TORNOS

2005

INTERIM CONSOLIDATED FINANCIAL STATEMENTS 2005

TORNOS HOLDING S.A., MOUTIER

TORNOS HOLDING S.A.

Interim consolidated income statement
(unaudited)

In thousands of CHF, except per share data

Six months ended June 30,	Notes	**2005**	**2004** Reclassified
Gross sales		**115'434**	**90'706**
Rebates and discounts		-1'549	-3'618
Net sales		**113'885**	**87'088**
Cost of sales		-71'575	-61'109
Gross profit		**42'310**	**25'979**
Marketing and sales		-16'735	-15'268
General and administrative expenses	5	-10'628	-10'496
Research and development		-6'013	-2'175
Operating income / (loss) before interest and taxes (EBIT)		**8'934**	**-1'960**
Financial expenses - net	4	-1'173	-1'784
Exchange gains / (losses) - net		858	-256
Income / (loss) before income taxes		**8'619**	**-4'000**
Income taxes		19	-588
Net income / (loss) for the period		**8'638**	**-4'588**

Profit / (loss) per share		
Basic	0.65	-0.34
Fully diluted	0.63	-0.34
Operating income / (loss) before interest and taxes (EBIT)	**8'934**	**-1'960**

Depreciation and amortisation	4'321	4'139
Profit before interest, income taxes, depreciation and amortisation (EBITDA)	**13'255**	**2'179**

Interim consolidated balance sheet

(unaudited)

In thousands of CHF

	Note	**June 30, 2005**	**December 31, 2004**
ASSETS			
Cash and cash equivalents		3’010	7’589
Trade receivables		39’859	39’549
Inventories		65’027	61’849
Other receivables and prepayments		8’790	9’276
Total current assets		**116’686**	**118’263**
Property, plant and equipment		51’541	54’010
Total non-current assets		**51’541**	**54’010**
Total assets		**168’227**	**172’273**

	Note	**June 30, 2005**	**December 31, 2004**
LIABILITIES AND EQUITY			
Interest bearing loans and borrowings	4	21’514	33’215
Trade payables		16’640	19’076
Other payables		17’988	16’940
Provisions		9’176	10’749
Total current liabilities		**65’318**	**79’980**
Interest bearing loans and borrowings		2’214	2’398
Retirement benefit obligations		1’473	1’415
Provisions		3’863	3’917
Deferred tax liabilities		990	1’025
Total non-current liabilities		**8’540**	**8’755**
Total liabilities		**73’858**	**88’735**
Total shareholders’ equity		**94’369**	**83’538**
Total liabilities and shareholders’ equity		**168’227**	**172’273**

Interim consolidated statement of changes in equity
(unaudited)

In thousands of CHF

	Note	Ordinary shares	Share premium	Retained earnings / (accumulated deficit)	Other comprehensive income / (expenses)	Currency translation difference	Total
At December 31, 2003		**66’919**	**13’943**	**-1’855**	**-**	**-580**	**78’427**
Issuance of new shares	5	250	12				262
Net loss for the period				-4’588			-4’588
Currency translation difference						-343	-343
At June 30, 2004		**67’169**	**13’955**	**-6’443**	**-**	**-923**	**73’758**
At December 31, 2004		**67’169**	**13’955**	**4’923**	**-11**	**-2’498**	**83’538**
Issuance of new shares	5	250	12				262
Net profit for the period				8’638			8’638
Other comprehensive income / (expenses) - net					549		549
Currency translation difference						1’382	1’382
At June 30, 2005		**67’419**	**13’967**	**13’561**	**538**	**-1’116**	**94’369**

Interim consolidated cash flow statement
(unaudited)

In thousands of CHF

For the six months ended June 30,	**2005**	**2004**
Net cash provided by operating activities	9’133	13’071
Net cash used in investing activities	-1’395	-2’127
Net cash used in financing activities	-12’440	-18’816
Net decrease in cash and cash equivalents	**-4’702**	**-7’872**
Cash and cash equivalents at January 1,	7’589	12’317
Effects of exchange rate changes	123	-67
Cash and cash equivalents at June 30,	**3’010**	**4’378**

Selected explanatory notes to the interim consolidated financial statements

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

1 Basis of preparation

The interim consolidated financial statements for the six months ended June 30, 2005 have been prepared in accordance with the International Accounting Standard 34 on interim financial reporting. The accounting policies used are consistent with those used in the 2004 annual consolidated financial statements which included the early adoption of new or revised standards.

These interim financial statements include additional disclosure required by the revised and or new standards only for items deemed significant.

Certain amounts reported in prior years have been reclassified to conform with current year presentation. The principal reclassifications relate to :

- Rebates previously deducted from Gross sales are classified as Rebates and discounts,
- Agent commissions previously deducted from Net sales are classified under Marketing and sales.

2 Scope of consolidation

Tornos Technologies Asia Limited, Hong Kong was founded on May 21, 2005 and is acting as a spare parts distributor and support services company in Asia. This is the only change in the scope of consolidation which occurred in the period under review.

3 Critical accounting estimates and judgements

The preparation of financial statements in conformity with IFRS requires us to make estimates and assumptions that affect the amounts we report in the financial statements and accompanying notes. On an ongoing basis, we evaluate our estimates, including those related to provisions for warranty purpose and other provisions resulting from pending litigation and patent disputes as well as other present obligations of uncertain timing, inventory obsolescence, bad debts and the assessment of income taxes and retirement benefit obligations. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. We believe the following critical accounting policies reflect the most significant judgments and estimates that we use in the preparation of our consolidated financial statements.

Seasonality of business

From a statistical perspective, Tornos business is influenced by economic cycles which may generate significant changes in business level from one period to another.

Bad debts

Allowances are made for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, we might need to make additional allowances.

Selected explanatory notes to the interim consolidated financial statements

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Inventory obsolescence

Machines, including work in progress machines on the assembly floors, are reviewed individually and recorded at the lower of cost and estimated net realisable value based upon assumptions about future demand and market conditions.

For raw material, component, semi-finished goods and spare parts the following inventory obsolescence and write-offs methodologies are applied for any slow moving or any otherwise obsolete inventory :

Raw material, components and semi-finished goods

For any article, the quantity of articles in stock cannot exceed 18 months of consumption based on the last 12 months of consumption. Any excess is fully provided for.

After 24 months without movement, the individual stock of articles is written-off. Once written-off, the articles are transferred to the Spare Parts department upon their request at NIL value.

After 48 months without movement, the stock is physically disposed of after second opinion from the Spare Parts department.

In case of a machine phase out all the related stocks of articles are fully written-off.

Spare parts in the spare parts department

For any article, the quantity of articles in stock cannot exceed 36 months of consumption based on the last 24 months of consumption. Any excess is fully provided for.

After 36 months without movement, the stock of articles is written-off.

After 72 months without movement, the stock is physically disposed of upon selective review.

If actual market conditions are less favorable than those we project, we may need to take additional inventory write-downs.

Impairment of long-lived assets

Long-lived assets are regularly reviewed for impairment whenever events or changes in circumstances indicate that the balance sheet carrying amount of the asset may not be recoverable. In order to assess if there is any impairment, estimates are made of the future cash flows expected to result from the use of the asset and its eventual disposal. If the balance sheet carrying amount of the asset exceeds the higher of its value in use or its anticipated net selling price, an impairment loss for the difference is recognised. Future cash flows could vary from the estimates used in preparing the discounted cash flows. Factors such as changes in the planned use of buildings, machinery or equipment, or closing of facilities or lower than anticipated sales performance could result in shortened useful lives or impairment.

Selected explanatory notes to the interim consolidated financial statements

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Deferred taxes

The Group had to take drastic restructuring measures in the recent past few years further to a history of severe down-turns and losses in its operating activities. Therefore, although profits before taxes of CHF 7.9 million and CHF 8.6 million were achieved for the twelve months ended December 31, 2004 and for the six months period ended June 30, 2005 respectively, no deferred tax assets have been recognised as the Group has not yet demonstrated that it can sustain profitability at a sufficient level to ensure recovery of the tax losses, a significant part of which matures in 2009.

Retirement benefit obligations

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. The expense incurred under the defined benefit retirement plans is based upon statistical and actuarial calculations, and is impacted by assumptions on discount rates used to determine the present value of future pension liabilities, expected returns that will be made on existing pension assets, future salary increases as well as future pension increases. Furthermore, our independent actuaries use statistical based assumptions covering future withdrawals of participants from the plan and estimates on life expectancy. The actuarial assumptions used may differ materially from actual results due to changes in market and economic conditions, higher or lower withdrawal rates or longer or shorter life spans of participants. These differences could impact significantly the amount of pension income or expense recognised in future periods.

Warranty provision

Warranty provision of CHF 8.7 million reflects management assessment of warranty claims. It is based on the level of sales as well as punctual quality issues which may be discovered. The total warranty provision takes into consideration all possible legally enforceable claims as well as actions undertaken for commercial reasons. Actual results may fluctuate significantly.

Other provisions

Other provisions amounting to CHF 4.3 million principally comprise the expected costs of pending litigation and patent disputes as well as other present obligations of uncertain timing, the outcome of which may prove to be more or less favorable than management currently believes.

Contingencies

Several of our subsidiaries are parties to various legal proceedings which are an ongoing feature of our business. As a result, claims could be made against them which might not be covered by existing provisions or by insurance. There can be no assurance that there will not be an increase in the scope of these matters or that any future lawsuits, claims, proceedings or investigations will not be material. Management does not believe that during the next few years, the aggregate impact, beyond current provisions, of these and other legal matters affecting the company could be material to the company's results of operations and cash flows, and to its financial condition and liquidity.

Selected explanatory notes to the interim consolidated financial statements

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

4 Interest bearing loans and borrowings

On April 25, 2005 the Group concluded a new Credit Facility Agreement with a new syndicate of banks lead by UBS, Zurich. Under this agreement the syndicate of banks grants to Tornos S.A. as borrower with Tornos Holding S.A. acting as guarantor a credit facility in the aggregate of CHF 42.5 million. Of this amount, CHF 30 million can be used for advances of up to 12 months and CHF 12.5 million for current overdrafts and the issuance of bank guarantees of up to 12 months. This Credit Facility Agreement which is valid until December 31, 2007 is subject to certain conditions and financial covenants related to total debt to EBITDA and interest cover ratios as well as tangible net worth.

The interest charged on the advances is based on the LIBOR rate plus an applicable margin. The applicable margin ranges between 1.30% and 3.10% per annum and is based on the total debt to EBITDA ratio. This Credit Facility Agreement is also subject to a commitment fee on the average undrawn and uncancelled amount of the Facility until the end of the availability.

5 Stock Compensation Plans

The General Meeting of Shareholders held on April 13, 2004 approved the issue of 450’000 conditional shares that may be used by the Board of Directors to satisfy stock purchase and option plan commitments set out below.

Share Purchase Plan

Under the 2004 Management and Board Participation Plan, eligible members selected by the Board of Directors were offered 150’000 registered shares at CHF 5.30 per share to be issued in three equal tranches over a three-year period. The purchase price was deemed equivalent to the fair market value at the date each eligible member contractually committed to purchasing the shares, hence no compensation expense has been calculated in respect of the above. As at June 30, 2005, 100’000 registered shares had been issued under the 2004 Management and Board Participation Plan. Subscriptions for 43’329 registered shares to be issued on May 1, 2006 had been received as at June 30, 2005. The 6’671 remaining shares available under this plan will be offered to the participants on May 1, 2006.

Stock Option Plan

Under the 2004 Management and Board Participation Plan, eligible members selected by the Board of Directors were issued options to purchase registered shares at a strike price of CHF 6.00 per share. The terms and conditions with respect to options granted were determined by the Board of Directors who administered these plans. Options vest over two years and remain outstanding for periods not exceeding three years. A total of 300’000 registered shares may be issued under this plan.

Compensation expense is recognised over the vesting period in accordance of the provisions of IFRS 2 “Share-based Payment”. Compensation expense of CHF 44’000.00 was recorded for the six month period ended June 30, 2005 (June 30, 2004 : CHF 6’000.00). Such amounts are accrued as a liability when the expense is recognised and subsequently credited to additional paid-in capital upon exercise of the related stock options. Compensation expense arising from stock options outstanding at June 30, 2005 to be recognised in future periods amounts to CHF 301’000.00 (June 30, 2004 : CHF 69’000.00).

Selected explanatory notes to the interim consolidated financial statements

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

A summary of activity under the stock option plans, including weighted average exercise price, is as follows:

	Options	**Exercise price** (CHF)	**Contractual live**
Outstanding at December 31, 2003	**-**	**-**	
Granted	100’000	6.00	3 years (April 30, 2007)
Exercised	-	-	
Cancelled or expired	-	-	
Outstanding at June 30, 2004	**100’000**	**6.00**	
Exercisable at June 30, 2004	**-**	**-**	

Outstanding at December 31, 2004	**100’000**	**6.00**	
Granted	100’000	6.00	3 years (April 30, 2008)
Exercised	-	-	
Cancelled or expired	-	-	
Outstanding at June 30, 2005	**200’000**	**6.00**	
Exercisable at June 30, 2005	**-**	**-**	

The fair value of the grants under the stock option plan was estimated using the Black-Scholes valuation model with the following assumptions and values :

	Options granted in 2004	Options granted in 2005
Options granted	100’000	100’000
Dividend yield	-	-
Expected life	2.5 years	2.5 years
Expected volatility	25%	25%
Risk free interest rate	1.60%	1.03%
Fair value of grants per option	CHF 0.75	CHF 2.95
Expected turnover of personnel	-	-

The expected volatility used to calculate the fair value differs from the historical volatility of the Company’s share price. Management considers that the historical volatility is not a reasonable basis upon which to estimate future volatility given the impact that the restructuring measures undertaken in 2002 had on both the share price and the trading volumes experienced during 2003 and 2004.

Selected explanatory notes to the interim consolidated financial statements

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6 Major shareholders

Credit Suisse and Doughty Hanson & Co, the two main shareholders of Tornos Holding S.A. with 24.7% and 27.4% respectively in the capital of the Company at December 31, 2004, supported the recapitalisation of the Group which took place in 2002. As these shareholders always intended to divest at the end of the restructuring process which is now complete, all shares held by these two establishments were placed with institutional investors and a group of shareholders formed by members of the board of directors and the management team of Tornos. This latter group now holds 10.4 % of the capital and is the largest shareholder of the company.

7 Segment reporting

7.1 Net sales by location of customers

Six months ended June 30,	**2005**	**2004** Reclassified
Switzerland	26’284	11’286
Other western European countries	62’402	61’766
North America	15’793	8’894
Asia and rest of world	9’406	5’142
Total net sales	**113’885**	**87’088**

7.2 Net sales by location of assets

Six months ended June 30,	**2005**	**2004** Reclassified
Switzerland:		
- To third parties	96’078	53’176
- To other segments	11’048	23’018
Other western European countries:		
- To third parties	2’072	25’021
- To other segments	554	821
North America:		
- To third parties	15’735	8’891
- To other segments	-	18
Elimination	-11’602	-23’857
Total net sales	**113’885**	**87’088**

Selected explanatory notes to the interim consolidated financial statements

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

7.3 Segment result (EBIT) by location of assets

Six months ended June 30,	2005	2004
Switzerland	8’189	-3’400
Other western European countries	541	1’846
North America	21	-314
Total	8’751	-1’868
Elimination	124	-39
Unallocated	59	-53
Total EBIT	**8’934**	**-1’960**

8 Post balance sheet events

The Board of Directors approved the interim consolidated financial statements on August 19, 2005. There were no events that took place between the balance sheet date and August 19, 2005 that would require adjustments to the amounts recognised in these interim consolidated financial statements or require disclosure.

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