative impact on sales of our higher priced sunglasses brands. In terms of volume, we sold 3.5 million units in 2002 compared to 4.0 million in 2001, representing a 14.3% decrease, which resulted primarily from a decrease in net sales of sunglasses.

We experienced particularly strong sales growth in *Polo Ralph Lauren* and *Oxydo* branded products, which was offset by weaker and flat sales growth with respect to higher priced brands, particularly sunglasses.

Rest of Europe. In the rest of Europe, our net sales increased 27.6% from €209.4 million in 2001 to €267.1 million in 2002. These increased sales have principally been seen in France, Spain, Germany and United Kingdom.

Far East. In the Far East, our net sales increased 0.7% (despite generally negative currency effects in 2002) from €56.7 million in 2001 to €57.1 million in 2002, and in Japan our net sales decreased 7.0% (after adverse currency effects) from €27.5 million in 2001 to €25.7 million in 2002.

Our volume remained steady as we sold 1.1 million units in 2002 in the Far East compared to 1.1 million in 2001, but in Japan our unit sales decreased from 510,000 units in 2001 to 454,600 in 2002, representing a 10.9% decrease, primarily as a result of our termination of the distribution relationship with our third-party *Carrera* sport distributor in Japan as we began selling *Carrera* sport products through our own distribution subsidiary and because we discontinued selling *Smith* products through optical retail channels, choosing to sell them only through sport retail channels.

In Japan we experienced particularly strong sales growth in *Dior* branded products but weakness in sales in most of our other leading licensed brands.

Cost of goods sold.

Cost of goods decreased 1.2% from €352.2 million in 2001 to €347.9 million in 2002, and our gross margin increased to 61.1% in 2002 compared to 58.3% in 2001.

The increase of gross margin resulted primarily from a reduced rate of inventory write-offs for obsolescence for goods that we forecast cannot be sold compared to 2001 due to the higher rate of obsolescence experienced in the second half of 2001 as a result of the global economic slowdown that was exacerbated by the events of September 11. In 2002, we also experienced a reduction in obsolescence that favorably impacted materials, finished products and changes in inventories as a result of disposing of slow moving products to outlets and stock houses instead of scrapping the products. The positive effect on cost of sales of our decreased rate of obsolescence in 2002 was partially offset by our increasing use of outsourcing the manufacture of finished products for some of our brands to third party manufacturers.

The costs of purchasing finished goods pursuant to this outsourcing was favorably impacted by currency effects as we purchase many finished products in U.S. dollars.

Also positively affecting our 2002 cost of sales was a 18.2% decrease in the other costs component from €15.9 million in 2001 to €3.0 million in 2002; this reduction resulted from positive effects of currency swaps entered into in connection with intercompany sales, which are recorded as a reduction of the cost of sales. The other components of cost of sales—salaries and related contributions, subcontracting costs and industrial depreciation—remained relatively constant in 2002 with respect to our growth in net sales for 2002.

Selling and marketing expenses.

Selling and marketing expenses increased 4.2% from €272.5 million in 2001 to €283.9 million in 2002, representing a decrease as a percentage of net sales from 32.2% in 2001 to 31.7% in 2002.

Selling expenses were positively impacted in 2002 by a 3.4% decrease in the services from independent salespersons component as a result of a decrease in commissions paid on sales. This decrease in commissions resulted from a relative decrease in sales of higher priced brands as compared to lower priced brands, which resulted in a lower commission paid on sales, and a higher portion of sales made directly to a customer without the services of a salesperson, principally to distribution chains.

The advertising and promotion component increased by 8.8% in 2002, as a result of our increased use of sponsorship of public events as a means of brand promotion and increased advertising and promotion costs associated with launching a new brand, *Yves Saint Laurent*, and paid under our license agreements generally due to prior year growth in sales of licensed brands.

In addition, the other selling expenses component increased 19.2% in 2002 primarily as a result of a new policy of shipping products to our customers more frequently than under the old policy when we would only ship products when at least 80% of the order was complete. Consequently, we may now ship products to our customers more frequently and in smaller batches, which, although more expensive, has the benefit of better serving the needs and requirements of our customers.

Royalties paid to licensors increased only 2.5% in 2002, which was lower than the 9.0% increase in net sales of licensed brands, as sales of our more expensive licensed products increased more slowly than sales of lower priced licensed products, which yield lower royalty costs.

General and administrative expenses.

General and administrative expenses increased 23.2% from €96.7 million in 2001 to €119.1 million in 2002, representing an increase in percentage of net sales from 11.4% in 2001 to 13.3% in 2002.

General and administrative expenses were negatively impacted in 2002 by a 23.0% increase in the other general and administrative expenses component, resulting from consultancy and advisory expenses incurred in connection with restructuring of the Group and from new operations started in 2002, such as our purchase of the Solstice special retail program at the beginning of 2002, which resulted in store opening and staffing costs related to these stores. As of December 31, 2002, we had 15 Solstice stores in operation. In 2002, we also experienced a 21.4% increase in the salaries and related contribution component and a 65.8% increase in the other staff related costs, resulting primarily from the hiring of additional administrative and management personnel as a consequence of our growth in 2000 and 2001 and the staffing of new foreign distribution subsidiary offices. The other components of general and administrative expenses—depreciation and amortization, annual fees for outsourcing information system and other provision—experienced, as a whole, changes approximately in line with our growth and activities in 2002.

Interest income/(expense) and other financial charges.

Interest expense and other financial charges increased from €34.3 million in 2001 to €70.9 million in 2002. This increase resulted primarily from higher interest expense resulting from our increased debt level for all of 2002, which debt was incurred in mid-2001.

Extraordinary income/(expense).

Extraordinary income decreased from €1.4 million in 2001 to €0.9 million in 2002. This decrease was primarily due to €1.6 million in extraordinary expenses incurred in 2002 arising from tax accruals that are not tax deductible.

Amortization of goodwill.

Goodwill amortization decreased 44.4% from €3.0 million in 2001 to €1.9 million in 2002. This decrease was primarily due to the application of increased useful life (increased from 10 years in 2001 to 20 years in 2002) for the amortization of €95.0 million of goodwill created in connection with the purchase of all remaining outstanding Safilo shares of capital stock in 2001 and remaining €9.0 million of goodwill from the purchase of Safilo shares of capital stock in 2002. Such increase in useful life is permitted under Italian Accounting Principles and was deemed to be appropriate by management.

Tax expense.

Tax expense decreased 2.2% from €36.4 million in 2001 to €35.6 million in 2002. The effective tax rate on income before taxation, depreciation and amortization increased from 28.1% in 2001 to 30.8% in 2002, primarily as a result of the expiration of losses carried forward within the Group. The Group has €1.8 million of losses carried forward available for tax purposes. The effective tax rate also increased as a result of an increase in foreign taxes payable by our operating subsidiaries.

5.B. Liquidity and Capital Resources

Historical Cash Flow

The following table summarizes our cash flow activity during the years ended December 31, 2001, 2002 and 2003.

	<u>Year ended December 31,</u>		
	<u>2001</u>	<u>2002</u>	<u>2003</u>
	<i>(€ in millions)</i>		
Net cash flows:			
Provided by operating activities.....	€9.3	€12.6	€23.9
Used in investment activities.....	(575.1)	(216.7)	(80.4)
(Used in)/provided by financing activities:.....	523.8	197.0	22.2
Cash and cash equivalents, end of period.....	(41.9)	44.2	10.6

Cash Flow from Operating Activities. Cash flow from operating activities consists of net income adjusted for changes in working capital and non-cash items such as depreciation and amortization. Cash flow from operating activities decreased to €23.9 million in 2003 from €12.6 million in 2002. The factors which have had the greatest impact are the lower net income as at December 31, 2003 respect to 2002 (approximately €21 million) and various exceptional events which effected the working capital in 2002. Cash flow from operating activities in 2003 was negatively effected by a €47.3 million increase in trade receivables and other current receivables, net of exchange rate effects due to increase of sales during the last quarter. During 2003, the steps taken to reduce our clients' terms of payment were continued, although it proved more difficult than expected as a result of the poor economic environment, particularly in the Italian and European markets. Additionally, the decrease in cash flow from operations in 2003 was impacted by a €1.2 million decrease in trade payables, other current payable and accrued expenses, compared to a €70.4 increase in 2002. This cash outflow from trade payables and other current payables in 2003 derives from a combined effect due on one side to an increase in debts for commission, royalties, advertising and sponsorship costs, linked to the new Armani license, but more than compensated for by the payments of costs related to refinancing. Cash flow from operating activities was also favourably affected in 2003 by a €1.9 million decrease in our inventories, net of exchange rate, from 2002 due to the Group's inventory control policy.

Cash flow from operating activities increased to €12.6 million in 2002 from €9.3 million in 2001. In the first half of 2002, we undertook a number of steps to improve our cash flow through a variation of the payment terms to suppliers and a reduction in collection times from customers. Consequently, cash flow from operating activities in 2002 was favorably affected by a €70.4 million increase in trade payables and accrued expenses, net of exchange rate effects, which increase was directly related to our variation of payment terms to suppliers and our accrual of fees and expenses incurred in connection with the December 2002 corporate refinancing, compared to a €24.7 million increase in trade payables and accrued expenses in 2001. Additionally, cash flow from operating activities was also favorably affected in 2002 by a €1.9 million decrease in our balance of trade receivables and prepayments as a result of the reduction in collection times from customers as well as the securitization bridge facility entered into in December 2002, net of exchange rate effects, compared to a €47.1 million increase in trade receivables and prepayments in 2001. These improvements in cash flow from operations in 2002 were offset by a €7.9 million reduction from the prior year in our amortization charges in 2002 as a result of our application of increased useful life to the amortization of goodwill, and a €41.5 million increase in our inventories from 2001, due to a build-up in inventories that continued in the beginning of 2002 following the rapid slow-down in sales during the second half of 2001, net of exchange rate effects, compared to a €20.7 million increase in inventory in 2001.

Cash Flow from Investment Activities. Net cash used in investment activities consists of additions to tangible fixed assets, net of disposals, acquisitions of equity investments and increases in intangible fixed assets.

Cash outflows from investment activities decreased in 2003 from a cash outflow of €16.7 million in 2002 to a cash outflow of €80.4 million in 2003. The greater cash outflow experienced in 2002 was a result of the re-financing activities which had required expenditures for the purchase of treasury shares and for the purchase of shares in public offer for a total of €109.9 million in 2002. Additionally, during 2003, our cash flow from investment activities was positively impacted by a €2.8 million decrease in the purchase of tangible assets, and by a €3.9 million decrease in the acquisition of intangible assets compared to 2002. The reduction in capital expenditure for fixed assets is derived mainly from the a decreased level of investment in the distribution facility in Padua, and in the production facilities.

Cash outflows from investment activities decreased in 2002 from a cash outflow of €75.1 million in 2001 to a cash outflow of €16.7 million in 2002. In 2002 and 2001, we continued to invest in our production facilities, generally, and the distribution facility in Padua in order to support continued revenue growth. Our cash outflows related to these improvements amounted to €45.0 million in 2001 and €58.4 million in 2002. In 2002, as a result of the corporate reorganization, we also obtained approximately 10% of our own shares that our predecessor had acquired in June of 2002 for €81.0 million. In addition, we had cash outflows in connection with the purchase of goodwill related to our corporate restructuring in the amount of €95.0 million in 2001 and €9.0 million in 2002.

In February 2001, we acquired 746,250 shares in Banca Popolare di Lodi for €0.2 million. These shares are quoted on the Italian Stock Exchange and have been booked to long-term financial assets. As of December 31, 2003, the market value of these shares was €6.6 million. The carrying value of these shares has not been written down to reflect the change in market value.

Cash Flow from Financing Activities. Net cash flows from financing activities are mainly driven by our borrowing activities but also include equity share capital movements and dividend payments to shareholders. We had cash inflows from financing activities of €197.0 million in 2002 and €2.2 million in 2003. In 2003 we had cash inflows from notes of €300 million which was offset by the repayment of borrowing for €305.6 million.

The Group's share issuance in May 2003 resulted in €30 million of positive cash flows financing activities, which was only partly off-set by a dividend payment of €2.2 million to minority interest shareholders.

We had cash inflows from financing activities of €23.8 million in 2001 and €197.0 million in 2002, which were principally related to new borrowing activities. In 2001, we had cash inflows from borrowing of €48.2 million in connection with the public-to-private transaction. In 2002, we had cash inflows from borrowing of €48.3 million which was offset by the repayment of existing debt in the amount of €617.2 million in connection with the December 2002 refinancing. We also had cash outflows in the form of dividend payments to Safilo's shareholders and minority shareholders of certain of our subsidiaries in the amounts of €4.7 million in 2001 and €23.7 million in 2002.

Senior Debt Covenants

We recently reached agreement with our senior bank lenders to amend certain of our financial covenants which could not be met under our recent operating results in order to provide greater operating flexibility under our senior credit facilities going forward. Please refer to Note 31 "Subsequent events" of the consolidated financial statements in the F-pages.

5.C. Research and development, patents and licenses, etc.

Licenses and Other Intellectual Property

Trademarks, Tradenames and Patents

As of December 31, 2003, our principal owned trademarks or trade names included *Safilo*, *Carrera*, *Smith*, *Optyl*, *Blue Bay*, *Oxydo*, *X* and *Elasta*. Our primary trademarks and trade names are registered in the countries in which we sell our products. We currently hold patents relating to many of our products, such as eyewear hinges and nose pieces, glasses cases, goggle protective surfaces and materials. We have approximately 20 patents registered in the United States and many European and Asian countries, and we apply for approximately six new patents each year, which generally are for hinges and other hardware items. In particular, our formerly patented, but now expired, and currently trademarked *Elasta* (self-adjusting hinges) is an important eyewear feature for many of our end customers. We possess the know-how for *Optyl* frames that are the result of a unique process which we developed. *Optyl* plastic frames are produced with a special combination of resins created in *Carrera* research laboratories. *Optyl* hard-plastic products are lightweight, non-allergenic, have attractive, sophisticated chromatic effects and are resilient despite extreme temperatures, thus retaining the shape of the frame under harsh conditions such as inside a hot vehicle. The molecular structure of this material also ensures strength and permanent elasticity, perfect fit and near indestructibility.

Licenses

We have license agreements with several companies pursuant to which we manufacture and distribute prescription frames and sunglasses. The table below sets forth the brands and geographic areas covered by our license agreements.

Licensor	Licensed Marks
Giorgio Armani S.p.A; GA International Diffusion B.V.	Giorgio Armani; Emporio Armani
Bottega Veneta S.r.l. & Bottega Veneta B.V.	Bottega Veneta
Burberry's Limited.....	Burberry
Christian Dior, Inc.; Christian Dior Couture S.A	Christian Dior
Diesel S.p.A.....	Diesel
FinMax Brands & Trademarks B.V.	Max Mara
Fossil, Inc.	Fossil
Guccio Gucci S.p.A.; Gucci America Inc.....	Gucci
Kate Spade LLC.....	Kate Spade; Jack Spade
Liz Claiborne Inc.	Liz Claiborne; Claiborne; Villager; Crazy Horse; First Issue
Nine West Development Corporation and Nine West Group, Inc. ...	Nine West
Pierre Cardin Italie S.r.l.	Pierre Cardin
PRL USA, Inc. and The Polo/Lauren Company, L.P	Polo by Ralph Lauren; Lauren by Ralph Lauren; Polo Sport; Polo Sport-RLX; Ralph; Ralph Lauren; Chaps
Saks & Co.	Saks Fifth Avenue S5A SFA
Stella McCartney Ltd.	Stella McCartney
Valentino S.p.A.....	Valentino; Oliver
Yves Saint Laurent Fashion AG and Yves Saint Laurent SAS... ..	Yves Saint Laurent YSL

We pay a royalty for use of the licensed brand name based on a percentage of net sales of that brand, which may be offset by guaranteed minimum royalty payments. Our licenses typically have a duration of five to eight years.

We paid royalties of €74.4 million in 2003, €70.9 million in 2002 and €69.2 million in 2001. In many of our agreements there are annual guaranteed minimum royalty payments to the licensor. Often the guarantee is 80% of the prior year's royalty payment or a certain amount is specified. The license agreements also provide for a mandatory payment for the advertising and promotion of the brand linked to the prior year's sales. Finally, in some cases, the licensor requires payments to assist the licensor in its own advertising and promotional activities.

5.D. Trend information

Over the past couple of years, our business has been significantly impacted by exceptional and unexpected events that have modified the growth trend which we have previously experienced.

During the course of 2003, international instability, the emergence of epidemics in the Far East that have substantially reduced tourism, and the overall global economic downturn have resulted in a decrease in sales in the entire fashion eyewear industry.

The area of our business that has been most significantly affected by the above economic trends is the sunglasses market, which has been impacted by the downturn in the fashion industry as well as by the reduction in the overall global consumption of luxury goods. More stable, on the other hand, has been the sales of prescription frames, which are influenced to a lesser extent by fluctuations in the global economy.

In terms of trends analysed for main markets, 2003 has not been a year of substantial growth for Europe. The reasons, which are the exceptional events mentioned above that have negatively influenced general market conditions and generated strong pessimism in the overall European population, have resulted in a lower demand for luxury goods such as sunglasses. For prescription frames, on the other hand, we have seen positive results in all markets. Among different European markets Italy experienced the weakest level of sales with respect to previous year. This decrease resulted from the high percentage of market share, and therefore exposure, that the Group maintains in the domestic market. Positive growths have been achieved in France, Germany, UK and Spain where we have increased our market share compared to our competitors.

Fashion eyewear industry trends in the United States have been strongly influenced by the exceptional external factors over the last couple of years which have impacted consumer confidence. The sunglasses market in particular has seen a decrease of about 15% in consumer sales during 2003 and 2002, with sharp declines in the high-end and luxury brand sectors of the market. The fact that the overall decline in gross sales was not driven by a large decrease in the number of sunglass units sold indicates that there has been a substantial reduction in average sales prices per unit. The sales trend of prescription frames has been similar to the trends seen in the sunglasses market but to a lesser extent. While the number of prescription frame units sold remained fairly constant during 2002 and 2003, there have been declines in the average sales prices per unit, which has consequently resulted in a decrease in gross sales volumes of about 3% over the past two years. Substantial increases in gross sales volumes of prescription frames are not anticipated over the next few years. We are operating in a mature market in the U.S., which is expected to experience a strong tendency for the consolidation of large distributors, accompanied by a continued decline of sales to independent opticians. An increase of one or two percentage points is expected nevertheless due to the continued increase of eyewear consumers resulting from the gradual aging of the American population.

Although 2003 has been a difficult year in the *Far East*, a positive growth trend in the fashion eyewear industry was evident towards the end of the year and has been confirmed during the course of 2004. The entire market in the Far East is demonstrating a turnaround that has been most noticeable in the prescription frames market. The demand for sunglasses, however, is still low as retailers in several markets continue to liquidate inventory levels that built up during 2003 due to the SARS epidemic.

5.E. Off-balance sheet arrangements

The Group does not have any material off-balance arrangements except for its derivative financial instruments which are discussed in Note 29(i) "Commitments and Lines of Credit" of the consolidated financial statements in the F-pages and a special purpose vehicle (SPV) relating to securitisation program as discuss in Note 6 "Trade receivables" of the consolidated financial statements in the F-pages .

5.F. Tabular disclosure of contractual obligations

We have numerous contractual commitments providing for payments pursuant to, among other things, royalty agreements with designers, leases for plant, warehouse and office facilities, as well as certain equipment leases. We also have, and will have, payment obligations pursuant to our outstanding borrowings, including the financial obligations arising from the senior credit facilities and the notes.

The following table summarizes the scheduled maturities of our long-term debt, minimum lease commitments and non cancellable royalty arrangements as of December 31, 2003:

<u>Contractual Obligations and Commercial Commitments</u>	<u>Payments Due by Period (€in thousands)</u>					<u>Total</u>
	<u>2004</u>	<u>2004 to 2005</u>	<u>2005 to 2006</u>	<u>2006 to 2007</u>	<u>After 2007</u>	
Long Term Debt.....	23,387	29,939	43,095	50,977	660,290	807,688
Operating Leases.....	5,445	5,128	4,951	3,988	15,401	34,913
Minimum Royalty Arrangements.....	62,100	34,479	34,651	21,205	19,316	171,751
Total	90,932	69,546	82,697	76,170	695,007	1,014,352

ITEM 6. Directors, Senior Management and Employees

6.A. Directors and senior management

General

Under Italian law, the Company's Board of Directors is responsible for managing the Company's business and supervising its operations. Within certain limits, the Board of Directors may delegate its powers to one or more members of Safilo S.p.A. senior management.

Board of Directors

The following table sets forth the names and ages of the members of the Board of Directors of Safilo S.p.A as of December 31, 2003.

Name	Year of Birth
Vittorio Tabacchi.....	1939
Ermenegildo Dino Tabacchi.....	1945
Giannino Lorenzon.....	1939
Roberto Vedovotto.....	1965
Massimiliano Tabacchi.....	1970
Samantha Tabacchi.....	1974
Carlo Maria Calabria.....	1960
Colin Taylor.....	1962
Agostino Ascani.....	1967

Vittorio Tabacchi is the second son of our founder, Guglielmo Tabacchi, and has been Chairman since 1993. Mr. Tabacchi joined us in 1970 as Manager of Production Activities. Currently he is also Chairman of ANFAO (National Association of Eyewear Manufacturers) in Italy.

Ermenegildo Dino Tabacchi, the third son of our founder, Guglielmo Tabacchi, joined Safilo in 1971 and in 1998 he was appointed vice president of Safilo S.p.A. In June 2002 he was appointed Chairman of Salmoiraghi & Viganò S.p.A., an Italian retail chain in the eyewear sector. In 2004 Mr. Ermenegildo Dino Tabacchi resigned as a member of the Board of Directors of Safilo S.p.A.

Giannino Lorenzon has been our Co-Chief Executive Officer since 1986 and Vice Chairman since 2003, and he oversees control and administration, personnel, information technology, legal issues, organization and quality. Mr. Lorenzon joined us in 1973 as Manager for finance, administration and control.

Roberto Vedovotto has been our Co-Chief Executive Officer since 2002 and oversees corporate finance, capital markets, acquisitions and business development. Previously, he worked for 11 years at Morgan Stanley International Limited and most recently served as Managing Director and Head of Investment Management for Southern Europe. Before joining Morgan Stanley, Mr. Vedovotto worked for Banca di Roma where he held various positions in New York and London. He graduated from Bocconi University in Milan and received a Masters in Finance from the London Business School.

Massimiliano Tabacchi, son of Mr. Vittorio Tabacchi, has been our Chief Operating Officer since 2002. He was appointed head of production of our manufacturing facility in Santa Maria di Sala, Italy in 2001. As a

mechanical engineer he oversees all our production plants and our research and development department. Mr. Tabacchi was previously the new equipment Contract Project Manager at OTIS (United Technologies).

Samantha Tabacchi, daughter of Mr. Vittorio Tabacchi, joined Safilo in 2000 as sponsoring manager with the introduction of the Motorcycle Gran Prix sponsorship. In 2001 she became Head of Licensing & Sponsoring. She was previously at Gucci International for three years working in public relations.

Carlo Maria Calabria is a Managing Director in the Investment Banking Division of Credit Suisse First Boston (Europe) Limited, Co-Head of European M&A, Head of Italian Investment Banking and a member of the European Investment Banking Management and Operating Committees. Prior to joining CSFB in 1990, Mr. Calabria began his career at Morgan Grenfell & Co. Limited where he held various positions in London and Milan. He received his M.A. in Business Studies and Economics from the Università di Roma, "La Sapienza" in 1983.

Colin Taylor is a Managing Director of Credit Suisse First Boston, based in London. He is responsible for the Firm's European private equity business. The Private Equity Division directs the private equity investment activities of the Credit Suisse Group. These activities include making direct investments in listed and unlisted companies using capital from Credit Suisse Group and partner institutional and family investors. Prior to joining Credit Suisse First Boston in 1990, Mr. Taylor worked for IBM as a system engineer, marketing representative and financial controller. Mr. Taylor received his undergraduate degree from Queen's University in Canada and his M.B.A. from the Harvard Business School.

Agostino Ascani is a Director of CSFB in the European Private Equity Group, based in London. Mr. Ascani joined CSFB as an Associate in the Mergers & Acquisitions department of Investment Banking in June 1996 and moved to Private Equity in November 1997. Prior to joining CSFB, Mr. Ascani spent six years with the Agarta Group, an equity investment group based in Singapore, where he held several positions and was involved in numerous acquisitions, disposals, financings and turnarounds. He graduated from LUISS in 1990 where he received his M.A. with honors in Business Studies and Economics. In 2004 Mr. Agostino Ascani resigned as a member of the Board of Directors of Safilo S.p.A.

CSFB Private Equity acquired an indirect minority interest in Safilo in December 2002 through the purchase of shares in our parent company, Safilo Holding S.p.A., and is represented by three members on Safilo's Board of Directors.

Board of Statutory Auditors

Pursuant to Italian law, we also maintain a Board of Statutory Auditors composed of three individuals who are required to have no other affiliation with Safilo and who must satisfy certain professional criteria and other standards. The Board of Statutory Auditors is required to verify that we: (i) comply with applicable law and bylaws; (ii) comply with accounting standards; (iii) ensure that our financial statements are consistent with our bookkeeping practices; and (iv) value our assets in accordance with the standards of Article 2426 of the Italian Civil Code. Although members of the Board of Statutory Auditors are required to attend the meetings of the board of directors and shareholders, they do not vote on matters submitted at such meetings. Currently the members of the Board of Statutory Auditors are Paolo Mazzi, Franco Corgnati and Lorenzo Lago. There are also two alternate members to the Board of Statutory Auditors.

Senior Management

The following table sets forth the names, ages and position of the senior management of Safilo S.p.A. as of December 31, 2003.

Name	Year of Birth	Position
Claudio Gottardi	1956	Managing Director and Business Unit Head of the Americas
Gianni Materassi.....	1959	Managing Director and Business Unit Head of Europe
Mario Pietribiasi	1957	Managing Director and Business Unit Head of the Far East
Christian De Felice	1970	Director of Finance
Massimo Lisot.....	1969	Director of Licensing & Business Development
Enzo Sopracolle	1952	Director of Design
Francesco Tagliapietra	1967	Director of Administration and Control

Claudio Gottardi joined us in 1985 as Area Manager Central Europe and, after gaining experience at Safilo USA, became Director of Marketing. In 1996 he assumed the position of Managing Director and Head of the Americas, and he is also CEO of Safilo USA, Smith Sport Optics, Solstice and Safilo Canada. Prior to joining Safilo he was Head of Marketing for the Italian subsidiary of W.L. Gore.

Gianni Materassi has been Managing Director and Unit Head of Europe since 1998. He joined us in 1988 as Sales Director for Italy, and in 1992 he became Sales Director for Europe. Prior to joining Safilo he was Sales Area Manager in Stefanel and Superga.

Mario Pietribiasi joined us in 1987 as area Manager, in 1993 became Sales Director of Europe and in 1997 became Managing Director and Unit Head of the Far East. Prior to joining Safilo he was Sales Area Manager in Cartiera Rossi and Simod.

Christian De Felice has been our Director of Finance since 2002. Mr. De Felice was previously Head of Structured Finance and Treasury at eBiscom and Fastweb, and Treasurer of Omnitel, the Italian subsidiary of Vodaphone Group.

Massimo Lisot has been our Director of Business Development since 2001 and of Licensing since 2003. Mr. Lisot worked previously at Morgan Stanley International Limited overseeing corporate finance in the Private Wealth Management Group for three years.

Enzo Sopracolle joined us in 1994 as Head of Design. Prior to joining Safilo he was a designer for De Rigo S.p.A.

Francesco Tagliapietra has been our Director of Administration and Control since 2000. He oversees the department responsible for budgeting, reporting and administration. He joined us in 1997 as Senior Controller. Previously, he held the position of Financial Controller at Tetra Laval Group.

6.B. Compensation

Director Compensation

According to Company by-laws, the Board of Directors receive reasonable compensation plus reimbursement for out of pocket expenses that they incur in connection with their service as members of the Board of Directors or a committee thereof. The aggregate compensation paid by the Company during 2003 to the Company's Board of Directors included Chairman and Chief Executive Officers amounted to €4.8 million.

Board of Statutory Auditors

Members of the Board of Statutory Auditors receive reasonable compensation plus reimbursement for out of pocket expenses that they incur in connection with their service as members of the Board of Statutory Auditors. The aggregate compensation paid by the Company during 2003 to the Board of Statutory Auditors amounted to €0,06 million.

Management Compensation

Members of our management team are compensated on the basis of a fixed salary plus a bonus based on economic and qualitative performance objectives. The aggregate compensation, including bonuses, paid by the Company during 2003 to the senior executives amounted to €6.2 million.

Stock Option Plans

On February 25, 2003 a stock option plan was implemented for selected Directors and senior managers. The total number of shares that can be issued upon exercise of these options is 992,128 of the equity shares of Safilo Holding S.p.A., and in certain circumstances, equity shares of Safilo S.p.A. Options granted under the Safilo Holding plan vest over a three-year period of time, but are not exercisable until 2006. Vesting of options accelerates in the case of certain defined events such as an initial public offering of Safilo Holding S.p.A. or Safilo S.p.A. shares or certain change of control events.

Certain senior managers of Smith Sport Optics, Inc. have been granted options to acquire shares of Smith Sport Optics.

6.C. Board Practices

Safilo S.p.A. Directors are appointed at the general meeting of the shareholders to serve a maximum 3 year terms. The terms of all current directors will expire upon approval by the Company's shareholders of its financial statements for the year ending December 31, 2005.

The Board must consist of a minimum of 3 members and a maximum of 11 members, and the Directors may be re-elected. They may be removed at any time by the voting shareholders at a general meeting, and they may resign at any time by written notice to the Board of Directors and to the Chairman of the Company's Board of Statutory Auditors. If a vacancy occurs on the Board, the remaining directors may choose an interim Director to fill the vacancy, which director will serve until the next meeting of shareholders at which meeting the shareholders will be asked to vote to ratify the nomination of the interim director.

During 2004, Mr. Ermenegildo Dino Tabacchi and Mr. Agostino Ascani resigned as members of the Board of Directors. Mr. Ermenegildo Dino Tabacchi was temporarily replaced by Mr. Carlo Gilardi until the next general elections.

6.D. Employees

As of December 31, 2003, we had 6,766 employees. Of our total employees, 532 are part-time employees and approximately 687 employees have fixed term contracts. We occasionally hire seasonal employees.

The following table sets forth information about our number of employees as of December 31, 2002 and 2003, respectively.

	December 31,	
	2003	2002
Headquarter (Padua – Italy)	637	593
Factory personnel	4.954	5.060
Subsidiaries	973	896
Solstice	202	102
Total	6.766	6.651

We believe that the majority of our European employees are represented by trade unions. We consider our relationship with the unions to be good and are committed to maintaining those relationships. We have not experienced any material labor strikes or disruptions.

We have approximately 1,300 sales agents world-wide.

6.E. Share ownership

We have one shareholder, Safilo Holding S.p.A., which owns 90,754% of our outstanding shares. The remaining share are owned by Safilo S.p.A. itself as treasury shares.

No members of the Board of Directors or senior managers hold shares of Safilo S.p.A. or its subsidiaries.

The Chairman and some members of the Board of Directors hold shares in companies having an indirect controlling interest in Safilo S.p.A.

ITEM 7. Major Shareholders and related Party Transactions

7.A. Major shareholders

Safilo's capital stock as of December 31, 2003 consisted of 34,350,000 ordinary shares with full voting rights, of which 31,174,000 are owned by Safilo Holding S.p.A. and outstanding and 3,176,000 are held by Safilo S.p.A. as treasury shares. At December 31, 2003, Safilo Holding owned, 31,174,000 ordinary shares or 100% of Safilo's outstanding ordinary shares.

In turn, 100% of Safilo Holding was owned by a company controlled collectively by Vittorio Tabacchi's family, funds advised by CSFB Private Equity and a company controlled by Vittorio Tabacchi's brother, Dino Tabacchi. In February 2004, Dino Tabacchi, sold his 8% ownership interest in Safilo Holding to Vittorio Tabacchi's family.

On December 16, 2002, in connection with the purchase of Safilo Holding shares from Vittorio Tabacchi, CSFB Private Equity and the shareholders of Safilo Holding entered into a shareholders agreement governing the management of both Safilo and Safilo Holding and the relationship among Safilo Holding's shareholders. Certain significant corporate actions, such as the issuance of capital stock and debt instruments, requires the mutual agreement of Vittorio Tabacchi and CSFB Private Equity.

7.B. Related party transactions

CSFB Private Equity, one of Safilo Holding's shareholders, is an affiliate of one of our lenders under our senior credit facility; Credit Suisse First Boston, as lender and Credit Suisse First Boston, Milan Branch, as arranger.

Caboto SIM S.p.A., has provided financing to companies controlled by Vittorio Tabacchi.

Safilo USA leases its headquarters and distribution center in the United States (New Jersey) from a company, TBR Inc., which is partly owned by Vittorio Tabacchi, our Chairman and a significant shareholder of Safilo Holding, and 33.33% owned by a subsidiary of the Company. We purchased the 33.33% interest in TBR Inc. in 2002 for €29,000. In 2003, we paid rent to TBR Inc. amounting to €1.1 million. We believe that the terms of this lease are consistent with what would be negotiated on an arm's length basis and the rent paid thereunder is consistent with market rates.

Safilo Far East Limited, one of our subsidiaries, owns 23.1% of Elegance International Holdings Limited, a company listed on the Hong Kong Stock Exchange. Elegance is a manufacturer of eyewear in the Far East to whom we outsource some of our production. In 2003, we purchased €7.3 million worth of products from Elegance, and we have an agreement that requires minimum purchases each year. The prices and other conditions of production are similar to those Elegance provides to its other customers. Vittorio Tabacchi, our Chairman, and Mario Pietribiasi, our Managing Director and Business Head for the Far East, are non-executive directors of Elegance, and Mario Pietribiasi is also a shareholder who owns less than 0.03% of the outstanding ordinary shares of Elegance.

See note 4 to our consolidated financial statements for further information on related party relationships and transactions.

7.C. Interest of experts and counsel

Not applicable

ITEM 8. Financial Information

8.A. Consolidated Statements and Other Financial Information

See ITEM 18 "Financial Statements."

8.A.7. Legal proceedings

We are currently a party to various claims and legal actions that arise in the ordinary course of business. We believe such claims and legal actions, individually and in the aggregate, will not have a material adverse effect on our business, financial condition or results of operations.

In 1999, Oakley, Inc. commenced an action for patent infringement against Smith Sport Optics, Inc. in the United States District Court for the Central District of California. Oakley alleges that the sale of certain sunglasses and goggles produced by Smith infringes on six U.S. patents owned by Oakley. Oakley is seeking injunctive relief and damages for lost profits and royalties for previously produced products. The case is currently in the discovery stage and the trial date is scheduled for July 13, 2004, absent any extensions. We intend to defend this action vigorously and believe we have several defenses to Oakley's action. We do not expect this action will have a material effect on our operations as a whole. We cannot guarantee an adverse determination would not have a material affect on Smith's operations.

8.A.8. Dividend Policy

The payment of an annual dividend may be recommended by the Company's Board of Directors subject to approval by shareholders at the annual general shareholders' meeting, which under Italian law must be held within the four (or, under certain circumstances, six) months following the Company's fiscal year-end.

Before dividends may be paid with respect to the results of any year, an amount equal to 5 percent of our net income for such year must be set aside to the legal reserve until the reserve, including amounts set aside during prior years, is at least equal to one-fifth of the nominal value of our issued share capital.

Safilo's dividend policy in future periods, and the amount of future dividends, will depend upon a number of factors including, but not limited to, Safilo's development plans, level of profitability and senior loan agreement.

8.B. Significant Changes

No significant changes have occurred since the date of our consolidated financial statements included in this Form 20-F.

ITEM 9. The Offer and Listing

9.A. Offers and listing details

The Company has 9.625% senior notes due May 2013 listed on the Luxembourg Stock Exchange. The table below sets forth, by fiscal quarter, the high and low closing sales prices of our notes since the notes began trading on the Luxembourg Stock Exchange in August 2003:

	<u>High</u>	<u>Low</u>
<u>2003</u>		
Third quarter	104.20%	95.07%
Fourth Quarter	95.07%	88.15%
<u>2004</u>		
First quarter	88.15%	78.70%

The table below sets forth the high and low closing sale prices of our notes for the past six months:

	<u>High</u>	<u>Low</u>
<u>2003</u>		
October	95.07%	95.07%
November	95.07%	95.07%
December	95.07%	88.15%
<u>2004</u>		
January	88.15%	78.70%
February	83.60%	78.70%
March	87.50%	83.00%

9.B. Plan of distribution

Not applicable.

9.C. Markets

Our 9.625% senior notes, due to May 15, 2013, are listed on the Luxembourg Stock Exchange. We have no other class of securities listed or traded on any other stock exchange.

9.D. Selling shareholders

Not applicable.

9.E. Dilution

Not applicable.

9.F. Expenses of the issue

Not applicable.

ITEM 10. Additional information

10.A. Share capital

Not applicable.

10.B. Memorandum and articles of association

Registration

As set forth in Article 4 of the Articles of Association, the Company's corporate purposes are:

- a) carrying out, directly or indirectly, through subsidiaries or affiliates, in Italy or abroad, activities in the sectors of the manufacturing and marketing of eyeglasses frames, sunglasses, sport glasses, lenses, machinery and equipment for the production of eyewear and other accessories for optics, sport and leisure-time gadgets;
- b) the acquisition, negotiation and management of shareholdings in companies operating in the sectors of optics and precision mechanics; implementation of financial transactions; financing of subsidiaries or affiliates and execution of financial agreements for the technical and financial co-ordination of their activities, except that any activity deemed "financial" under the law will not be carried out in relation to the public at large but exclusively within the group;
- c) advising on the economic, administrative, structural and commercial planning of some sectors of the market or of single enterprises; their restructuring; feasibility studies on acquisitions of companies; management of development programmes for relationships with foreign countries; management of industrial and commercial enterprises operating in the field of optics and precision mechanics. The company may carry out all commercial and industrial transactions, on movable or immovable property, which the board deems necessary or instrumental to achieve the corporate purpose; it may receive loans from its shareholders, and grant or receive intra-group loans; it may give guarantees and endorsements, and any other security, provided not in relation with the public; it may represent national or foreign enterprises, and directly or indirectly, purchase shares in other companies, consortia, partnerships and enterprises which have an identical, similar related corporate purpose.

Directors' Voting Powers

Under Italian law, attendance of a majority of the Board of Directors at a Board meeting is required in order to establish a quorum.

Any director also may participate in any meeting of the board in person, by telephone conference call, video conference or by any other similar means allowing all directors participating in the meeting to hear one another.

There is no age limit for directors and there are no requirements that a director must own a minimum number of shares in order to qualify to act as a director.

According to Italian law, in the case of a conflict of interest of a director, the director must inform the board of directors of the conflict and refrain from deliberating and voting on the relevant matter.

Shareholders vote on director's compensation at the general meeting of shareholders. The Board of Directors may determine specific compensation for those of the directors appointed in the Board of Directors with the specific office of Chairman, Vice Chairman and Chief Executive Officer.

For financing over euro3,000,000.00 (or equivalent foreign value) for any single operation, the approval of the Board of Directors is requested.

Share Rights, Preferences and Restrictions

The authorised and issued share capital is EUR 34,350,000.00, divided into 34,350,000 registered shares, each with a nominal value of EUR 1.00.

The shareholders' meeting may, in the circumstances provided for by law, reduce the share capital by assigning to the single shareholders certain assets of the company ("attività sociali") or shares/quotas of other companies which it owns.

On February 25, 2003 the shareholders' meeting resolved to increase the share capital by EUR 672,510.00, through issue of 672,510 ordinary shares, to be subscribed by June 30, 2007, and reserved to the beneficiaries of the Stock Option Plan Safilo Holding and Safilo 2003-2007. As the capital increase may be executed in one or more occasions, the share capital of Safilo shall be deemed as automatically increased by an amount equal to the nominal value of the shares subscribed from time to time.

If a shareholder wishes to sell all or some of the owned shares, the shareholder must offer them to the other shareholders and to those legal or physical entities having securities rights over the shares of the company, duly registered in the shareholders' ledger ("Offerees").

In case of capital increases, the other shareholders will have a pre-emption right on any subscription rights that a shareholder may want to sell.

Meetings of Shareholders

The ordinary shareholders' meeting must be convened at least once a year, within four months from the end of the financial year, or within six months if the board so resolves.

The provisions of the Civil Code will apply to determine the valid constitution of shareholders' meetings and the validity of their resolutions. Meetings may be held by video or telephone conference if some conditions aimed at ensuring full participation by all shareholders are met.

Ownership Limitations

No restrictions are stated on who may hold interests in the Company.

Change in Control

The transfer of Company's shares is subject to the pre-emption right as above stated.

10.C. Material contracts

Senior Secured Credit Facilities

Safilo S.p.A. and certain of its direct and indirect subsidiaries entered into a senior credit agreement with Credit Suisse First Boston, Milan Branch, Sanpaolo IMI S.p.A. and Unicredit Banca Mobiliare S.p.A. as arrangers, the banks and financial institutions named therein as lenders, and Unicredit Banca Mobiliare S.p.A. as facility agent, security agent and issuing bank.

Structure

As of December 31, 2003 the total amount outstanding under the senior credit agreement was €600 million through a €50 million revolving credit facility, a €60 million capex facility and four term loan facilities as follows:

- term loan facility A1, which consists of two tranches, one tranche in the amount of €50 million and another tranche in the amount of \$146.6 million;
- term loan facility A2 in the amount of \$68.4 million;
- term loan facility B in the amount of €35 million; and
- term loan facility C in the amount of €35 million.

Interest Rate and Fees

Loans under the various facilities bear interest at rates per annum equal to EURIBOR (or, for loans not denominated in euro, LIBOR) plus, where appropriate, any applicable mandatory costs and plus the following applicable margins:

- 2.25% for term loan facility A1;
- 2.25% for term loan facility A2;
- 2.75% for term loan facility B;
- 3.25% for term loan facility C;
- 2.25% for the revolving credit facility; and.
- 2.50% for the capex facility.

The margins for term loan facility A1, term loan facility A2, the revolving credit facility, and the capex facility may be adjusted further to a step down mechanism if the ratio of total net debt to consolidated EBITDA falls within specified ranges provided by the senior credit agreement.

In addition to paying interest on loans outstanding under the revolving facility and the capex facility, we are also required to pay a commitment fee at a rate of 0.75% per annum on any undrawn and uncanceled amount. This fee is payable at the end of each quarter.

Any bank guarantees, letters of credit or similar extensions of credit issued under the revolving credit facility bear a guarantee fee equal to the amount of the margin per annum for the revolving credit facility noted above on the maximum aggregate amount payable under the bank guarantee for the term of the bank guarantee. An additional fee of 0.125% per annum is payable quarterly in arrears to the issuing bank on such aggregate amount of all bank guarantees, subject to certain deductions.

Security and Guarantees

Certain companies in the Safilo Group, including Safilo S.p.A., a guarantor of the notes, have guaranteed the borrowers' obligations under the senior secured credit facilities and, where legally possible or commercially viable, have granted in favor of the lenders under the senior secured credit facilities, a security interest over their operating assets, including a charge over their properties, bank accounts, proceeds of insurance policies, commercial contracts and intellectual property. In addition, the shares of Safilo S.p.A. and the shares of certain of its direct and indirect subsidiaries have been pledged, or legal mortgages over them have been granted, in favor of the lenders under the senior secured credit facilities.

Covenants

The senior credit agreement contains customary operating and financial covenants in line with this kind of agreement. The senior credit agreement also requires us to observe certain customary affirmative covenants. Our financial and operating performance will be monitored by a comprehensive financial covenant package typical for leveraged transactions of the kind governed by the senior credit agreement.

Maturity and Amortization

Term loan facilities A1 and A2 are to be repaid in semiannual installments beginning September 30, 2003, and continuing through December 31, 2009. Term loan facility B is to be repaid in full on December 31, 2010. Term loan facility C is to be repaid in full on December 31, 2011.

The revolving credit facility will cease to be available for drawing on November 30, 2009.

With respect to the €60 million senior secured capex facility, loans under such facility may be made through December 31, 2005 and any loans outstanding on that date then must be repaid, in eight equal semiannual instalments, by December 31, 2009.

Mandatory Prepayments

All obligations under the senior credit facilities must be prepaid in full if there is a change of control or if all or substantially all of our assets are sold.

Certain mandatory partial prepayments are required in some circumstances.

Events of Default

The senior credit agreement sets out certain customary events of default, the occurrence of which would allow the lenders to accelerate all outstanding loans and terminate their commitments. These events of default are standard for this kind of financing.

Hedging Arrangements

The borrowers are required by the terms of senior credit facilities to enter into hedging arrangements to provide protection in respect of interest rate risk exposure arising because the financing under the senior credit facilities is at floating interest rates.

Capex Facility

We have a €60 million senior secured capex facility, which is available but undrawn as at December 31, 2003. The capex facility has been effected by an amendment of the senior credit agreement and, accordingly, is subject to the provisions in respect of security, guarantees, covenants, prepayments and events of default as described above in relation to the senior credit agreement.

The purpose of the capex facility is to finance certain approved capital expenditures, including the proposed Outlook acquisition, and Armani license-related costs and expenses up to a maximum aggregate amount of €50 million and working capital requirements and other expenditures up to a maximum aggregate amount of €10 million.

There are certain limitations on the availability of advances under the capex facility. Prior to receiving an advance, Safilo must certify that it shall meet certain projected financial covenant ratios, including cash flow coverage and leverage ratios, for the next four fiscal quarters.

Put Option Agreement

Safilo Capital International S.A., the issuer of the notes, is owned by Safilo S.p.A. and Safilo International B.V., a subsidiary of Safilo S.p.A. Pursuant to the put option agreement, Safilo S.p.A. has the right to put the shares of Safilo Capital International S.A. to Safilo S.p.A.'s parent company, Safilo Holding S.p.A. The put right has been assigned to Unicredit Banca Mobiliare S.p.A., as the security agent for the lenders under the senior credit agreement. The effect of the put option agreement and the assignment is to allow the lenders, if they enforce their security pursuant to a company share charge enforcement sale, to exclude Safilo Capital International S.A. from a sale of the Safilo Group.

Indenture

In 2003, Safilo Capital International S.p.A. issued €300,000,000 9 5/8% Senior Notes due 2013 and guaranteed on a senior subordinated basis by Safilo S.p.A. and certain of its subsidiaries which are governed by an indenture dated as of May 15, 2003, between Safilo Capital International S.p.A., Safilo Holding S.p.A., Safilo S.p.A. and the subsidiary guarantors of the Notes and The Bank of New York as trustee. The Notes will mature on May 15, 2013. The indenture places certain limitations on Safilo's operations. The indenture contains covenants that limit the ability of Safilo and its subsidiaries to incur additional indebtedness; pay dividends or distributions on, or redeem or repurchase capital stock; make investments; issue or sell capital stock of subsidiaries; engage in transactions with affiliates; create liens on assets; transfer or sell assets; guarantee indebtedness; restrict dividends or other payments of subsidiaries; impair security interests supporting the Notes; and engage in unrelated businesses.

Intercreditor Agreement

As part of our refinancing in 2003, we entered into an intercreditor agreement to establish the relative rights of certain creditors dated as of May 15, 2003, between Safilo Capital, Safilo, its parent Safilo Holding S.p.A., the subsidiary guarantors of the Notes, the lenders under the senior credit agreement and The Bank of New York as the trustee under the indenture for the Notes. The intercreditor agreement restricts, among other things, the ability of the obligors under the notes:

- If there is a payment default under the senior credit agreement or if there is an outstanding payment blockage notice, to make payments on;
- To grant security for;
- To defease; or
- Otherwise to provide financial support in relation to

the Notes and the related guarantees for so long as any indebtedness under the senior secured credit facilities remains outstanding. The postponement, subordination, blockage or prevention of payment on the issuer loan

agreement is not a waiver by the issuer of its claims and other rights under the issuer loan agreement. Payments on the issuer loan agreement shall remain due and payable, and interest shall continue to accrue.

Any of the trustee under the indenture and the noteholders may bring an action to enforce the obligations of Safilo Capital and the guarantors under the notes and guarantees. The intercreditor agreement does not restrict enforcement in respect of the Notes against the Safilo Capital, but does not permit other enforcement action against the guarantors and places certain limitations on enforcement action of Safilo Capital in respect of the issuer loan agreement.

In the event of insolvency, the intercreditor agreement provides that all obligations in respect of the Notes, the guarantees and the issuer loan agreement are subordinated to the prior payment in full of all obligations under the senior credit agreement. Any release by the lenders under the senior credit agreement of their security for the shares of Safilo S.p.A. must be a release of the security over all of the shares and not part of them. In the event the lenders enforce their security over these shares and the shares are sold, the intercreditor agreement provides for certain circumstances in which the guarantors of the Notes shall be released from all their obligations relating to the Notes.

Securitization Bridge Facility

In December 2002 we have securitized some of our Italian trade receivables. In order to do this, Sunlight S.r.l., a special purpose entity owned by a Dutch charitable trust, was formed. Pursuant to a note issuance facility agreement, Credit Suisse First Boston International and Unicredito Italiano Bank (Ireland) PLC agreed to purchase notes of Sunlight S.r.l. in aggregate principal amount of €50 million. The notes are secured by trade receivables purchased irrevocably and without recourse by Sunlight S.r.l. from Safilo S.p.A., pursuant to a trade receivables purchase agreement between the two companies. We have a servicing obligation to act as collection agent on behalf of Sunlight S.r.l. In December 2003, Safilo S.p.A. entered into a factoring agreement with Centro Factoring S.p.A. that provides for the sale without recourse of Safilo's trade receivables on a rotating basis. Such arrangement with Centro Factoring S.p.A. substantially replaced Safilo's securitization program. The securitization program was concluded in January 2004.

10.D. Exchange controls

There are no exchange controls in Italy. Residents of Italy may hold fore consent is required in Italy for the transfer to persons outside Italy of dividends or other distributions with respect to, or of the proceeds from the sales of, shares of an Italian company. Neither Italian law nor the Company's bylaws limit the right of non resident or foreign owners to hold or vote the Ordinary Shares or ADSs.

10.E. Taxation

U.S. Federal Income Tax Considerations

The following discussion is a summary of certain material U.S. federal income tax consequences of the purchase, ownership and disposition of the notes by U.S. Holders (as defined below). The summary is not a complete analysis or description of all potential tax consequences to U.S. Holders and does not address all tax considerations that may be relevant to all categories of holders (such as dealers or traders in securities, commodities, or currencies, tax-exempt investors, investors whose "functional currency" is not the U.S. dollar, investors who own 10 percent or more of our voting stock, financial institutions, thrifts, regulated investment companies, insurance companies, grantor trusts, individual retirement accounts or other tax-deferred accounts, investors that hold the notes as part of a "hedging", "integrated", "conversion" or constructive sale transaction or a "straddle", persons who have ceased to be U.S. citizens or to be taxed as resident aliens, or investors liable for the alternative minimum tax.

This summary is based on the Internal Revenue Code of 1986, as amended (the "Code"), judicial decisions, administrative pronouncements, and existing and proposed U.S. Treasury Regulations, changes to any of which after the date of this offering memorandum could apply on a retroactive basis and affect the tax consequences described herein.

You are a US holder if you are:

- a citizen or resident of the United States;
- a corporation, or other entity treated as a corporation, created or organized in or under the laws of the United States or any State;
- an estate, the income of which is subject to U.S. federal income taxation regardless of its source; or
- a trust:
 - (a) the administration of which is subject to the primary supervision of a court within the United States and for which one or more U.S. persons have the authority to control all substantial decisions; or
 - (b) that has a valid election in effect under applicable U.S. Treasury Regulations to be treated as a U.S. person.

If a partnership holds notes, the U.S. federal income tax treatment of a partner generally will depend upon the status of the partner and the activities of the partnership. Partners of partnerships holding the notes should consult their own tax advisors concerning the associated tax consequences.

Payments of Interest

Payments of interest on a note will be includible in the gross income of a U.S. Holder as ordinary income from foreign sources at the time it is received or accrued, in accordance with the U.S. Holder's method of accounting for U.S. federal income tax purposes, under the rules set forth below.

In the case of a U.S. Holder that is not required to accrue interest income prior to the receipt thereof (for example, an individual U.S. Holder who uses the cash method of accounting), the amount of interest income in respect of any interest payment will be determined by translating such payment into U.S. dollars at the spot exchange rate in effect on the date such interest payment is received. No exchange gain or loss will be realized with respect to the receipt of such interest payment, other than exchange gain or loss that is attributable to the actual disposition of the euros received.

In the case of a U.S. Holder that is required to accrue interest income prior to receipt thereof (for example, a U.S. Holder that uses the accrual method of accounting), the amount of any interest income accrued during any accrual period will generally be determined by translating the accruals into U.S. dollars at the average spot exchange rate applicable to the accrual period, or, with respect to an accrual period that spans two taxable years, the part of the period within the taxable year. A U.S. Holder will additionally realize exchange gain or loss with respect to any interest income accrued on the date such interest income is received (or on the date the note is disposed of) in an amount equal to the difference between (x) the amount determined by converting the amount of the payment received into U.S. dollars at the spot exchange rate in effect on the date such payment is received (or on the date the note is disposed of) and (y) the amount of interest income accrued in respect of such payment according to the rule set forth in the preceding sentence. Notwithstanding the preceding two sentences, a U.S. Holder that is required to accrue interest income prior to receipt thereof may alternatively make an election to apply a "spot accrual convention," as set forth in Section 1.988-2(b)(2)(iii)(B) of the U.S. Treasury Regulations. A U.S. Holder who

makes this election translates accrued interest into U.S. dollars at a single spot exchange rate, which is generally the rate in effect on the last day of the accrual period or, in the case of an accrual period that spans two taxable years, the exchange rate in effect on the last day of the part of the accrual period within the taxable year. If the last day of the accrual period is within five business days of the date the interest payment is actually received, an electing accrual basis U.S. Holder may instead translate that interest payment at the exchange rate in effect on the day of actual receipt. This election must be applied consistently to all debt instruments from year to year and cannot be changed without consent from the Internal Revenue Service. Exchange gain or loss is treated as ordinary income or loss from sources within the United States for U.S. federal income purposes.

With certain exceptions, interest payments on a note will be treated as "passive" income or, in the case of certain U.S. Holders, "financial services" income for purposes of computing the U.S. Holder's foreign tax credit allowable under U.S. federal income tax law. The rules relating to foreign tax credits and the timing thereof are complex and U.S. Holders should consult their own tax advisors regarding the availability of a foreign tax credit and the application of foreign tax credit limitations to their particular situation.

Sale, Exchange, Retirement and Other Disposition of the Notes

Upon the sale, exchange, retirement or other disposition of a note, a U.S. Holder will generally recognize taxable gain or loss equal to the difference between the amount realized (not including any amounts received that are attributable to accrued and unpaid interest, which will be taxable as interest income, and exchange gain or loss on such accrued, unpaid interest, as set out above) and the U.S. Holder's tax basis in the note. A U.S. Holder's tax basis in a note generally will be its U.S. dollar cost calculated at the exchange rate in effect on the date of purchase.

Gain or loss on the sale, exchange or retirement of a note that is attributable to changes in currency exchange rates will be ordinary income or loss and will be characterised as principal exchange gain or loss. Principal exchange gain or loss will generally equal the difference between the U.S. dollar value of the issue price of the note in foreign currency determined using the spot exchange rate on the date of the sale, exchange or retirement, and the U.S. dollar value of the issue price of the note in foreign currency determined using the spot exchange rate on the date the U.S. Holder acquired the note. Such gain or loss will be recognised only to the extent of the total gain or loss realised by the U.S. Holder on the sale, exchange or retirement of the note, and will generally be treated as ordinary income or loss from sources within the United States for U.S. federal income tax purposes.

Gain or loss in excess of principal exchange gain or loss will be capital gain or loss, and will be long-term capital gain or loss if the note was held for more than one year at the time of the disposition. Certain U.S. Holders (including individuals) are eligible for preferential rates of U.S. federal income tax in respect of long-term capital gain. The deduction of long-term capital losses is subject to significant limitations. Gain or loss recognized by a U.S. Holder generally will be treated as U.S. source income or loss.

Non-US Holders

As used herein, a non-US Holder is a person who is not a US Holder. Subject to the discussion concerning information reporting and backup withholding below, generally, a non-US Holder will not be subject to US federal income tax on payments of interest on, or gain on the sale of a note, unless such non-US Holder held the note in connection with a US trade or business carried on by such non-US Holder, or in the case of the sale of a note to a non-US Holder who is an individual, such individual was present in the US for 183 days or more during the tax year in which such gain is realized and certain other conditions are met.

Backup Withholding and Information Reporting

The paying agent or the financial intermediary through which you hold the notes may be required to file information returns with the US Internal Revenue Service in connection with payments made in respect of a note to certain US persons. If you are a US Holder, you generally will not be subject to a US backup withholding tax on such payments if you provide your taxpayer identification number and certain other information in the required

manner to such paying agent or financial intermediary. You may also be subject to information reporting and backup withholding tax requirements with respect to the proceeds from a sale or other disposition of the notes. If you are not a US Holder, you may have to comply with certification procedures to establish that you are not a US person in order to avoid information reporting and backup withholding tax requirements. Backup withholding is not an additional tax. Amounts withheld as backup withholding may be credit against a holder's US federal income tax liability.

Italian Tax Considerations

The statements herein regarding taxation are based on the laws in force in Italy as of the date of this Annual Report and are subject to any changes in law occurring after such date, which changes could be made on a retroactive basis. The following summary does not purport to be a comprehensive description of all the tax considerations which may be relevant to non-individual holders or to individual holders that hold notes in a business.

Interest on the Notes

Interest, premium and other proceeds paid on Notes by the non-resident Issuer to a beneficial owner who is not resident in Italy for tax purposes, without a permanent establishment in Italy to which the Notes are effectively connected, should not be subject to any Italian taxation.

If you are a resident of Italy for Italian tax purposes, and you are a private individual holding Notes not in connection with entrepreneurial activity, payments of interest, premium and other proceeds in respect on the Notes will be subject to final *imposta sostitutiva* (substitute tax) at a rate of 12.5%. The 12.5% final *imposta sostitutiva* will be applied by the Italian resident qualified financial intermediaries that will intervene, in any way, in the collection of Interest, premium and other proceeds on the Notes or in the transfer of the Notes. Where interest, premium and other proceeds, on the Notes are not collected through the intervention of an Italian resident qualified financial intermediary and as such no *imposta sostitutiva* is applied, the Italian resident beneficial owners will be required to declare interest, premium and other proceeds, in their yearly income tax return and subject them to final substitute tax at a rate of 12.5%, unless option for a different regime is allowed and made.

The same regime upon described is also applicable to Italian resident beneficial owners who are partnerships, other than public and private entities, not carrying out commercial activities.

Payments of interest, premium and other proceeds in respect on the Notes, to Italian resident corporations or permanent establishments in the Republic of Italy of non resident corporations, will not be subject to the *imposta sostitutiva* at the rate of 12.5%. In fact, interest, premium and other proceeds on Notes accrued to these subjects will be included in the taxable business income for corporate income tax purposes (and, in certain cases, depending on the *status* of the Notes holders, may also be included in their taxable net value of production for purposes of regional tax on productive activities – IRAP) of such beneficial owners, subject to tax in Italy in accordance with ordinary tax rules. A tax credit for withholding taxes applied outside Italy, if any, should be generally available.

Capital gains

If you are not a resident of Italy for income tax purposes, gains realized on the sale or other disposition of notes will not be subject to Italian tax, even if Notes, listed on a regulated market, are held in Italy.

If capital gain, realised upon the sale for consideration or redemption of the Notes, derives by Noteholders who are Italian resident corporations, permanent establishments in Italy of foreign corporations to which the Notes are effectively connected or Italian resident individuals carrying out a commercial activity, would be treated as part of the taxable business income (and, in certain cases, may also be included in taxable net value of production for IRAP purpose), subject to tax in Italy according to the relevant tax provisions.

Any capital gain realised by Italian resident individuals holding Notes not in connection with entrepreneurial activity, upon sale for consideration or redemption of the Notes would be subject to an *imposta sostitutiva* at the current rate of 12.5%.

Inheritance and gift taxes

According to Law No. 383 of 18 October 2001 ("Law No. 383"), Italian inheritance and gift tax, previously payable on transfer of securities on death or by gift, has been abolished as of 25 October 2001.

However, according to the current literal interpretation of Law No. 383, for donees other than spouses, direct descendants or ancestors and other relatives within the fourth degree, if and to the extent that the value of the gift to any such donee exceeds € 180,759.91, the gift of Notes may be subject to the ordinary transfer taxes that would apply if the Notes had been transferred for consideration. Future official ministerial decrees or guidelines should clarify this point.

Moreover, an anti-avoidance rule is provided by Law No. 383 for any gift of assets (such as Notes) which, if sold for consideration, would give rise to capital gains subject to Italian *imposta sostitutiva* on capital gains. In particular, if the donee sells Notes for consideration within 5 years from the receipt thereof as gift, the donee will be required to pay the relevant Italian *imposta sostitutiva* on capital gains, where applicable, as if the gift has never taken place.

Other taxes

No Italian transfer, stamp turnover or other similar taxes will be payable upon the issue, purchase or sale of the notes.

Changes in The European Union "Savings Directive"

On June 3, 2003, the Council of the European Union adopted a directive regarding the taxation of savings income (the "Directive"). According to the Directive, Member States will be required as from January 1, 2005 to provide to the tax authorities of another Member State details of payments of interest within the meaning of the Directive (including interest, premiums, discounts or other debt income) made by a paying agent within the jurisdiction to an individual resident in that other Member State (the "Disclosure of Information Method"). The term "paying agent" is defined in the Directive as any economic operator who pays, or secures the payment of interest for the immediate benefit of individuals, who are the beneficial owners of the interest. However, throughout the transitional period, paying agents established in certain Member States (the Grand Duchy of Luxembourg, Belgium and Austria) will withhold an amount on interest payments instead of using the Disclosure of Information Method used by other Member States. The rate of such withholding tax would equal 15% for the first three years after the date of implementation of the Directive, this rate being increased to 20% (three years after the date of implementation of the Directive) and 35% (six years after the date of implementation of the Directive). Such transitional period will end if and when the European Union enters into agreements on exchange of information upon request with several jurisdictions (Switzerland, Liechtenstein, San Marino, Monaco and Andorra) and when the Council of the European Union agrees that the United States is committed to use the Disclosure of Information Method.

The obligation to implement the Directive as from January 1, 2005 is subject to a decision, before July 1, 2004 whereby the ECOFIN will decide that third countries (Switzerland, Liechtenstein, San Marino, Monaco and Andorra) and dependant and associated territories (the Channel Islands, the Isle of Man, the Netherlands Antilles and certain Caribbean territories) will apply from that same date measures equivalent to those contained in the Directive.

No additional amounts will be payable with respect to the notes if a payment thereon is reduced as a result of any tax, assessment or other governmental charge that is required to be made pursuant to any European Union

directive (including the Directive) on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, any such directive.

10.F. Dividends and paying agents

Not applicable.

10.G. Statement by experts

Not applicable.

10.H. Documents on display

You may inspect the documents concerning us referred to in this annual report at Safilo S.p.A. headquarters at Settima Strada, 15 – Padua – Italy.

10.I. Subsidiary Information

Not applicable.

ITEM 11. Quantitative and qualitative disclosures about Market Risk

Not applicable.

ITEM 12. Description of Securities Other Than Equity Securities

Not applicable.

PART II

ITEM 13. Defaults, dividend arrearages and delinquencies

None.

ITEM 14. Material modifications to the rights of security holders and use of proceeds

None.

ITEM 15. Controls and procedures

Not applicable.

ITEM 16. [Reserved]

PART III

ITEM 17. Financial Statements

Not applicable.

ITEM 18. Financial Statements

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ITEM 19. Exhibits

Not applicable.

REPORT OF INDEPENDENT AUDITORS
To the Board of Directors of Sàfilo S.p.A.

We have audited the accompanying consolidated balance sheets of Sàfilo S.p.A. and its subsidiaries as at 31 December 2003 and 2002, and the related consolidated statements of operations, cash flows and changes in shareholders' equity for each of the three years in the period ended 31 December 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Sàfilo S.p.A. and its subsidiaries as of 31 December 2003 and 2002, and the consolidated results of their operations and their cash flows for each of the three years in the period ended 31 December 2003 in conformity with Italian Accounting Principles.

Padua, 28 April 2004

PricewaterhouseCoopers S.p.A.

SÀFILO GROUP
CONSOLIDATED BALANCE SHEETS
at December 31,
(in thousands of Euro, unless otherwise stated)

	<u>Note</u>	<u>2003</u>	<u>2002</u>
ASSETS			
Current assets:			
Cash and cash equivalents	5	38,741	51,443
Trade receivables (net of provision for doubtful accounts).....	6	209,077	197,024
Inventory, net.....	7	166,580	191,058
Other current receivables.....	8	83,309	45,697
Total current assets		497,707	485,222
Non-current assets:			
Property, plant and equipment, net.....	9	184,096	176,875
Intangible assets.....	10	427,871	431,255
Investments in associates and long-term financial assets.....	11	107,593	131,179
Deferred income taxes	15	12,804	—
Total non-current assets		732,364	739,309
Total assets		1,230,071	1,224,531
LIABILITIES & SHAREHOLDERS' EQUITY			
Current liabilities:			
Short-term borrowings	12	28,118	7,222
Current portion of long-term debt	13	23,388	8,860
Trade payables	14	141,594	151,817
Income tax payables.....	15	16,259	18,829
Other current payables and accrued expenses	16	70,470	73,843
Current provisions.....	17	5,607	139
Total current liabilities		285,436	260,710
Non-current liabilities:			
Long-term borrowings.....	13	784,301	835,198
Termination Indemnity Liability (TFR)	18	28,784	26,546
Long-term provisions.....	19	32,981	11,423
Total non-current liabilities		846,066	873,167
Total liabilities		1,131,502	1,133,877
Shareholders' equity attributable to minority shareholders		5,425	6,002
Shareholders' equity:			
Share capital.....	20	34,350	33,350
Other reserves and retained earnings.....		69,727	40,980
Income pertaining to the Group.....		(10,933)	10,322
Total shareholders' equity attributable to the Group		93,144	84,652
Total shareholders' equity		98,569	90,654
Total liabilities and shareholders' equity		1,230,071	1,224,531

(The accompanying notes are an integral part of these consolidated financial statements.)

SÀFILO GROUP
CONSOLIDATED STATEMENTS OF OPERATIONS
for the years ended December 31,
(in thousands of Euro, unless otherwise stated)

	<u>Note</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Net sales.....	21	900,130	894,052	844,952
Cost of sales	22	(375,243)	(347,947)	(352,202)
Gross profit		524,887	546,105	492,750
Selling and marketing expenses	23	(300,672)	(283,868)	(272,453)
General and administrative expenses.....	24	(124,414)	(119,116)	(96,703)
Other income/(expense).....	25	(60)	(34)	(240)
Operating income		99,741	143,087	123,354
Interest income/(expense) and other financial charges.....	26	(68,091)	(70,858)	(34,275)
Extraordinary income/(expense)	27	(7,121)	937	1,442
Amortization of goodwill	10	(23,333)	(23,850)	(43,012)
Income before taxation		1,196	49,316	47,509
Tax expense.....	15	(8,540)	(35,598)	(36,412)
Net income/(loss) before minority shareholders		(7,344)	13,718	11,097
Income attributable to minority shareholders	28	(3,589)	(3,396)	(3,816)
Net income/(loss)		(10,933)	10,322	7,281

(The accompanying notes are an integral part of these consolidated financial statements.)

SÀFILO GROUP
CONSOLIDATED STATEMENTS OF CASH FLOWS
for the years ended December 31,
(in thousands of Euro, unless otherwise stated)

	<u>Note</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Cash flows from operating activities				
Net income/(loss)		(10,933)	10,322	7,281
Adjustments to reconcile net income to net cash provided by operating activities:				
Amortization	10	35,307	36,413	54,270
Depreciation	9	26,415	29,708	27,627
Assets impairments	27	8,220	—	—
Change in accounting method for equity investments	27	(6,862)	—	—
Loss/(gain) on disposal of property, plant and equipment		67	(100)	22
Changes in operating assets and liabilities:				
Trade receivables and other current receivables		(47,323)	1,867	(47,116)
Inventory		11,878	(41,531)	(20,687)
Trade payables and other current payables and accrued expenses		(1,199)	70,419	24,749
Termination Indemnity Liability (TFR)		2,238	2,910	2,417
Other		6,131	2,641	709
Net cash provided by operating activities		23,939	112,649	49,272
Cash flows from investing activities:				
Purchase of property, plant and equipment (net of disposals)		(45,507)	(58,350)	(44,980)
Acquisition of investments in associates		—	(630)	(11,316)
Purchase of treasury shares	11	—	(80,988)	—
Disposal of investments in associates		—	986	256
Purchase of shares in public offer		—	(28,948)	(502,488)
Acquisition of intangible assets		(34,921)	(48,815)	(16,609)
Net cash used in investing activities:		(80,428)	(216,745)	(575,137)
Cash flows from financing activities:				
Proceeds from issue of ordinary shares		—	—	5,110
Proceeds from borrowings		300,000	848,278	548,229
Dividend paid by Sàfilo S.p.A.		—	(22,011)	(2,966)
Dividends paid by subsidiaries	28	(2,202)	(1,664)	(1,765)
Share issuance	20	30,000	—	—
Repayment of bond		—	(10,329)	(5,165)
Repayment of borrowings		(305,590)	(617,238)	(19,656)
Net cash provided from financing activities		22,208	197,036	523,787
Effect of exchange rate		683	(6,760)	(3,581)
Net increase in cash and cash equivalents		(33,598)	86,180	(5,659)
Cash and cash equivalents at the beginning of the period		44,221	(41,959)	(36,300)
Cash and cash equivalents at the end of the period		10,623	44,221	(41,959)

Cash and cash equivalents at the end of the period include:

Cash and cash equivalents	5	38,741	51,443	30,856
Bank overdraft.....	12	(152)	(686)	(5,347)
Short term loans.....	12	(27,966)	(6,536)	(67,468)
Cash and cash equivalents at the end of the period.....		10,623	44,221	(41,959)

Supplementary disclosure

Cash paid for interest.....		63,999	68,165	26,586
Cash paid for income taxes.....		35,647	38,632	38,465

(The accompanying notes are an integral part of these consolidated financial statements.)

SÀFILO GROUP
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
ATTRIBUTABLE TO THE GROUP

for the years ended 31 December 2002 and 2003
(in thousands of Euro, unless otherwise stated)

	Share capital	Other reserves and retained earnings ⁽¹⁾	Net income for the period	Group shareholder's equity	Minority Interest	Total shareholders' ' equity
Total consolidated shareholders' equity attributable to the Group at 1 December 2001	25,823	79,861	27,593	133,277	88,627	221,904
Allocation of 2001 net income:						
—dividend paid.....	—	—	(2,966)	(2,966)	—	(2,966)
—reserves.....	—	24,627	(24,627)	—	—	—
Capital stock conversion in Euro.....	177	(177)	—	—	—	—
Increase in share capital.....	7,050	(7,050)	—	—	—	—
Corporate reorganization ⁽³⁾	—	(24,778)	—	(24,778)	(82,867)	(107,645)
Share issuance.....	300	4,810	—	5,110	—	5,110
Net income for the year.....	—	—	7,281	7,281	3,816	11,097
Foreign currency translation.....	—	1,564	—	1,564	163	1,727
Total consolidated shareholders' equity attributable to the Group at 31 December 2001	33,350	78,857	7,281	119,488	9,739	129,227
Allocation of 2001 net income:						
—dividend paid.....	—	(22,011)	—	(22,011)	—	(22,011)
—reserves.....	—	7,281	(7,281)	—	—	—
Net income for the year.....	—	—	10,322	10,322	3,396	13,718
Foreign currency translation.....	—	(23,147)	—	(23,147)	(7,133)	(30,280)
Total consolidated shareholders' equity attributable to the Group at 31 December 2002	33,350	40,980	10,322	84,652	6,002	90,654
Allocation of 2002 net income:						
—reserves.....	—	10,322	(10,322)	—	—	—
Share issuance.....	1,000	29,000 ⁽²⁾	—	30,000	—	30,000
Net loss for the year.....	—	—	(10,933)	(10,933)	3,589	(7,344)
Foreign currency translation.....	—	(10,575)	—	(10,575)	(4,166)	(14,741)
Total consolidated shareholders' equity attributable to the Group at 31 December 2003	34,350	69,727	(10,933)	93,144	5,425	98,569

(1) Other reserves and retained earnings include a foreign currency translation reserve amounting to €(5,372), €5,203 and €1,564 as at December 31, 2003, 2002 and 2001, respectively.

(2) €29,000 relates to share premium.

- (3) The Group accounted for the purchases of shares from minority shareholders as if it occurred on January 1, 2001. Consequently €24,778 representing the profit for the year attributable to minority shareholders in the holding Company, was accounted for as a reduction of other reserves and retained earnings.

(The accompanying notes are an integral part of these consolidated financial statements.)

SÀFILO GROUP
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
as of 31 December
(in thousands of Euro, unless otherwise stated)

1. Description of the Company

The Sàfilo Group and its operations

The principal activity of Sàfilo S.p.A. and its subsidiaries ("the Company" or the "Sàfilo Group" or the "Group") is the production of eyewear. The Group's manufacturing facilities are primarily based in Italy (five plants), Austria and Slovenia (one plant each). The 2003 parent company Sàfilo S.p.A. is incorporated as a limited liability company in Italy and due to changes in the structure of the Group since July 2001, is the successor of Fimit S.p.A. and Programma 2001 S.p.A., the holding companies of the Group in 2001 and 2002, respectively. For the country of incorporation of the subsidiaries refer to Note 30. At December 31, 2003 the Group employed 6,766 employees. The registered office of Sàfilo S.p.A. is in Belluno.

Corporate reorganisation

Sàfilo is the successor business entity of its former parent companies, Fimit S.p.A., Programma 2001 S.p.A. and Programma 2002 S.p.A. as a result of a series of mergers and corporate reorganizations completed in 2001 and 2002. These transactions were undertaken in connection with, and following, the acquisition by Vittorio Tabacchi and members of his family of all of the publicly held shares of the predecessor of Sàfilo, which shares were subsequently delisted from the Italian Stock Exchange in December 2001.

The corporate reorganisation was accounted for in the following manner: the mergers of Fimit S.p.A. and Programma 2001 S.p.A., of Programma 2002 S.p.A. with Programma 2001 S.p.A. and Sàfilo S.p.A. were accounted for under the purchase method, under which the purchase price was allocated to the fair value of assets and liabilities, with any residual amount being allocated to goodwill.

Changes in consolidation area

In December 2003, the Group's Dutch subsidiary Safilo International BV purchased an additional 5% interest in the shares of an Austrian production company Carrera Optyl Brillen GMBH, and Carrera Optyl Brillen GmbH thereby became a wholly-owned subsidiary of the Group as of December 31, 2003.

Sàfilo Trading (Shenzhen) Co.Ltd - China has been consolidated since the fourth quarter 2003. This company was newly formed in September 2003 and is owned 51% by the Group. Sàfilo Trading Co. Ltd. will be the distributor for the Safilo Group collection in the territory of the People's Republic of China and will commence operations in January of 2004.

Sàfilo India Private Ltd and Sàfilo Singapore Pte Ltd have been consolidated since January 1, 2002. Before that date, these investments were recorded at cost as they were not significant.

2. Basis of preparation of the consolidated financial statements

Basis of preparation—The accompanying financial statements are derived from the financial statements that were prepared for Italian legal and statutory purposes in accordance with the law governing the preparation of financial statements in Italy, as interpreted by, and integrated with, the accounting principles established by Consiglio Nazionale dei Dottori Commercialisti e dei Ragionieri, the Italian accounting profession. The balance sheets and the statements of

operations have been reclassified in accordance with the Statements of the Consiglio Nazionale dei Dottori Commercialisti e dei Ragionieri (the "Italian Accounting Principles"). The reclassification, however, does not affect the consolidated results of operations and consolidated shareholders' equity in any of the years presented. In addition, the notes to the consolidated financial statements include a level of detail as is customary for international reporting.

Principles of consolidation— The consolidated financial statements of the Company include all majority-owned domestic and foreign subsidiaries. Equity investments, in which the Company has ownership interests between 20% and 50%, are accounted for using the equity method, if such investments are material.

Insignificant subsidiaries, companies held exclusively for sale and companies in liquidation, if their exclusion does not result in a misrepresentation of the Company's financial condition and consolidated results, are not included in the scope of consolidation.

The financial statements used for the consolidation are those approved, or prepared for approval, at the shareholders' meetings of the respective Group companies. They are adjusted, where necessary, to conform with the Company's accounting principles, which are in conformity with Italian Accounting Principles.

All intercompany transactions and balances are eliminated. Significant unrealised intercompany profits and gains and losses arising from transactions between Group companies are also eliminated.

Use of estimates—In conformity with Italian Accounting Principles, the preparation of the financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

3. Summary of significant accounting policies

Foreign currency translation

The financial statements of foreign subsidiaries are translated into Euro using the year-end exchange rate for balance sheet items and the average exchange rate for the year for statements of operations. Translation differences are recorded in a foreign currency translation reserve within consolidated shareholders' equity.

Foreign currency transactions are translated into Euro using the exchange rate prevailing at the date of the transaction. Balances outstanding at year end are translated into Euro at the year end exchange rate. Translation gains derived from non monetary financial assets and liabilities are deferred and charged to profit when realised.

Cash and cash equivalents

Cash comprises cash in hand and cash held on deposit with banks. All highly liquid investments with original short term maturities are considered cash equivalents.

Trade receivables

Trade receivables are stated at their estimated net realisable value.

Inventory

Inventories are stated at the lower cost, or their corresponding market value. The cost of inventories is determined by the weighted average cost method. Obsolete and slow-moving inventories are written down to their estimated net realizable value, and such write downs are recorded as part of cost of sales.

Property, plant and equipment

Tangible fixed assets are recorded at purchase or production cost or revalued amount. Cost includes related charges and direct and indirect expenses reasonably attributable to individual assets.

Certain property, plant and equipment have been revalued on the basis of indices established by laws issued by the Italian Ministry of Finance, with the objective of restating the net book value of the assets to a level which more closely reflects market value of such assets. Based on statutory limitations, such revaluations should not exceed the recoverable amount of the assets, which is confirmed by independent appraisals at the date of revaluation.

Tangible fixed assets are depreciated each year on a straight-line basis using rates that reflect the technical and economic residual useful lives of the assets.

The estimated useful life and the depreciation rates applied are as follows:

—Buildings.....	20 to 33 years
—Plant and machinery	5 to 12 years
—Industrial and commercial equipment.....	up to 5 years
—Other assets	3 to 10 years

Maintenance costs are expensed as incurred. Improvement expenditures, which extend asset lives, are allocated to the related assets and depreciated over their residual useful lives.

Intangible assets

Intangible assets are stated at purchase or production cost, including any directly-related charges, and are amortised on a straight-line basis over the period of expected benefit.

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired subsidiary at the date of acquisition.

Capitalized costs relating to intellectual property mainly include trademarks and licenses and are amortised over a maximum of ten years, or over the life of the license contract, whichever is shorter.

Marketing research expenses mainly represent deferred expenses related to studies for a proprietary database and software and are amortised over a 5 year period.

Start-up and development costs benefiting future accounting periods are deferred, with the approval of the Board of Statutory Auditors, and amortised over five years. Start-up costs mainly includes advisory and legal costs related to start-up operations. Development expenses include cost related to the refurbishing and overhauling of sales and/or production facilities.

Other intangible assets including leasehold improvements are amortised over the lower of the remaining useful lives of the assets or the life of the contract.

The useful lives adopted to amortise intangible assets are as follows:

—Start-up and development costs	5 years
—Research and development.....	up to 5 years
—Industrial trademarks	life of the contract
—Concessions, licenses and trademarks	5 years/life of contract
—Goodwill.....	up to 20 years
—Other deferred charges	3 years/life of contract

Investments in associates

Associates, in which the company has ownership interests between 20% and 50%, are accounted for using the equity method, if such investments are material.

Investments in associates that are deemed to be insignificant in the context of the Group's consolidated financial statements are generally stated at cost, determined on the basis of their purchase, subscription or appraised value. They are written down to reflect any permanent impairment in value.

Treasury shares

Treasury shares are recorded at cost and included in long term financial assets.

Provisions for risks and charges

Provisions for risks and charges are recognised when the Group has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made. The provisions reflect the best estimate of losses to be incurred based on the information available.

Payables

Payables are stated at their nominal value.

Employee benefits

Social costs

The Group incurs employee costs relating to the provision of benefits such as health services. Such benefit plans are not administrated by the Company and contributions are made in accordance with the provisions of negotiated contracts with trade unions. These amounts principally represent an implicit cost of employing production workers and, accordingly, have been charged to cost of sales.

Termination indemnity liability (TFR)

The liability for termination indemnities ("TFR" or "*Trattamento di fine rapporto*") relates to the Sàfilo Group's employees in its Italian operations. In accordance with Italian Severance Pay Statutes, an employee benefit is to be accrued for service to date and is payable immediately upon separation between the employee and each company. The TFR is calculated in accordance with local civil and labour laws based on each employee's length of service, employment category

and remuneration. The liability is adjusted annually for a cost of living index provided by the Italian Government. There is no vesting period or funding requirement associated with the liability. The liability recorded in the balance sheet is unfunded and represents the amount that the employee would be entitled to if the employee leaves at the balance sheet date.

Social pension costs

In certain territories outside of Italy, the Group contributes independently to state pension schemes on behalf of its employees. Mandatory contributions to governmental pension schemes are expensed when incurred. Discretionary pensions and other post-employment benefits are included in labour costs in the statement of operations.

Income taxes

Current income taxes are provided for on the basis of estimated taxable income, determined in accordance with current fiscal legislation, taking into account any available exemptions, benefits and tax credits.

Deferred tax assets and liabilities are recorded for the expected future tax consequences of tax loss carry forwards and temporary differences between the carrying amounts and the tax bases of the assets and liabilities based upon enacted tax rates. Deferred tax assets are recognized to the extent it is probable that the temporary difference will be realized.

Revenue recognition

Revenues from the sale of products are recognized at the time ownership passes, which is generally upon shipment to the customer, as this is the date that the risks and rewards of ownership are transferred to customers. Sales of products are shown net of product discounts, rebates, returns and VAT.

Sales that include the right of the dealer to return unsold products, which mainly occur in the United States, are recognised upon shipment of the product to the dealer. Provision for product return is estimated based upon historical trends and specific knowledge of any dealer to return products and is accrued and included within the provision for doubtful accounts which is offset against the receivable. After revenues are recognized, discounts for early payment are recorded as interest expense.

Revenues from royalties are recognised on an accrual basis in accordance with the substance of the relevant agreements.

Revenues are measured at the fair value of the consideration received.

The Group records amounts billed to customers for shipping and handling as a reduction in other selling expenses.

Extraordinary items

Transactions are recorded as extraordinary items when they are not directly related to the ordinary activities of the Group during the fiscal year.

Debt issuance costs

Expenditures arising from issuance of debt are recorded as intangible assets and amortised over the period of the related borrowings.

Environmental and product liabilities

The Group recognises losses and accrues liabilities relating to environmental matters and product liability cases, when available information indicates that a loss is probable and reasonably estimable. In the event of a loss being neither probable nor reasonably estimable but still possible, the Group discloses this contingent loss in the notes to its consolidated financial statements.

With respect to environmental liabilities, the Group estimates losses on a case-by-case basis and makes the best estimate on the basis of available information. With respect to product liabilities, the Group estimates losses on the basis of current facts and circumstances, prior experience with similar matters, the number of claims, and the anticipated cost of administering, defending or, in some cases, the settlement of such cases.

Leases

Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased property or the present value of the minimum lease payments. Capitalized fixed asset costs under a finance leases are depreciated over the shorter of the useful life of the asset or the lease term. The corresponding rental obligations, net of finance charges, are included in other long-term payables. The interest element of the finance cost is charged to the income statement over the lease period.

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

Derivative instruments

The Group uses derivative instruments to manage exposure to fluctuations in both foreign currency and interest rates. The Group does not enter into derivative instruments for speculative purposes. To hedge against exposure to changes in foreign currency exchange rates on assets and liabilities denominated in currencies other than Euro, the Group enters into foreign currency forward contracts. Discounts or premiums on forward contracts and options (the difference between the current spot exchange rate and the forward exchange rate at the inception of the contract) are amortised over the life of the contract on a straight line basis.

The Group periodically enters into foreign currency contracts to hedge commitments, transactions or foreign income. For foreign currency contracts acquired for the purpose of hedging identified commitments, gains or losses are recognised in cost of sales and offset the gains or losses on the related transaction. If the underlying transaction is not completed at the end of a given period the contract's fair value is reflected in the notes to the consolidated financial statements. Foreign currency contracts acquired for the purpose of hedging commitments are disclosed in Note 29.

The Group periodically enters into interest rate swaps (IRS), to adjust the effective interest rates on certain indebtedness. IRS involve the exchange of fixed and floating rate interest payments over the life of the swap contract without the exchange of the notional amount. The differential to be paid or received is accrued as an adjustment to interest expense over the life of the original IRS contract. Upon early termination of an interest rate swap, gains or losses are deferred and amortised as adjustments to interest expense of the related debt over the remaining period covered by the terminated swap.

Concentration of credit risk

Financial assets, which potentially subject Group entities to credit risk, consist principally of trade receivables. The Group has policies in place to ensure that sales of products and services are made to customers with an appropriate

credit history. The carrying amount of accounts receivable, net of the provision for doubtful accounts, represents the maximum amount exposed to credit risk. The Group has no significant concentrations of single customers or geographical risk.

Impairment

The Group assesses annually whether there is any permanent impairment of its assets. In accordance with Italian legislation, impairments, other than those that are temporary, are expensed in the statement of operations. Assets are written down whenever events and changes in circumstances indicate that the carrying amount may not be recoverable. The write down is calculated as the difference between the fair value and the book value of the assets. When circumstance causing impairment cease to exist, the Company reverses previously recorded impairment charges net of depreciation.

Stock Compensation

Stock options offered to employees for no consideration are recorded within the equity accounts in the Company's statutory financial statements when the shares are issued. In particular, stock grants made for no cash consideration are recorded at nominal value as a debit against a specific equity reserve, while shares issued after exercise of options are recorded as a capital increase for the nominal value and as an increase in the special reserve for the difference between amounts paid for exercising the options and the nominal value of issued shares. No compensation expense is recorded.

Dividend policy

Dividends are recorded in the Group's financial statements in the period in which they are approved by the Group's shareholders.

Restructuring costs

The costs of redundancy incentives are accrued when a workforce reduction program is defined and the conditions precedent for its implementation have been satisfied. Such charges are recorded as extraordinary items. Restructuring charges also include the costs of closures of facilities and asset impairments.

4. Related parties

The nature of the related party relationships for those related parties with whom the Group entered into significant transactions or had significant balances outstanding are detailed below. Transactions were entered into with related parties during the ordinary course of business.

i. Year-end balances with related parties:

Balances with related parties of the Group as at December 31, 2003 and 2002 consist of the following:

<u>Balance sheet</u>	<u>Relationship</u>	<u>2003</u>	<u>2002</u>
<u>Trade receivables:</u>			
—Optifashion As Istanbul.....	Unconsolidated subsidiary	161	129
— Safilens Srl	Other shareholdings	24	—
<u>Trade payables:</u>			

—Elegance International Holdings Ltd	Associate	5,809	8,423
<u>Other current receivables:</u>			
—Elegance International Holdings Ltd	Associate	304	396
<u>Other intangible assets:</u>			
—Credit Suisse First Boston.....	Indirect shareholder	1,841	2,037
<u>Long term financial assets (loans)</u>			
—Safilens Srl.....	Other shareholdings	150	200
<u>Long term borrowings:</u>			
—Credit Suisse First Boston.....	Indirect shareholder	—	299,229

ii. Transactions with related parties:

Transactions with related parties of the Group for the years ended December 31, 2003, 2002 and 2001 consist of the following:

<u>Statement of Operations</u>	<u>Relationship</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
<u>Net sales:</u>				
—Optifashion As Istanbul.....	Unconsolidated subsidiary	240	171	203
—Elegance International Holdings Ltd.....	Associate	318	—	—
<u>Cost of sales:</u>				
—Elegance International Holdings Ltd.....	Associate	17,328	17,116	21,074
<u>General and administrative expenses</u>				
—Elegance International Holdings Ltd.....	Associate	3	—	—
<u>Rent:</u>				
—TBR Inc (USA).....	Entity under common control	1,104	1,322	—
<u>Dividends from associated subsidiaries:</u>				
—Elegance International Holdings Ltd.....	Associate	974	1,167	1,228
<u>Interest income:</u>				
—Safilens Srl.....	Associate	6	2	—
<u>Interest expenses:</u>				
—Credit Suisse First Boston.....	Indirect shareholder	10,852	1,249	—
<u>Debt issuance costs:</u>				
—Credit Suisse First Boston.....	Indirect shareholder	196	383	—

Jointly with other banks, Credit Suisse First Boston is also lender of the long term loans, as indicated in Note 13.

During 2002, treasury shares were purchased from Programma 5000 S.r.l., an indirect shareholder, for a total amount of €80,988, and the Group acquired 33.33% in TBR Inc. from indirect shareholders of Safilo for €629.

5. Cash and cash equivalents

These items total €38,741 as at December 31, 2003, compared with €51,443 as at December 31, 2002, and reflect short term investments at market rates.

	<u>December 31,</u>	
	<u>2003</u>	<u>2002</u>
Currency		
US Dollar.....	15,994	6,277
Euro.....	14,107	36,706
Hong Kong Dollar.....	2,249	928

Canadian Dollar	1,546	1,058
Japanese Yen	631	2,193
Swedish Krone	823	1,127
Slovenian Taller.....	825	580
Australian Dollar	552	748
GB Pound Sterling.....	905	802
Swiss Franc.....	274	237
South African Rand.....	40	378
Brazilian Real.....	343	138
Singapore Dollar.....	98	178
Indian Rupee	58	54
Malaysian Ringgit	116	38
China Renmimbi	180	—
	<u>38,741</u>	<u>51,443</u>

Cash and cash equivalents as at December 31, 2003 include €1,572 (€25,000 as at December 31, 2002) of restricted cash related to transaction fees arising from the December 2002 refinancing, which were not paid until after December 2003.

6. Trade receivables (net of provision for doubtful accounts)

	December 31,	
	2003	2002
Gross value.....	221,733	213,128
Provision for doubtful accounts	(12,656)	(16,104)
Net value	<u>209,077</u>	<u>197,024</u>

Trade receivables are derived from sales of products to domestic and foreign customers. The exchange risk of receivables in currencies other than Euro are hedged by specific hedging contracts arranged centrally.

Since December 2002, Safilo S.p.A. participated in securitisation program stipulated that each month a gross amount of receivables, as determined by the Company, were sold without recourse to a special purpose vehicle (SPV) in exchange for cash. The transaction was carried out in accordance with the securitisation agreement entered pursuant to Law no. 130 of 30 April 1999 and pursuant to article 1267 of the Italian Civil Code. As at 31 December 2003 the total amount of receivables sold to Sunlight S.r.l. (SPV) was €75,094. The difference between cash received and trade receivables sold to the securitisation vehicle has been included in “Other current receivables” (Note 8). The securitisation program was concluded in January 2004 and partially replaced by a factoring agreement with Centro Factoring S.p.A. that provides for the sales without recourse of Safilo’s trade receivables on a rotating basis.

During 2003 we were informed that bankruptcy proceedings had been initiated against two of our larger Italian clients. The total value of the loss for these bad debts was already provided for in full in the consolidated provision for doubtful accounts.

The provision for doubtful accounts also includes amounts for unsold products that are expected to be returned, in accordance with contracts with final dealers. This provision for expected returns was €4.1 million as at December 31, 2003 and 2002. During 2003, additional provisions for doubtful accounts were not made for expected returns, as the existing provision was considered to be sufficient to cover possible future product returns.

7. Inventory, net

	December 31,	
	2003	2002
—Raw materials and supplies.....	32,954	37,161
—Work in progress	9,561	11,337
—Finished products.....	124,065	142,560
	<u>166,580</u>	<u>191,058</u>

Inventory is recorded net of an obsolescence and slow moving inventory provision amounting to €13,232 and €13,074 as at December 31, 2003 and 2002, respectively.

During 2003 Sàfilo Group focused on the reduction of the amount of finished products in stock. This policy, together with the devaluation of inventory values held by U.S. subsidiaries due to the decline of the US dollars against the Euro, collectively lead to a reduction of total stock amounting to €24,478.

8. Other current receivables

	December 31,	
	2003	2002
Value added tax (VAT) receivables.....	2,842	6,812
Tax credits and advance payments.....	13,890	8,449
Current deferred income taxes.....	16,378	18,026
Receivables due from Sunlight S.r.l.	37,533	-
Prepayments and accrued income	4,182	3,600
Receivables from salespersons.....	4,148	3,600
Other receivables	4,336	5,210
	<u>83,309</u>	<u>45,697</u>

The item “Receivables due from Sunlight S.r.l.” as at December 31, 2003 of €37,533 represents the difference between receivables sold to Sunlight Srl and cash received upfront under the Company’s securitisation programme. This difference, less commissions due, was collected in January 2004 at the end of securitisation program.

Current deferred income taxes represent temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements..

Prepayments and accrued income amount to €4,182 as at December 31, 2003 and €3,600 as at December 31, 2002 include:

As at December 31, 2003:

- Prepaid advertising expenses of €1,175;
- Prepaid lease instalments of €482;

- Prepaid royalties of €93;
- Other accrued income and prepayments of €332.

As at December 31, 2002:

- Prepaid advertising expenses of €1,150;
- Prepaid lease instalments of €1,760;
- Other accrued income and prepayments of €90.

Receivables from sales persons primarily represent receivables for the sale of samples to agents.

9. Property, plant and equipment, net

	Land and Buildings	Plant and equipment	Furniture, office equipment and vehicles	Assets under construction	Total
Cost					
Balance at January 1, 2002.....	79,525	152,051	45,411	4,515	281,502
Revaluations.....	1,579	10,729	7	—	12,315
<i>Sub total</i>	<i>81,104</i>	<i>162,780</i>	<i>45,418</i>	<i>4,515</i>	<i>293,817</i>
Additions.....	7,783	25,148	12,031	21,397	66,359
Translation differences.....	(1,091)	(1,591)	(4,526)	(135)	(7,343)
Transfer from assets under construction.....	56	1,385	(122)	(6,614)	(5,295)
Disposals.....	(63)	(3,788)	(2,226)	—	(6,077)
Balance at December 31, 2002	87,789	183,934	50,575	19,163	341,461
Accumulated Depreciation					
Balance at January 1, 2002.....	(14,189)	(101,579)	(26,537)	—	(142,305)
Depreciation charge.....	(2,213)	(21,285)	(6,210)	—	(29,708)
Translation differences.....	82	774	2,701	—	3,557
Transfer from assets under construction.....	(245)	(659)	(418)	—	(1,322)
Disposals.....	22	3,119	2,051	—	5,192
Balance at December 31, 2002	(16,543)	(119,630)	(28,413)	—	(164,586)
Cost					
Balance at December 31, 2002.....	86,210	173,226	50,568	19,163	329,167
Revaluations.....	1,579	10,708	7	—	12,294
<i>Sub total</i>	<i>87,789</i>	<i>183,934</i>	<i>50,575</i>	<i>19,163</i>	<i>341,461</i>
Additions.....	9,899	28,474	10,017	11,122	59,512
Translation differences.....	(866)	(1,292)	(4,782)	(84)	(7,024)
Transfer from assets under construction.....	—	—	194	(13,304)	(13,110)
Impairments.....	(5,408)	(2,291)	(480)	—	(8,179)
Disposals.....	(78)	(3,334)	(2,756)	—	(6,168)
Balance at December 31, 2003	91,336	205,491	52,768	16,897	366,492
Accumulated Depreciation					
Balance at December 31, 2002.....	(16,543)	(119,630)	(28,413)	—	(164,586)
Depreciation charge.....	(2,556)	(17,209)	(6,650)	—	(26,415)
Translation differences.....	90	672	2,637	—	3,399
Transfer from assets under construction.....	—	—	(194)	—	(194)
Disposals.....	26	2,369	3,005	—	5,400
Balance at December 31, 2003	(18,983)	(133,798)	(29,615)	—	(182,396)

Net Book Value

Balance at December 31, 2002.....	71,246	64,304	22,162	19,163	176,875
Balance at December 31, 2003.....	72,353	71,693	23,153	16,897	184,096

As at December 31, 2003, property, plant and equipment in the amount of €32.8 million was pledged as collateral for long term bank borrowings.

Selected properties, plant and equipment located in Italy were revalued in accordance with specific Italian laws during the years 1975, 1983, 1991 and 2000. Such laws allowed the revaluation of selected property, plant and equipment based upon indices established under the law, with the limitation that the revalued amount net of the accumulated depreciation should not exceed the recoverable amount of the assets.

During 2003, the Austrian company Carrera Optyl Brillen GmbH, decided to close its factory in Traun during the first six months of 2004 and has written down the related fixed assets to the estimated fair values through additional depreciation of €8,220.

In the course of 2003, the Directors have taken steps to carry out a detailed analysis of the appropriateness of the useful lives of fixed assets. As a result of this analysis, it was deemed to be appropriate to extend the useful lives of the "Machinery" category from 8 to 12 years, in order to adjust the useful lives to the actual period of future economic benefit of such assets. This modification has led to a lower depreciation cost in 2003 of €1,368.

10. Intangible assets

	Goodwill	Intellectual property	Marketing research expenses	Start up and development costs	Other intangible assets	Total
Cost						
Balance at January 1, 2002.....	439,687	16,086	3,889	2,569	20,914	483,145
Additions.....	34,762	944	—	—	41,759	77,465
Currency translation.....	(6,183)	(146)	(53)	(1)	(87)	(6,470)
Disposals.....	—	152	—	202	(65)	289
Balance at December 31, 2002..	468,266	17,036	3,836	2,770	62,521	554,429
Amortization charge						
Balance at January 1, 2002.....	(56,488)	(10,411)	(3,412)	(2,533)	(13,917)	(86,761)
Amortization charge.....	(23,850)	(1,420)	(124)	(31)	(10,988)	(36,413)
Balance at December 31, 2002..	(80,338)	(11,831)	(3,536)	(2,564)	(24,905)	(123,174)

	Goodwill	Intellectual property	Marketing research expenses	Start up and development costs	Other intangible assets	Total
Cost						
Balance at December 31, 2002	468,266	17,036	3,836	2,770	62,521	554,429
Additions.....	2,982	21,607	87	131	10,530	35,337
Currency translation.....	(2,751)	(112)	(32)	—	(62)	(2,957)
Impairments.....	—	(41)	—	—	—	(41)
Disposals/transfer to other categories	—	(416)	—	—	—	(416)
Balance at December 31, 2003..	468,497	38,074	3,891	2,901	72,989	586,352
Amortization charge						
Balance at December 31, 2002	(80,338)	(11,831)	(3,536)	(2,564)	(24,905)	(123,174)
Amortization charge.....	(23,333)	(3,857)	(133)	(69)	(7,915)	(35,307)
Disposals.....	—	—	—	—	—	—
Balance at December 31, 2003..	(103,671)	(15,688)	(3,669)	(2,633)	(32,820)	(158,481)
Net Book Value						
Balance at December 31, 2002..	387,928	5,205	300	206	37,616	431,255
Balance at December 31, 2003..	364,826	22,386	222	268	40,169	427,871

Goodwill as at December 31, 2003 mainly reflects the following:

- Goodwill totalling €43,986 (€64,221 as at December 31, 2002), net of amortization, arose in connection with the repurchase of Sáfico S.p.A shares from the public. Starting from 2002 the useful life of such goodwill was extended to 20 years, based upon management's estimate of the effective benefits expected from the corporate reorganisation which include the share repurchases.
- The acquisition of Smith Sport Optics, with a net book value of €9,661 (€12,616 as at December 31, 2002). The original amount of goodwill is being amortised on a straight-line basis over 20 years since 1996.
- Goodwill of €6,471 (€7,760 as at December 31, 2002) resulting from the acquisition of minor subsidiaries. The original amount is being amortised on a straight-line basis over 15 years since 1994.
- Goodwill attributable to the acquisition of Solstice Marketing Corp., which consisted of six stores in the US market. The original goodwill is being amortised over five years and the residual amount is €1,389 (€2,231 as at December 31, 2002).
- Goodwill of €2,137 resulting from the 2003 acquisition of all the assets of SRLC LCC (Outlook Eyewear), an American company located in Colorado, for the purpose of creating a second distribution center in North America. The goodwill is being amortised over five years.

Intellectual property includes:

- Trademarks and licenses of €2,386 as at December 31, 2003 (€2,205 as at December 31, 2002) net of amortization. Included in the December 31, 2003 balance is €18,524 for fees and other costs related to the renewal of certain license contracts, and €3,054 paid for the Carrera trademarks (€3,911 as at December 31, 2002).

"Start-up and development costs" totalling €68 as at December 31, 2003 (€206 as at December 31, 2002), net of amortization, relate to costs incurred by certain subsidiaries to develop marketing and operating plans for the start of new sales divisions.

"Marketing research costs" totalling €22 as at December 31, 2003 (€300 as at December 31, 2002), net of amortization, relate to costs incurred for software applications. During 2003, €31 were capitalized because those costs are expected to have a benefit in future years.

As at December 31, 2003, "Other intangible fixed assets" include:

- Transaction costs totalling €37,796 (€37,616 as at December 31, 2002) incurred for the corporate reorganisation, refinancing, and related debt issuance.
- Costs incurred by the Parent Company during the year for improvements to leasehold premises amounting to €15 (€1,002 as at December 31, 2002), net of amortization. This cost is being amortised over the life of the lease contracts.
- The cost of new software and IT applications totalling €1,458 (€1,502 as at December 31, 2002).

11. Investments in associates and long term financial assets

	December 31,	
	2003	2002
Investments in associates at January 1,	18,339	20,089
Additions	1	630
Disposals	(2)	(986)
Translation differences	(2,427)	(1,394)
Other	6,862	—
Investments in associates at December 31,	22,773	18,339
Long term financial assets	84,820	112,840
	107,593	131,179

In 2003, the Group's investment in the associate company Elegance International Holdings LTD was accounted for under the equity method. Prior to 2003, such investment was held at cost. The Directors considered that it was appropriate to change the method of accounting for its investment in Elegance International Holdings LTD due to the fact that in the course of 2003, commercial transactions with the aforementioned company reached a significant level and the activities of the associate company were becoming material to the Group. This change in the carrying value of the Group's investment in Elegance International Holdings LTD is included above in the line "Other".

	<u>Interest in share capital %</u>	<u>Relationship</u>	<u>December 31, 2003</u>
Investment:			
Banca Popolare di Lodi.....	0.65%	Other shareholdings	10,198
Elegance International Holdings Lts	23.05%	Equity investment	11,530
TBR Inc. (USA).....	33.33%	Entity under common control	471
Optifashion As (Turkey).....	50%	Unconsolidated subsidiary	353
Safilens Srl.....	17.50%	Associate	129
Other.....	—	Other shareholdings	92
			<u>22,773</u>

During 2002 the Group acquired 33.33% in TBR Inc. from indirect shareholders of Sàfilo for consideration of €629.

Long term financial assets as at December 31, 2003 include:

- €80,988 relating to 3,176,000 of the Group's own treasury shares which represents 9.246% of share capital;
- €1.257 (€2,632 as at December 31, 2002) of uncollected grants due from the Ministry of Industry;
- €571 (€685 as at December 31, 2002) refers to a non-interest bearing loan granted to an associate company;
- €424 (€677 as at December 31, 2002) relating to tax prepayments on the reserve for termination indemnities paid by certain Italian Group companies; and
- the remainder regards guarantee deposits.

12. Short-term borrowings

	<u>December 31,</u>	
	<u>2003</u>	<u>2002</u>
Bank overdraft	152	686
Short term loans.....	27,966	6,536
	<u>28,118</u>	<u>7,222</u>

The increase in short term borrowing is due to borrowings received in the ordinary course of business necessary to cover working capital requirements.

Short-term loans consist of the following:

	December 31, 2003
—Secured loan in Euro from UBM to Parent Company , bearing interest at 4.393%, repayable on 31 March 2004	12,500
— Secured loan in Euro from UBM to Parent Company, bearing interest at 4.446%, repayable on 28 April 2004	5,000
— Unsecured loan in Euro from “Banca Popolare di Vicenza” , bearing interest at 2.771%, repayable on 22 March 2004	5,000
— Secured loan in UDS from UBM, bearing interest at 3.460%, repayable on 30 April 2004	3,959
— Unsecured loan in YEN from “Banca Intesa Spa” of Tokyo to our subsidiary in Japan , bearing interest at 0.68%, repayable on 19 March 2004	1,481
—Unsecured l other short-term loans.....	26
	<u>27,966</u>

13. Long-term borrowings

	December 31,	
	2003	2002
Loans	490,873	534,274
Less: Current portion of loans	(21,040)	(8,359)
Notes	300,000	299,229
Other providers of financing	14,608	10,167
Less: Current portion in other providers of financing	(2,348)	(501)
Other long term debt.....	2,208	388
	<u>784,301</u>	<u>835,198</u>

During 2002 we incurred a significant amount of indebtedness in connection with the reorganization of the ownership structure of the Sàfilo Group. The reorganisation phase was concluded during the course of 2003.

The weighted average interest rates for long-term borrowings are as follows:

	2003 weighted average interest rate	2002 weighted average interest rate
Euro	7.34%	5.79%
USD	5.14%	3.59%
JPY	0.92%	—

The maturity profile of the carrying amount of the Group's long-term debt as at December 31, 2003 was as follows:

	December 31, 2003
2005	30,728
2006	42,304
2007	50,978
2008	56,474
2009	29,871
2010 and beyond.....	573,946
	784,301

The Group has entered into hedging arrangements with respect to its foreign currency obligations and interest rate exposures.

Long-term loans can be analysed as follows:

December 31, 2003	Outstanding balance	Current portion
Long-term loans of Sàfilo		
— Secured loan in Euro from Credit Suisse First Boston jointly with San Paolo IMI and UniCredit Banca Mobiliare—Term A1—bearing interest rate of 5.1529%—payable on 31 December 2009.....	48,420	4,170
— Secured loan in Euro from Credit Suisse First Boston jointly with San Paolo IMI and UniCredit Banca Mobiliare—Term B—bearing interest rate of 5.6529%—payable on 31 December 2010.....	135,000	—
— Secured loan in Euro from Credit Suisse First Boston jointly with San Paolo IMI and UniCredit Banca Mobiliare—Term C—bearing interest rate of 5.6529%—payable on 31 December 2011.....	135,000	—
— Secured loan in US\$146,613,400 from Credit Suisse First Boston jointly with San Paolo IMI and UniCredit Banca Mobiliare—Term C—bearing interest rate of 3.5876%—payable on 31 December 2009.....	116,083	9,992
Long-term loans of Group subsidiaries:		
— Secured loan in US\$68,338,750 from Credit Suisse First Boston jointly with San Paolo IMI and UniCredit Banca Mobiliare—Term A2—bearing interest rate of 3.5876%—payable on 31 December 2009.....	54,148	4,656
— Unsecured loan in YEN300,000,000 —bearing interest rate of 0,92%—payable on 29 March 2004.....	2,222	2,222
	490,873	21,040

The above long term loans have been secured by certain shares, real estate, equipment, intellectual property, and receivables of the Group.

Notes

On May 15, 2003 the Company successfully is issued €300,000 of secured Senior Notes. The debt proceeds were used to repay bridge from Credit Suisse First Boston outstanding at 31 December 2002. Senior Notes bear interest at 9.625%, are due on May 15, 2013, and are listed on the Luxembourg Stock Exchange.

The Senior Notes are guaranteed by a pledge of the Company's ordinary shares and by a security assignment over the proceeds of the Notes.

The balance as at December 31, 2002 includes:

- €97,766 in secured notes payable with a nominal value of US\$100,000 from Credit Suisse First Boston bearing an interest rate of 9.91%—repayable quarterly and maturing on December 16, 2012.
- €201,463 in secured notes payable to Credit Suisse First Boston bearing interest at 9.68%—repayable quarterly and maturing on December 16, 2012.

Other providers of financing

The balance as at December 31, 2003 includes:

- €1,239, of which €413 represents the current portion (€1,653 as at December 31, 2002), of a loan bearing interest at a fixed rate of 1.44%, granted to Sàfilo by SIMEST S.p.A., a financial institution owned by the Italian Government, for a project involving the commercial penetration of the Japanese market;
- €1,050 (same amount as at December 31, 2002) representing the long-term portion of a loan under the economic development law sponsored by Government of Italy;
- €2,319 of capital leases, of which €1,935 represents the current portion.

Capital leases include €2,056, relating to machinery whose leasing contracts expire in 2008, and €10,262, relating to leasehold improvements whose leasing contracts expire in 2014.

Other long term debt

The balance as at December 31, 2003 includes €1,584, which represents the residual payment due in 2005 relating to Sàfilo's acquisition of all the assets of a Colorado-based American company SRLS LCC (Outlook Eyewear). The purpose of acquiring such assets was principally for using and distributing the Liz Claiborne brand as well as other brands, and for establishing a second distribution center in North America.

14. Trade payables

The following table illustrates in detail the total of trade payables divided according to supply types:

	December 31,	
	2003	2002
Purchase of materials	27,674	36,316
Purchase of products and subcontract costs	37,708	35,479
Commission and royalties	33,389	22,605
Advertising and sponsorship costs	14,288	11,005
Services received from third parties	16,291	20,239
Purchase of fixed assets	6,435	17,750
Amounts owed to related companies	5,809	8,423
	<u>141,594</u>	<u>151,817</u>

15. Income taxes

Income tax

Income taxes totalled €8,540 in 2003 (€35,598 in 2002), and take into account available exemptions, benefits and tax credits, available to the parent company and the US subsidiaries.

Income taxes include deferred tax assets (net of deferred tax liabilities) that have been calculated on provisions, tax loss carry-forwards, and other temporary differences whose tax benefits are deferred over time. These deferred taxes have been recognised because it is reasonably certain that they will be recovered in future years.

The components of income tax expense (benefit) reflected in the statements of operations are as follows:

	December 31,		
	2003	2002	2001
Income tax expense/(benefit):			
Italian	5,503	4,273	12,017
Foreign.....	20,446	31,772	26,769
Total current.....	25,949	36,045	38,786
Deferred tax charge/(credit):			
Italian	(11,590)	(46)	(2,098)
Foreign.....	(5,819)	(401)	(276)
Total deferred.....	(17,409)	(447)	(2,374)
	8,540	35,598	36,412

Tax loss carryforwards in Italy:

<u>Expiring</u>	<u>Amount</u>
2004.....	—
2005.....	—
2006.....	785
2007.....	1,529
2008 and beyond.....	39,446
	41,760

The tax for the year ended 31 December 2003 is higher than the standard rate of corporation tax in Italy (38.25%). The differences are explained below:

	December 31, 2003 (millions of Euro)
Corporation Tax at 38.25%	0.4
Amortization of goodwill not deductible for tax purpose.....	7.5
Foreign tax	0.4
Other.....	0.2
Consolidated income tax.....	8.5

Each entity of the Group is subject to taxation in its country of incorporation. The entities incorporated in Italy are subject to income taxes in Italy (IRPEG tax) which had a statutory tax rate of 34% for the years ended 31 December 2003 and 36% for the year ended December 31, 2002 and 2001. The statutory tax rate in Italy (IRPEG tax) was lowered to 33% and was enacted during 2003. This new tax rate of 33% is effective from January 1, 2004. Italian entities are also subject to a 4.25% local income tax (IRAP tax). Net operating loss carryforward amounts for Italian entities may be utilised only to offset taxable income for IRPEG tax.

In the context of tax legislation and the Group's current structure, tax losses and current tax assets of different Group companies may not be off-set against current tax liabilities and tax benefit of other Group companies. Accordingly, taxes may accrue even where there is a net consolidated tax loss.

For entities incorporated in Italy, periods remain open to review by the Italian tax and customs authorities with respect to tax liabilities for five years.

Income tax payable

Outstanding payables to the tax authorities are €16,259 as at December 31, 2003 and €18,829 as at December 31, 2002, and relate to the liabilities for current income taxes of Group companies.

16. Other current payables and accrued expenses

	December 31,	
	2003	2002
Payroll	22,821	17,004
Social security	7,282	7,073
Accruals for bonuses to salespersons.....	16,450	17,309
Payable to salespersons.....	2,481	1,315
Accrual for advertising and sponsorship expenses.....	4,137	6,607
Accrual for loan interest expense.....	4,092	2,692
Accruals for insurance, leasing and other charges	4,966	4,492
Payable to minority shareholders	3,169	2,732
Other payable	5,272	14,619
	<u>70,470</u>	<u>73,843</u>

Amounts due to social security, €7,282 as at December 31, 2003 and €7,073 as at December 31, 2002, mainly relate to contributions payable one month in arrears by Group companies in relation to employees' wages and salaries.

Payable to minority shareholders includes dividends approved in previous year shareholders' meetings and therefore accrued.

17. Current provisions

	Movements in the year				Balance as at December 31, 2002
	Balance as at January 1, 2002	Accruals	Utilisation	Translation difference	
Foreign exchange risks.....	2,979	—	(2,979)	—	—
Other.....	706	74	(632)	(9)	139
Total	3,685	74	(3,611)	(9)	139

	Movements in the year				Balance as at December 31, 2003
	Balance as at January 1, 2003	Accruals	Utilisation	Translation difference	
Other.....	139	5,791	(323)	—	5,607
Total	139	5,791	(323)	—	5,607

The provision for other risks and charges as at January 1, 2002 amounted to €706 and also includes:

- €03 for a risk with a specific client;
- €124 for a provision relating to a reorganisation restructuring in the subsidiary in Slovenia.

As at December 31, 2003 the provision for other risks amounted to €5,607, of which €5,529 relates to the accrual for involuntary employee termination costs by the Austrian subsidiary Carrera Optyl Brillen GmbH following the closure, in 2004, of the plant in Traun.

18. Termination Indemnity Liability (TFR)

	December 31,	
	2003	2002
At January 1,.....	26,546	23,636
Provision for the year.....	6,078	6,064
Utilised.....	(3,840)	(3,154)
Balance at December 31,.....	28,784	26,546

19. Long-term provisions

	Movements in the year				Balance as at December 31, 2002
	Balance as at January 1, 2002	Accruals	Utilisation	Translation difference	
Employee benefits	1,311	1,889	(1,572)	(241)	1,387
Product warranty	2,224	556	(368)	(123)	2,289
Provision for deferred foreign currency gains on long term borrowings	—	5,478	—	—	5,478
Agents indemnity	2,073	207	(11)	—	2,269
Total	5,608	8,130	(1,951)	(364)	11,423

	Movements in the year				Balance as at December 31, 2003
	Balance as at January 1, 2003	Accruals	Utilisation	Translation difference	
Employee benefits	1,387	1,625	(1,717)	(225)	1,070
Product warranty	2,289	884	(332)	(88)	2,753
Provision for deferred foreign currency gains on long term borrowings	5,478	21,208	—	—	26,686
Agents indemnity	2,269	205	(2)	—	2,472
Total	11,423	23,922	(2,051)	(313)	32,981

The pensions fund ("Employee benefits") represents the liability of certain Group companies under supplementary labour agreements to pay additional retirement benefits to their employees. The product warranty reserve has been provided to cover the estimated cost of replacing defective products.

The Agents indemnity provision represents the costs that would be incurred if agreements with agents were terminated by the Group. The provision for Agents indemnity is estimated based upon Italian and European law and historical trends.

Provision for deferred gains on foreign currency exchange rates represents the translation gain on loans in US dollars other than those that are current. Such translation gains will be recorded as profit if and when realised.

20. Shareholders' equity attributable to the Group

Share capital

Sàfilo's capital stock as of December 31, 2003 consisted of 34,350,000 ordinary shares (33,350,000 shares at December 31, 2002), having a par value of €1.00 per share, with full voting rights. At December 31, 2003, Sàfilo Holding owned 31,174,000 ordinary shares or 100% of Sàfilo's issued and outstanding ordinary shares.

The shareholders' meeting on April 30, 2003 approved the company's share capital increase by means of the issuance of 1,000,000 shares (nominal value of a share = 1.00 Euro). The shares were subsequently issued at price of €30.00 per share and resulted in share premium of €29,000.

As at December 31, 2003 and 2002 the Sàfilo S.p.A. held 3,176,000 treasury shares amounting to €80,988.

21. Segment Information

The Group operated only one business segment during the three years ended 31 December 2003, being the production of prescription frames, sunglasses and sport goggles. The following is a geographical analysis based on the countries in which the Group's customers are located:

	Year ended December 31, 2003	Year ended December 31, 2002	Year ended December 31, 2001
Net sales by geographic area:			
Italy	140,431	145,691	159,429
Europe (excluding Italy)	310,385	267,055	209,401
North America	323,223	353,469	345,419
Far East	45,786	51,981	49,365
Japan	24,001	24,046	24,237
Australia	11,027	11,123	10,613
Other countries	45,277	40,687	46,488
	900,130	894,052	844,952

22. Cost of sales

	Year ended December 31, 2003	Year ended December 31, 2002	Year ended December 31, 2001
Materials, finished products and changes in inventories	214,991	172,632	179,254
Salaries and related contributions	88,412	90,738	85,218
Subcontracting costs	40,922	46,973	46,613
Industrial depreciation	20,925	24,607	25,206
Other costs	9,993	12,997	15,911
	375,243	347,947	352,202

Materials, finished products and changes in inventories

This item includes purchases of raw material, consumables, finished products and obsolescence provisions:

- Inventory variation of finished products amounted to €7,505 in 2003, €4,769 in 2002 and €17,019 in 2001;
- Inventory variation of work-in-progress amounted to €1,316 in 2003, €4,281 in 2001 and €3,100 in 2001;
- Inventory variation of raw materials amounted to €3,309 in 2003, €1,079 in 2002 and €7,072 in 2001;
- Purchase costs amounted to €204,158 in 2003, €14,762 in 2002 and €202,493 in 2001.

Changes in inventories, representing a decrease in inventories in comparison to the same period in prior years, was achieved due to Sàfilo's focus on limiting the quantity of finished products held as stock in warehouses.

Sàfilo continuously monitors market demand for our products and attempts to adjust production and inventories to reflect prevailing market conditions.

Salaries and related contributions

This item includes:

- Wages, salaries, social security, termination indemnities, pension costs and other costs relating to staff involved in production activities and amounted to €78,837 in 2003, €82,312 in 2002 and €85,218 in 2001;

Salaries and related contributions have been reduced by the capitalisation of labour costs on internally constructed machinery and equipments and amounted to €9,098 in 2003, €8,406 in 2002 and €6,180 in 2001.

Subcontracting costs

This item includes the cost of third party outsourcing of manufactured semifinished products, whereby raw materials are provided by the Group. The costs of subcontractors has been heavily reduced in 2003 as compared to 2002 in order to increase utilisation of in-house resources.

Industrial depreciation

	Year ended December 31, 2003	Year ended December 31, 2002	Year ended December 31, 2001
Buildings.....	2,556	2,213	2,777
Plant and machinery	7,957	16,193	14,826
Equipment.....	9,251	5,092	6,460
Other assets.....	1,161	1,109	1,143
	20,925	24,607	25,206

Other costs

This item includes industrial services, maintenance costs, rental costs related to production, and energy costs. Other costs also include (gains)/losses on currency swaps totalling €(8,309) in 2003, €(3,105) in 2002 and €1,356 in 2001.

23. Selling and marketing expenses

	Year ended December 31, 2003	Year ended December 31, 2002	Year ended December 31, 2001
Staff costs.....	36,461	31,535	30,125
Services from independent salespersons	73,980	76,993	79,685
Royalties	74,374	70,887	69,154

Advertising and promotion.....	80,699	73,309	67,430
Other selling expenses	35,158	31,144	26,059
	300,672	283,868	272,453

Staff costs

This item includes wages, salaries, social security, termination indemnities, pension and other costs of staff involved in commercial departments.

Services from independent salespersons

This item includes:

- Wages, salaries, social security, termination indemnities, pension and other costs of agents employed by the Group and amounted to €3,860 in 2003, €4,041 in 2002 and €5,224 in 2001;
- Commissions to independent salespersons amounted to €69,916 in 2003, €72,745 in 2002 and €73,856 in 2001;
- Provisions in relation to the independent agents' termination indemnity reserve amounted to €205 in 2003, €207 in 2002 and €605 in 2001. This provision represents the Group's estimate of the costs that would be incurred if Sàfilo terminated its contracts with agents.

Royalties

Royalties include fees paid for the utilisation of trademarks or brands, usually charged based upon quantities sold. Royalties in 2003 represent 8.3% of net sales compared with 7.9% in 2002 and 8.2% in 2001.

Advertising and promotion

Advertising and promotion includes fees paid to media, advertising agencies and contribution to licensor for advertising campaigns under royalties contracts.

Increases in 2003 is due to higher investment in advertising during the year associated with launching new brands (i.e. *Giorgio Armani*, *Emporio Armani*).

Other selling expenses

	Year ended December 31, 2003	Year ended December 31, 2002	Year ended December 31, 2001
Transport, logistics and other sales costs.....	33,124	28,246	22,677
Bad debt provision.....	1,308	2,639	2,944
Warranty provision.....	726	259	438
	35,158	31,144	26,059

24. General and administrative expenses

	Year ended December 31, 2003	Year ended December 31, 2002	Year ended December 31, 2001
Staff costs	75,716	65,697	54,122
Other staff related costs	6,268	5,813	3,505
Depreciation and amortization	10,907	8,095	5,454
Other general and administrative expenses	29,605	38,182	31,042
Annual fees for outsourcing information system	1,498	1,255	1,129
Other provision	420	74	1,451
	124,414	119,116	96,703

Other general and administrative expenses include fees for services related to administrative, legal and tax consulting.

Depreciation and amortization

	Year ended December 31, 2003	Year ended December 31, 2002	Year ended December 31, 2001
Amortization start up and development	69	31	230
Amortization marketing research costs	85	124	294
Amortization intellectual properties	4,033	1,421	1,429
Amortization of other capitalised costs	1,231	1,418	1,080
Depreciation of other costs	5,489	5,101	2,421
	10,907	8,095	5,454

25. Other income/(expenses), net

	Year ended December 31, 2003	Year ended December 31, 2002	Year ended December 31, 2001
Losses on disposal of assets	(176)	(220)	(170)
Other operating charges	(444)	(1,251)	(789)
Gain on disposal of assets	109	120	192
Other operating income	1,463	2,246	1,529
Other taxes	(1,012)	(929)	(1,002)
	(60)	(34)	(240)

26. Interest income/(expense) and other financial charges

Net interest expense

	Year ended December 31, 2003	Year ended December 31, 2002	Year ended December 31, 2001
Interest expense.....	66,124	60,000	24,312
Less: interest income	(8,443)	(847)	(624)
Bank charges	3,855	2,085	2,362
Debt issuance costs	6,555	9,620	8,225
	68,091	70,858	34,275

Interest expense for 2003 includes:

- Interest totalling €1,475 on senior loans and other debts, including interest in the amount of €3,371 on the notes issued by the SPV that purchases Sàfilo's trade receivables;
- Discounts granted to customers for early payments totalling €4,335;
- other financial costs totalling €14.

Interest income during 2003 includes €6,751 of currency exchange rate gains and excludes any gains or losses on currency swaps, which effects are included in cost of sales.

Debt issuance costs mainly relate to legal and other fees, which were incurred upon the issuance of debt and are amortised over the repayment period of the related borrowings.

27. Extraordinary income/(expenses), net

	Year ended December 31, 2003	Year ended December 31, 2002	Year ended December 31, 2001
Impairment of tangible and intangible assets	(8,220)	—	—
Income for equity investment	490	—	—
Dividend on investments	217	1,306	1,427
Indemnities and reimbursement.....	198	390	371
Other extraordinary income/(expenses).....	194	(759)	(356)
	(7,121)	937	1,442

Impairment of tangible and intangible assets: this item refers to a write-down of the fixed assets of the subsidiary Carrera Optyl Brillen GmbH in connection with the Group's decision to close the Traun factory in 2004..

Income for equity investment: this item refers to the Group's equity percentage of the 2003 earnings of the equity investee Elegance International Holding Ltd.

Other extraordinary income/(expenses) in 2003 mainly include:

- *Other extraordinary expenses:* €5,529 relating to involuntary employee termination costs and €490 of inventory write-downs incurred by the company Carrera Optyl Brillen GmbH in connection with the closure of the production plant in Traun;
- *Other extraordinary income:* €7.339 is related to the change in accounting for an investment in the associated company Elegance International Holding Ltd to the equity method as at 31 December 2002 for the amount of the previous period.

Other extraordinary income/(expenses) in 2002 mainly include:

- *Other extraordinary expenses:* €1,570 representing expenses which are not tax deductible, mainly relating to prior year under accrual of costs;
- *Other extraordinary income:* €1,104 of tax credit on foreign dividends that Sàfilo S.p.A. is confident it can collect and €699 representing non taxable revenues.

Other extraordinary income/(expenses) in 2001 mainly include:

- *Other extraordinary expenses:* €2,097 representing an extraordinary provision for unexpected fluctuations in foreign currency exchange rates and €56 of cost incurred during the year as the result of a tax assessment at the Parent Company in 2000.
- *Other extraordinary income:* €2,066 relating to the release of a provision set aside in prior years against possible liabilities, but which was no longer required as the reasons for the provision no longer existed; €78 of deferred tax assets relating to carry-forward tax losses and the release of provisions pertaining relating to prior years in the financial statements of certain subsidiaries; €340 for the proceeds received from a settlement with a former minority partner of our Japanese subsidiary.

28. Income attributable to minority shareholders

Income attributable to minority shareholders include:

		Year ended December 31, 2003	Year ended December 31, 2002	Year ended December 31, 2001
	%			
Sàfilo Hellas	49.00%	2,034	1,663	931
Sàfilo Australia.....	49.00%	1,002	957	1,151
Sàfilo Hong Kong.....	49.00%	487	399	186
Lenti Srl.....	46.00%	14	179	214
Sàfilo Switzerland.....	23.00%	90	108	—
Sàfilo S.p.A.'s minority shareholders.....		—	—	1,115
Other.....		(38)	90	219
		3,589	3,396	3,816

Actual dividends paid to minority shareholders other than minority shareholders in the holding company were:

	Year ended December 31, 2003	Year ended December 31, 2002	Year ended December 31, 2001
Sàfilo Hellas	1,201	768	611
Sàfilo Australia	1,002	896	1,154
	2,203	1,664	1,765

29. Contingencies, commitments and operating risks

i. Minimum contractual obligations

Expenditures contracted for at the balance sheet date but not recognised in the financial statements are as follows:

	At December 31, 2003
Within one year.....	67,545
Between one and two years	39,607
In more than two years	99,512
	206,664

Minimum contractual obligations include minimum payments under royalty agreements and sponsorships contracts totalling €171,751 and non-cancellable operating leases totalling €34,913.

Unsecured and secured guarantees

	As at December 31, 2003
<i>Unsecured guarantees given to third parties.....</i>	3,202
<i>Secured guarantees given to third parties:</i>	
—Mortgage and lien on machinery, plant and other tangible assets of Group companies	132,812
—Lien on trade receivables of the holding company.....	147,341
—Lien on shares and quotas of certain subsidiaries	193,086
—Lien on shares of the Parent Company	80,988
—Lien on trade mark and patents of the Group.....	3,054
<i>Total secured guarantees</i>	557,281
	560,483

Commitments and lines of credit

As at December 31, 2003, the Group had open currency swaps contracts, having a nominal value of US dollars 42,000 (€33,254 at the year end exchange rate), which expire by December 31, 2004. These contracts hedge expected foreign currency revenue receipts, which are denominated US dollars and are due to certain overseas subsidiaries.

These currency swap contracts at 31 December 2003 have a positive fair value of €6,367.

As at December 31, 2003, the Group also has open interest rate swap contracts, in order to hedge interest rate risk related to medium term loans, having aggregate nominal values of €18,052 and US dollars 129,001.

These interest rate contracts at December 31, 2003 have a negative fair value of €1,776 and US dollars 862.

As at December 31, 2002, the Group was party to foreign currency forward sale and barrier option contracts, having aggregate nominal value of US dollars 74,000 (€76,285 at the year end exchange rate) which expire by April 30, 2004. Such foreign currency contracts at December 31, 2002 had a positive fair value of €7,131. These contracts hedge expected foreign currency revenue denominated in US dollars, which is due to certain overseas subsidiaries.

The Group had also open currency forward purchase contracts having a nominal value of US dollars 100,000 (€95,356 at the year-end exchange rate), which expired on April 30, 2003. Such foreign currency contracts at December 31, 2002 had a negative fair value of €2,680. These contracts hedge expected cash outflows relating to the interest due on the Company's senior loan..

Stock option plan

On February 25, 2003, a stock option plan has been implemented for selected Directors and senior managers. The total number of shares that can be issued upon exercise of these options is 992.128 of the equity shares of Safilo Holding S.p.A., and in certain circumstances, equity shares of Safilo S.p.A. Options granted under the Safilo Holding plan vest over a three-year period of time and are not exercisable until 2006.

The Group has a stock option plan at one of its subsidiaries, involving five employees. Under this plan, as at December 31, 2003 these employees have 210,138 options outstanding.

Credit line

Below is reported the undrawn line of credit available to the Group as of December 31, 2003:

- €32,208 from bank overdrafts;
- €48,455 from short-term loans;
- €35,000 from factoring;
- €65,210 from swap contracts;
- €60,000 from medium and long term loans.

ii. Environmental matters

The enforcement of environmental regulation in Italy and other countries where the Sàfilo Group operates production facilities is evolving, and the enforcement posture of government authorities is continually being reconsidered.

The Group periodically evaluates its obligations under environmental regulations. As obligations are determined to exist and to be estimable, they are recognised immediately. Management believes that there are no significant liabilities for environmental damage and accordingly has not provided for such obligations.

iii. Legal proceedings

Various claims and legal proceedings have been asserted or initiated against the Group, including some which could result in expenditures and some which are claims for monetary damages. There is a range of possible outcomes for all such legal matters in which the companies of the Group are involved. The Company does not believe any of the legal matters, if adversely decided, are reasonably likely to have a material adverse effect on the Group.

30. Principal subsidiaries

The Group's consolidated subsidiaries are:

<u>Entity—Location</u>	<u>Share capital</u>	<u>Ownership %</u>
<i> Holding Company</i>		
Sàfilo S.p.A.....	€ 34,350,000	
<i> Other Italian entities</i>		
Oxsol S.r.l.—Pieve di Cadore, Belluno	€ 45,000	100.00
Lenti S.r.l.—Bergamo	€ 500,000	54.00
Smith Sport Optics S.r.l.—Florence.....	€ 102,775	100.00
<i> Foreign entities</i>		
Sàfilo International B.V.—Rotterdam, The Netherlands	€ 24,165,700	100.00
Safint B.V.—Rotterdam, The Netherlands.....	€ 18,200	100.00
Sàfilo Capital International S.A.—Luxembourg	€ 31,000	100.00
Sàfilo Benelux S.A.—Zaventem, Belgium.....	€ 560,000	100.00
Sàfilo Espana S.A.—Madrid, Spain.....	€ 390,650	100.00
Sàfilo France S.a.r.l.—Paris, France	€ 960,000	100.00
Sàfilo GmbH—Cologne, Germany.....	€ 511,300	100.00
Sàfilo Nordic AB—Taby, Sweden	SEK 500,000	100.00
Sàfilo Far East Ltd.—Hong Kong	HKD 49,700,000	100.00
Safint Optical Investment—Hong Kong.....	HKD 10,000	51.00
Sàfilo Hong Kong Ltd.—Hong Kong.....	HKD 100,000	51.00
Sàfilo Singapore Pte. Ltd.—Singapore	S\$ 400,000	100.00
Sàfilo Optical Sdn. Bhd—Kuala Lumpur, Malaysia.....	MYR 100,000	100.00
Safilo Trading (Shenzhen) Co. Inc. — China	CNY 2,481,000	51.00
Sàfilo Hellas Ottica S.A.—Athens, Greece.....	€ 300,000	51.00
Sàfilo Nederland B.V. —Bilthoven, The Netherlands.....	€ 18,200	100.00
Sàfilo South Africa PTY Ltd.—Bryanston, South Africa.....	ZAR 3,383	100.00
Sàfilo Austria GmbH—Traun, Austria	€ 217,582	100.00
Carrera Optyl GmbH—Traun, Austria	€ 7,630,648	100.00
Carrera Optyl d.o.o.—Ormoz, Slovenia	SIT 135,101,000	100.00
Carrera Optyl Marketing GmbH—Traun, Austria	€ 181,683	100.00
Sàfilo Japan Co Ltd—Tokyo, Japan.....	YEN 100,000,000	100.00
Sàfilo do Brasil Ltda—San Paulo, Brasil	R\$ 8,077,500	100.00
Sàfilo Portugal Lda.—Lisbon, Portugal.....	€ 500,000	100.00
Sàfilo Switzerland A.G.—Liestal, Switzerland	SFR 1,000,000	77.00
Sàfilo India PTV Ltd—Mumbai, India.	INR 42,000,000	75.00

Safint Australia Pty Ltd—Sydney, Australia	AUD	3,000,000	100.00
Sàfilo Australia Partnership—Sydney, Australia	AUD	204,081	51.00
Safint Optical UK Ltd.—United Kingdom.....	GBP	21,139,001	100.00
Sàfilo UK Ltd.—North Workshire, United Kingdom.....	GBP	250	100.00
Sàfilo America Inc.—Delaware, USA	US\$	8,430	100.00
Sàfilo USA Inc.—New Jersey, USA.....	US\$	23,289	100.00
FTL Corp.—Delaware, USA	US\$	110	100.00
Sàfilo Realty Corp.—Delaware, USA	US\$	10,000	100.00
Smith Sport Optics Inc.—Idaho, USA.....	US\$	329,954	100.00
Solstice Marketing Corp.—New Jersey, USA.....	US\$	1,000	100.00
2844-2580 Quebec Inc.—Montreal, Canada	CAD	100,000	100.00
Sàfilo Canada Inc.—Montreal, Canada.....	CAD	2,470,425	100.00
Canam Sport Eyewear Inc.—Montreal, Canada.....	CAD	300,011	100.00

31. Subsequent events

We recently reached agreement with our senior bank lenders to amend certain of our financial covenants which could not be met under our recent operating results in order to provide greater operating flexibility under our senior credit facilities going forward. In connection with that agreement, certain shareholders of our parent company, Safilo Holding, are required to provide funding for Safilo Holding to contribute to us Euro 25 million of equity; and such shareholders will commit to provide contingent funding for Safilo Holding to contribute to us up to Euro 50 million of additional equity under certain circumstances. It is uncertain whether, or what portion, of such contingent commitment will be used by us in the future.