REPORT OF THE GROUP AUDITORS TO THE BOARD OF DIRECTORS OF TORNOS HOLDING S.A., MOUTIER (THE COMPANY)

As mandated by the Board of Directors we have audited the interim consolidated financial statements of Tornos Holding S.A., Moutier and subsidiaries (Tornos Group), consisting of the interim consolidated income statement, the interim consolidated balance sheet, the interim consolidated statement of changes in equity, the interim condensed consolidated cash flow statement and selected notes for the six months ended June 30, 2002, appearing on pages F-2 to F-11 of this Prospectus. The comparative figures of the interim consolidated income statements, interim consolidated statements of changes in equity and interim condensed consolidated cash flows statement have not been audited.

These interim consolidated financial statements are the responsibility of the board of directors. Our responsibility is to express an opinion on these interim consolidated financial statements based on our audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with auditing standards promulgated by the Swiss profession and with the International Standards on Auditing issued by the International Federation of Accountants (IFAC), which require that an audit be planned and performed to obtain reasonable assurance about whether the interim consolidated financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the interim consolidated financial statements. We have also assessed the accounting principles used, significant estimates made and the overall interim consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the interim consolidated financial statements give a true and fair view of the financial position, the results of operations and the cash flows in accordance with International Accounting Standard 34 (IAS 34) and comply, except for the following, with Swiss law:

The interim consolidated financial statements were prepared on a going concern basis. As a result of the adverse economic development since the 2nd semester of 2001 both Tornos Holding S.A. and its wholly-owned subsidiary Tornos S.A., Moutier have encountered a severe lack of liquidity and over-indebtedness. The restructuring measures proposed by the Board of Directors based on a revised business plan were approved at the General Meeting of Shareholders held on June 28, 2002 and have been partially implemented as of the date of this report (see note 3). The Group's ability to continue as a going concern depends on both the successful completion of all planned restructuring measures and the achievement of the revised business plan.

We further draw your attention to the fact that as of June 30, 2002, the Company's unconsolidated accounts indicate that, before financial restructuring and recapitalisation, its liabilities exceed its assets, whether measured at going concern or liquidation values. We therefore refer to article 725 paragraph 2 of the Swiss Code of Obligations according to which the Board of Directors is required, in the case of an obvious over-indebtedness, to notify the court. The Board of Directors decided not to notify the court since the restructuring plan will remove the Company's over-indebtedness upon its implementation.

KPMG Fides Peat

Elmar Ittensohn
Swiss Certified Accountant
Auditor in Charge

Bryan DeBlanc
Certified Public Accountant (USA)

Gümligen-Berne, August 26, 2002

INTERIM CONSOLIDATED INCOME STATEMENT

In thousands of CHF

Six months ended June 30,	Note	2002	2001
			(unaudited)
Gross sales revenue		86,749	206,142
Commissions and discounts		(5,217)	(9,413)
Net sales		**81,532**	**196,729**
Material expenses		(47,772)	(96,095)
Personnel expenses		(41,790)	(61,496)
Other operating income (expenses), net		(19,024)	(20,550)
Earnings before interest, tax, depreciation and amortisation and restructuring charges		**(27,054)**	**18,588**
Restructuring charges	6	(55,580)	–
Earnings before interest, tax, depreciation and amortisation (EBITDA)		**(82,634)**	**18,588**
Depreciation of property, plant and equipment		(4,625)	(4,027)
Amortisation of goodwill and intangibles		(4,953)	(5,303)
Impairment loss on intangible assets	7	(73,814)	–
Operating result (EBIT)		**(166,026)**	**9,258**
Financial income (expense), net		(5,291)	(14,164)
Loss before tax		**(171,317)**	**(4,906)**
Income tax income (expense)		4,068	(1,202)
Loss after tax		**(167,249)**	**(6,108)**
Minority interest		–	(30)
Net loss for the period		**(167,249)**	**(6,138)**
Basic and diluted earnings per share (CHF)		**(72.72)**	**(3.23)**

The accompanying notes form an integral part of these interim consolidated financial statements.

INTERIM CONSOLIDATED BALANCE SHEET

In thousands of CHF

	June 30, 2002	December 31, 2001
ASSETS		
Cash and cash equivalents	7,065	5,978
Trade receivables	41,305	75,982
Other receivables and prepayments	14,112	15,582
Inventories	65,611	120,654
Total current assets	**128,093**	**218,196**
Property, plant and equipment	72,665	71,896
Intangible assets	2,352	79,463
Financial assets	453	641
Deferred tax assets	315	2,617
Total non-current assets	**75,785**	**154,617**
Total assets	**203,878**	**372,813**
LIABILITIES AND EQUITY		
Trade payables	53,872	69,959
Other payables	26,610	31,093
Current tax liabilities	571	1,192
Interest-bearing loans and borrowings	122,007	111,769
Provisions	18,098	2,977
Total current liabilities	**221,158**	**216,990**
Interest-bearing loans and borrowings	9,631	7,901
Retirement-benefit obligations	1,643	2,385
Provisions	2,955	2,273
Deferred tax liabilities	1,846	7,661
Total non-current liabilities	**16,075**	**20,220**
Total liabilities	**237,233**	**237,210**
Capital and reserves		
Share capital	115,000	115,000
Share premium	44,055	44,055
Accumulated deficit	(192,410)	(23,452)
Total equity	**(33,355)**	**135,603**
Total liabilities and equity	**203,878**	**372,813**

The accompanying notes form an integral part of these interim consolidated financial statements.

INTERIM CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

In thousands of CHF

	Ordinary shares	Preferred shares	Share Premium	Currency Translation	Retained earnings	Total	Minority interest
At December 31, 2000	10,000	55,000	–	2,327	2,230	69,557	145
Effect of first application of IAS 39	–	–	–	–	1,535	1,535	–
At January 1, 2001	10,000	55,000	–	2,327	3,765	71,092	145
Net loss for the period	–	–	–	–	(6,138)	(6,138)	30
Acquisition of minority interest	–	–	–	–	–	–	(42)
Conversion of shares	55,000	(55,000)	–	–	–	–	–
Issuance of new shares	50,000	–	44,055	–	–	94,055	–
Currency translation adjustment	–	–	–	2,080	–	2,080	–
At June 30, 2001 (unaudited)	**115,000**	**–**	**44,055**	**4,407**	**(2,373)**	**161,089**	**133**
At December 31, 2001	115,000	–	44,055	2,704	(26,156)	135,603	–
Net loss for the period	–	–	–	–	(167,249)	(167,249)	–
Currency translation adjustment	–	–	–	(1,709)	–	(1,709)	–
At June 30, 2002	**115,000**	**–**	**44,055**	**995**	**(193,405)**	**(33,355)**	**–**

The accompanying notes form an integral part of these interim consolidated financial statements.

INTERIM CONDENSED CONSOLIDATED CASH FLOW STATEMENT

In thousands of CHF

Six months ended June 30,	**2002**	**2001**
		(unaudited)
Net cash from operating activities	1,613	6,976
Net cash used in investing activities	(2,438)	(3,665)
Net cash used in financing activities	1,990	(502)
Net increase in cash and cash equivalents	1,165	2,809
Cash and cash equivalents at January 1,	5,978	13,324
Effects of exchange rate changes	(78)	96
Cash and cash equivalents at June 30,	7,065	16,229

The accompanying notes form an integral part of these interim consolidated financial statements.

SELECTED EXPLANATORY NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

All figures are in thousands of CHF unless otherwise stated

1 Basis of preparation

The interim consolidated financial statements for the six months ended June 30, 2002 have been prepared in accordance with International Accounting Standard 34 on Interim financial reporting. The accounting policies used are consistent with those used in the annual consolidated financial statements.

2 Going concern

Due to a difficult market environment in North America and Europe and the decline in the markets for electronic and telecom industries, Tornos began to experience order cancellations by customers and a very low order volume since the last quarter of 2001. Despite the company's immediate action to reduce its costs and increase order intake, the Group experienced significant losses and faced a serious lack of liquidity in March 2002. As a result of Tornos' loss-making situation, it did not comply with most of the debt covenants required by the banks as of December 31, 2001. Interim balance sheets as of April 30, 2002 for both Tornos Holding SA (Tornos Parent Company) and Tornos SA (Tornos), using both going-concern and liquidation values showed that both companies were clearly over-indebted. In order to protect the interests of employees, creditors and shareholders, and to comply with the Swiss Code of Obligations, the Board of Directors initiated organisational and financial restructuring measures.

The restructuring plan drawn up by the Board of Directors foresaw principally that the share capital be reduced to CHF 11.5 million by a reduction in the par value of each share (from CHF 50 to CHF 5) together with an accompanying capital increase in two tranches to a minimum of CHF 58 million and a maximum of CHF 84.5 million. At the same time, members of the banking consortium as well as other creditors, such as suppliers, agreed to waive their claims in substantial amounts. On an operating level, the restructuring plan foresaw a substantial reduction in production capacities.

The basis of the restructuring plan and the agreement with creditor banks is the Framework Agreement on Restructuring and Financial Reorganisation of the Tornos Group (the Framework Agreement) which was concluded by Tornos Parent Company on June 6, 2002 with the consortium of banks and various investors, including the previous principal shareholder. The restructuring measures foreseen in the Framework Agreement were approved by the Ordinary General Meeting of Shareholders on June 28, 2002. On June 28, Tornos concluded a credit agreement with the banks in which new credit arrangements were fixed.

The validity of the Framework Agreement, of the credit agreement and thus the consummation of the financial restructuring of the group is dependent upon the various conditions set forth in the aforementioned agreements which were not completely fulfilled as of August 26, 2002 (see Note 4). However, as of today, the implementation of the restructuring measures are proceeding according to the plan and the Board of Directors is of the opinion that the entire financial restructuring will be consummated.

3 Resolutions of the General Meeting of Shareholders of June 28, 2002

The General Meeting of Shareholders held on June 28, 2002 adopted the following resolutions:

- Reduction of the existing share capital by an amount of CHF 103.5 million from CHF 115 million to CHF 11.5 million in order to eliminate the accumulated deficit by way of a reduction in the par value of all 2,300,000 registered shares from CHF 50 to CHF 5.
- Simultaneous increase of the share capital in two tranches up to a minimum of CHF 46.6 million and a maximum of CHF 84.5 million in total as follows:
  - i tranche A: increase of the share capital of CHF 11.5 million by a nominal amount of not less than CHF 35.0 million and not more than CHF 50.0 million up to not less than CHF 46.5 million and not more than CHF 61.5 million by creation and issuance of a minimum of 7,000,000 and an maximum of 10,000,000 new bearer shares with a par value of CHF 5. The Board is authorized to determine the issuing price of the new shares.
  - ii tranche B: increase of the share capital by a nominal amount of not less than CHF 0.1 million and not more than CHF 23.0 million by creation and issuance of a minimum of 20,000 and a maximum of 4,600,000 new registered shares with a par value of CHF 5 each. The issuing price shall be the same as the one determined for tranche A.
- Creation of a new conditional share capital of CHF 11.75 million. An amount of CHF 5.75 million is reserved for the issuance of shares upon the exercise of option rights which will be granted to the shareholders within the framework of the reduction of the share capital. An amount of CHF 6.0 million is reserved for the issuance of shares upon the exercise of option rights which will be granted to certain creditor banks in consideration of them waiving part of their claims.
- The existing conditional capital which was reserved for a stock option plan for employees is revoked.
- Creation of an authorised share capital of CHF 10 million.
- The bearer shares shall be converted into registered shares in connection with the execution of the increase of the share capital referred to as tranche B.

The liquidity situation of the Group required immediate action to provide the Group with new funds at short notice. To achieve this, the capital increase was divided in two tranches. The capital increase referred to as tranche A has already been implemented and was entered into the Commercial Register on July 7, 2002. The share capital was increased by CHF 35.075 million (7,015,002 bearer shares with a par value of CHF 5 each) up to an amount of CHF 46.575 million. The shares were issued at a price of CHF 6. The proceeds from the capital increase amounted to CHF 42.09 million.

All figures are in thousands of CHF unless otherwise stated

4 Revised Credit Agreement with banks

In June 2002, Tornos Holding S.A. was granted a bridging loan by the creditor banks which was repaid on July 9, 2002. As compensation, the banks were granted options on 300,000 shares which entitle them to purchase 300,000 registered shares with a par value of CHF 5 for a price of CHF 6 per share. The options are secured by the conditional share capital created in the shareholders meeting held on June 28, 2002.

On June 28, 2002, Tornos concluded a new Credit Agreement with the creditor banks, which laid down the following new conditions:

- The banks waive credits of up to a maximum amount of CHF 60 million out of a total amount due to them of CHF 120 million under the previously valid senior credit facility agreement.
- The remaining amount of CHF 60 million is due for repayment on December 31, 2003.
- As compensation for their debt waiver, the banks shall receive 750,000 options which entitle them to purchase shares of a par value of CHF 5 for a consideration of CHF 6. The options are secured by the conditional share capital which was approved by the General Meeting of Shareholders of June 28, 2002.

The following is a list of the key conditions precedent under the new Credit Agreement with the banks which are already fulfilled:

- The banks were to receive a copy of the Memorandum of Understanding (MoU) signed by at least Tornos Parent Company, Tornos, each of the Lendors and Doughty Hanson.
- The banks were to receive a written confirmation from Tornos Parent Company that documents the commitments from the investors to purchase shares (tranche A and tranche B combined) of Tornos Parent Company in an aggregate amount of not less than CHF 60 million to be paid in cash for such newly issued shares.
- The General Shareholders' Meeting held on June 28, 2002 was to to approve at least items no. 5 (concerning the financial restructuring) on the agenda and all other resolutions the Board of Directors of Tornos Parent Company proposed to be passed for the purpose of the MoU and was to elect all Board members proposed to be elected in connection with the resolutions to be passed under item no. 5 on the agenda.
- The share capital of Tornos Parent Company as part of tranche A was to be increased by at least CHF 38.5 million, by way of cash contribution of at least CHF 46.2 million (20% share premium). This requirement was subsequently revised downward by the banks to require a nominal amount of CHF 35.075 million, by way of a cash contribution of CHF 42.09 million

In addition, the new Credit Agreement with the banks contains the following resolutory conditions, which must be fulfilled during the coming weeks. Failure by Tornos Parent Company and/or Group companies to fulfill these conditions could result in nullifying the agreement with the banks and causing all amounts to be repayable. These conditions were not yet due as of the date when these interim consolidated financial statements were approved.

- Creditors of Tornos and/or group companies shall have waived their claims for an amount of CHF 10.0 million and shall have subscribed for shares of Tornos Parent Company with a nominal value of CHF 5 and a subscription price of CHF 10 each, in the aggregate amount of at least CHF 10.0 million the subscription price of which shall be paid by way of set-off against such subscribing creditors' claims which have been assigned and transferred to THSA prior to the issuance of the respective shares on or prior to August 31, 2002 (or, in case of an extension of the Memorandum of Understanding, October 31, 2002). The creditors have agreed in writing to the proposed plan. Formal completion of the debt/equity swap transaction is under way.

All figures are in thousands of CHF unless otherwise stated

- The increase of the share capital of Tornos Parent Company with respect to tranche B of at least CHF 11.5 million, by way of cash contribution of at least CHF 13.8 million (20% share premium) shall have been successfully entered into the Commercial Register on or prior to September 30, 2002. The Board of Directors believes that this condition will be met in time.
- The ruling of the Swiss Takeover Board confirming that neither the MoU nor implementation of the actions contemplated thereby would trigger a duty of the investors to make an offer to acquire all listed equity of Tornos Parent Company pursuant to the Swiss Exchange and Securities Trading Act shall have entered into force. This condition has been met as of the date of this report.

Accordingly the debt waiver of CHF 60 million mentioned above was not recognised in these interim consolidated financial statements.

5 Scope of consolidation

No changes in the scope of consolidation occurred in the period under review.

6 Restructuring charges

Certain valuation adjustments and provisions were necessary as a result of the restructuring measures which impacted the interim consolidated income statement as follows:

Write-down of inventories (included in material expenses)	39,483
Redundancy costs	7,741
Other provisions	8,356
	55,580

Inventory write-downs arose as a result of reduced business activity levels as well as a streamlining of the product range. Additional expenses may be incurred in the course of the continuing restructuring process.

7 Impairment loss on intangible assets

The impairment-loss reflects the write off of goodwill and capitalised development costs.

All figures are in thousands of CHF unless otherwise stated

8 Segment reporting

Six months ended June 30,	**2002**	**2001**
		(unaudited)
Net sales by location of customers		
Switzerland	16,343	28,407
Other western European countries	43,531	127,992
North America	11,120	30,214
Asia	10,415	8,882
Rest of world	123	1,234
Total net sales	**81,532**	**196,729**
Net sales by location of assets		
Switzerland		
To third parties	28,396	64,533
To other segments	34,442	109,306
	62,838	**173,839**
Other European countries		
To third parties	42,145	103,525
To other segments	530	847
	42,675	**104,372**
North America		
To third parties	10,991	28,671
To other segments	159	100
	11,150	**28,771**
Eliminations	(35,131)	(110,253)
Total net sales	**81,532**	**196,729**
Segment result (EBIT) by location of assets		
Switzerland	(156,769)	5,624
Other Western European countries	(4,839)	4,472
North America	(2,887)	1,307
	(164,495)	11,403
Eliminations	863	(2,054)
Unallocated	(2,394)	(91)
Total EBIT	**(166,026)**	**9,258**

EBIT is adversely affected by expenses in the amount of CHF 55.6 million relating to the restructuring process (note 6).

SELECTED EXPLANATORY NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

All figures are in thousands of CHF unless otherwise stated

9 Settlement of contingencies

During the period under review, the following contingencies were settled:

In March 2002, the former shareholders of Moutier Machines Holding (MMH), a company acquired by the Group on 31 December 1998, had filed a claim against the Group for additional monies that they alleged to be entitled to under the Stock Purchase Agreement regarding the sale of MMH to the Group. In June 2002, Tornos entered into a settlement agreement with the plaintiffs. The two parties agreed on the following:

- The plaintiffs will withdraw their claims.
- An amount of CHF 5 million that had been paid to an escrow account will be released and paid to the plaintiffs including accrued interest.
- The plaintiffs will participate in the capital increase referred to as tranche A with an amount of CHF 5.24 million
- The plaintiffs shall receive 125,000 share options, which entitle them to purchase 125,000 registered shares with a par value of CHF 5 each for a price of CHF 6 per share.

In December 1999, Tornos had acquired certain activities from Mabinvest SA (previously Schaublin SA) for a consideration of CHF 6.8 million The purchase consideration was never paid over as Tornos had had asserted counter-claims for non-performance of certain contractual obligations on its part and had reflected these in the balance sheet. On June 4, the parties entered into settlement agreement under the terms of which Tornos shall pay to Mabinvest an amount of CHF 2.75 million, of which CHF 1.75 million is to be settled in cash. Mabinvest shall receive 100,000 registered shares out of the approved conditional share capital.

10 Assets pledged

During the period under review, the creditor banks have been provided with security over the properties in Moutier amounting to CHF 40 million. In addition, the banks have demanded a global assignment of the receivables of Tornos S.A. and its subsidiaries.

11 Post balance sheet events

These interim consolidated financial statements were approved by the Board of Directors on August 26, 2002. No events have occurred between June 30, 2002 and August 26, 2002 which would require adjustment to the carrying amounts of the Group's assets and liabilities as of June 30, 2002 or require disclosure.

For the measures in connection with the restructuring of the Group that took place after the balance sheet date, reference is made to Notes 3 and 4.