



SÀFILO GROUP

Annual Report Year 2004

April 29th, 2005

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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 (collectively, "Italian GAAP"). There are significant differences between Italian GAAP and International Financial Reporting Standards ("IFRS", or formerly "IAS") and between Italian GAAP 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

Throughout this Annual Report, when we use the terms the "Company", "Safilo", the "Group", "we", "us" and "our", unless otherwise indicated or the context otherwise requires, we are referring to Safilo Group S.p.A. and its consolidated subsidiaries.

EXCHANGE RATES

The following chart shows for the period from January 1, 2000, through March 17, 2005, 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 17, 2005, was US\$ 1.34 per euro.

	Low	High	Average⁽¹⁾	Period End
	<i>(dollars per euro)</i>			
Year				
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
2004.....	1.18	1.36	1.24	1.35
Month				
October 2004.....	1.23	1.28	1.25	1.27
November 2004	1.27	1.33	1.30	1.33
December 2004	1.32	1.36	1.34	1.35
January 2005	1.30	1.35	1.31	1.30
February 2005	1.28	1.33	1.30	1.33
March 2005	1.31	1.35	1.33	1.34

(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

Selected financial data

The following tables set forth selected consolidated financial data for the periods indicated. The selected historical consolidated financial data included below for and as of the years ended December 31, 2000, 2001, 2002, 2003 and 2004 have been derived from our audited Consolidated Financial statements included in Item 18 of this annual report.

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

You should read this selected historical consolidated financial data in conjunction with our audited consolidated financial statements, the related notes included elsewhere in this annual report and with "Operating and Financial Review and Prospects" in Item 5 of this annual report.

	Year ended December 31,				
	2000	2001	2002	2003	2004
Statement of Operations Data:					
Net sales.....	685.6	845.0	894.1	900.1	939.8
Cost of sales.....	(297.6)	(352.2)	(347.9)	(375.3)	(379.3)
Gross profit	388.0	492.8	546.2	524.8	560.5
Gross margin (1)	56.6%	58.3%	61.1%	58.3%	59.6%
Selling and marketing expenses.....	(220.4)	(272.5)	(283.9)	(300.7)	(310.4)
General and administrative expenses.....	(80.6)	(96.7)	(119.1)	(124.4)	(130.7)
Other income (expenses), net	(0.4)	(0.2)	--	--	(1.5)
Operating income	86.6	123.4	143.2	99.7	117.8
Operating margin (2).	12.6%	14.6%	16.0%	11.2%	12.5%
Interest income (expense) and other financial charges.....	(11.5)	(34.3)	(70.9)	(68.1)	(66.0)
Extraordinary income (expense), net	0.2	1.4	0.9	(7.1)	26.0
Amortization of goodwill (3).....	(3.7)	(43.0)	(23.9)	(23.3)	(23.5)
Income before taxation and minority interest.....	71.6	47.5	49.3	1.2	54.3
Income tax expenses.....	(21.9)	(36.4)	(35.6)	(8.5)	(31.3)
Net income/(loss) before minority interest	49.7	11.1	13.7	(7.3)	23.0
Income attributable to minority interest	(22.1)	(3.8)	(3.4)	(3.6)	(3.2)
Net income/(loss).....	27.6	7.3	10.3	(10.9)	19.8

	As of December 31,				
	2000	2001	2002	2003	2004
Cash Flow Data:					
Net cash provided by operating activities.....	52.4	49.3	112.6	23.9	44.3
Net cash used in investment activities	(48.0)	(575.1)	(216.7)	(80.4)	(31.2)
Net cash (used in)/provided by financing activities.....	(28.0)	523.8	197.0	22.2	2.8

	As of December 31,				
	2000	2001	2002	2003	2004
Balance Sheet Data:					
Cash and cash equivalent	14.8	30.9	51.4	38.7	33.8
Property, plant and equipment, net	134.0	151.5	176.9	184.1	184.1
Net working capital (4)	208.1	261.1	189.1	224.2	239.1
Total assets.....	577.5	1,053.9	1,224.5	1,236.5	1,232.3
Total debt (5)	158.8	704.2	851.3	835.8	791.5
Net debt (6)	144.0	673.3	799.8	797.1	757.7
Total shareholders' equity.....	221.9	129.2	90.7	98.6	138.6

	Year ended December 31,				
	2000	2001	2002	2003	2004
Other Data:					
Capital expenditure, net (7)	45.9	45.0	58.4	45.5	27.9
EBITDA (8).....	114.1	154.0	175.8	131.6	150.3

- (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 and cash equivalent) less total current liabilities (excluding short-term borrowing and current portion of long-term debt). 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 property, plant and equipment, net of disposals.
- (8) We define EBITDA as operating income before depreciation and amortization of intangible assets excluding goodwill and debt issuance costs amortization. EBITDA is not a measurement of performance under generally accepted 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) as a measure of our operating performance, (b) cash flows from operating, investing and financing activities (as determined in accordance with generally accepted accounting principles) as a measure of our ability to meet cash needs or (c) any other measures of performance under generally accepted accounting principles. We believe that EBITDA is a measure commonly reported and widely used by investors and other interested parties as a measure of a company's operating performance and debt servicing ability because it assists in comparing performance on a consistent basis without regard to depreciation and amortization, which can vary significantly depending upon accounting methods (particularly when acquisitions are involved) or non operating factors (such as historical cost). Accordingly, this information has been disclosed in this offering circular to permit a more complete and comprehensive analysis of our operating performance relative to other companies and of our debt servicing ability. Because all companies do not calculate EBITDA identically, our presentation of EBITDA may not be comparable to similarly titled measures of other companies.

The following is a reconciliation of operating income to EBITDA:

	Year ended December 31,				
	2000	2001	2002	2003	2004
Statement of Operations Data:					
Operating income.....	86.6	12.3.4	143.2	99.7	117.6
Depreciation	24.6	27.6	29.7	26.4	26.3
Amortization (*).....	2.9	3.0	2.9	5.5	6.2
EBITDA.....	114.1	154.0	175.8	131.6	150.3

(*)Represent the amortization of intangible assets excluding goodwill and debt issuance costs amortization which are not included in operating income.

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 2004, the majority of our total net sales was 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 future operating performance depends upon our ability to successfully introduce new products.

The mid- and premium-price categories of the prescription frame and sunglasses markets in which we compete are particularly vulnerable to changes in fashion trends and consumer preferences. Our historical success is attributable, in part, to our introduction of innovative eyewear products which are perceived to represent an improvement over products otherwise available in the market. Our future success will depend on our continued ability to develop and introduce such innovative products.

We may be unable to achieve and manage growth, which could harm our business.

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

Our business could be adversely affected by the availability of vision correction alternatives to prescription eyeglasses.

Our business could be negatively impacted by the availability and acceptance of vision correction alternatives to prescription eyeglasses, such as contact lenses and refractive optical surgery. According to industry estimates, over 30 million people wear contact lenses in the United States, and disposable contact lenses is the fastest growing segment of the lens subsector. In addition, the use of refractive optical surgery has grown substantially since it was approved by the U.S. Food and Drug Administration in 1995.

Increased use of vision correction alternatives could result in decreased use of our prescription eyewear products, which would have a material adverse impact on our business, results of operations, financial condition and prospects.

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 and Slovenia, 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 100% of the capital shares of our parent company, Safilo Holding. In addition, all 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, 2004, we had approximately €92 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

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 the administrative seat 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 and one in Ormoz (Slovenia). 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. 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 nascent 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), *Emporio Armani* (2003), *Boucheron* (2004), *Marc Jacobs* (2004) and *Alexander McQueen* (2004).

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 September 2003 a newly formed company, Safilo Trading (Shenzhen) Co.Ltd has been established in China. This company, 51% owned by the Group, has commenced its operations in January 2004 and is the distributor for the Safilo Group collection in the territory of People's Republic of China.

The Austrian facility located in Traun has terminated its activity at the end of June 2004 as a consequence of a Group production rationalisation program.

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 27 of our largest markets through subsidiaries.

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 above €100 in Europe and the United States. Sales of our prescription frames and sunglasses positioned in the premium market segments represented an estimated 50% of our total net sales of €39.8 million in 2004. In light of our recent acquired licence agreements we believe we could soon become 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 2004, we distributed 31.3 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 46% of our total net sales in 2004, sales of sunglasses accounted for 50%, 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>	2000	2001	2002	2003	2004
Prescription frames	347.3	396.7	425.2	443.5	431.5
Sunglasses	302.7	410.5	435.6	423.6	469.5
Sport goggles and other	35.6	37.8	33.3	33.0	38.8
Total	685.6	845.0	894.1	900.1	939.8

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 *Alexander McQueen*, *Bottega Veneta*, *Boucheron*, *Burberry*, *Diesel*, *Dor*, *Emporio Armani*, *Fossil*, *Giorgio Armani*, *Gucci*, *Kate Spade*, *Liz Claiborne*, *Max Mara*, *Marc Jacobs*, *Nine West*, *Oliver*, *Pierre Cardin*, *Polo Ralph Lauren*, *Saks Fifth Avenue*, *Stella McCartney*, *Valentino*, *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 4,600 models of prescription frames and sunglasses, and we introduce more than 2,800 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 successes in renewing existing licences and obtaining new ones.

In 2004, we operated six principal manufacturing plants, five of which located in northeast Italy 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, whose activity has been terminated in June 2004, was closed as a consequence of high production costs in Austria and in order to get a higher level of production flexibility in Italy integrating our existing production facilities in Italy. Our plants manufactured approximately 16.0 million eyewear units in 2004 compared to approximately 13.5 million units in 2003 and 13.9 million units in 2002 (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 18.2 million units of outsourced products of the 31.3 million total units distributed by us in 2004.

For the year ended December 31, 2004, we generated net sales of €39.8 million as compared to net sales of €00.1 million and €94.1 million in 2003 and 2002, respectively. For the year ended December 31, 2004, we generated EBITDA of €50.3 million as compared to €31.6 million and €175.8 million in 2003 and 2002, respectively.

Seasonality

Our revenues are partially influenced by seasonality, as we experience our highest level of demand during the first semester 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.

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 170 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.

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 38 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. During 2004 sunglasses sector achieved a significant result becoming the most important business segment for Safilo Group in terms of net sales and units sold. On a geographic basis, our net sales in the North America region (35% of total net sales in 2004) are less to our revenues in Italy and Europe (50% of total net sales in 2004). Within the United States, our largest single market, our sales are divided between prescription frames (52% of net sales in 2004) and sunglasses (40% of total net sales in 2004), 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 38 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 world-wide sales force of approximately 1,400 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 was led in 2004 by Vittorio Tabacchi, our Chairman, and by Giannino Lorenzon and Roberto Vedovotto, our Co-Chief Executive Officers. In January 2005 Roberto Vedovotto was named sole Chief Executive Officer with Giannino Lorenzon retaining his position of Vice Chairman. 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 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. 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 27 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 subsidiary 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 Safilo Group, and since then our design group has continuously grown reaching a present work force of more than 170 employees including 7 managers responsible for product development and 5 senior 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 42% of our prescription eyewear and sunglasses products at our six facilities in Europe. We outsource the production of the other 58% to third party manufacturers in Italy, Japan and Asia. More than a half 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.

As part of our ongoing close collaboration with the Gucci Group, we started the distribution of *Boucheron* starting from January 2004 and *Alexander McQueen* from April 2004.

In March 2004, as part of our collaboration with LVMH Group, we entered into a license agreement for the *Marc Jacobs* brand eyewear collection.

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 several brand building campaigns. 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, representing one of the most well-known sports brands in the world and is a market leader in Europe. Starting from 2004 *Carrera* is also sponsoring the motorcycle world championship team. 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 colours. *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 2004 and 2005.

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, *Alexander McQueen*, *Bottega Veneta*, *Boucheron*, *Burberry*, *Diesel*, *Dior*, *Emporio Armani*, *Fossil*, *Giorgio Armani*, *Gucci*, *Kate Spade*, *Liz Claiborne*, *Marc Jacobs*, *Max Mara*, *Nine West*, *Oliver*, *Pierre Cardin*, *Polo Ralph Lauren*, *Saks Fifth Avenue*, *Sella McCartney*, *Valentino*, and *Yves Saint Laurent*.

Alexander McQueen. The eyewear collections were first introduced in April 2004, both for men and women. They are characterized by the typical "McQueen-style": emotional power and raw energy as well as the romantic but determinedly contemporary nature of the clothes. It is typical of McQueen to use the juxtaposition between contrasting elements: the sunglasses collections follow this line thanks to modern design and with the use of innovative materials such as coloured plastics and shining metals. *Alexander McQueen* is positioned as one of the most creative high fashion niche-brands, developing collections in the high-end of the luxury market, offering a unique sartorial, theatrical and image-driven product. The brand is recognized as one of the most creative collections within the Gucci Group portfolio, offering an opportunity to leverage brand awareness and growth from this positioning.

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.

Boucheron. Under the brand Boucheron we produce high-end prescription frames and sunglasses sold worldwide. The frames take inspiration from the fabulous creations of the famous French jeweller and watchmaker founded in 1858. The collections are timeless pieces in precious materials, that target a mature and classic female of 40 and above (optical) and of 30 and above (sun).

Burberry. The collections are targeted to men and women aged 20 to 50 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. We are working closely with the licensor to successfully exploit the brand working on new icons. The brand is edgy high fashion with a clean, functional and modern yet traditional design.

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 have further developed 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 16 to 40. 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. 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. *Emporio Armani* collections are targeted to young people (focus target is between 16 and 34), who are students or young professional. It's a unisex collection, where formal and sportswear, sobriety and extravagance mix together, making it young, exciting and vibrant. Collections - with over 60 sunglasses models and 55 models in the optical segment, are distinguished by a wide range of shapes and colours.

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. The range was completed in June and updated in August and October, to make one of the most respected collections in the high-end eyewear market, worldwide distributed. *Giorgio Armani* eyewear means elegance, sobriety, uniqueness and essentiality in lines and shapes. Materials are of premium quality, like titanium, very light steel and exclusive acetates. *Giorgio Armani* products are targeted to men aged 35 to 55 and women aged 25 to 45.

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 new creative director Frida Giannini, under whose direction the brand is experiencing a renewed great success. 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.

Marc Jacobs. *Marc Jacobs* is the 21st Century's quintessential American Designer with Global Appeal. We introduced the first Collection in February 2005 consisting in sunglasses and prescription frames that are defined by clean, linear design and with sophisticated, unusual and original details. The Collection are sold worldwide (with particular strength in United States, Italy, France and UK) and are targeted to women and men aged 25 to 40.

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.

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*, *J. Lo*, *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 *Max Mara* target more mature customers.

Distribution and Customers

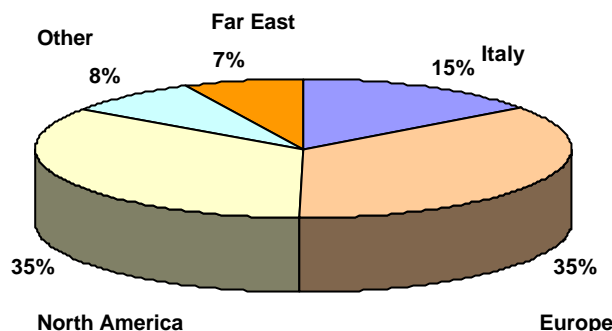
Our products are sold in 120 countries and are supplied to approximately 130,000 points of sale worldwide. We distribute our products directly in 27 of our largest geographic markets (92% of net sales in 2004) through company controlled distribution subsidiaries and a sales force of approximately 1,400 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 71% of our net sales in 2004.

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 2004 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 2004 net sales. Our net sales in Europe (including Italy) were €471.2 million in 2004, selling 11.1 million units, compared to €450.8 million in 2003, selling 11.0 million units, representing a 4.5% increase in net sales. Net sales of prescription frames accounted for 43%, net sales of sunglasses accounted for 55% and net sales of goggles and other accessories accounted for less than 2% of our total net sales in Europe in 2004.

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 2004. Our net sales for North America were €326.2 million in 2004 from sales of 16.6 million units compared to €323.2 million in 2003 from sales of 11.6 million units, which represents a 0.9% increase in net sales. Net sales of prescription frames accounted for 52%, net sales of sunglasses accounted for 40% and net sales of goggles and other accessories accounted for 8% of our total net sales in North America in 2004.

Solstice. At the end of December 2004, we had a total of 41 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 is raising 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, Singapore and China 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. We believe that the opening of our new subsidiary located in Shenzhen (China) will allow us to increase our market shares in the Far Eastern area, one of the most strategic areas for the future development of our business.

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 €7.6 million in 2004 and €80.7 million and €73.3 million in 2003 and 2002, 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 Slovenian subsidiary Carrera Optyl D.o.o. We manufacture our products through six owned facilities in Europe, five of which are located in Italy 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. During 2004 we have transferred the production from the Austrian facility to Italian factories. This decision is aimed to a reduction of high production costs, an improved flexibility and an 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 six 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, 2004.

<u>Plant Location</u>	<u>Production</u>	<u>Employees</u>
Martignacco (Italy).....	Components and Accessories	746
Longarone (Italy).....	Steel/Metal eyewear	1,077
Calalzo di Cadore (Italy).....	Metal and Plastic Frames Finishing	264
Santa Maria di Sala (Italy).....	Plastic eyewear	692
Precenicco (Italy).....	Metal and Plastic Frames Finishing Painting	269
Ormoz (Slovenia).....	<i>Optyl</i> Injection Frames and Ski Goggles	1,513

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 2004 two new roles dedicated to a specific project related to the guarantee of the quality of goods produced by external suppliers were introduced. In particular:

- a quality manager, with significant experience in Safilo S.p.A. moved to Hong Kong in order to coordinate the quality team in the Far Eastern area;
- a full time quality manager dedicated to the guaranteeing the quality and conformity to quality standards of goods produced by Italian external suppliers.

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 property, plant and equipment were €27.9 million for 2004, €45.5 million and €58.4 million for 2003 and 2002, respectively.

The majority of the Group's capital expenditures in 2004 were given to: (i) the completion of the headquarter expansion of the Distribution Centre in Padova; (ii) the modernization of existing production facilities for the purpose of increasing production capacity and improving product quality (iii) Investments in specific equipment for particular eyewear models that are frequently re-designed and internally produced.

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., 54% owned by Safilo Group.

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 product design and our approach to it 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 Safilo Group, and since then our design group has continuously grown reaching a present work force of more than 170 employees including 7 managers responsible for product development and 5 senior designers.

Our product development team serves both our own and licensed brands. Each of our managers responsible for product development is in charge of the creation of manual and technical designs and models for specific brands. The design team works closely with the brand managers and with each of our licensors in order to get a proper feedback related to market and fashion trends, in order to guarantee, when developing new models, consistency between design contents, product positioning and market targets to be achieved for the specific brands.

Each of our managers responsible for product development shares the themes and fashion concepts that reflect the attribute of the licensor's brand with our senior designers supported by junior designers. Licensors must always approve all designs and models sold under their brand.

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 2,800 new models of prescription frames and sunglasses and one new model of sport goggles. There are approximately 4,600 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.

Technical designers are responsible for fabricating the eyewear models. 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 six 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.

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.

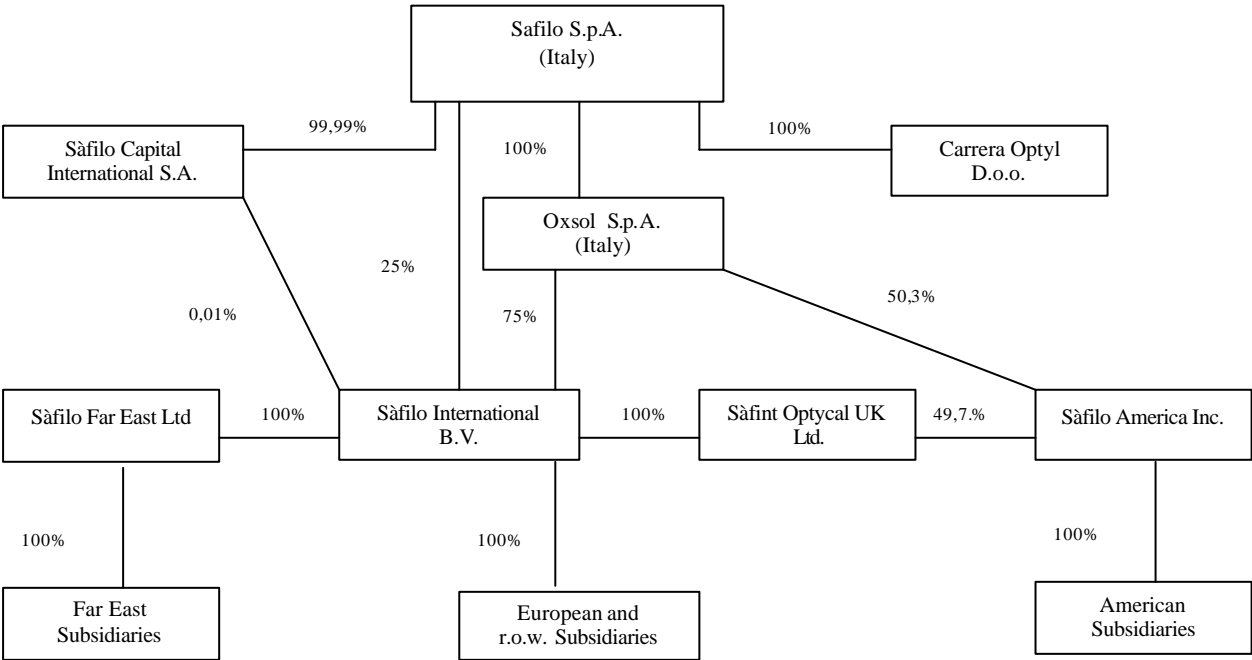
Regulatory matters

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.

Organisational structure

Safilo S.p.A. is an Italian operating company and virtually all of our operations are conducted through wholly owned subsidiaries. Our Group have three manufacturing subsidiaries, and our marketing and distribution subsidiaries distribute directly in 27 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, 2004.



Set forth below is certain information regarding our subsidiaries.

<u>Location—Entity</u>	<u>Ownership %</u>
<i>Italian entities</i>	
Oxsol S.p.a—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	70.00
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 Brillen Vertriebs GmbH—Traun, Austria	100.00
Carrera Optyl d.o.o.—Ormoz, Slovenia.....	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

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 as of December 31, 2004 is set forth 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	13,000
Longarone, Italy	Steel/Metal Eyewear Manufacturing Facility	32,000
Pieve di Cadore, Italy	Metal and Plastic Frames Finishing Facility	6,000
Santa Maria di Sala, Italy	Plastic Frames Manufacturing Facility	17,000
Preceniccio, Italy	Metal and Plastic Frames Painting Facility	5,000
	Plastic and Injection Frames and Ski Goggles	
Ormoz, Slovenia.....	Manufacturing Facility	16,000
Traun, Austria.....	Manufacturing Facility (not operative)	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.

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, 2004, 2003 and 2002 which were prepared in accordance with Italian Accounting Principles. These accounting principles differ in certain respects from U.S. GAAP and IFRS.

Overview

Safilo S.p.A. is the parent company of the Safilo Group, a leader in the design production and sale of high-quality eyewear products, including 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 46%, 50% and 4%, respectively, of our net sales in 2004. We also sell a limited line of complementary accessories, including ski helmets included in the sport goggles category.

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. 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.

Our net sales are splitted by product category and geographic region. Starting from 2004 the sunglasses business become the most important sector in terms of our total net sales and sales volume.

On a geographic basis, North American is one of our main market. Within Europe, besides our home market of Italy, we have significant sales in the key markets of France, Spain, Greece and the United Kingdom. Far East market is increasing with significant growth rates.

Foreign Exchange Effects

As 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 British pound and the Japanese yen. In 2004, 39% of our consolidated net sales were settled in U.S. dollars or related currencies, due to sales 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 2004.

In order to prepare our consolidated financial statements, we must translate 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 2002, 2003 and 2004.

Average Noon Buying Rates				
<i>(dollars per euro)</i>				
<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>% Change 2002-2003</u>	<u>% Change 2003-2004</u>
0.9454	1.1313	1.2439	19.7%	10.0%

We periodically enter into foreign currency contracts to hedge commitments, transactions or foreign income. See notes 3 and 28 to our consolidated financial statements.

Inflation

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

Critical Accounting Policies

Our discussion of the Group’s results of operations and liquidity and capital resources with reference to the fiscal year ended December 31, 2004, 2003 and 2002 are based upon the Company’s audited consolidated financial statements which have been prepared 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 (collectively, “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 are based on historical experience and assumptions determined to be reasonable and realistic based on currently available information. Actual results may differ significantly from such estimates given the uncertainty surrounding the assumptions and conditions upon which the estimates are based. 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. The following is a discussion of what management believes are our most critical accounting policies:

Revenue Recognition

We recognize revenue from sales of products at the time of shipment, when title and the risks and rewards of ownership of the goods have been assumed by the customers, or upon receipt by the customer, depending on the terms of the sales agreement. 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.

Allowance for Doubtful Accounts

We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and the customer's current creditworthiness. We continuously monitor our customer collections and payments and maintain a provision for estimated credit losses based on historical experience and specific issues related to any customer. Provision for estimated returns of products that can not be resold is included in the allowance for doubtful accounts. In the event we determined that a smaller or larger reserve was appropriate, we would record a credit or a charge to selling and marketing expenses in the period in which we made such a determination.

Inventories

Inventories are carried at the lower of purchase or production cost (on weighted average cost basis) and their market value. Purchase and production costs include additional charges such as transport costs and ancillary expenses. We also continually monitor 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 favourable than those projected by management, we would account for and additional provision in the period which we made such a determination.

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 required, an impairment loss is measured and consequently accounted for as the difference between the carrying value and the fair value of the assets. Considerable judgment is required to estimate the fair value of the impaired asset.

Deferred income taxes

The Company estimates its income taxes for each jurisdiction where it operates. This process involves the jurisdiction-by-jurisdiction estimation of actual current tax exposure and the assessment of the temporary differences resulting from the delta between the consolidated financial statements and the tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. 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 taxable income will be sufficient to realize deferred tax benefits. Considerable management judgment is required in determining the capability to fully recover deferred tax assets.

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 in the Notes to the consolidated financial statements. 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 un-realized 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.

Goodwill

We capitalize acquired goodwill and we amortize it over its useful economic life. There is a rebuttable presumption that the useful economic life of purchased goodwill is limited and does not exceed 20 years from the date of acquisition. Management is required to assess the useful economic life of goodwill within this period of time. This assessment involves management making judgments and assumptions over:

- the nature of the acquired business;
- the economic environment in which it operates; and
- the period of time over which the value of the business is expected to exceed the value of assets.

Different assumptions and judgments may lead to a different amortization charge being recognized in income during the period.

Provision for Risks and Charges

Provisions are made for risks, charges, litigations, product warranty and probable liabilities whose timing and extent cannot be determined at period-end or at the time the financial statements are prepared. The use of different estimates or assumptions by management could produce different provisions for risks and charges.

Operating results

Year Ended December 31, 2004, Compared to Year Ended December 31, 2003

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

	Year ended December 31,			
	2003		2004	
	€	% of Net sales	€	% of Net sales
	<i>(in millions, except percentages)</i>			
Consolidated Statement of Operations Data:				
Net sales	900.1	100.0%	939.8	100%
Cost of sales	(375.3)	41.7%	(379.3)	40.4%
Gross profit	524.8	58.3%	560.5	59.6%
Selling and marketing expenses	(300.7)	33.4%	(310.4)	33.0%
General and administrative expenses	(124.4)	13.8%	(130.7)	13.9%
Other income/(expense).....	—	—	(1.5)	0.2%
Operating income	99.7	11.2%	117.9	13.1%
Interest income/(expense) and other financial charges	(68.1)	7.6%	(66.0)	7.0%
Extraordinary income/(expense).....	(7.1)	0.8%	26.0	2.8%
Amortization of goodwill	(23.3)	2.6%	(23.5)	2.5%
Income before taxation and minority interest.....	1.2	0.1%	54.4	5.8%
Income tax expense	(8.5)	0.9%	(31.3)	3.3%
Net income/(loss) before minority interest.....	(7.3)	0.8%	23.1	2.5%
Income attributable to minority interest.....	(3.6)	0.4%	(3.2)	0.3%
Net income/(loss).....	(10.9)	1.2%	19.9	2.1%

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

Net Sales and Units Sold by Region 2004
(sales in €millions and units in thousands)

Region	Total		Prescription Frames			Sunglasses		Sport Goggles	
	Net Sales	Units	%	Net Sales	Units	Net Sales	Units	Net Sales	Units
			Net Sales						
North America	326.2	16,652	34.7%	169.9	4,904	130.6	9,643	25.4	2,105
Europe (excluding Italy).....	329.3	7,949	35.0%	148.6	3,581	170.9	3,743	9.9	624
Italy	141.9	3,173	15.1%	54.0	1,479	86.6	1,639	1.4	55
Far East.....	67.8	1,378	7.2%	36.1	699	30.4	609	1.3	70
Other ⁽¹⁾	74.6	2,201	7.9%	23.0	701	51.0	1,386	0.7	115
Total	939.8	31,353	100%	431.6	11,364	469.5	17,020	38.7	2,969

(1) Other includes net sales in Australia (€3.9million in 2004) and global duty free sales (€20.2 million in 2004).

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

Region	Total		Prescription Frames			Sunglasses		Sport Goggles	
	Net Sales	Units	%	Net Sales	Units	Net Sales	Units	Net Sales	Units
			Net Sales						
North America	323.2	11,627	35.9%	179.6	4,665	122.2	5,315	21.4	1,647
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 (€3.7 million in 2003) and global duty free sales (€16.6 million in 2003).

Net sales.

Net sales for the period ended December 31, 2004 grew by 4.4%, from €00.1 million in 2003 to €39.8 million in 2004. The overall sales results were negatively affected by the appreciation of Euro against other currencies, in fact, at constant exchange rates, the increase would have been approximately 8.5%. The strongest revenue growth has been seen in sunglasses and sport goggles business. On geographic basis, Far East and Europe achieved the best performances. In volume terms, the 2004 Group turnover increase was equal to 19.6% compared with the same period of the previous year. This growth was mainly due to sunglasses (+38.8%) and sport goggles (+24.2%) while prescription frames sales volume decrease by 2.6% as a consequence of the weakness in specific markets such as Italy and Europe. The positive sales trend has been driven by a combination of the successful introduction of the *Giorgio Armani* and *Emporio Armani* brands, the stronger performance of existing collections and the extremely positive results achieved in the Far East. The average revenue per frame decreased 12.4% from €34.20 in 2003 to €29.97 in 2004 as a consequence of the growth of the Outlook business, which operates in a market with high volumes and lower sales prices per unit.

Geographical analysis.

North America. 2004 sales in North America were substantially in line with the previous year as a consequence of the U.S. dollar decline versus the Euro. Despite the weakness of the U.S. dollar, sales in local currency in 2004 compared to 2003 increased by 10%, also due to the recovery of the American economy. In volume terms, there has been a 43% increase with the best results achieved by the sunglasses and sport goggles business (+81% and +28% respectively). The significant growth in volumes was mainly due to: (i) the stronger performance of Outlook business; (ii) the increase in the number of retail stores of the Solstice network (5 new openings during 2004 with a total of 41 stores as of December 2004); (iii) the successful of the new *Armani* brands combined with the positive results of *Burberry*, *Kate Spade*, *Liz Claiborn* and *Diesel*.

Italy. Despite the recession in the Italian economy, net sales during 2004 increased by 1.1% compared to prior year. Sales volume decreased by 2.2% during 2004 compared to 2003 due to a decrease of 10.8% in prescription frames partially offset by an increase in sunglasses of 5.9% and sport goggles of 25%. This increase in net sale is mainly due to the good performance of the luxury brands such as *Dior* and the new *Giorgio Armani* and *Emporio Armani* collections. In terms of units sold, the prescription frames business has been the most severely impacted by the weakness of the domestic market.

Europe (excluding Italy). In 2004 the European market has achieved a 6.1% increase in net sales and 2% sales volume compared to 2003. This growth is due to the positive results obtained in Spain, France, Portugal and Sweden and the increase in sales of luxury brands such as *Armani*, *Burberry*, *Dior* and *Max Mara*. The increase in sales volumes mainly relates to the sunglasses and sport goggles business whereas prescription frames have showed some weaknesses.

Far East. In 2004 net sales in the Far East shows a very positive growth trend returning to the levels of the previous years. Despite the negative exchange rate effects, net sales during 2004 increased by 30% compared to 2003. Sales volume during 2004 increased by 28.4% compared to 2003, basically due to the prescription frames business. This significant increase is due to the excellent performance of the following brands: *Giorgio Armani*, *Emporio Armani*, *Gucci*, *Dior*, and *Burberry*.

Cost of goods sold

Cost of goods sold increased by 1.4% from €375.3 in 2003 to €380.4 million in 2004. The gross profit increased by 6.8% from a gross margin of 58.3% in 2003 to a gross margin of 59.6% in 2004. This is mainly due to the cost cutting initiatives implemented at the cost of goods sold level and activities aimed to reduce production inefficiencies.

Selling and marketing expenses.

Selling and marketing expenses increased by 3.1% from €300.7 million in 2003 to €309.9 million in 2004. Commercial costs, being substantially variable costs, showed a slight decrease (from 33.4% in 2003 to 33.0% in 2004) when considered as a percentage of net sales.

The reduction as a percentage of net sales mainly relates to a lower impact of fixed costs and a significant saving in advertising and promotion expenses. The €0.1 million increase in absolute value is mainly due to: (i) an increase in royalty costs due to a shift in sales mix towards licensed brands and collections with a higher royalty incidence; (ii) a slight rise in other sales costs due to the *Armani* brands.

General and administrative expenses.

General and administrative expenses increased by 4.8% from €124.4 million in 2003 to €130.4 million in 2004. These expenses increased in absolute value by €7.5 million compared to the previous year as a result of higher costs associated with the consolidation of the Outlook business, the opening costs of Solstice stores opened during the second half of 2004 and personnel costs associated with an increased number of employees in specific and strategic areas, primarily at the Padova headquarters.

Interest income/(expense) and other financial charges.

Interest expense and other financial charges decreased 3.1% from €68.1 million in 2003 to €66.0 million in 2004. Interest expense net was positively impacted by a decrease in interest on senior loan and other debts partially offset by a reduction of gains on currency exchange rates (which effect excludes gains on currency swap contracts that are included in "Costs of sales").

Amortization of goodwill.

Goodwill amortization, made on a straight-line basis over the estimated useful life of this asset, is substantially in line with previous years.

Extraordinary income/(expense).

During the year ended December 31, 2004, extraordinary income was €26.0 million, as compared to the extraordinary expense of €7.1 million recorded in the year ended December 31, 2003. The extraordinary income recorded in 2004 was mainly due to the reversal of the provision for deferred currency translation gain in accordance with the new accounting pronouncement effective on January 1, 2004 (see notes 3 and 18 to the consolidated financial statements). The extraordinary expense recorded in 2003 was mainly due to the impairment charges and restructuring expenses relating to the closure of the production plant in Austria, partially offset with the change in accounting method on equity investments.

Tax expense.

During the year ended December 31, 2004, income tax expense were €31.3 million, an increase of €2.7 million, as compared to the year ended December 31, 2003. Our effective tax rate on income before taxation and amortization of goodwill increased to 40.2% in 2004 from 34.8% in 2003. This increase is mainly due to permanent differences between our income for financial reporting and tax purposes.

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.

Europe (excluding Italy). 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 units 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).

During the year ended December 31, 2003, extraordinary expense was €7.1 million, as compared to the extraordinary income of €0.9 million recorded in the year ended December 31, 2002. The extraordinary expense recorded in 2003 was mainly due to the impairment charges and restructuring expenses relating to the closure of the production plant in Austria, partially offset with the change in accounting method on equity investments for the Group's associate company Elegance International Holding Ltd. The extraordinary income recorded in 2002 was mainly due to the dividend received from investments recorded at cost.

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).

Liquidity and Capital Resources

Historical Cash Flow

The following table summarizes our cash flow activity during the years ended December 31, 2002, 2003 and 2004.

	Year ended December 31,		
	2002	2003	2004
	<i>(€ in millions)</i>		
Net cash flows:			
Provided by operating activities.....	€12.6	€3.9	€4.3
Used in investment activities.....	(216.7)	(80.4)	(31.2)
(Used in)/provided by financing activities:.....	197.0	22.2	2.8
Cash and cash equivalents, end of period.....	44.2	10.6	18.2

Cash Flow from Operating Activities.

The cash flow from operating activities increased by €20.4 million, from €3.9 million in 2003 to €4.3 million in 2004. This increase was mainly due to following reasons (i) a higher operating income during 2004 compared to 2003 due to the growth of the business (ii) increase in trade payables as a consequence of higher purchases of finished products from external suppliers; and partially offset by (iii) higher level of inventory stocks, particularly for finished products, due to the company's business strategy aimed to have a more timely reaction to customer needs, based on a significant reduction of delivery time.

Cash flow from operating activities decreased to €3.9 million in 2003 from €12.6 million in 2002. The factors which have had the greatest impact are the lower net income in 2003 respect to 2002 and various exceptional events which affected working capital in 2002. Cash flow from operating activities in 2003 was negatively affected by a €7.3 million increase in trade receivables and other current receivables, net of exchange rate effects due to increase of sales during the fourth 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 million 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 commission payables, 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, due to the Group's inventory control policy.

Cash Flow from Investment Activities.

Cash used in investment activities decreased in 2004 as compared to 2003 as a result of lower investments in property, plant and equipment and in intangible assets. In 2003 the higher acquisition of intangible assets relates to debt issuance costs of the Senior Notes and acquisition of intellectual property relating to the renewal or acquisition of license contracts. Additionally the higher levels of investments in property, plant and equipment in 2003 is due to the expansion works of the headquarters and distribution centre in Padua (finished in early 2004) and due to the investments in the production plant in Austria (closed in the first semester of 2004).

Cash used investment activities decreased in 2003 as compared to 2002 as a result of the purchase of the treasury shares and purchase of shares in public offer in 2002 and lower investments in property, plant and

equipment and in intangible assets. 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 €09.9 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 in fixed assets is derived mainly from a lower level of investment in the distribution facility in Padua, and in the production facilities.

In February 2001, we acquired 746,250 shares in Banca Popolare di Lodi for €10.2 million. These shares are quoted on the Italian Stock Exchange and have been booked to long-term financial assets. As of December 31, 2004, the market value of these shares was €6.1 million. The carrying value of these shares has not been written down to reflect the change in market value because accounting to Italian GAAP temporary impairments relating to long term investments can not be recorded.

Cash Flow from Financing Activities

Cash provided from financing activities decrease by €19.4 million from €2.2 million in 2003 to €2.8 million in 2004. Cash provided from financing activities during 2004 are mainly due to the issuance of share of €25.0 million partially off-set by the repayment of borrowings of €19.4 million due to better liquidity. The decrease in the cash provided from financing activities during 2004 as compared to 2003 is mainly due to higher repayments of borrowing.

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 €300.0 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.

Research and development, patents and licenses, etc.

Licenses and Other Intellectual Property

Trademarks, Tradenames and Patents

As of December 31, 2004, our principal owned trademarks or trade names included *Safilo*, *Carrera*, *Smith*, *Optyl*, *Blue Bay*, *Oxydo* 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, 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 covered by our license agreements.

Licensor	Licensed Marks
Autumnpaper Limited	Alexander McQueen
Bottega Veneta S.r.l. & Bottega Veneta B.V.	Bottega Veneta
Boucheron Holding.....	Boucheron
Burberry's Limited.....	Burberry
Christian Dior, Inc.; Christian Dior Couture S.A	Christian Dior
Diesel S.p.A.....	Diesel
Giorgio Armani S.p.A; GA International Diffusion B.V.	Giorgio Armani; Emporio Armani
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
Marc Jacobs International LLC.....	Marc Jacobs
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 €80.0 million in 2004, €74.4 million in 2003 and €70.9 million in 2002. 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.

Trend information

Financial year 2004 has been affected by the following events: (i) the full year sale of new important brands and the stronger performance of the existing ones; (ii) the sudden depreciation of the American currency; and (iii) general weakness in the Italian market. The combined effects of the above events has resulted in a growth in the Group's turnover, which at the end of 2004 reached €935 million, an increase of 4% compared to the previous year, at constant exchange rates, 2004 sales would have been higher by about 8.5% when compared with 2003.

In terms of regional performance, turnover has increased in all our strategic markets. A geographical analysis of sales shows recovery in 2004 in the Asian market, confirmation of recovery in the American market, and substantial stability in the European market with a persistent weakness in several important markets such as Italy.

Significant increases in net sales have been achieved in the Far East (+30.4%) and also in Europe, excluding Italy (+6.1%) where Switzerland, Portugal, France and Spain have shown the best performances. Net sales in the Italian market during 2004 increased by 1.1% , which represents a very important sign of recovery considering the weakness during the first part of 2004. Net sales in North America are substantially in line with the previous year mainly as a result of the U.S. dollar's decline in relation to the Euro.

During 2004, the sunglasses business segment has become the most important sector in terms of net sales and unit sold as a consequence of the strengthening of Outlook business in the American market and the significant impact deriving from the new licensed brands.

Our strategy for the future is to develop the opportunities offered in the retail market, which has high growth rates, and a medium-low price range. Our efforts will aim to increase own brand sales, which have high margins and a medium-low price range, and increase traditional luxury brand sales.

On the production side, the Company is gradually implementing and developing a new production strategy, based on an increased use of external suppliers rather than internal production, in order to reduce production costs and reach a greater flexibility to cope with oscillations in demand.

As part of the above project, during the first semester of 2004 the Austrian facility in Traun has been closed and its activities have been transferred to the Slovenian and Italian facilities.

At the end of 2004 the commercial structure of the European sports channel was reorganised in order to optimise resources dedicated to this sector. This reorganisation, that will lead to the integration in the headquarters in Padova of Smith's European branch, should allow business potential to develop by using the distribution system already used for optical retailers.

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 28(i) "Commitments and Lines of Credit" to the consolidated financial statements.

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, 2004:

<u>Contractual Obligations and Commercial Commitments</u>	<u>Payments Due by Period (€in thousands)</u>				
	<u>Total</u>	<u>Less than 1 year</u>	<u>1-3 years</u>	<u>3-5 years</u>	<u>More than 5 years</u>
Long Term Debt Obligations (including current portion)	763,652	25,650	84,961	78,884	574,156
Finance Lease obligations (including current portion).....	12,213	2,524	2,599	2,000	5,091
Operating Lease Obligations	37,493	6,323	10,571	8,016	12,583
Minimum Royalty Arrangements	152,362	59,725	50,036	30,675	11,926
Total	965,720	94,222	148,167	119,575	603,756

ITEM 6. Directors, Senior Management and Employees

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, 2004.

Name	Year of Birth
Vittorio Tabacchi.....	1939
Giannino Lorenzon.....	1939
Roberto Vedovotto.....	1965
Massimiliano Tabacchi.....	1970
Carlo Maria Calabria	1960
Colin Taylor.....	1962
Carlo Gilardi.....	1942
Thompson Dean.....	1958

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. He has been also Chairman of ANFAO (National Association of Eyewear Manufacturers) in Italy. In 2003 Mr. Tabacchi was awarded the title of "Cavaliere del Lavoro" and in 2004 he received an honorary degree in engineering from University of Padova.

Giannino Lorenzon has been our Co-Chief Executive Officer since 1986 until December 2004 and Vice Chairman since 2003, and he oversees, 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 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 Master 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).

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. In 2005 Mr. Calabria resigned as a member of the Board of Directors of Safilo spa

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.

Carlo Gilardi was CEO of Cofiri from 2001 to 2003. Prior to joining Cofiri he was CEO of Benetton Group for the period 1995-2001. Mr. Gilardi also matured significant experience in Banca di Roma as Joint General Manager and Chief Executive International. Further to the transformation of Banco di Roma into Banca di Roma in 1992, he was appointed General Manager of Finance. Mr. Gilardi began his career in Banca d'Italia where he held several positions before becoming Joint Chief Manager of Monetary and Financial Markets, and subsequently Chief Manager of Foreign Capital Markets. Among the several prestigious posts he held, he was Chairman of the AIOTE Association (Italian Bond Dealer Association) from 1989 to 1995. Carlo Gilardi graduated with honours in Statistics and Demographic Sciences at the University of Rome, La Sapienza, where he was Assistant Professor in Demography from 1966 to 1968.

Thompson Dean is Head of Leveraged Corporate Private Equity, Credit Suisse First Boston, Investment Committee Co-Chairman and Managing Partner of DLJ Merchant Banking Partners III. Mr. Dean joined DLJ's Merchant Banking Group in 1988 and became a Managing Partner of DLJ Merchant Banking Partners in 1995. In November 2000, The Credit Suisse Group acquired DLJ. Mr. Dean has been named the head of Leveraged Corporate Private Equity, responsible for CSFB's worldwide leverage buyout business. Prior to joining DLJ, he was a Vice President in the Special Finance Group (Leveraged Transactions) at Goldman, Sachs & Co. Mr. Dean received a B.A. from the University of Virginia in 1979, where he was an Echols Scholar, and an M.B.A. with high distinction from Harvard Business School in 1984, where he was a Baker Scholar. Mr. Dean serves as Chairman of the Board of Arcade Holding Corporation, DeCrane Aircraft Holdings, Inc. and Von Hoffmann Press, Inc., and as a director of Charles River Laboratories, Inc. (NYSE:CRL), and Mueller Holdings (N.A.), Inc. Mr. Dean previously served as Chairman of the Board of Fiberite Holdings, Inc., Katz Media Group, Inc. and IVAC Holdings, Inc., and as a director of several other companies. He also serves as a director of the Lenox Hill Neighborhood Association, and on various committees for The Society of Memorial Sloan Kettering, The Museum of the City of New York, The Boys Club of New York and The University of Virginia.

Board of Statutory Auditors and External Auditors

As a result of a change in the Italian corporate governance law which occurred during 2004, the Italian Civil Code prescribes that for limited liability companies, the below external bodies take responsibility, in terms of corporate governance.

Board of Statutory Auditors ("Collegio Sindacale"): the Board of Statutory Auditors is responsible for monitoring the management of Safilo and its compliance with laws, regulations and by-laws, assess and monitor the adequacy of the company's organization, internal controls, administrative and accounting systems and its disclosure procedures. The Board of Statutory Auditors is appointed by shareholders at a general meeting for a term of three years and members may be re-elected. The current members of the Board of Statutory Auditors of Safilo, Paolo Mazzi, Franco Corgnati and Lorenzo Lago (plus two alternative members to the Board of Statutory Auditors), will hold office until the annual general meeting of our shareholders called to approve Safilo's financial statements for the fiscal year ending December 31, 2006.

External Auditors: our annual financial statements have to be audited by external auditors appointed by the shareholders at a general meeting. Our Board of Statutory Auditors expresses an opinion on such an

appointment. The external auditors examine our annual financial statements and issue an opinion regarding whether our annual statutory and consolidated financial statements are presented fairly in all material respects. Their opinion is made available to our shareholders prior to the annual general shareholders' meeting. The general shareholder's meeting held on 29 April 2004 appointed PricewaterhouseCoopers S.p.A. as statutory auditor for the three-year period ending with the approval of the statutory financial statements as of December 31, 2006.

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, 2004.

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	Designer
Francesco Tagliapietra	1967	Director of Administration and Control
Massimo Zuccarelli	1967	Designer

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 Designer. 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.

Massimo Zuccarelli joined us in 2004 as Designer. Prior to joining Safilo he was the designer of accessories for Dolce&Gabbana. His professional background includes previous experiences in prescription frames and jewellery design.

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 2004 to the Company's Board of Directors included Chairman and Chief Executive Officers amounted to €4.2 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 2004 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 2004 to the senior executives amounted to €7.4 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.

With resolutions of the extraordinary shareholders' meetings on December 16, 2004, a new stock option plan was offered to selected Directors and senior managers. The total number of shares that can be issued upon exercise of these options is 1,004,079 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 subject to the fact that some conditions are realised, but are not exercisable until 2007. 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.

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 and Mr. Ascani were replaced by Mr. Carlo Gilardi and Mr. Thomson Dean.

At the end of the year 2004 Ms. Samantha Tabacchi resigned as member of the Board of Directors. The next Shareholder meeting, to be held according with Italian Law, will provide to replace her with a new Director.

Employees

As of December 31, 2004, we had 6,513 employees. Of our total employees, 637 are part-time employees. We occasionally hire seasonal employees.

The following table sets forth information about our number of employees as of December 31, 2003 and 2004, respectively.

	December 31,	
	2004	2003
Headquarter (Padua – Italy)	707	637
Factory personnel	4,561	4,954
Subsidiaries	1,024	973
Solstice	221	202
Total	6,513	6,766

We have approximately 1,400 sales agents world-wide.

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 labour strikes or disruptions.

Italian law provides that, upon termination of employment, employees are entitled to receive certain indemnity payments based on their length of employment. As of December 31, 2004, the Group had accrued €1.9 million in respect of such termination liabilities, such reserves being equal to the amount required by Italian law.

Share ownership

We have one shareholder, Safilo Holding S.p.A., which owns 90,9% of our ordinary 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

Major shareholders

Safilo's capital stock as of December 31, 2004 consisted of 35,000,000 ordinary shares with full voting rights, of which 31,824,000 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, 2004, Safilo Holding owned, 31,824,000 ordinary shares or 100% of Safilo's outstanding ordinary shares.

As of December 31, 2004 Safilo Holding was owned by a company controlled collectively by Vittorio Tabacchi's family and funds advised by CSFB Private Equity.

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.

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.

Safilo USA leases its headquarters and distribution center in the United States (New Jersey) from an associate, TBR Inc., which is controlled by Vittorio Tabacchi, our Chairman and a significant shareholder of Safilo Holding. In 2004, we paid rent to TBR Inc. amounting to €1.1 million. We believe that the terms of this lease agreement 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 2004, we purchased €1.7 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. During 2004 Mr. Vittorio Tabacchi, our Chairman, resigned as director of Elegance and on September, 24 2004 Mr. Massimiliano Tabacchi, our Chief Operating Officer, was appointed to substitute him; consequently Mr. Massimiliano Tabacchi 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.

ITEM 8. Financial Information

Consolidated Statements and Other Financial Information

See ITEM 18 “Financial Statements.”

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 August 22, 2005 and Trial set for January 17, 2006. 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.

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 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.

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

Offers and listing details

The Company has 9.625% senior notes due May 2013, issued through its subsidiary Safilo Capital International S.A.(the “Notes”), listed on the Luxembourg Stock Exchange. The table below sets forth the annual high and low closing sales prices of the Notes, as reported by Bloomberg L.P., for the two most recent full financial years since the Notes began trading on the Luxembourg Stock Exchange in May 2003:

	<u>High</u>	<u>Low</u>
<u>2003</u>	105.09%	86.04%
<u>2004</u>	102.37%	76.74%

The table below sets forth, by fiscal quarter, the high and low closing sales prices of the Notes, as reported by Bloomberg L.P., for the two most recent full financial years:

	<u>High</u>	<u>Low</u>
<u>2003</u>		
Third quarter	105.09%	91.21%
Fourth quarter	93.90%	86.04%
<u>2004</u>		
First quarter	87.58%	76.74%
Second quarter	94.32%	86.00%
Third quarter	96.83%	93.78%
Fourth quarter	102.38%	96.60%

The table below sets forth the high and low closing sale prices of the Notes, as reported by Bloomberg L.P., for the most recent six months:

	<u>High</u>	<u>Low</u>
<u>2004</u>		
October	98.20%	96.60%
November	98.20%	96.60%
December	102.38%	100.61%
<u>2005</u>		
January	102.78%	101.54%
February	106.36%	103.00%
March ⁽¹⁾	106.63%	105.75%

⁽¹⁾ As of March 16, 2005

Markets

We have no other class of securities listed or traded on any other stock exchange.

ITEM 10. Additional information

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.

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 euro 3,000,000.00 (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 35,000,000.00, divided into 35,000,000 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 and redeemable 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.

On December 16, 2004, the shareholders' meeting resolved to increase the share capital by EUR 714,285.00, through the issuing of 714,285 ordinary and redeemable shares, to be offered through subscription to the beneficiaries of the Stock Option Plan Safilo Holding and Safilo 2004-2008. 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.

The ordinary shares which are issued for the Safilo Holding Spa and Safilo Spa Stock Option Plan 2003 to 2007 and the Safilo Holding Spa and Safilo Spa Stock Option Plan 2004 to 2008 are redeemable shares, in accordance with and for the purposes of Article 2437 *sexies* of the Italian Civil Code and the redemption characteristics are specifically stated in the company's articles of association.

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 in case certain events occur.

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.

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, 2004 the total amount outstanding under the senior credit agreement was €50 of which:

- term loan facility A1, which consists of two tranches, one tranche in the amount of €4.2 million and another tranche in the amount of \$98.4 million;
- term loan facility A2 in the amount of \$45.9 million;
- term loan facility B in the amount of €35 million;
- term loan facility C in the amount of €35 million.;
- capex facility of €0 million; and
- revolving credit facility of €0 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 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.

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 instalments, beginning September 30, 2003, and continuing through December 31, 2009. Starting from 2004 each instalment expires on the 30th June and 31st December. 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 at December 31, 2004. 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.

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.

Factoring agreement

In 2004 Safilo S.p.A. entered into a factoring agreement with Centro Factoring S.p.A. We have sold some of our Italian trade receivables on a revolving basis and received at inception up to 85% of the amounts sold. The difference between cash received and trade receivables sold will be collected at its maturity date. We have a servicing obligation to act as a collection agent on behalf of Centro Factoring S.p.A.. At December 31, 2004 to cancel the factoring agreement the Company would have to pay to the Factor €26.5 millions.

Italian Exchange Controls

The following is a summary of relevant Italian laws in force as at the date of this annual report but does not purport to be a comprehensive description of all exchange control considerations that may be relevant.

There are no exchange controls in Italy. Residents and non-residents of Italy may effect any investments, disinvestments and other transactions that entail a transfer of assets to or from Italy, subject only to the reporting, record-keeping and disclosure requirements described below. In particular, residents of Italy may hold foreign currency and foreign securities of any kind, within and outside Italy, while non-residents may invest in Italian securities without restriction and may export from Italy cash, instruments of credit or payment and securities, whether in foreign currency or Euro, representing interest, dividends, other asset distributions and the proceeds of dispositions.

Updated reporting and record-keeping requirements are contained in recent Italian legislation which implements a European Union directive regarding the free movement of capital. Such legislation requires that transfers into or out of Italy of cash or securities in excess of Euro 12,500 be reported in writing to the *Ufficio Italiano Cambi* (the Italian Exchange Office) by residents or non-residents that effect such transfers directly, or by banks, securities dealers or "*Poste Italiane S.p.A.*" (Italian Mail) or other intermediaries that effect such transactions on their behalf. In addition, banks, securities dealers or "*Poste Italiane S.p.A.*" (Italian Mail) or other intermediaries effecting such transactions on behalf of residents or non-residents of Italy are required to maintain records of such transactions for five years, which may be inspected at any time by Italian tax and judicial authorities. Non-compliance with these reporting and record-keeping requirements may result in administrative fines or, in the case of false reporting and in certain cases of incomplete reporting, criminal penalties. The *Ufficio Italiano Cambi* will maintain reports for a period of ten years and may use them, directly or through other government offices, to police money laundering, tax evasion and any other crime or violation.

Individuals, non-profit entities and certain partnerships that are resident in Italy must disclose on their annual tax declarations all investments held outside Italy and financial assets held at the end of a taxable period,

as well as the total amount of transfers effected during a taxable period to, from, within and between countries other than Italy relating to such foreign investments or financial assets, even if at the end of the taxable period such persons no longer owned such foreign investments or financial assets. No such disclosure is required if the total value of the investments and assets at the end of a taxable period, or the total amount of the transfers effected during the year is not greater than Euro 12,500. Corporations and partnerships resident in Italy are exempt from such disclosure requirements with respect to their annual tax declarations because this information is required to be disclosed in their financial statements.

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

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, partnerships and other pass-through entities and persons who hold the notes through such partnerships or other pass-through entities, investors that hold the notes as part of a "hedging", "integrated", "conversion" or constructive sale transaction, as part of a "synthetic security" 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 annual report could apply on a retroactive basis and affect the tax consequences described herein.

You are a U.S. Holder if you are, for U.S. Federal income tax purposes:

- 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.

Holders of the notes should consult their own tax advisors concerning the U.S. Federal, state and local tax consequences of the purchase, ownership and disposition of the notes.

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.

Interest payments on a note received by a U.S. Holder will be treated as foreign source 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. The amount realized on the sale, exchange or retirement of a note for an amount of foreign currency will be the U.S. dollar value of that amount on (i) the date the payment is received in the case of a cash basis U.S. holder, (ii) the date of disposition in the case of an accrual basis U.S. holder, or (iii) in the case of a note traded on an established securities market (as defined in the applicable U.S. Treasury Regulations), that is sold by a cash basis U.S. holder (or an accrual basis U.S. holder that so elects), on the settlement date for the sale.

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 characterized 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 recognized only to the extent of the total gain or loss realized 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 a non-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 credited 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 €80,759.91, 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 July 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.

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.

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.

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 December 31, 2004 and 2003, and the related consolidated statements of operations, cash flows and changes in shareholders' equity for each of the three years in the period ended December 31, 2004. 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 2004 and 2003, and the consolidated results of their operations and their cash flows for each of the three years in the period ended 31 December 2004 in conformity with the Italian law governing consolidated financial statements and generally accepted accounting principles in Italy.

Without qualifying our opinion we draw your attention to the following matters:

1. As discussed in Note 3, the Company adopted the provisions of Legislative decree No. 6 of January 1, 2004, related to the conversion of receivable and payable denominated in foreign currency. The effect of such change is discussed on the mentioned Note 3.
2. The company is subject to certain restrictive debt covenants. Note 13 to the consolidated financial statements discloses the main covenants conditions as well as the impact of such covenants on the future operational and financial position of the Company.

Padua, April 14, 2005

PricewaterhouseCoopers S.p.A.

Antonio Taverna
(Partner)

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

	<u>Note</u>	<u>2004</u>	<u>2003</u>
ASSETS			
Current assets:			
Cash and cash equivalents	5	33,795	38,741
Trade receivables (net of provision for doubtful accounts).....	6	220,320	209,077
Inventory, net.....	7	196,254	166,580
Other current receivables.....	8	78,266	82,445
Total current assets		528,635	496,843
Non-current assets:			
Property, plant and equipment, net	9	184,108	184,096
Intangible assets	10	395,349	427,871
Investments in associates and long-term financial assets	11	105,448	107,593
Deferred income taxes	15	18,760	20,123
Total non-current assets		703,665	739,683
Total assets		1,232,300	1,236,526
LIABILITIES & SHAREHOLDERS' EQUITY			
Current liabilities:			
Short-term borrowings	12	15,644	28,118
Current portion of long-term debt	13	28,174	23,388
Trade payables	14	173,747	141,594
Income tax payables.....	15	19,180	16,259
Other current payables and accrued expenses	16	62,780	76,077
Total current liabilities		299,525	285,436
Non-current liabilities:			
Long-term borrowings.....	13	747,691	784,301
Termination Indemnity Liability (TFR)	17	31,870	28,784
Long-term provisions.....	18	6,982	32,981
Deferred tax liabilities		7,675	6,455
Total non-current liabilities		794,218	852,521
Total liabilities		1,093,743	1,137,957
Shareholders' equity attributable to minority shareholders		4,751	5,425
Shareholders' equity:			
Share capital.....	19	35,000	34,350
Other reserves and retained earnings.....		78,958	69,727
Income pertaining to the Group.....		19,848	(10,933)
Total shareholders' equity attributable to the Group		133,806	93,144
Total shareholders' equity		138,557	98,569
Total liabilities and shareholders' equity		1,232,300	1,236,526

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

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

	<u>Note</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
Net sales.....	20	939,764	900,130	894,052
Cost of sales	21	(379,275)	(375,243)	(347,947)
Gross profit		560,489	524,887	546,105
Selling and marketing expenses	22	(310,433)	(300,672)	(283,868)
General and administrative expenses.....	23	(130,741)	(124,414)	(119,116)
Other income/(expense).....	24	(1,507)	(60)	(34)
Operating income		117,808	99,741	143,087
Interest income/(expense) and other financial charges.....	25	(65,972)	(68,091)	(70,858)
Extraordinary income/(expense)	26	26,016	(7,121)	937
Amortization of goodwill	10	(23,509)	(23,333)	(23,850)
Income before taxation and minority interest		54,343	1,196	49,316
Income tax expenses.....	15	(31,310)	(8,540)	(35,598)
Net income/(loss) before minority interest		23,033	(7,344)	13,718
Income attributable to minority interest.....	27	(3,185)	(3,589)	(3,396)
Net income/(loss)		19,848	(10,933)	10,322

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

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

	<u>Note</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
Cash flows from operating activities				
Net income/(loss)		19,848	(10,933)	10,322
Adjustments to reconcile net income to net cash provided by operating activities:				
Amortization	10	34,485	35,307	36,413
Depreciation	9	26,265	26,415	29,708
Assets impairments	26	—	8,220	—
Change in accounting method for equity investments	26	—	(7,339)	—
Dividend received from equity investments		770	974	—
Share (income)/loss on equity investment		112	(497)	—
Loss/(gain) on disposal of property, plant and equipment		111	67	(100)
Changes in operating assets and liabilities:				
Trade receivables and other current receivables		(10,487)	(47,323)	1,867
Inventory		(36,791)	11,878	(41,531)
Trade payables and other current payables and accrued expenses		36,179	(1,199)	70,419
Termination Indemnity Liability (TFR)		3,099	2,238	2,910
Other		(29,318)	6,131	2,641
Net cash provided by operating activities		44,272	23,939	112,649
Cash flows from investing activities:				
Purchase of property, plant and equipment (net of disposals)		(27,864)	(45,507)	(58,350)
Acquisition of investments in associates		(80)	—	(630)
Purchase of treasury shares	11	—	—	(80,988)
Disposal of investments in associates		—	—	986
Purchase of shares in public offer		—	—	(28,948)
Acquisition of intangible assets		(3,241)	(34,921)	(48,815)
Net cash used in investing activities		(31,185)	(80,428)	(216,745)
Cash flows from financing activities:				
Proceeds from borrowings		—	300,000	848,278
Dividend paid by Sàfilo S.p.A.		—	—	(22,011)
Dividends paid by subsidiaries	27	(2,792)	(2,202)	(1,664)
Share issuance	19	25,000	30,000	—
Repayment of bond		—	—	(10,329)
Repayment of borrowings		(19,402)	(305,590)	(617,238)
Net cash provided from financing activities		2,806	22,208	197,036
Effect of exchange rate		(8,365)	683	(6,760)
Net increase in cash and cash equivalents		7,528	(33,598)	86,180
Cash and cash equivalents at the beginning of the period		10,623	44,221	(41,959)
Cash and cash equivalents at the end of the period		18,151	10,623	44,221

	<u>Note</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
Cash and cash equivalents at the end of the period include:				
Cash and cash equivalents	5	33,795	38,741	51,443
Bank overdraft.....	12	(12,144)	(152)	(686)
Short term loans.....	12	(3,500)	(27,966)	(6,536)
Cash and cash equivalents at the end of the period.....		<u>18,151</u>	<u>10,623</u>	<u>44,221</u>

Supplementary disclosure on cash payments:

Interest.....		60,143	63,999	68,165
Income taxes		<u>24,258</u>	<u>35,647</u>	<u>38,632</u>

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

SÀFILO GROUP
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
ATTRIBUTABLE TO THE GROUP
for the years ended December 31, 2004, 2003 and 2002
(in thousands of Euro, unless otherwise stated)

	Share capital	Other reserves and retained earnings	Net income/(loss) for the year	Group shareholder's equity	Minority Interest	Total shareholders' equity
Total shareholders' equity attributable to the Group at December 31, 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 differences	—	(23,147)	—	(23,147)	(7,133)	(30,280)
Total shareholders' equity attributable to the Group at December 31, 2002	33,350	40,980	10,322	84,652	6,002	90,654
Allocation of 2002 net income:						
—reserves	—	10,322	(10,322)	—	—	—
Issue of common shares.....	1,000	29,000	—	30,000	—	30,000
Net loss for the year.....	—	—	(10,933)	(10,933)	3,589	(7,344)
Foreign currency translation differences	—	(10,575)	—	(10,575)	(4,166)	(14,741)
Total shareholders' equity attributable to the Group at December 31, 2003	34,350	69,727	(10,933)	93,144	5,425	98,569
Allocation of 2003 net income:						
—reserves	—	(10,933)	10,933	—	—	—
Issue of common shares.....	650	24,350	—	25,000	—	25,000
Net income for the year.....	—	—	19,848	19,848	3,185	23,033
Foreign currency translation differences	—	(4,186)	—	(4,186)	(3,859)	(8,045)
Total shareholders' equity attributable to the Group at December 31, 2004	35,000	78,958	19,848	133,806	4,751	138,557

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

SÀFILO GROUP
NOTES TO THE FINANCIAL STATEMENTS
as of December 31, 2004, 2003 and 2002
(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 "Sàfilo Group" or the "Group") is the production of eyewear through the Group's manufacturing facilities, five of which based in Italy and one in Slovenia. For the country of incorporation of the subsidiaries refer to Note 30. At December 31, 2004 the Group employed 6,513 employees. The registered office of Sàfilo S.p.A. is in Belluno.

Changes in the scope of consolidation

In December 2004 Safilo International BV purchased an additional 19% interest in the share capital of Safilo Hellas S.A increasing its stake to 70%.

In December 2003, Safilo International BV purchased an additional 5% interest in the share capital of Carrera Optyl Brillen GMBH (sunglasses production company in Austria), becoming wholly owned subsidiary of the Group as of December 31, 2003.

The Group owns 51% in the share capital of Sàfilo Trading (Shenzhen) Co.Ltd formed in September 2003. The Chinese subsidiary has been consolidated since the fourth quarter in 2003. This subsidiary is the distributor for the Safilo Group collection in the territory of the People's Republic of China.

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 (collectively, "Italian GAAP"). The balance sheets and the statements of operations and related notes to the consolidated financial statements have been reformatted from the original Italian statutory financial statement presentation and include certain additional disclosures in order to conform more closely to the form and content of financial statements used in international offerings. The reclassification, however, does not affect the consolidated results of operations and 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 are not included in the scope of consolidation, unless, their exclusion does not result in a misrepresentation of the Company's financial condition and consolidated results. The investments in insignificant subsidiaries are stated at the cost of acquisition and may be written down to reflect any permanent loss in value.

The financial statements used for the consolidation are those approved, or prepared for approval, at the shareholders' meetings of the respective Group companies. They may be adjusted in accordance with the company's accounting principles, which must comply with Italian GAAP.

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

Use of estimates—In conformity with Italian GAAP, 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.

Reclassifications—Some account balances of 2003 Consolidated Financial Statements have been reclassified for a proper comparison with the 2004 structure of the Consolidated Financial Statements required by the new principle deriving from the Italian Civil Code (Legislative Decree No. 6 January 17, 2003) and the related changes in Italian GAAP (Principio Contabile OIC n.1).

3. Summary of significant accounting policies

Foreign currency translation

The financial statements of foreign subsidiaries are translated into Euro, which is the functional currency of the parent company and the reporting currency of the Company, using the year-end exchange rate for balance sheet items and the average exchange rate for the year for statements of operations items. The resulting cumulative translation adjustments have been recorded in a foreign currency translation reserve within 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 long-term financial liabilities are deferred and charged to profit when realized. On January 17, 2003 was issued a new principle deriving from the Italian Civil Code, Legislative Decree No. 6 with an effective date January 1, 2004. Among other things, this new pronouncement no longer permits to defer currency translation net gain until realized, instead requires that such net gain should be recorded in the statement of operations (see Note 18).

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.

Short-term investments are recorded at cost.

Trade receivables and credit risk

Trade receivables are stated at their estimated net realizable value. The allowance for doubtful accounts is estimated based on the aging of accounts receivables balances and historical write-off experience. Account receivables are write-off when they are considered finally uncollectible and collection efforts have ceased.

Trade receivables are potentially subject to credit risk. 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 trade receivables, 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.

Inventory

Inventories are stated at the lower between purchase or production cost (on weighted average cost basis) and their net realizable 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. Upon the sale or disposition of property and equipment, the cost of the assets and their accumulated depreciation are removed from the accounts and any resulting gain or loss is included in the statements of income.

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 capitalized 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.

Intangible assets

Intangible assets are stated at cost, including any directly-related charges, and are amortized 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 acquired subsidiary at the date of acquisition and amortized up to 20 years.

Capitalized costs relating to intellectual property mainly include trademarks, licenses and fees related to the renewal of certain license contracts. Intellectual property intangibles are amortized over a maximum of five years, or over the life of the license contract, whichever is shorter.

Start-up, research and developing costs benefiting future accounting periods are deferred and amortized over a period up to five years. Start-up, research and developing costs mainly include advisory and legal costs related to start-up operations and deferred expenses related to restructuring cost.

Other intangible assets mainly represent debt issuance costs relating to the issuance of the secured senior notes in 2003 that are amortized over the period of the related borrowings. Additionally includes leasehold improvements that are amortized over the lower of the remaining useful lives of the assets or the life of the contract.

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

—Start-up, research and development costs	up to 5 years
— Intellectual properties	5 years/life of contract
—Goodwill	up to 20 years
—Other intangible assets	3 years/life of contract

Impairment

The Group assesses annually whether there is any permanent impairment event 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.

Investments

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 considered insignificant in the context of the Group's financial statements are recorded at cost, determined on the basis of their purchase, subscription or appraised value. They are written down to reflect any permanent impairment in value.

Other investments are recorded at cost, adjusted for 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 recognized when the Group has a present legal or constructive obligation as a result of a past event, 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 in employee costs relating to health benefits. 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 a cost of employing production workers, 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, the company is registered to record an indemnity liability for severance of employment. This liability accrues during the employment relationship and payment of the employee severance benefit is due immediately upon termination of employment. The amount due is calculated in accordance with local civil and labor laws based on the employee's length of service, employment category and remuneration. The liability is adjusted annually accounting for a cost of living index, which is determined by the Italian Government. There is no vesting period or funding requirement associated with the liability. The liability recorded in the balance sheet represents the amount that the employee would be entitled to if the employment had been terminated 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 staff costs, salaries and related contributions costs in the statement of operations.

Income taxes

Current income taxes are accounted for by each entity 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 consequence of tax loss carry forwards and significant temporary differences between the carrying amounts and the tax basis 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

We recognize revenue from sales of products at the time of shipment, when title and the risks and rewards of ownership of the goods have been assumed by the customers, or upon receipt by the customer, depending on the terms of the sales agreement. 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.

Payment terms are generally determined based on the location and the relationship with the customer. The Group provides to its clients an additional discount for early payments. These discounts are recorded as interest expense in the statement of operation.

Shipping & Handling costs

Shipping & Handling costs are recorded on accrual basis in other selling expenses. Revenues arising from amounts billed to the customer for those costs are recorded as reduction of cost.

Marketing and promotions expenses

Marketing and promotion expenses, which include advertising, public relations and visual display expenses, are expensed as incurred.

Extraordinary items

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

Environmental and product liabilities

The Group recognizes losses and accrues liabilities relating to environmental matters and product liability cases, when it becomes probable or certain that a liability has been incurred and the amount can be reasonably estimated. 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 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.

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 amortized 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 recognized 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 financial statements. Foreign currency contracts acquired for the purpose of hedging commitments are disclosed in Note 28.

The Group periodically enters into interest rate swaps (IRS), to adjust the effective interest rates on certain indebtedness. IRS involves 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 amortized as adjustments to interest expense of the related debt over the remaining period covered by the terminated swap.

Stock Compensation

Stock options offered to directors and senior management for no consideration is 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.

In accordance with Italian Accounting Principles, compensation expenses relative to stock options offered to the Company's management at the grant date are not recognized in the financial statements. At the exercise date, the issue of the new shares or the allocation of treasury shares are recognized in the balance sheet accounts, with no effect on the statement of income.

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 has 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:

The outstanding balances as of December 31, 2004 and 2003 from transactions with related parties are as follows:

<u>Balance sheet</u>	<u>Relationship</u>	<u>2004</u>	<u>2003</u>
<u>Trade receivables:</u>			
—Optifashion As Istanbul.....	Unconsolidated subsidiary	—	161
— Safilens Srl	Investment recorded at cost	—	24
<u>Trade payables:</u>			
—Elegance International Holdings Ltd	Associate	10,715	5,809
<u>Other current receivables:</u>			
—Elegance International Holdings Ltd	Associate	525	304
<u>Other intangible assets:</u>			
—Credit Suisse First Boston	Indirect shareholder	1,645	1,841
<u>Long term financial assets</u>			
—Safilens Srl	Investment recorded at cost	—	150

ii. Transactions with related parties:

The main transactions with related parties included in the consolidated financial statements for the years ended December 31, 2004, 2003 and 2002 are the followings:

<u>Statement of Operations</u>	<u>Relationship</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
<u>Net sales:</u>				
—Optifashion As Istanbul.....	Unconsolidated subsidiary	268	240	171
—Elegance International Holdings Ltd.....	Associate	4	318	—
<u>Cost of sales:</u>				
—Elegance International Holdings Ltd.....	Associate	21,654	17,328	17,116
—Safilens Srl.....	Associate	387	—	—
<u>Rent:</u>				
—TBR Inc (USA).....	Investment recorded at cost	1,054	1,104	1,322
<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

5. Cash and cash equivalents

	December 31,	
	2004	2003
Currency		
US Dollar.....	10,063	15,994
Euro	12,779	14,107
Hong Kong Dollar.....	1,132	2,249
Canadian Dollar.....	781	1,546
Japanese Yen.....	4,077	631
Swedish Crone	1,248	823
Slovenian Taller.....	691	825
Australian Dollar.....	1,273	552
GB Pound Sterling.....	253	905
Swiss Franc.....	669	274
Other	829	835
	<u>33,795</u>	<u>38,741</u>

Cash and cash equivalents at December 31, 2004 and 2003 include €25 and €1,572, respectively, of restricted cash relating to the payment of the senior notes issuance costs.

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

	December 31,	
	2004	2003
Gross value.....	236,323	221,733
Provision for doubtful accounts	(16,003)	(12,656)
Net value.....	<u>220,320</u>	<u>209,077</u>

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

During 2003, Sáfico S.p.A. participated in a securitization program that each month a gross amount of trade receivables were sold without recourse to a special purpose vehicle ("SPV"). At December 31, 2003 the total amount of trade receivables sold to the SPV was €75,094. The difference between cash received and trade receivables sold to the SPV was included in other current receivables and will be collected at maturity (see Note 8).

The securitization program was concluded in January 2004 and partially replaced by a factoring agreement under which the Company continues to sell trade receivables and receives up to 85% of the amounts sold. The difference between cash received and trade receivables sold to the Factor is included in other current receivables and will be collected at maturity (see Note 8). At December 31, 2004 to cancel the factoring agreement the Company would have to pay to the Factor €26.5 millions and would received €8.1 of trade receivables

The provision for doubtful accounts also includes amounts that are expected to be returned. This provision for expected returns was €5.8 million and €4.1 million at December 31, 2004, 2003 and 2002 respectively.

7. Inventory, net

	December 31,	
	2004	2003
—Raw materials and supplies	34,941	35,385
—Work in progress	9,006	9,675
—Finished products.....	166,903	134,752
—Obsolescence provision	(14,596)	(13,232)
	<u>196,254</u>	<u>166,580</u>

The increase of the finished products inventory during the year period ended December 31, 2004 is mainly due to a new market strategy based on an increased level of inventory aimed at reducing delivery time to market and to customers' demand, increasing the company's competitiveness.

8. Other current receivables

	December 31,	
	2004	2003
Tax receivables	15,783	16,732
Deferred tax assets	18,378	15,514
Receivables due from Factor/SPV.....	31,604	37,533
Receivables from salespersons.....	4,045	4,148
Other receivables	3,133	4,378
Prepaid expenses	5,323	4,140
	<u>78,266</u>	<u>82,445</u>

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, 2003.....	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 net of transfers	9,899	28,474	10,211	(2,182)	46,402
Currency translation differences.....	(866)	(1,292)	(4,782)	(84)	(7,024)
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 January 1, 2003.....	(16,543)	(119,630)	(28,413)	—	(164,586)
Depreciation charge.....	(2,556)	(17,209)	(6,650)	—	(26,415)
Currency translation differences.....	90	672	2,637	—	3,399
Disposals.....	26	2,369	2,811	—	5,206
Balance at December 31, 2003	(18,983)	(133,798)	(29,615)	—	(182,396)
Cost					
Balance at December 31, 2003	89,769	195,263	52,761	16,897	354,690
Revaluations.....	1,567	10,228	7	—	11,802
<i>Sub total</i>	<i>91,336</i>	<i>205,491</i>	<i>52,768</i>	<i>16,897</i>	<i>366,492</i>
Additions net of transfers	7,158	20,771	4,958	(4,403)	28,484
Currency translation differences.....	(341)	(544)	(2,094)	(35)	(3,014)
Disposals.....	(712)	(10,412)	(4,578)	—	(15,702)
Balance at December 31, 2004	97,441	215,306	51,054	12,459	376,260
Accumulated Depreciation					
Balance at December 31, 2003	(18,983)	(133,798)	(29,615)	—	(182,396)
Depreciation charge.....	(2,562)	(17,568)	(6,135)	—	(26,265)
Currency translation differences.....	51	287	1,200	—	1,538
Disposals.....	1,438	9,504	4,029	—	14,971
Balance at December 31, 2004	(20,056)	(141,575)	(30,521)	—	(192,152)
Net Book Value					
Balance at December 31, 2003	72,353	71,693	23,153	16,897	184,096
Balance at December 31, 2004	77,385	73,731	20,533	12,459	184,108

As at December 31, 2004, property, plant and equipment in the amount of €125.8million were 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.

In 2003, the Group decided to closure the production plant of the Austrian subsidiary in Traun. As a result of the closure, the Group recorded an impairment charge of €8,179 to write-down the related fixed asset to its estimated fair values.

10. Intangible assets

	Goodwill	Intellectual property	Start up, research & development costs	Other intangible assets	Total
Cost					
Balance at January 1, 2003	468,266	17,036	6,606	62,521	554,429
Additions	2,982	21,607	218	10,530	35,337
Currency translation differences ..	(2,751)	(112)	(32)	(62)	(2,957)
Impairments	—	(41)	—	—	(41)
Disposals	—	(416)	—	—	(416)
Balance at December 31, 2003..	468,497	38,074	6,792	72,989	586,352
Amortization charge					
Balance at January 1, 2003	(80,338)	(11,831)	(6,100)	(24,905)	(123,174)
Amortization charge	(23,333)	(3,857)	(202)	(7,915)	(35,307)
Balance at December 31, 2003..	(103,671)	(15,688)	(6,302)	(32,820)	(158,481)
Cost					
Balance at December 31, 2003	468,497	38,074	6,792	72,989	586,352
Additions	—	595	1,567	1,546	3,708
Currency translation differences ..	(1,112)	(23)	(34)	(109)	(1,278)
Disposals	(273)	(4)	—	(190)	(467)
Balance at December 31, 2004..	467,112	38,642	8,325	74,236	588,315
Amortization charge					
Balance at December 31, 2003	(103,671)	(15,688)	(6,302)	(32,820)	(158,481)
Amortization charge	(23,509)	(3,906)	(415)	(6,655)	(34,485)
Balance at December 31, 2004..	(127,180)	(19,594)	(6,717)	(39,475)	(192,966)
Net Book Value					
Balance at December 31, 2003..	364,826	22,386	490	40,169	427,871
Balance at December 31, 2004..	339,932	19,048	1,608	34,761	395,349

Goodwill as at December 31, 2004 mainly reflects the following:

- Goodwill totaling €23,753 (€43,986 as at December 31, 2003), net of amortization, arose in connection with the repurchase of Sàfilo S.p.A shares from the public. Goodwill is being amortized on a straight-line basis over 20 years.
- The acquisition of Smith Sport Optics, with a net book value of €1,150 (€9,661 as at December 31, 2003). The original amount of goodwill is being amortized on a straight-line basis over 20 years.

At December 31, 2004 and 2003 the outstanding amount of debt issuance costs, included in other intangible assets, is €2,679 and €7,796, respectively.

11. Investments in associates and long term financial assets

	Interest in Share capital %	December 31,	
		2004	2003
Investment recorded at equity method:			
Elegance International Holdings Lts.....	23.05%	9,806	11,530
Investment recorded at cost:			
Banca Popolare di Lodi.....	0.65%	10,198	10,198
Optifashion As (Turkey).....	50.00%	353	353
TBR Inc. (USA).....	33.33%	436	471
Safilens Srl.....	17.50%	206	129
Other.....	—	94	92
		<u>21,093</u>	<u>22,773</u>
Long term financial assets			
Treasury shares		80,988	80,988
Grant receivables with Government.....		1,257	1,257
Guarantee deposit		1,297	1,580
Other.....		813	995
		<u>84,355</u>	<u>84,820</u>
		<u>105,448</u>	<u>107,593</u>
		December 31,	
		2004	2003
Investments in associates at January 1,.....		22,773	18,339
Income / (loss) for the year.....		(112)	497
Dividends received.....		(770)	(974)
Additions / (disposals).....		80	(1)
Translation differences		(878)	(2,427)
Other		—	7,339
Investments in associates at December 31,.....		<u>21,093</u>	<u>22,773</u>

In 2003, the Group started accounting its investment in Elegance International Holding LTD 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 during 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 accounting method is included above as "Other".

12. Short-term borrowings

	December 31,	
	2004	2003
Bank overdraft	12,144	152
Short term loans.....	3,500	27,966
	<u>15,644</u>	<u>28,118</u>

At December 31, 2004 unsecured bank overdraft are mainly denominated in Euros bearing a variable interest rate of EURIBOR + 0.4%.

The short-term loans represent an unsecured loan in Euro from "Cassa di Risparmio di Padova e Rovigo S.p.A.", bearing interest at 2.532%, repayable on January 4, 2005.

13. Long-term borrowings

	December 31,	
	2004	2003
Loans	460,662	490,873
Senior notes	300,000	300,000
Capital leases	12,213	12,319
Other long term debt.....	2,990	4,497
Less:		
Current portion of loans	(25,237)	(21,040)
Current portion of capital leases and other long term debt.....	(2,937)	(2,348)
	<u>747,691</u>	<u>784,301</u>

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

	2004	2003	2002
	Weighted average	Weighted average	Weighted average
	interest rate	interest rate	interest rate
Euro	7,81%	7.34%	5.79%
USD	4,64%	5.14%	3.59%
JPY	1,20%	0.92%	—

The maturity profile of the carrying amount of the Group's long-term debt as at December 31, 2004 was as follows:

	December 31, 2004
2006	39,710
2007	47,850
2008	53,170
2009	27,714
2010	271,886
2011 and beyond.....	307,361
	<u>747,691</u>

	December 31, 2004			
	Interest Rate	Maturity	Outstanding balance	Current portion
Long-term loans of Sàfilo:				
Secured loan in Euro:				
Term A1 Tranche 1	EURIBOR + 2.25%	12/31/2009	44,250	5,920
Term B	EURIBOR + 2.75%	12/31/2010	135,000	—
Term C	EURIBOR + 3.25%	12/31/2011	135,000	—
Secured loan in US\$:				
Term A1 Tranche 2 US\$ 134 million	LIBOR + 2.25%	12/31/2009	98,373	13,171
Long-term loans of Group subsidiaries:				
Secured loan in US\$:				
Term A2 US\$ 62.5 million	LIBOR + 2.25%	12/31/2009	45,891	6,146
Unsecured loan in YEN:				
YEN 300 million	1.29%	3/27/2006	2,148	—
Total long-term loans			<u>460,662</u>	<u>25,237</u>
Senior Notes	9.625%	5/15/2013	<u>300,000</u>	<u>—</u>

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

On May 15, 2003 the Company issued €300,000 of secured Senior Notes due on May 15, 2013. Senior Notes bear interest at 9.625%, payable on semi-annual-basis, 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 contractual agreements related to the loans issued by the pool of banks (composed of Credit Suisse First Boston, San Paolo IMI Spa and UniCredit Banca D'Impresa Spa) include a series of obligations connected to operating and financial aspects.

The senior credit facilities also require the Company to maintain specified ratios and satisfy specified financial tests. In the event of a violation of such covenants, the lenders could terminate their commitments and declare all amounts owed to them, to be due and payable.

As of December 31, 2004 the Company was in compliance with the covenants contained in the indenture agreement. The possibility is not remote that, on based forecasts approved by the board of directors in January 2005, in the current circumstances, that the covenants may not be met during 2005 or thereafter. In the event the covenants are not met (“Event of Default”) the Company will renegotiate with the lenders the conditions with which to continue the financing arrangement. The covenants were also not met based on the financial statement data as at 31 December 2003. In that occasion, a waiver was negotiated and obtained from the lenders that permitted the continuation of the financing agreement. The occurrence of an ‘Event of Default’ grants the lenders, following a notice, the ability to request immediate payment of the outstanding loans that at 31 December 2004 totaled approximately Euro 483 million. The Company, to be able to pay the amounts in question, would have to obtain appropriate financing since it does not have immediately available the necessary liquidity.

14. Trade payables

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

	December 31,	
	2004	2003
Purchase of materials	23,951	27,674
Purchase of products and subcontract costs	70,664	37,708
Commission and royalties	23,208	33,389
Advertising and sponsorship costs	14,707	14,288
Services received from third parties	17,715	16,291
Purchase of fixed assets	12,787	6,435
Related parties trade payable (see note 4)	10,715	5,809
	<u>173,747</u>	<u>141,594</u>

15. Income taxes

Income tax

Income tax expenses take into account available exemptions, benefits and tax credits, available to the parent company and its 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 recognized 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,		
	2004	2003	2002
Income tax expense:			
Italian	6,487	5,503	4,273
Foreign.....	24,645	20,446	31,772
Total current.....	<u>31,132</u>	<u>25,949</u>	<u>36,045</u>
Deferred tax charge/(credit):			
Italian	110	(11,590)	(46)
Foreign.....	68	(5,819)	(401)
Total deferred.....	<u>178</u>	<u>(17,409)</u>	<u>(447)</u>
	<u>31,310</u>	<u>8,540</u>	<u>35,598</u>

The tax loss carry forwards in Italy at December 31, 2004 expire as follows:

<u>Expiring</u>	<u>Amount</u>
2005	—
2006	785
2007	1,530
2008	32,592
2009 and beyond.....	285
	<u>35,192</u>

Income tax expenses differs from that computed at the statutory tax rate in Italy of 33% during 2004, as follows :

	December 31, 2004 (millions of Euro)
Corporation Tax at 33% (IRES)	17.9
Italian income tax at 4.25% (IRAP).....	6.5
Amortization of goodwill not deductible for tax purpose.....	6.3
Effect of different statutory rates applicable to foreign subsidiaries	(1.9)
Others	<u>2.5</u>
Consolidated income tax.....	<u>31.3</u>

Each entity of the group is subject to income taxes in Italy (IRES former IRPEG tax), at an enacted tax rate of 33% for the year ended December 31, 2004 and 34% for the year ended December 31, 2003 and 35% for the year ended December 31, 2002. Italian entities are also subject to a 4.25% local income tax (IRAP tax). Net operating tax-loss carry forward amounts for Italian entities may be utilized only to offset taxable income for IRES 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 €19,180 as at December 31, 2004 and €16,259 as at December 31, 2003, and relate to the liabilities for current income taxes of Group companies.

16. Other current payables and accrued expenses

	December 31,	
	2004	2003
Payroll	21,028	22,821
Social security contributions	7,065	7,282
Accruals for bonuses to salespersons.....	15,586	16,450
Payable to salespersons.....	2,103	2,481
Accrual for advertising and sponsorship expenses.....	1,938	4,137
Interest expense payables	3,617	4,092
Accruals for insurance, leasing and other charges	4,730	4,966
Dividend payables	1,771	3,169
Other payables	4,374	5,272
Restructuring provision.....	568	5,607
	<u>62,780</u>	<u>76,077</u>

Social security contributions mainly relate to contributions payable one month in arrears by Group companies in relation to employees' wages and salaries.

Dividend payables are dividends approved by subsidiaries during the year that remain unpaid at the year-end.

At December 31, 2003 the Group recorded a restructuring provision related to the closure of the production plant of the Austrian subsidiary in Traun amounted to €5,607, of which €5,529 relates to involuntary termination costs. During 2004 the provision was utilized remaining an outstanding balance at December 31, 2004 of €68.

17. Termination Indemnity Liability (TFR)

	December 31,	
	2004	2003
Balance at the beginning of the year	28,784	26,546
Provision for the year.....	5,940	6,078
Utilized.....	(2,854)	(3,840)
Balance at the end of the year	<u>31,870</u>	<u>28,784</u>

18. Long-term provisions

	Movements in the year				Balance at December 31, 2003
	Balance at January 1, 2003	Accruals	Utilization	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 currency translation gain	5,478	21,208	—	—	26,686
Agents indemnity	2,269	205	(2)	—	2,472
Total	11,423	23,922	(2,051)	(313)	32,981

	Movements in the year				Balance at December 31, 2004
	Balance at January 1, 2004	Accruals	Utilization	Translation difference	
Employee benefits	1,070	1,400	(1,562)	(64)	844
Product warranty	2,753	665	(104)	(20)	3,293
Provision for deferred currency translation gain	26,686	—	(26,686)	—	—
Agents indemnity	2,472	398	(26)	—	2,844
Total	32,981	2,463	(28,378)	(84)	6,982

The pensions fund ("Employee benefits") represents the liability of certain Group companies under supplementary labor 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 sold.

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.

The provision for deferred currency translation gains represented the translation gain on long-term loans in U.S. dollars. The deferred currency translation gains were recorded in the statement of operation when realized. Effective on January 1, 2004 the new accounting principle OIC n. 1 requires to record in the statement of operations all the currency translation gains. As a result the provision for deferred currency translation gains was reversed.

19. Shareholders' equity attributable to the Group

Share capital

Sàfilo's capital stock at December 31, 2004 consisted of 35,000,000 ordinary shares having a nominal value of €1 per share. The holders of ordinary shares are entitled to 1 vote per share and to participate in 100% of profit distribution of earnings realized.

The shareholders' meetings on May 19, 2004 and April 30, 2003 approved the increase of the company's share capital through the issuance of 650,000 and 1,000,000 of ordinary shares having a nominal value of €1 per share, respectively. The shares were subsequently issued in 2004 at a price of €38.46 and in 2003 at a price of €30.00, resulting in a share premium of €24,350 and €29,000, respectively.

In 2002 the Group repurchased 3,176,000 ordinary shares or 9.1% of share capital for an aggregate cost of €80,988. At December 31, 2004, 2003 and 2002 held those treasury shares as long-term financial assets.

Sàfilo Holding S.p.A. is the sole parent company of the Group, holding 90.9% of Sàfilo's ordinary shares.

Restrictions on Distribution of Profits

In accordance with the Italian Law, 5% of the company's statutory net income for the year must be transferred to the company's Legal Reserve, until it reaches 20% of the share capital.

20. Segment Information

The Group operated only one business segment during the three years ended 31 December 2004, 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, 2004	Year ended December 31, 2003	Year ended December 31, 2002
Net sales by geographic area:			
Italy	141,886	140,431	145,691
Europe (excluding Italy)	329,318	310,385	267,055
North America	326,214	323,223	353,469
Far East	53,967	45,786	51,981
Japan	31,674	24,001	24,046
Australia	12,063	11,027	11,123
Other countries	44,642	45,277	40,687
	939,764	900,130	894,052

21. Cost of sales

	Year ended December 31, 2004	Year ended December 31, 2003	Year ended December 31, 2002
Purchase of materials and finished products	262,354	202,861	212,760
Changes in inventories	(37,623)	12,130	(40,128)
Payroll and social security.....	84,291	88,412	90,738
Subcontracting costs	33,307	40,922	46,973
Depreciation of property, plant and equipment.....	21,140	20,925	24,607
Other costs	15,806	9,993	12,997
	379,275	375,243	347,947

Changes in inventories, representing an increase in inventories in comparison to the same period in prior years, was achieved due to a new market strategy based on an increased level of inventory aimed at reducing delivery time to market and to customers' demand, increasing the company's competitiveness.

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

Payroll and social security

This item includes:

Wages, salaries, social security, termination indemnities, pension costs and other costs relating to staff involved in production activities and amounted to €90,870 in 2004, €97,873 in 2003 and €82,312 in 2002;

Salaries and related contributions have been reduced by the capitalization of labor costs on internally constructed machinery and equipments and amounted to €6,173 in 2004, €9,098 in 2003 and €8,406 in 2002.

Subcontracting costs

This item includes the cost of third party outsourcing of manufactured semi-finished products, whereby raw materials are provided by the Group. The costs of subcontractors have been heavily reduced in 2003 and 2004 mainly due to the effects of cost reduction policies and a different procurement and production strategy.

Depreciation of property, plant and equipment

	Year ended December 31, 2004	Year ended December 31, 2003	Year ended December 31, 2002
Buildings.....	2,562	2,556	2,213
Plant and machinery	8,178	7,957	16,193
Equipment.....	9,391	9,251	5,092
Other assets.....	1,009	1,161	1,109
	21,140	20,925	24,607

Other costs

This item includes industrial services, maintenance costs, rental costs related to production, and energy costs. Other costs also include gains on foreign currency swaps in the year ended December 31, 2004, 2003 and 2002 of €4,190, €3,309 and €3,105, respectively.

22. Selling and marketing expenses

	Year ended December 31, 2004	Year ended December 31, 2003	Year ended December 31, 2002
Payroll and social security.....	37,214	36,461	31,535
Services from independent salespersons	74,548	73,980	76,993
Royalties	79,980	74,374	70,887
Advertising and promotion costs	77,664	80,699	73,309
Shipping and other sales costs	36,299	33,124	28,246
Allowance for doubtful account.....	4,213	1,308	2,639
Warranty provision.....	515	726	259
	310,433	300,672	283,868

Payroll and social security

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 €3,659 in 2004, €3,860 in 2003 and €4,041 in 2002;
- Commissions to independent salespersons amounted to €70,474 in 2004, €69,916 in 2003 and €72,745 in 2002;
- Provisions in relation to the independent agents' termination indemnity reserve amounted to €415 in 2004, €205 in 2003 and €207 in 2002. This provision represents the Group's estimate of the costs that would be incurred if Sàfilo terminated its contracts with agents.

Royalties

Royalties represent fees paid for the utilization of trademarks or brands and are recognized at the time of sale of the licensed products. Royalties in 2004 represent 8.5% of net sales compared to 8.3% in 2003 and 7.9% in 2002.

23. General and administrative expenses

	Year ended December 31, 2004	Year ended December 31, 2003	Year ended December 31, 2002
Staff costs.....	79,365	75,716	65,697
Other staff related costs	6,647	6,268	5,813
Depreciation and amortization.....	11,321	10,907	8,095
Annual fees for outsourcing information system.....	1,628	1,498	1,255
Other	31,780	30,025	38,256
	130,741	124,414	119,116

Other includes fees for services related to administrative, legal and tax consulting.

Depreciation and amortization

	Year ended December 31, 2004	Year ended December 31, 2003	Year ended December 31, 2002
Amortization start up, research & development.....	415	154	155
Amortization intellectual properties.....	3,906	4,033	1,421
Amortization of other intangible assets.....	1,875	1,231	1,418
Depreciation of property, plant and equipment.....	5,125	5,489	5,101
	11,321	10,907	8,095

24. Other income/(expenses), net

	Year ended December 31, 2004	Year ended December 31, 2003	Year ended December 31, 2002
Losses on disposal of assets.....	(242)	(176)	(220)
Other operating charges	(537)	(444)	(1,251)
Gain on disposal of assets	131	109	120
Other operating income.....	826	1,463	2,246
Other taxes	(1,685)	(1,012)	(929)
	(1,507)	(60)	(34)

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

	Year ended December 31, 2004	Year ended December 31, 2003	Year ended December 31, 2002
Interest expense.....	64,284	66,124	60,000
Interest income	(523)	(1,692)	(847)
Currency exchange rate gains	(7,255)	(6,751)	—
Bank charges	4,686	3,855	2,085
Amortization of debt issuance costs	4,780	6,555	9,620
	65,972	68,091	70,858

Interest expense for 2004 includes:

- Interest totaling €9,480 on senior loans and other debts, including interest in the amount of €1,161 related to the factoring agreement;
- Discounts granted to customers for early payments totaling €4,635;
- Other financial costs totaling €169.

Currency exchange rate gains excludes any gains or losses on foreign currency swaps, which effects are included in cost of sales.

26. Extraordinary income/(expenses), net

	Year ended December 31, 2004	Year ended December 31, 2003	Year ended December 31, 2002
Provision for deferred currency translation gain (see note 18).....	26,686	—	—
Impairment charges	—	(8,220)	—
Restructuring expenses	—	(6,019)	—
Change in accounting method on equity investments (see note 11)	—	7,339	—
Share income/(loss) on equity investments	(112)	497	—
Dividend from investments recorded at cost.....	154	217	1,306
Other.....	(712)	(935)	(369)
	26,016	(7,121)	937

In 2003, the Group decided to close the production plant of the Austrian subsidiary in Traun. As a result of the closure, the Group recorded impairment charges of €8,220 relating to intangible assets and property plant and equipment, a provision of €5,529 related to involuntary termination costs and inventory write-downs of €490.

27. Income attributable to minority shareholders

Income attributable to minority shareholders include:

		Year ended December 31, 2004	Year ended December 31, 2003	Year ended December 31, 2002
	<u>%</u>			
Sàfilo Hellas	30.00%	1,373	2,034	1,663
Sàfilo Australia.....	49.00%	1,171	1,002	957
Sàfilo Hong Kong.....	49.00%	586	487	399
Lenti Srl.....	46.00%	4	14	179
Sàfilo Switzerland.....	23.00%	115	90	108
Other.....		(64)	(38)	90
		<u>3,185</u>	<u>3,589</u>	<u>3,396</u>

Dividends paid by subsidiaries to its minority shareholders:

	Year ended December 31, 2004	Year ended December 31, 2003	Year ended December 31, 2002
Sàfilo Hellas	1,583	1,201	768
Sàfilo Australia	1,209	1,002	896
	<u>2,792</u>	<u>2,203</u>	<u>1,664</u>

28. Contingencies, commitments and operating risks

i. Minimum contractual obligations

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

<u>Contractual Obligations and Commercial Commitments</u>	<u>Total</u>	<u>Payments Due by Period</u>			<u>More than 5 years</u>
		<u>Less than 1 year</u>	<u>1-3 years</u>	<u>3-5 years</u>	
Operating Lease Obligations.....	37,493	6,323	10,571	8,016	12,583
Minimum Royalty Arrangements.....	152,361	59,725	50,036	30,675	11,925
Total	189,854	66,048	60,607	38,691	24,508

Unsecured and secured guarantees

	As at December 31, 2004
<i>Unsecured guarantees given to third parties</i>	2,845
<i>Secured guarantees given to third parties:</i>	
—Mortgage and lien on machinery, plant and other tangible assets of Group companies	125,751
—Lien on trade receivables of the holding company.....	169,333
—Lien on shares and quotas of certain subsidiaries	686,242
—Lien on shares of the Parent Company	80,988
<i>Total secured guarantees</i>	<u>1,062,314</u>
	<u>1,065,159</u>

Foreign exchange and interest rate risk management

Since the Group has operations in a variety of countries throughout the world, a substantial portion of its assets, liabilities and results are denominated in foreign currencies, primarily the US dollar. As a result, the Company is subject to foreign currency exchange risk due to exchange rate movements, which affect the Group's transaction costs.

The Company uses a combination of interest rate and foreign currency exchange swaps to hedge variable rate exposures resulting from changes in interest rates and foreign currency exchange rates on sales in currencies other than Euro. The Company's objective in managing exposures to interest rate and foreign exchange rate fluctuations on receivables is to reduce income and cash flow volatility.

Interest rate swaps allow the Company to maintain a target range of floating debt.

The nominal value of the derivative contracts and its fair values are segregated by the maturity of the contracts are presented in the table below:

Maturity	December 31, 2004		December 31, 2003	
	Nominal amount	Fair Value	Nominal amount	Fair Value
Interest rate swap:				
Year 2007	322,228	(3,432)	320,191	(2,538)
Year 2010	25,000	(1,804)	—	—
Year 2011	25,000	(2,104)	—	—
Foreign currency swap:				
Year 2004	—	—	\$42,000	6,367
Year 2005	\$27,000	1,911	—	—

Stock option plan

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.

With resolutions of the extraordinary shareholders' meetings on December 16, 2004, a new stock option plan was offered to selected Directors and senior managers. The total number of shares that can be issued upon exercise of these options is 1,004,079 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 subject to the fact that some conditions are realized, but are not exercisable until 2007. 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.

The Group has a stock option plan at one of its subsidiaries, involving six employees. Under this plan, as at December 31, 2004 these employees have 220,318 options outstanding.

Credit line

Below is reported the undrawn line of credit available to the Group at December 31, 2004:

- Bank overdrafts €25,156;
- Short-term loans €66,500;
- Factoring €8,480;
- Swap contracts €85,902;
- Medium and long term loans €60,000.

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 recognized 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.

In 1999, Oakley, Inc. commenced an action for patent infringement against Smith Sport Optics, Inc. in the United States with 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 August 22, 2005 and trial set for January 17, 2006. 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.

30. Principal subsidiaries

The Group's consolidated subsidiaries are:

<u>Entity—Location</u>	<u>Share capital</u> (in local currency)	<u>Ownership %</u>
<i> Holding Company</i>		
Sàfilo S.p.A.....	€ 35,000,000	
<i> Other Italian entities</i>		
Oxsol S.p.A—Pieve di Cadore, Belluno.....	€ 121,000	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.....	€ 489,990	70.00
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 Brillen Vertrieb GmbH—Traun, Austria.....	€ 7,630,648	100.00
Carrera Optyl d.o.o.—Ormoz, Slovenia.....	SIT 135,101,000	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 Yorkshire, 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\$ 10	100.00
Sàfilo Realty Corp.—Delaware, USA.....	US\$ 10,000	100.00
Smith Sport Optics Inc.—Idaho, USA.....	US\$ 12,162	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

No material events have come to our attention which should be considered in reporting on the consolidated financial statements of Safilo Group as at December 31, 2004.

We will adopt IFRS accounting standards in 2005 in order to improve financial reporting and to have the same quality of financial information like other public companies in the European Union. We currently prepare our financial statements in accordance with Italian GAAP.

Although existing Italian GAAP requirements are similar in some ways to IFRS, there are key differences.

After an initial impact study, we have started the actual conversion to, and implementation of IFRS. The conversion project and implementation consist of: making accounting policy decisions, training relevant staff, rewriting our accounting manual, adjusting existing reporting systems, adapting procedures and business policies where applicable, and converting the opening balance sheet and other comparative financial information.

As we have so far only performed an initial impact study, we are not yet able to provide a quantitative analysis of the impact of IFRS on this year's financial results and balance sheet. However we expect the main differences between Italian GAAP and IFRS in the following sections:

- goodwill will not be amortized for IFRS purposes. However will be subject to impairment test;
- accounting of financial instruments;
- stock option accounting;
- capitalization of intangible assets is more restricted under IFRS than Italian GAAP.