Consolidated Financial Statements 2003

TORNOS Holding SA, Moutier

Tornos Holding S.A., Moutier

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Report of the group auditors
to the general meeting of

Tornos Holding S.A., Moutier

As group auditors, we have audited the consolidated financial statements of Tornos Holding S. A. and subsidiaries (the group), consisting of the consolidated income statement, the consolidated balance sheet, the consolidated statement of changes in equity, the consolidated cash flow statement and notes to the consolidated financial statements for the year ended December 31, 2003.

These consolidated financial statements are the responsibility of the board of directors. Our responsibility is to express an opinion on these 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 (ISA), which require that an audit be planned and performed to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the consolidated financial statements. We have also assessed the accounting principles used, significant estimates made and the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements give a true and fair view of the financial position, the results of operations and the cash flows in accordance with the International Financial Reporting Standards (IFRS) and comply with Swiss law.

We recommend that the consolidated financial statements submitted to you be approved.

Berne, March 15, 2004

BDO Visura

André Faessler	Karel Hojac
Swiss Certified Accountant Auditor in Charge	Swiss Certified Accountant

Enclosures

- Consolidated financial statements (income statement, balance sheet, statement of changes in equity, cash flow statement and notes)

Consolidated income statement

In thousands of CHF, except per share data

For the years ended December 31,	Notes	**2003**	**2002**
Gross sales revenue		**174’683**	**180’567**
Commissions and discounts		(5’936)	(10’910)
Net sales		**168’747**	**169’657**
Material expenses	6, 7	(72’452)	(133,463)
Personnel expenses	6, 8	(59’856)	(83’595)
Forgiveness of trade payables, net of VAT	6	-	9’894
Other operating income (expenses), net	9	(26’705)	(47’547)
Earnings before interest, tax, depreciation/amortisation (EBITDA)		**9’734**	**(85’054)**
Depreciation of property, plant and equipment	16	(9’099)	(9’478)
Amortisation of goodwill and other intangibles	17	(247)	(5’632)
Impairment loss on intangible assets	17	-	(76’125)
Operating result (EBIT)		**388**	**(176’289)**
Forgiveness of bank debt	6	-	60,000
Other financial income (expense), net	10	(3’443)	(9’864)
(Loss) before tax and minority interest		**(3’055)**	**(126’153)**
Income tax expenses	11	235	4’744
(Loss) after tax		**(2’820)**	**(121’409)**
Minority interest		-	-
Net loss for the year		**(2’820)**	**(121’409)**
Basic and fully diluted loss per share	26	**(0.21)**	**(18.19)**

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

Consolidated balance sheet

In thousands of CHF

As at December 31,	Notes	2003	2002
ASSETS			
Cash and cash equivalents		12'317	21'743
Trade receivables	13	44'716	46'588
Current tax assets		-	1'102
Other receivables and prepayments	14	7'175	8'513
Inventories	15	55'764	59'463
Total current assets		**119'972**	**137'409**
Property, plant and equipment	16	59'473	67'482
Intangible assets	17	62	251
Financial assets		22	20
Total non-current assets		**59'557**	**67'753**
Total assets		**179'529**	**205'162**
LIABILITIES AND EQUITY			
Trade payables		12'876	17'451
Other payables	19	15'207	15'672
Current tax liabilities		423	642
Interest bearing loans and borrowings	20	52'775	56'288
Provisions	23	7'471	18'017
Total current liabilities		**88'752**	**108'070**
Interest bearing loans and borrowings	20	4'425	7'656
Retirement benefit obligations	22	1'624	1'513
Provisions	23	5'480	4'636
Deferred tax liabilities	18	821	1'373
Total non-current liabilities		**12'350**	**15'178**
Total liabilities		**101'102**	**123'248**
Capital and reserves			
Ordinary shares	24, 25	66'919	66'919
Share premium		13'943	13'943
Retained earnings		(1'855)	965
Currency translation reserve		(580)	87
Total equity		**78'427**	**81'914**
Total liabilities and equity		**179'529**	**205'162**

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

Consolidated statement of changes in equity

In thousands of CHF	**Ordinary shares**	**Share premium**	**Retained earnings**	**Currency translat.**	**Total**
At December 31, 2001	**115'000**	**44'055**	**(26'156)**	**2'704**	**135'603**
Reversal of accrued equity transaction cost*		975			975
Reduction in capital	(103'500)	(45'030)	148'530		-
Issuance of new shares:					
- cash	50'000	10'000			60'000
- debt equity swap	5'419	5'419			10'838
- charges of capital increase		(1'476)			(1'476)
Net loss for the year			(121,409)		(121,409)
Currency translation adj.				(2'617)	(2'617)
At December 31, 2002	**66'919**	**13'943**	**965**	**87**	**81'914**
Net loss for the year			(2'820)		(2'820)
Currency translation adj.				(667)	(667)
At December 31, 2003	**66'919**	**13'943**	**(1'855)**	**(580)**	**78'427**

* relating to the capital increase in 2001

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

Consolidated cash flow statement

In thousands of CHF

For the years ended December 31,	Notes	**2003**	**2002**
Operating activities			
Loss before tax and minority interest		(3’055)	(126’153)
Adjustments for:			
Depreciation of property, plant and equipment	16	9’099	9’478
Loss on disposal of property, plant and equipment		304	221
Amortisation of/impairment loss on goodwill and other intangible assets	17	247	81’757
Release of provisions		(3’244)	(403)
Write-down of inventories	6, 7	4’276	42’483
Change in allowance for bad debts		(1’030)	362
Forgiveness of bank debt and trade payables		-	(69’894)
(Increase) decrease in working capital	27	(7’241)	22’356
Interest expense		4’001	6’389
Other non cash items		825	2’426
Income tax paid		(569)	(895)
Net cash provided by / (used in) operating activities		**3’613**	**(31’873)**
Investing activities			
Payment on settlement of acquisition of Schäublin activities		-	(1’750)
Cash received on disposal of Schäublin activities	6.1	425	1’000
Purchase of property, plant and equipment	16	(905)	(1’204)
Disposal of property, plant and equipment	16	150	524
Capitalisation of development expenditures	17	-	(1’893)
Purchase of intangible assets	17	(53)	(656)
Interest received		174	422
Net cash used in investing activities		**(209)**	**(3’557)**
Financing activities			
Payments on borrowings		(3’064)	-
Proceeds from borrowings		-	3’441
Payments of finance lease liabilities		(4’439)	(5’568)
Proceeds from issuance of share capital, net	24	-	58’524
Interest paid		(5’671)	(5’016)
Net cash (used in) / provided by financing activities		**(13’174)**	**51’381**
(Decrease) increase in cash and cash equivalents		(9’770)	15’951
Cash and cash equivalents at January 1		21’743	5’978
Effects of exchange rate changes		344	(186)
Cash and cash equivalents at December 31		**12’317**	**21’743**

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

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

GENERAL INFORMATION

1 Business

Tornos Holding SA (the Company) is a company domiciled in Moutier, Switzerland. The Group is exclusively active in developing, manufacturing, marketing and servicing of machine tools for turning applications. The Group's product lines primarily include sliding headstock lathes and multi-spindle lathes. The Group manufactures solely in Moutier, Switzerland and markets the product lines on a worldwide basis. The Group's operations outside of Switzerland principally include western European countries and North America.

2 Basis of preparation

2.1 Statement of compliance

The consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) and comply with Swiss law.

2.2 Accounting framework and reporting currency

The consolidated financial statements are prepared on the historical cost basis except for certain financial instruments that are stated at fair value (see accounting policy 3.5). The consolidated financial statements are presented in Swiss francs (CHF), rounded to the nearest thousand.

2.3 Accounting estimates and assumptions

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet date and the reported amounts of revenues and expenses during the reporting period of the consolidated financial statements. Actual results could differ from those estimates and assumptions.

2.4 Going concern

The consolidated financial statements as of December 31, 2002 and 2003 have been prepared on a going concern basis. The Group undertook restructuring measures in 2002 and achieved its planned EBIT as of December 31, 2003, while incurring a net loss of CHF 2.8 million.

The total borrowings under the credit agreement with the syndicate banks in the amount of CHF 49 million as of December 31, 2003 were extended until April 30, 2005 as confirmed by the lead bank on March 15, 2004. The detailed conditions of the credit facility agreement including credit covenants and interest rates are subject to contract.

In 2004, main focus of the Group is to achieve the budgeted sales and margins. Should it become apparent that the targets cannot be met the Board of Directors will take immediate appropriate steps.

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

3 Summary of significant accounting polices

The accounting policies have been consistently applied by the Group companies and are consistent with those used in the previous year.

3.1 Basis of consolidation

Subsidiaries

Subsidiaries are those companies in which the Company, directly or indirectly, holds an interest of more than 50% of the voting rights or otherwise has power to exercise control over the operations. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Acquisitions are accounted for using the purchase method. A listing of the Company's subsidiaries is set out in Note 4.

Balances and transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

3.2 Foreign currencies

Foreign currency transactions

Transactions in foreign currencies are translated to CHF at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to CHF at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated to CHF at the foreign exchange rate ruling at the date of the transaction.

Financial statements of foreign operations

The Group's foreign operations are not considered an integral part of the Company's operations. Accordingly, the assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on consolidation, are translated to CHF at foreign exchange rates ruling at the balance sheet date. The revenues, expenses and cash flows of foreign operations are translated to CHF at the average exchange rates prevailing during the reporting period. Foreign exchange differences arising on this translation are recognised directly in equity.

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

3.3 Revenue recognition

Revenues include sales of machines and service costs which can be directly charged to customers. Sales are recognised on the full completion of the delivery or service (upon delivery of products or customer acceptance in the case of "bill and hold" sales, or performance of services), net of sales taxes and discounts, and after eliminating sales within the Group.

Other revenues earned by the Group are recognised on the following bases:

- Interest income: on a time apportioned basis taking account of the yield on assets
- Royalties: on an accrual basis in accordance with the substance of the relevant agreement
- Dividend income: when the shareholder's right to receive payment is established

3.4 Cash and cash equivalents

Cash and cash equivalents consist of cash balances and short-term liquid investments with original maturities of three months or less. They are stated at their nominal amounts.

3.5 Financial instruments

Current and non-current investments held by the Group are classified as being available-for-sale and are stated at fair value, with any resultant gain or loss being recognised in the income statement. The fair value is the quoted bid price at the balance sheet date.

Derivative financial instruments are recognised on the balance sheet at fair value. Changes in fair values are recognised in the income statement. Hedge accounting is not applied.

At December 31, 2003 and 2002 the Group did not hold any derivative financial instruments.

3.6 Trade and other receivables

Trade and other receivables are stated at anticipated realisable value, being cost less allowances determined based on a review of all outstanding amounts at the year end.

3.7 Inventories

Inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

Until 2002 the cost of inventories was based on the first-in-first-out principle. In 2003, the Group changed to the moving average principle. The effect of the change in method was not material.

The cost of inventories includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of overheads, except interest expenses, based on normal operating capacity.

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

3.8 Property, plant and equipment

Owned assets

Property, plant and equipment are stated at cost less accumulated depreciation (see below) and impairment losses, if any (see accounting policy 3.10). Interest cost on borrowings to finance property, plant and equipment during the course of construction are expensed.

Subsequent expenditure

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately, including major inspection and overhaul costs, is capitalised. Other subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property, plant and equipment. All other expenditure is recognised in the income statement as an expense as incurred.

Leased assets

Leases with terms for which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Plant and equipment acquired by way of finance leases are stated at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the leases, less accumulated depreciation (see below) and impairment losses, if any (see accounting policy 3.10).

Each lease payment is allocated between the liability and financial charges so as to achieve a constant rate on the finance balance outstanding. The corresponding lease obligations, net of financial charges, are included in interest bearing borrowings. The interest element of the finance charge is recognised in the income statement over the lease period.

Depreciation

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of items of property, plant and equipment. Land is not depreciated. The estimated useful lives are as follows:

- Buildings 20-40 years
- Plant and machinery 8-12 years
- Equipment and motor vehicles 3-10 years

3.9 Intangible assets

Goodwill

Goodwill arising on an acquisition represents the excess of the cost of acquisition over the fair value of the net identifiable assets acquired. Goodwill is stated at cost less accumulated amortisation (see below) and impairment losses, if any (see accounting policy 3.10).

Research and development

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognised in the income statement as an expense as incurred.

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

Expenditure on development activities, whereby research findings are applied to a plan or design for the production of new or substantially improved products and processes, is capitalised if the product or process is technically and commercially feasible and the Group has sufficient resources to complete development. The expenditure capitalised includes the cost of materials, direct labour and an appropriate proportion of overheads. Other development expenditure is recognised in the income statement as an expense as incurred. Capitalised development expenditure is stated at cost less accumulated amortisation (see below) and impairment losses, if any (see accounting policy 3.10).

Other intangible assets

Other intangible assets acquired by the Group are stated at cost less accumulated amortisation (see below) and impairment losses, if any (see accounting policy 3.10).

Amortisation

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets. Goodwill is amortised from the date of initial recognition; other intangible assets are amortised from the date the asset is available for use. The estimated useful lives applied are as follows:

▪ Goodwill	15 years
▪ Capitalised development costs	4 - 7 years
▪ Patents and trademarks	6 years

3.10 Impairment

The carrying amounts of the Group's assets, other than financial instruments (see accounting policy 3.5), inventories (see accounting policy 3.7), deferred tax assets (see accounting policy 3.11) and pension assets (see accounting policy 3.12), are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount, being the higher of the asset's net selling price and value in use, is estimated. For intangible assets that are not yet available for use, the recoverable amount is estimated at each balance sheet date. An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement.

3.11 Income taxes

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised using the balance sheet liability method on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not subject to recognition of deferred taxes:

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

- goodwill not deductible for tax purposes;
- differences relating to the initial recognition of assets or liabilities that, at the time of the transaction, affect neither accounting nor taxable profit; and
- differences relating to investments in subsidiaries to the extent that they are controlled and will probably not reverse in the foreseeable future.

The amount of deferred tax recognised is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

3.12 Employee benefits

The Group has established defined benefit and defined contribution plans around the world. Most of the pension schemes are final salary defined benefit plans and are either funded or unfunded. The assets of the funded plans are held independently of the Group's assets in separate trustee-administered / funds.

Defined contribution plans

Contributions to defined contribution pension plans are recognised as an expense in the income statement as incurred.

Defined benefit plans

The Group's net obligation in respect of defined benefit pension and healthcare plans is calculated separately for each defined benefit plan by estimating the amount of future benefits that employees have earned in return for their service in the current and prior periods; such benefits are discounted to determine their present value, and the fair value of any plan assets is deducted from the defined benefit obligation. The discount rate is the yield at balance sheet date on AAA credit rated bonds that have maturity dates approximating the terms of the Group's obligations. The calculation is performed by a qualified actuary every year using the projected unit credit method.

When the benefits of a plan change, the portion of the increased benefits relating to past service by employees is recognised as an expense in the income statement on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognised immediately in the income statement.

In calculating the Group's obligation in respect of a plan, to the extent that any actuarial gain or loss exceeds ten percent of the greater of the present value of the defined benefit obligation and the fair value of plan assets, it is recognised in the income statement over the expected average remaining working lives of the employees participating in the plan. Otherwise, the actuarial gain or loss is not recognised.

Where the calculation results in a surplus, the recognised asset is limited to the present value of any future refunds from the plan or reductions in future contributions to the plan.

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

3.13 Provisions

A provision is recognised in the balance sheet when the Group has a legal or constructive present obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

3.14 Interest -bearing borrowings

Interest-bearing borrowings are recognised initially at cost, less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest rate basis.

3.15 Segment reporting

The Group is engaged in the business of developing, manufacturing, marketing and servicing of machine tools for turning applications. The Group's product lines primarily include sliding headstock lathes and multi-spindle lathes. These products are mainly purchased by companies active in the electronic, automotive, connector, watch and medical engineering industries, as well as other specialised manufacturers of high precision turned parts.

The two product lines of the Group require similar materials and production processes. Management does not consider that there is currently a clear distinction of risks and returns among the products and therefore concluded that the Group operates in one business segment, i.e. automatic lathes.

In view of the foregoing and in accordance with IAS 14, management has chosen the geographical segmentation for the purposes of the Group's primary segment reporting.

Switzerland is the domicile of the parent company and the main operating company. The Swiss operating company conducts all development and manufacturing activities. The subsidiaries located in the other western European countries (France, Germany, Great Britain, Italy, Spain and the United Kingdom) and the United States only have sales and distribution activities. Additionally, the Swiss company sells via its sales agents located in Asia and rest of the world. This organisation has the effect that the risks and returns of each geographical location are dependent to a large extent on the operating company in Switzerland. Management has identified three geographical segments, namely, Switzerland, other western European countries and North America. For the purpose of presenting net sales by location of customers, two other geographical segments, namely Asia and rest of world, are identified.

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

4 Scope of consolidation

Principal subsidiaries

Name	Domicile	Purpose
Tornos S.A., Moutier	Switzerland	Production and sales
Tornos Services S.A., Moutier	Switzerland	Inactive*
Tornos Deutschland GmbH, Pforzheim	Germany	Sales & services
Tornos Technologies Iberica, Granollers	Spain	Sales & services
Tornos Holding France, Paris	France	Holding company
Tornos Technologies France, St Pierre	France	Sales & services
Tornos Technologies Italia Sarl, Assago	Italy	Sales & services
Tornos Technologies UK Ltd., Coalville	United Kingdom	Sales & services
Tornos Technologies U.S. Corp Brookfield CT	United States	Sales & services

*As of January 1, 2003, all business activities of Tornos Services S.A. were transferred to Tornos S.A.

All subsidiaries are held at 100% at December 31, 2003 and 2002.

Acquisitions and disposals

2003

There were no acquisitions or disposals in the year 2003.

2002

Acquisitions

There were no acquisitions in the year 2002.

Disposal of Schäublin activities

With effect from July 18, 2002, certain business activities were sold to Schäublin Machines SA for a consideration of CHF 1.4 million. The assets sold included inventories as well as the client database, construction plans and the trademark. The inventories with a carrying amount of CHF 6.1 million had been fully written off prior to the sale. The sales price was paid in two instalments: CHF 1.0 million in 2002 and CHF 0.4 million in 2003.

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

5 Foreign currency exchange rates

Currency	Balance sheet rate		Average rate	
	2003	2002	2003	2002
EUR	1.5590	1.4525	1.5231	1.4657
USD	1.2360	1.3885	1.3361	1.5479
GBP	2.2045	2.2343	2.1967	2.3304

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

NOTES TO THE CONSOLIDATED INCOME STATEMENT

6 Restructuring in 2002

6.1 Economic development and operational restructuring

During 2001, there commenced a period of perceptible downturn in the economy and of decline in demand for Tornos' rotary machines. The situation peaked in autumn of 2001 and led to a high number of order cancellations and to a significant under-utilisation of available capacity. In October 2001, the capacities were brought into line with the reduced level of orders and 180 employees in the production company in Moutier and 20 employees in the sales companies had to be laid off.

The continuing negative trend in 2002 led to a severe drain on liquidity and the continuation of operations was compromised. In June 2002, a rescue agreement with syndicate banks and new investors was reached and a short-term bridge loan secured the liquidity of the group. The restructuring plan contained the following cornerstone points:

- adjustment of production capacities (additional reduction of 350 employees)
- simplification of product lines (streamlining of product range; sale of activities transferred from Schäublin in 1999 (refer to note 4); overhaul of current development projects); and
- repositioning on markets.

In autumn 2002, a further structural adjustment became inevitable in view of the fact that the recovery in the economy foreseen to have occurred by the end of 2002 did not materialise. In November 2002, a further 100 employees had to be laid off. The restructuring of operational capacities is considered to be completed with this third wave of redundancies.

In 2003, no further employees had to be laid off and the number of employees was 688 at December 31, 2003.

6.2 Financial restructuring

The financial restructuring was provided for in the basic rescue agreement for Tornos Group which was adopted at the general meeting of shareholders of June 28, 2002. The financial restructuring encompassed principally a revaluation of the balance sheet and a capital reorganisation.

Restructuring charges and income:

The following restructuring charges were recognised in 2002:

- valuation adjustment on inventories of CHF 42.5 million (refer to note 7)
- recognition of an impairment loss of goodwill and development costs of CHF 76.1 million (refer to note 17)
- increase of general warranty provisions of CHF 3.5 million, and recognition of a specific provision for an upgrade program of existing machines of CHF 5.0 million (refer to notes 9 and 23)
- recognition of a provision of CHF 9.1 million for personnel redundancies (refer to note 8), and of other provisions for restructuring, production reorganisation as well as settlement of legal and patent disputes totalling CHF 6.9 million (refer to note 23).
- write-down of deferred tax assets of CHF 2,6 million (refer to note 11)

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

The following restructuring income was recognised in 2002:

- debt forgiveness by syndicate banks of CHF 60 million
- forgiveness of trade and other payables by suppliers of CHF 9.9 million (net of VAT)

Capital reorganisation:

- 90% reduction of share capital from CHF 115 million to CHF 11.5 million by reduction in par value from CHF 50 per share to CHF 5 per share
- capital increase in two steps (Tranche A/B, refer to note 24); capital increase by payment in cash of CHF 60 million and through debt-equity swap by suppliers in the amount of CHF 10.8 million.

No additional restructuring charges were recognised in 2003. At December 31, 2003 the management reassessed the restructuring provisions and the following adjustments were made:

- Reduction of the provision for personnel redundancy by CHF 1.3 million (refer note 8)
- Reduction of the other restructuring provision by CHF 1 million (refer note 7)
- Reduction of the warranty provision by CHF 0.8 million (refer note 9)

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

7 Material expenses

	2003	2002
Material expenses	(68’176)	(90’980)
Write-down of inventories	(4’276)	(42’483)
Total material expenses	**(72’452)**	**(133,463)**

In 2002, inventory write-downs arose as a result of reduced business activity levels and streamlining of the product range. Included in the restructuring write-down of CHF 42.5 million is a full write-off of the semi-finished and finished goods of the Schäublin business unit in the amount of CHF 6.1 million. As set out in note 4, the related business activities were disposed of in July 2002. In 2003, an additional write-down of inventories in the amount of CHF 4.3 million was necessary. At the balance sheet date, the management reassessed the restructuring provision and CHF 1.0 million were released through the income statement in the material expenses (refer note 6).

8 Personnel expenses

	2003	2002
Wages and salaries	(51’382)	(61’282)
Social security costs	(5’973)	(7’375)
Pension costs:		
Defined benefit plans (note 22.2)	(2’737)	(4’819)
Defined contribution plans	(193)	(223)
Redundancy costs (note 6)	1’336	(9’086)
Training expenses	(122)	(102)
Other personnel expenses	(785)	(708)
Total personnel expenses	**(59’856)**	**(83’595)**
Number of employees at December 31,	688	782

2003

In 2003, the Group paid redundancy cost of CHF 2.8 million relating to the restructuring of the operational capacities in 2002. No additional lay-offs were necessary in 2003. At the balance sheet date, the management reassessed the restructuring provision and CHF 1.3 million were released through the income statement (refer note 6).

2002

Because of the reduced business activity and the weak economical development in 2002, additional restructuring efforts were necessary (refer to note 6). In June 2002 and November 2002, additional lay-offs had to be made by the Swiss operating company and certain subsidiaries in order to adjust the Group's capacity to the reduced market demand. An amount of CHF 5.9 million has already been paid in 2002.

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

9 Other operating income (expenses), net

	2003	2002
Indirect production costs	(7'408)	(7'739)
Administrative expenses	(12'800)	(20'260)
Selling expenses	(7'317)	(25'437)
Gain (loss) on disposal of property, plant & equipment	(304)	(221)
Other operating income	1'124	6'110
Other operating income (expenses), net	**(26'705)**	**(47'547)**

In 2002, selling expenses included the recognition of a provision to upgrade existing machines in the amount of CHF 5.0 million, other increases to warranty provisions in the amount of CHF 3.5 million and restructuring expenses in the amount of CHF 4.7 million. In 2003, selling expenses include a release of warranty provisions in the amount of CHF 0.8 million (refer to note 6).

10 Financial income (expenses), net

	2003	2002
Financial income		
Interest income from third party	174	422
Exchange gains	614	25
Other financial income	148	706
Total financial income	**936**	**1'153**
Financial expenses		
Interest expenses for third parties	(4'175)	(6'811)
Bank charges and other financial expenses	(184)	(3'564)
Exchange losses	(20)	(642)
Total financial expenses	**(4'379)**	**(11'017)**
Financial income (expenses), net	**(3'443)**	**(9'864)**

11 Income tax expenses

	2003	2002
Current income tax credit	104	1,352
Current income tax expenses	(433)	(427)
Deferred tax	564	3'819
Total income tax	**235**	**4'744**

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

The Group's expected tax expense for each year is based on the weighted average of the statutory corporate income tax rates, which in 2003 ranged between 11 % and 47 %, in the tax jurisdictions in which the Group operates. The reconciliation of the expected and the effective income tax expense is as follows:

	2003	2002
Loss before tax	**(3'055)**	**(126'153)**
Expected tax (expense) income	**(196)**	**36'214**
Non-taxable income *	-	16'824
Tax effect of temporary differences on investments in subsidiaries	15	3'731
Utilisation of previously unrecognised tax loss carryforwards	877	-
Reversal of write-down of deferred tax assets	781	-
Over- / underfunded in previous years	235	(203)
Write-down of deferred tax assets	-	(2'022)
Unrecognised tax loss carry forwards	(1'193)	(44'162)
Non-tax deductible amortisation of intangible assets	-	(5'463)
Other effects	(284)	(175)
Income tax recognised	**235**	**4'744**

* relating to a non-taxable debt forgiveness by Tornos Holding SA to Tornos SA in the amount of CHF 150 million

The expected tax expense / income is calculated at entity level since the Group does not file consolidated tax returns. As such, profits and losses generated by different entities cannot be offset against each other.

12 Research and development

Research and development expenses for 2003 totalled CHF 6.4 million (2002: CHF 8.2 million), amounting to around 3.8 % (2002: 4.8%) of net sales.

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

NOTES TO THE CONSOLIDATED BALANCE SHEET

13 Trade receivables

	2003	**2002**
Trade receivables	47’609	50’511
Less allowance for doubtful accounts	(2’893)	(3’923)
Trade receivables, net	**44’716**	**46’588**

14 Other receivables and prepayments

	2003	**2002**
Prepaid expenses and accrued income	2’292	2’498
Other assets	4’883	6’015
Total other assets and prepaid expenses	**7’175**	**8’513**

15 Inventories

	2003	**2002**
Materials and components	30’582	32’787
Work in progress	26’351	27’087
Finished goods and spare parts	28’480	89’223
	85’413	**149’097**
Less allowance for obsolescence	(29’649)	(89’634)
Total inventories	**55’764**	**59’463**

In 2003, the decrease in inventory gross value and allowance for obsolescence is a result of articles being discarded for which a 100% allowance had previously been established. In addition, the cost of spare parts that had been transferred from Tornos Services S.A. to Tornos S.A. were written-down by offsetting the existing valuation allowance.

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

16 Property, plant and equipment

	Land and buildings	Technical Machinery	Other Equipment	PP&E under construction	Total
Cost					
At January 1, 2003	55'256	86'650	11'495	1'067	154'468
Additions	5	519	1'023	7	1'554
Disposals		(11'141)	(2'464)		(13'605)
Transfers	1'074			(1'074)	-
Translation adjustment	(299)	(4)	91		(212)
At December 31, 2003	**56'036**	**76'024**	**10'145**	**-**	**142'205**
Accumulated depreciation					
At January 1, 2003	(19'149)	(57'494)	(10'343)	-	(86'986)
Charge for the year	(2'496)	(6'050)	(553)		(9'099)
Written back on disposal		10'857	2'294		13'151
Transfer					
Translation adjustment	102	164	(64)		202
At December 31, 2003	**(21'543)**	**(52'523)**	**(8'666)**	**-**	**(82'732)**
Carrying amounts					
January 1, 2003	36'107	29'156	1'152	1'067	67'482
December 31, 2003	34'493	23'501	1'479	-	59'473

Of which related to leased assets:

	Land and buildings	Technical Machinery	Other Equipment	PP&E under construction	Total
Additions					
December 31, 2002	-	5'252	-	-	5'252
December 31, 2003	-	452	197	-	649
Carrying amounts					
December 31, 2002	1'358	15'490	193	-	17'041
December 31, 2003	1'322	13'248	171	-	14'741

The fire insurance value of PP&E amounts to approximately CHF 245 million (prior year: CHF 244 million).

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

17 Intangible assets

	Goodwill	Other intangible assets	Total
Cost			
At January 1, 2003	80'067	31'204	111'271
Additions		53	53
Translation adjustment		18	18
At December 31, 2003	**80'067**	**31'275**	**111'342**
Accumulated amortisation			
At January 1, 2003	(18'286)	(16'609)	(34'895)
Charge for the year		(247)	(247)
Translation adjustment		(13)	(13)
At December 31, 2003	**(18'286)**	**(16'869)**	**(35'155)**
Accumulated impairment loss			
At January 1, 2003	(61'781)	(14'344)	(76'125)
Charge for the year			
Translation adjustment			
At December 31, 2003	**(61'781)**	**(14'344)**	**(76'125)**
Carrying amounts			
At January 1, 2003	-	251	251
December 31, 2003	-	62	62

Due to the difficult market environment and the Group's loss making situation the recoverable amounts of Goodwill and the capitalised development costs were tested for impairment in 2002. The Goodwill had arisen from the acquisition of Tornos S.A. and its subsidiaries in 1999 (change of ownership and formation of Tornos Holding). Based on the calculation of their value in use, the carrying amounts of the goodwill and development costs were fully written down during 2002. The discount rate applied to this calculation is 12 %.

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

18 Deferred income taxes

18.1 Deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	2003		2002	
	Assets	**Liabilities**	**Assets**	**Liabilities**
Trade and other receivables	53	8	16	8
Property, plant and equipment	-	1'236	-	1'236
Financial assets	116	-	-	-
Trade and other payables	159	196	2	635
Provisions	59	346	22	-
Borrowings	578	-	466	-
Tax value of loss carry forwards	-	-	-	-
Tax assets / liabilities	**965**	**1'786**	**506**	**1'879**
Set off	-965	-965	-506	-506
Net tax assets / liabilities	**-**	**821**	**-**	**1'373**

18.2 Unrecognised deferred tax assets

Deferred tax assets have not been recognised in respect of the following items:

	2003	**2002**
Tax affected amounts:		
Deductible temporary differences	1'681	1'532
Tax losses	52'524	51'099
	54'205	**52'631**

Due to uncertainty of their recoverability no tax assets on tax loss carry forwards have been recognised.

The expiry dates of unrecognised tax loss carry forwards in the respective years are:

	2003	**2002**
Year 2006	17'867	17'867
Year 2007	1'950	830
Year 2008	19'113	17'567
After 2008	217'003	209'737
Losses not subject to expiry	2'441	1'882
Total	**258'374**	**247'883**

The deductible temporary differences for which no deferred tax asset has been recognised do not expire.

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

18.3 Tax rulings

On July 5, 2000, tax rulings were obtained from the tax authorities of the Canton of Berne and the local authorities of Moutier whereby tax holidays were granted to the Swiss operating companies.

Tornos S.A. was 100% tax exempted for the years 2000 to 2001, is 80% tax exempted from 2002 to 2003 and 60% tax exempted from 2004 to 2006. Tornos Services SA was 80% tax exempted for the years 2000 and 2001 and is 60% tax exempted for the years 2002 to 2003.

19 Other payables

	2003	2002
Advances received	5’146	4’040
Payable to pension plans	293	589
Deferred income and other accrued expenses	9’768	11’043
Total other payables	**15’207**	**15’672**

20 Interest bearing loans and borrowings

	2003	2002
Current portion:		
Current portion of senior (Term A) Facility	22’000	25’000
Current portion of senior (Term B) Facility	20’000	20’000
Current portion of senior (Term C) Facility	7’000	7’000
Current portion of senior (Term D) Facility	-	-
Other short-term bank borrowings	3	66
Short-term leasing liabilities (refer to note 20.10)	3’772	4’222
Current portion	**52’775**	**56’288**
Non-current portion:		
Other bank borrowings	36	33
Long-term leasing liabilities (refer to note 20.10)	4’342	7’579
Mortgage	47	44
Non-current portion	**4’425**	**7’656**
Total interest bearing loans and borrowings	**57’200**	**63’944**

20.1 Credit agreement with banks

All interest bearing loans and borrowings are made to the Swiss operating company. In June 2002, Tornos Holding SA was granted a bridge 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 par value of CHF 5 for a price of CHF 6 per share. These options are secured by the conditional share capital created in the shareholders meeting held on June 28, 2002.

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

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

- The banks waive debts 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 was due for repayment on December 31, 2003.
- As a compensation for their debt waiver, the banks received 750'000 options which entitle them to purchase 750'000 shares of a par value of CHF 5 for a price of CHF 6 per share. The options are secured by the conditional share capital which was approved by the shareholders meeting held on June 28, 2002.

In December 2003 Tornos repaid CHF 3 million of the facility A.

The credit facility agreement was extended by the creditor banks until March 31, 2004 on November 27, 2003 and until April 30, 2005 as confirmed by the lead bank on March 15, 2004. The detailed conditions of the credit facility agreement including credit covenants and interest rates are subject to contract.

20.2 Facility A

Facility A consists of a term loan up to an aggregate principal amount not exceeding CHF 25 million payable in full on March 31, 2004. The facility bears interest at LIBOR plus a fixed margin (6 %) for periods of up to twelve months.

20.3 Facility B

Facility B consists of a bullet credit up to an aggregate principal amount not exceeding CHF 20 million payable in full on March 31, 2004. The facility bears interest at LIBOR plus a fixed margin (6 %) for periods of up to twelve months.

20.4 Facility C

Facility C consists of a working capital facility up to an aggregate principal amount not exceeding CHF 7 million payable in full on March 31, 2004. The facility bears interest at LIBOR plus a fixed margin (6 %) for periods of up to twelve months.

20.5 Facility D

Facility D consists of a working capital facility up to an aggregate principal amount not exceeding CHF 8 million payable in full on March 31, 2004. The facility may be used in the form of advances, current accounts, Letters of Credit, performance, bid and advance payment bonds or guarantees up to an aggregate amount of CHF 8 million payable on demand. The facility bears interest at LIBOR plus a fixed margin (6 %) for periods of up to twelve months.

At December 31, 2003 Tornos utilised the facility in form of guarantees in the amount of CHF 3.5 million.

20.6 Covenants

As of December 31, 2002 the Group's borrowings were subject to certain covenants and conditions for the financial year 2003 including, among other things, the achievement of certain financial targets. The approved budget 2003 showed that the Group would most likely not be able to comply with some of the covenants set out in the credit agreement during 2003. On February 26, 2003, the consortium of banks offered a waiver of the existing covenants and agreed to revised covenants relating to the achievement of budgeted net sales and EBITDA with an acceptable

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

shortfall of 10% and 5% respectively, that had to be complied with in 2003 on a quarterly basis. During 2003 the Group complied with such revised covenants.

20.7 Maturity schedule

	2003	2002
Within 1 year	52'775	56'288
Between 1 and 2 years	3'075	3'748
Between 2 and 5 years	655	3'079
Over 5 years	695	829
Total borrowings	**57'200**	**63'944**

20.8 Interest rate exposure

	2003	2002
At fixed rates	6'361	11'801
At floating rates	50'839	52'143
Total borrowings	**57'200**	**63'944**

20.9 Exchange rate exposure

The original currencies of the Group's borrowings are:

	2003	2002
Swiss franc	55'331	61'998
Euro	1'749	1'946
Other European currencies	66	-
US Dollar	54	-
Total borrowings	**57'200**	**63'944**

20.10 Finance lease liabilities

	2003	2002
Minimum lease payments		
Within 1 year	4'239	4'707
Between 2 to 5 years	4'115	7'597
More than 5 years	780	959
Total minimum lease payments	**9'134**	**13'263**
Future finance charges on finance leases	(1'020)	(1'462)
Present value of finance lease liabilities	**8'114**	**11'801**
Of which		
Due with 1 year	3'772	4'222
Between 2 to 5 years	3'647	6'750
More than 5 years	695	829

The finance lease liabilities of the Group carry an effective interest rate of 4.8 % at December 31, 2003 (2002: 5.2%).

The Company does not act as a lessor.

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

21 Financial instruments

21.1 Interest rate risks

The Group is exposed to changes in interest rates on borrowings bearing interest at floating rates. At December 31, 2003 and 2002 the Group did not hold any derivative financial instruments in order to limit the interest rate exposure of the Group.

21.2 Foreign currency risk

Tornos S.A., the Swiss operating company of the Group invoices its revenues to the subsidiaries in local currencies and revenues to final customers in CHF. Therefore the currency risk is transferred from the subsidiaries to the Swiss operating company. The Group decided not to follow any systematic hedging policy against currency and market price risk through financial instruments.

21.3 Credit risk

The Company and the Group have no significant concentration of credit risk.

21.4 Fair values

The carrying amounts of the following financial assets and financial liabilities approximate their fair values: Cash, trade receivables and payables, other receivables and payables, loans, short term borrowings and long-term borrowings.

22 Pensions and other post retirement benefit obligations

22.1 Description of pension schemes

Substantially all employees are eligible for retirement benefits. Among the benefit schemes are defined benefit plans as well as defined contribution plans. The locations of the significant defined benefit plans are Switzerland, USA, France, Germany and Italy.

Retirement benefits are provided based on a final pay and service formula. Some of the plans provide only lump sum benefits in the events of leaving and retirement. The latest actuarial valuation was performed as of December 31, 2003 using the projected unit credit method.

The following summarises the components of pension cost, the funded status, the resulting prepaid assets or accrued liability and the actuarial assumptions used for the defined benefit plans:

22.2 Period pension cost recognised in personnel expenses

	Switzerland		**Outside Switzerland**		**Total**	
	2003	**2002**	**2003**	**2002**	**2003**	**2002**
Current service cost	4’868	6’807	274	453	5’142	7’260
Interest on obligation	4’528	5’453	227	230	4’755	5’683
Expected return on assets	(5’044)	(6’108)	(105)	(154)	(5’149)	(6’262)
Amortisation of						
unrecognised past service cost	17	21	(6)	-	11	21
unrecognised net (gain)/loss	(13)	48	51	8	38	56
Remeasurement of asset ceiling	236	1’822	-	-	236	1’822
Curtailment /Settlement	-	(758)	(95)	(10)	(95)	(768)
Expected employees’ contributions	(2’201)	(2’993)	-	-	(2’201)	(2’993)
Net periodic pension cost recognised	**2’391**	**4’292**	**346**	**527**	**2’737**	**4’819**

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22.3 Actual return on plan assets

	Switzerland		Outside Switzerland		Total	
	2003	2002	2003	2002	2003	2002
Actual return	15'972	(11'436)	354	(299)	16'326	(11'735)

22.4 Pension liability recognised

	Switzerland		Outside Switzerland		Total	
	2003	2002	2003	2002	2003	2002
Projected benefit obligation (funded)	129'987	125'817	2'516	3'238	132'503	129'055
Projected benefit obligation (unfunded)	894	647	417	348	1'311	995
Less fair value of plan assets	(126'600)	(117'160)	(1'788)	(1'654)	(128'388)	(118'814)
(Over) under funded	**4'281**	**9'304**	**1'145**	**1'932**	**5'426**	**11'236**
Unrecognised net actuarial gain (loss)	(3'549)	(8'394)	(169)	(1'197)	(3'718)	(9'591)
Unrecognised prior service cost	(115)	(132)	31	-	(84)	(132)
Accrued pension cost, net	**617**	**778**	**1'007**	**735**	**1'624**	**1'513**

The assets of the funded plans are held independently of the Group's assets in separate trustee administered funds. They include marketable securities, real estate and other assets. They also include 424'952 shares issued by the Company with a fair value of CHF 1.96 million. In Switzerland, the Pension Fund is controlled by an equal number of representatives of management and the employees. This parity of control implies that neither side individually controls the funds paid into the pension fund. The Company cannot, therefore, dictate on its own that any excess funds will be used for the benefit of the Company (i.e. to reduce future contributions).

The movements in net accrued pension costs are as follows:

	2003	2002
At January 1,	1'513	1'764
Exchange differences	(19)	(65)
Net periodic pension costs recognised (Note 22.2)	2'737	4'819
Contributions to the plan	(2'607)	(4'800)
Others	-	(205)
At December 31,	**1'624**	**1'513**

22.5 Weighted average assumptions

The following are the major assumptions used in the actuarial calculations:

	Switzerland		Outside Switzerland	
	2003	2002	2003	2002
Discount rate	3.75	3.75	5.87	6.56
Expected return on plan assets	4.50	4.50	6.27	6.69
Salary increases	1.94	1.98	3.92	3.99
Pension indexation	0.50	0.50	1.46	1.59

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

23 Provisions

	Warranties	Restruc-turing	Other	Total
At January 1, 2003	**9'688**	**8'823**	**4'142**	**22'653**
Additional provisions	3'682	272	363	4'317
Utilised during year	(5'717)	(3'910)	(1'228)	(10'855)
Released via income statement	(836)	(2'336)	(72)	(3'244)
Exchange differences	8	39	33	80
At December 31, 2003	**6'825**	**2'888**	**3'238**	**12'951**

Presentation of provisions on the consolidated balance sheet is as follows:

	2003	2002
Current liabilities	7'471	18'017
Non-current liabilities	5'480	4'636
	12'951	**22'653**

Warranties

The Company gives a one-year warranty on machines sold and undertakes to repair or replace items that fail to perform satisfactorily. In 2002, the Group also recognised a provision to upgrade existing machines for an amount of CHF 5 million. The expenditures occurred in 2003 in connection with the machine upgrade program amounted to CHF 1.4 million. At December 31, 2003 the upgrade program was reassessed by the management and an amount of CHF 0.4 million was released through income statement.

Restructuring

Please refer to note 6 (Restructuring) and note 8 (Personnel expenses).

Other Provisions

Other provisions include the expected costs of pending litigation and patent disputes as well as other present obligations of uncertain timing and amount.

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

24 Share capital

24.1 Capital structure

	Issued registered shares	Treasury shares	Total shares in circulation
Issued and fully paid in at December 31, 2001	**2’300’000**	**0**	**2’300’000**
Issued for cash	10’000’002		10’000’002
Issued for debt equity swap	1’083’753		1’083’753
Issued and fully paid in at December 31, 2002	**13’383’755**	**0**	**13’383’755**
Acquisition of own shares		168’110	(168’110)
Issued and fully paid in at December 31, 2003	**13’383’755**	**168’110**	**13’215’645**

2003

There were no changes in the capital structure in 2003.

2002

Subsequent to the General Meeting of Shareholders held on June 28, 2002 the following share capital changes were adopted in the second semester 2002:

- 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. Additionally, share premium in the amount of CHF 45.0 million was netted against the accumulated loss.

- Simultaneous increase of the share capital in two tranches:

  Tranche A: Increase of the share capital by CHF 35.1 million by issuance of 7’015’002 bearer shares at the price of CHF 6 per share. The capital increase was entered to the Commercial Register on July 8, 2002.

  Tranche B: Increase of the share capital by CHF 20.3 million by issuance of 4’068’753 registered shares. 2’985’000 shares were paid cash for the price of CHF 6 per share and 1’083’753 were paid by a debt equity swap for the price CHF 10 per share. The capital increase was entered to the Commercial Register on September 20, 2002.

- Creation of an authorised share capital of CHF 10 million of which CHF 5.4 million were used for the above mentioned debt equity swap.

- Creation of a new conditional share capital of CHF 11.75 million which is reserved for the issuance of shares upon the exercise of option rights which were granted to shareholders and

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

creditor banks. The existing conditional capital which was reserved for a stock option plan for employees was revoked.

- All bearer shares were converted into registered shares in connection with the increase of share capital referred to as Tranche B.

24.2 Shares outstanding and rights attached to each class of shares

As of December 31, 2003 the share capital consisted of 13’383’755 ordinary registered shares with a par value of CHF 5 each. The holders of the ordinary shares are entitled to receive dividends as declared by the meeting of shareholders and are entitled to one vote per share at the meetings of shareholders.

24.3 Treasury shares

In connection with the Group's financial restructuring in 2002, Tornos Holding SA entered into agreements with its suppliers, under which it received 168’110 of its own shares from one of its suppliers in August 2003. The Company paid CHF 0 compensation for these shares and they have been recorded pro memoria in the December 2003 balance sheet.

24.4 Authorised share capital

The shareholders meeting of June 28, 2002 resolved to create an authorised share capital of CHF 10 million, of which CHF 5.4 million were used for the debt equity swap in 2002 and CHF 4.6 million were outstanding as of December 31, 2003.

24.5 Conditional share capital

The shareholders meeting of June 28, 2002 resolved to create a conditional capital of CHF 11.75 million (2’350’000 registered shares with a par value of CHF 5 each). An amount of CHF 5.75 million is reserved for the issuance of shares upon the exercise of option rights which were granted to the shareholders within the framework of the reduction of the share capital. An amount of CHF 6 million is reserved for the issuance of shares upon exercise of option rights which were granted to certain creditor banks in consideration of them waiving part of their claims.

24.6 Significant shareholders

The following shareholders or groups of shareholders held more than 5 percent of the share capital of the Company at December 31, 2002 and 2003:

	2003	**2002***
Doughty Hanson Group	27.5%	24.9%
Credit Suisse Group	24.8%	24.8%
Günther and Helmut Rothenberger	6.5%	6.5%
Berner Kantonalbank	6.2%	6.2%
Tornos Pension Fund	3.2%	5.0%

* Estimated percentage, not fully registered in the share register as of December 31, 2002

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All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

25 Stock options

In 2002, the Group granted options to the shareholders in the framework of the reduction of the share capital (refer to note 24) and to the creditor banks as compensation for their debt waiver and for granting a bridge loan (refer to note 20). Additional options were granted to the former shareholders in connection with the settlement of a legal dispute in 2002. Until December 31, 2003, none of these options were exercised.

At December 31, 2003, the following options were outstanding

	Number of options	Expiry date
Options quoted at SWX*	2'300'000	09.09.2004
Options granted to creditor banks for waiver of loans	750'000	08.07.2007
Options granted to creditor banks for bridge loan	300'000	16.07.2007
Options granted to former shareholders	125'000	08.07.2007

* These options had originally been granted to existing shareholders (see above)

The quoted options entitle to purchase 1'150'000 registered shares in total for a price of CHF 10 per share. Each of the options granted to the creditor banks and to the former shareholders entitles the holder to purchase one registered share for a price of CHF 6.

The options are secured by the conditional share capital of 11.75 million (refer to note 24.5)

OTHER NOTES TO THE CONSOLIDATED INCOME STATEMENT

26 Loss per share, basic and fully diluted

The calculation of earnings per share is based on a weighted average of 13'324'917 (previous year: 6'675'837) outstanding shares and the net loss for the year as presented in the consolidated income statement. There are no potential ordinary shares that had a dilutive effect in the years under review.

27 (Increase) decrease in working capital

The components of the (increase) decrease in working capital as disclosed in the consolidated cash flow statement are:

	2003	2002
Trade receivables	3'976	26'887
Other receivables	2'181	4'510
Inventories	(287)	16,598
Trade payables	(4'784)	(32'257)
Other current payables and provisions	(8'327)	6'618
(Increase) decrease in working capital	**(7'241)**	**22'356**

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

28 Segment information

As described in Note 3.15 above, management of the Group has chosen geographical segments for the purpose of primary segment reporting in accordance with IAS 14. The reportable segments identified are Switzerland, other western European countries and North America. For the purpose of presenting net sales by location of customers, two other geographical segments, namely Asia and rest of world, are identified.

28.1 Net sales by location of assets

	2003	**2002**
Switzerland:		
- To third parties	57’283	54'953
- To other segments	75’297	77'352
	132’580	**132'305**
Other western European countries:		
- To third parties	90’429	91'898
- To other segments	6’532	888
	96’961	**92'786**
North America:		
- To third parties	21’035	22'806
- To other segments	4	110
	21’039	**22'916**
Elimination	(81’833)	(78'350)
Total net sales	**168’747**	**169'657**

28.2 Net sales by location of customers

	2003	**2002**
Switzerland	23’905	29'126
Other western European countries	117’470	102'023
North America	21’412	23'277
Asia	4’135	13'971
Rest of world	1’825	1'260
Total net sales	**168’747**	**169'657**

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

28.3 Segment result (EBIT) by location of assets

	2003	2002
Switzerland	(5’247)	(166’435)
Other western European countries	4’786	(5’406)
North America	29	(2’701)
Total	**(432)**	**(174’542)**
Elimination	34	645
Unallocated	786	(2’394)
Total EBIT	**388**	**(176’289)**

The transactions between Group companies are conducted based on internationally acceptable transfer pricing policies, thereby leaving reasonable margins at local subsidiary level.

28.4 Segment assets

	2003	2002
Switzerland	171’603	186'079
Other western European countries	53’371	57'526
North America	13’868	12'432
Total	**238’842**	**256'037**
Elimination	(59’313)	(51'977)
Unallocated assets:		
- Tax receivables	-	1'102
Total assets	**179’529**	**205’162**

28.5 Segment liabilities

	2003	2002
Switzerland	43’379	45'050
Other western European countries	54’312	60'541
North America	2’590	1'075
Total	**100’281**	**106'666**
Elimination	(57’623)	(49'387)
Unallocated liabilities:		
- Tax liabilities	1’244	2'015
- Interest bearing borrowings	57’200	63'944
Total liabilities	**101’102**	**123'238**

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

28.6 Depreciation of property, plant and equipment by segment

	2003	2002
Switzerland	(8'416)	(8'428)
Other western European countries	(525)	(843)
North America	(158)	(207)
Total depreciation	**(9'099)**	**(9'478)**

28.7 Amortisation/impairment loss of goodwill and other intangible assets by segment

	2003	2002
Amortisation		
Switzerland	(212)	(5'589)
Other western European countries	(35)	(43)
North America	-	-
Total amortisation	**(247)**	**(5'632)**
Impairment loss		
Switzerland	-	(76'125)
Other western European countries	-	-
North America	-	-
Total impairment loss	**-**	**(76'125)**
Total amortisation/impairment loss	**(247)**	**(81'757)**

28.8 Capital expenditure on property, plant and equipment and other intangible assets by segment

	2003	2002
Switzerland	694	8'931
Other western European countries	804	74
North America	91	-
Total capital expenditure	**1'589**	**9'005**

29 Commitments and contingencies

29.1 Operating lease commitments

Operating lease liabilities, minimum lease payments

	2003	2002
Year 1	1'242	2'788
Year 2	534	1'065
Year 3	330	342
Year 4	12	27
Year 5	-	-
After 5 years	163	165
Total minimum lease payments	**2'281**	**4'387**

Notes to the consolidated financial statements

All figures are presented in thousands of Swiss francs (CHF) unless otherwise stated

29.2 Other commitments

As of December 31, 2003 there were no other commitments not in the ordinary course of business.

29.3 Assets pledged

At December 31, 2003 and 2002, the following assets were pledged to creditor banks or leasing companies:

	2003	**2002**
Carrying amount of pledged assets		
Trade receivables	44'716	46'588
Land and buildings	32'132	31'665
Technical equipment & machinery	13'419	15'683
	90'267	**93'936**

At December 31, 2003, the total value of the pledged mortgage notes related to land and buildings amount to CHF 40'016.

29.4 Contingencies

There were no contingencies at December 31, 2003

30 Related party transactions

Related parties include the Doughty & Hanson Partnerships, Credit Suisse Group, the Board of Directors and the management of the Group.

Total remuneration to the Board of Directors and Group management amounted to CHF 2.0 million (CHF 2.1 million in 2002). For further information refer to the ‚Corporate Governance' section of the annual report. As of December 31, 2003, the Board of Directors and Group management held 11'470 shares (0.09%) of the Company.

Credit Suisse, a significant shareholder of the Company (refer to note 24.6) is the lead bank of a consortium of banks that granted credit facilities (loans and guarantees) in the amount of CHF 52.5 million as of December 31, 2003 (CHF 55.6 million as of December 31, 2002). The financial expenses related to such facilities amounted to CHF 3.6 million in 2003 (CHF 5.8 million in 2002). Also refer to notes 10 and 20.

There are no other related party transactions that should be disclosed under this heading.

31 Post balance sheet events

On March 8, 2004 the Board of Directors approved the consolidated financial statements for issue. The financial statements will be approved by the general meeting on April 13, 2004. Except as disclosed below, there were no other events that took place between the year end date and March 8, 2004 that would require adjustments to the amounts recognised in these consolidated financial statements or otherwise require disclosure in accordance with IAS 10:

The total borrowings under the credit facility agreement with the banks in the amount of CHF 49 million as of December 31, 2003 (refer note 20.1) were extended until April 30, 2005 as confirmed by the lead bank on March 15, 2004. The detailed conditions of the credit facility agreement including covenants and interest rates are subject to contract.

Report of the statutory auditors
to the general meeting of

Tornos Holding S.A., Moutier

As statutory auditors, we have audited the accounting records and the financial statements (balance sheet, income statement and notes) of Tornos Holding S.A. for the year ended December 31, 2003.

These financial statements are the responsibility of the board of directors. Our responsibility is to express an opinion on these 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, which require that an audit be planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the financial statements. We have also assessed the accounting principles used, significant estimates made and the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accounting records and financial statements and the proposed appropriation of available earnings comply with Swiss law and the company's articles of incorporation.

We recommend that the financial statements submitted to you be approved.

Berne, March 15, 2004

BDO Visura

André Faessler	Karel Hojac
Swiss Certified Accountant Auditor in Charge	Swiss Certified Accountant

Enclosures

- Financial statements (income statement, balance sheet, statement of changes in equity and notes)
- Proposed appropriation of available earnings

BALANCE SHEET

(in thousands of CHF)

as of December 31,	Note	2003	2002
ASSETS			
Cash and cash equivalents		**69**	**69**
Other receivables third		1	1
Other receivables group		800	0
Other receivables		**801**	**1**
TOTAL CURRENT ASSETS		**870**	**70**
Investment in group companies	4	65 000	65 000
Loans group companies	4	16 000	16 000
Financial assets		**81 000**	**81 000**
TOTAL NON-CURRENT ASSETS		**81 000**	**81 000**
TOTAL ASSETS		**81 870**	**81 070**
LIABILITIES AND EQUITY			
Other payables group		105	0
Other payables		**105**	**0**
Accrued expenses and deferred income		374	131
CURRENT LIABILITIES		**479**	**131**
Ordinary shares	5	66 919	66 919
Additional paid in capital	5	13 943	13 943
Retained earnings		77	148 852
Net profit / (loss) of the year		452	-148 775
SHAREHOLDERS EQUITY		**81 391**	**80 939**
TOTAL LIABILITIES AND EQUITY		**81 870**	**81 070**

The accompanying notes form an integral part of these financial statements

INCOME STATEMENT

(in thousands of CHF)

	Note	2003	2002
Management fee income		0	170
Total other operating income		**0**	**170**
Legal and consulting fees		-325	-144
Taxes other than income taxes		-23	-20
Total other operating expenses		**-348**	**-164**
EBITDA		**-348**	**6**
Amortisation of intangible assets		0	-273
EBIT		**-348**	**-267**
Interest income third		0	3
Interest income group companies		800	2 653
Other financial income		0	634
Financial income		**800**	**3 290**
Interest expenses third		0	-20
Other financial expenses		0	-173
Financial expenses		**0**	**-193**
Net profit before taxes and e.o. items		**452**	**2 830**
Income tax expenses		0	0
Cancellation of loans to group companies	4	0	-151 605
Net profit (loss) for the year		**452**	**-148 775**

The accompanying notes form an integral part of these financial statements

STATEMENT OF CHANGES IN EQUITY
(in thousands of CHF)

	Note	Ordinary shares	Additional paid in capital	Retained Earnings	Total Equity
Shareholder's Equity as of 31.12.2001		**115 000**	**44 055**	**322**	**159 377**
Decrease in capital	5	-103 500	-44 055	147 555	0
Issuance of new shares	5	55 419	15 419		70 838
Charges of the capital increase	5		-1 476	975	-501
Net income (loss) for the year				-148 775	-148 775
Shareholder's Equity as of 31.12.2002		**66 919**	**13 943**	**77**	**80 939**
Net income (loss) for the year				452	452
Shareholder's Equity as of 31.12.2003		**66 919**	**13 943**	**529**	**81 391**

The accompanying notes form an integral part of these financial statements

NOTES TO THE FINANCIAL STATEMENTS 2003
(in thousands of CHF)

1 Basis of preparation

The financial statements of Tornos Holding SA, Moutier (the Company) as of December 31, 2003 have been prepared in accordance with the provisions of the Swiss law and the Company's Articles of Incorporation.

2 Valuation of assets / going concern

The Company's financial statements as of December 31, 2002 and 2003 have been prepared on a going concern basis. The Group undertook restructuring measures in 2002 and achieved its planned EBIT as of December 31, 2003, while incurring a consolidated net loss of CHF 2.8 million.

The total borrowings under the credit agreement with the syndicate banks in the amount of CHF 49 million as of December 31, 2003 were extended until April 30, 2005 as confirmed by the lead bank on March 15, 2004. The detailed conditions of the credit facility agreement including credit covenants and interest rates are subject to contract.

In 2004, main focus of the Group is to achieve the budgeted sales and margins. Should it become apparent that the targets cannot be met, the Board of Directors will take immediate appropriate steps.

3 Guarantees

Tornos Holding SA entered as parent company and the original guarantor into a Senior Facility Agreement (CHF 60 million) dated June 28, 2002 with the creditor banks. At December 31, 2003 Tornos SA has as subsidiary and additional borrower drawn down CHF 52.5 million.

4 Subsidiaries

			Ownership (%)	
Name	**Purpose**	**Share capital**	**31/12/03**	**31/12/02**
Tornos SA, Moutier	Production, Sales	CHF 65'000'000	100,00	100,00

As of June 30, 2002 the subsidiary was overindebted. After the recapitalisation of Tornos Holding SA, the loans given to Tornos SA were abandoned by CHF 151.6 million in 2002.

5 Share capital changes 2002

In accordance with the resolutions adopted at the General Meeting of Shareholders held on June 28, 2002 the Company's share capital changed as follows:

Decrease of capital
- The share capital was reduced by CHF 103.5 million to eliminate the accumulated deficits by reducing the par value of all 2.3 million registered shares (issued and outstanding) from CHF 50 to CHF 5 per share

Issuance of new shares in two steps
- Tranche A: Increase of the share capital by CHF 35.1 million by issueance of 7'015'002 bearer shares at the price of CHF 6 per share. The capital increase was entered to the Commercial Register on July 8, 2002.
- Tranche B: Increase of the share capital by CHF 20.3 million by issuance of 4'068'753 registered shares. 2'985'000 shares were paid cash for the price of CHF 6 per share and 1'083'753 were paid by a debt equity swap for the price of CHF 10 per share. The capital increase was entered to the Commercial Register on September 20, 2002.

NOTES TO THE FINANCIAL STATEMENTS 2003

(in thousands of CHF)

All bearer shares were converted into registered shares in connection with the increase of share capital referred to as Tranche B.

As of December 31, 2002 and 2003 the Company's share capital is CHF 66.9 million, represented by 13'383'755 shares with par value of CHF 5 each. There were no changes in the capital structure in 2003.

6 Conditional and authorised share capital

According to the Company's Articles of incorporation, the capital can be increased as follows:

Conditional share capital of up to CHF 11.75 million
- Up to 1'150'000 shares with par value of CHF 5 can be issued by the exercise of stock options, given to the shareholders because of the capital decrease, until September 2004.
- Up to 1'200'000 shares with par value of CHF 5 can be issued by the exercise of stock options, given to the banks and certain creditors who participated at the financial restructuring, until July 2007.

Authorised share capital of up to CHF 4.6 million
- In case of financial restructuring or acquisitions, the Board of Directors may increase the share capital by up to 916'247 shares with par value of CHF 5 until September 2004.

7 Treasury stock

In connection with the Group's financial restructuring the Company entered into agreements with its suppliers, under which it received 168'110 of its own shares from one of its suppliers in August 2003. The Company paid CHF 0 compensation for these shares and they have been recorded pro memoria in the December 2003 balance sheet. Therefore, a reserve for own shares is not required.

8 Major shareholders

The following shareholders or groups of shareholders held more than 5 percent of the share capital of the Company:

At December 31,	2003	2002*
- Doughty Hanson Group	27,5%	24,9%
- Credit Suisse Group	24,8%	24,8%
- Günter und Helmut Rothenberger	6,5%	6,5%
- Berner Kantonalbank	6,2%	6,2%
- Tornos Pension Fund	3,2%	5,0%

* Estimated percentage, not fully registered in the share register as of December 31, 2002

PROPOSED APPROPRIATION OF AVAILABLE EARNINGS

(in thousands of CHF)

	2003	**2002**
Retained earnings brought forward	77	148 852
Net income (loss) for the year	452	-148 775
Available earnings	**529**	**77**

The board of Directors proposes to the General Meeting of Shareholders the following appropriation of available earnings:

Available earnings	529	77
To be carried forward	**529**	**77**