



# TORNOS IS GOING A STEP FURTHER...



## **Production...**

The technology market is developing rapidly. Manufacturers of precision turned parts continually expect increased efficiency, safety and productivity. This is provided by Tornos, a company involved in the continuous development of machines with greater manufacturing output at the best possible price.

Our innovations are borne out of the constant dialogue with our clients, so that they can operate successfully; whether they are active in the automotive, medical, electronics or the horological sectors.

## **... is an everyday activity...**

Because of its unbeatable quality-to-price ratio, precision turning is a must for executing small parts. Whether extremely simple or complex parts, the technological solutions always drive back the limits of potential operations. What is more, Tornos make it possible to produce parts that are more and more subtly incorporated in many items of everyday life throughout the world.

## **...that is becoming more simple!**

Many factors have to be taken into account when purchasing a production tool. It must correspond exactly to the manufacturing and precision requirements, provide an excellent service and in some cases have an interesting design. Today, Tornos is going that step further by pushing its solutions towards operational and programming simplicity and ergonomics.

# REPORT OF THE PRESIDENT OF THE BOARD OF DIRECTORS



## **Ladies and Gentlemen, Dear Shareholders,**

Following 2004, a year dedicated to consolidating the Group's recovery, we wanted to confirm the sustained nature of this revival, as witnessed during the success of 2005. We are pleased to inform you that we have achieved our goal. In fact, the financial year closed with a net profit of CHF 12.8 million. The equity is now standing at CHF 100.2 million and represents 60.4% of the balance sheet total, amounting to CHF 165.8 million. Apart from these figures, we would also like to share with you the other striking developments that have marked this financial year. More detailed information on our activities is provided in the following pages.

Tornos is a group centred around its products – products that play an overriding role in the company's success. Since 2004, considerable effort has been devoted to product development. The initial results of this policy materialized in 2005. In this respect, 2005 was rich in innovations with the launch of four new machines and the presentation of numerous improvements to the existing range.

In addition to the «a» line, which remains our flagship for complex parts, the single-spindle product range has been enhanced by the «s» line. It is dedicated to the production of precise parts of average, geometric complexity - a market we had hitherto neglected. For this new segment,

we offer a product that is unique throughout the world – the 8sp.

The multi-spindle machines continued to be upgraded. They are now more and more integrated into specialized production systems that incorporate additional functions to the standard machining operations, depending on the client's specific application.

The customer reception of the new products was highly positive and other launches will regularly take place, so that we can renew what we have on offer over the next three years.

With regard to geographic coverage, following the opening of an agency office in Shanghai, our expansion in Asia is continuing at a sustained rate. The orders recorded there in 2005 represent 2.4 times those achieved for 2004. To accompany this rapid development and offer the ultimate technical support to our clients, we opened a technical support centre for Asia in June 2005, based in Hong-Kong.

Improved geographical coverage, renewal of the current range and the launch of products destined for new market segments represent the motors of our development. Whilst smoothing out the short-term effects of economic crises, it is our aim to break through the CHF 300 million



sales barrier in 2008. At this point, we intend to be profitable with an operational margin (EBIT) of 10%. This is an ambitious goal and its success will mean that we can wipe out total group debt in 2007 and possibly even pay a dividend. Besides discharging our debts, we also want to accumulate cash reserves. The aim is to enable the Group to finance itself completely, especially during the starting phases of a bullish economic cycle, which requires a strong and immediate increase in working capital. Once this reserve is in place, our policy will be to distribute a substantial portion of our results to the shareholders, since our strategy will not involve major acquisitions in the medium term.

During the last General Meeting, we reported on the intentions of Credit Suisse and Doughty Hanson & Co. to sell their shares of 24.7% and 27.4% respectively in Tornos Holding S.A. capital. All their shares were placed with institutional investors and a group of shareholders made up of members of the Board of Directors and the management of Tornos.

With these important shareholder changes, 2005 was dedicated to the final stage of the Group's recovery.

To conclude, on behalf of the Board of Directors, I would like to thank our shareholders for their confidence in us and also thank our staff, clients and partners that have helped us achieve our objectives.

**François Frôté**  
Chairman of the Board of Directors

# OPERATIONS, RESULTS AND OUTLOOK



## Business activities

The year 2005 was characterised by a very high level of activity during the first quarter, followed by a gradual return to an average level during the second quarter. A marked downturn in the market was felt in the autumn, which was partly compensated for by the impact of new products exhibited at the EMO in September. The fourth quarter confirmed this change in trend. In the end, the total orders for the year amounted to CHF 212.5 million, i.e. a drop of 5.5% compared with 2004, which was marked by a growth of 31.9%.

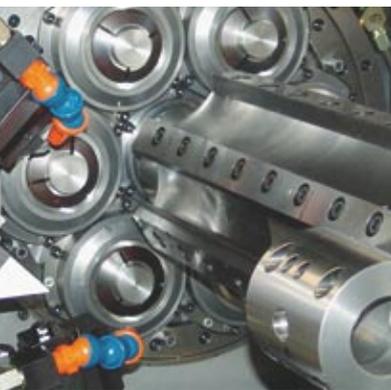
In geographical terms, the year was marked by great contrast. Compared with the previous year, we felt a net downturn in Italy, France and Spain, whilst our business developed well in Germany, Switzerland and Eastern Europe. These divergent trends more-or-less balanced themselves out and in all, Europe shows a slight growth. In North America, 2004 was an exceptional year, with 82% growth in the USA, partly owing to two single orders which alone came to more than 40 machines. 2005 was disappointing with a 58.8% downturn of the orders for machines on a market that reduced long-term investments in modern machining technology. Our growth in Asia was remarkable, since our overall volume of business there increased 2.4 times in one year. It now accounts for more than 10% of our total activities. To summarise, with regards to order for machines only, Asia is growing, Europe is generally stable, North America is declining and the rest of the world is marginal.

Under these circumstances gross sales for the year 2005 amounted to CHF 222.6 million, which is 4.5% up compared with the previous financial year.

## Finance

The audited consolidated accounts as at 31.12.2005 are enclosed. They were produced in compliance with International Accounting Standards.

The financial year closed with a net consolidated profit of CHF 12.8 million, compared with CHF 6.8 million in 2004. This significant improvement in profitability is attributed to the growth in sales and to pursuing cost-cutting exercises. Hence the gross margin increased from 32.7% to 35.6% on gross sales. The result before interest and tax (EBIT) is CHF 14.2 million (2004: 11.0) and the EBITDA achieved CHF 23.2 million (2004: 19.4). It should be pointed out that this progress was also characterised by marked growth in R&D costs, which rose from CHF 5.5 million in 2004 to CHF 12.4 million for the current year, whilst the other operational costs dropped overall by CHF 0.2 million. This profitability meant that we could further reduce the net group debt from CHF 28.0 million



to CHF 10.8 million during the year under review. As at December 31, 2005, the equity of CHF 100.2 million represented 60.4% of the total consolidated balance sheet of CHF 165.8 million.

### Organisation

Despite the development of our sales organisation in China and the opening of our regional centre in Hong-Kong, the organisational structures of the group showed little development during 2005.

The priority was to reinforce the After-Sales department with a view to improving our response times to clients. Following this direction we created a «Techno Centre» in Moutier; its purpose is to welcome and provide support and training to our clients. We also intend to use this centre to improve our customer services with respect to testing, trials and validations, as well as to assist customers to develop their skills in running our machines to achieve maximum productivity. Finally, we stopped redeploying our R&D team, so that we can guarantee the regular launch of products based on actual technological innovations. The 8sp, the only and unique product in the world capable of machining parts within a tolerance of +/- 1 thousandth of a millimetre is a perfect illustration of this point.

In 2005, we systematically implemented a «make or buy» policy, with the aim of ensuring the internal manufacture of parts that incorporate our own know-how and/or offer us a benefit in terms

of logistical flexibility. Additional parts are subcontracted, provided the price is comparable or even better. This policy of concentrating on our strengths releases resources and means that we can reduce our exposure to economic cycles. In the same vein, we also introduced a system of flexible working hours, according to the order book, within a range of between 16 and 55 hours a week. As indicated above, the year 2005 made a strong start at the beginning of the year and gradually declined to its lowest ever point in the last quarter. Thanks to a drastic increase in working hours from January 2005 onwards, the equivalent of employing 17 full-timers for 6 months, Tornos was able to satisfy demand without increasing lead times. Then, by gradually reducing the hours to below 40 hours a week from August 2005, the reverse happened. With such a system, we theoretically created 17 jobs in January, only to dispense with 34 in August. Against this background, our policy is to adjust our production capacity in real time so as to keep our order backlog within a range of CHF 40 to 50 million. This will mean that we can guarantee fast delivery times to customers and provide sufficient transparency to efficiently manage production.



#### Outlook for 2006

We anticipate a weak first quarter in 2006, with an economic upturn during the second quarter, which will have little impact on the invoicing for the first half year. Against this, we anticipate a much improved second half. We believe that on the one hand the economic situation will improve and on the other hand the new products launched in the spring of 2005 will reach a high volume. A good number of these products can be added to the current range, since they are only marginal replacements.

Unless there is a hiccup in the economic recovery in our sector, we anticipate 5 to 10% growth in sales for 2006. The operating margin in relation to sales will remain stable, especially owing to the influence of two negative factors. In the first place, R&D investment will be above its normal level in 2006 and secondly, we will be at the start of the learning curve with respect to several new products, which will have a temporary negative effect on our margins.

At operational level, the priority will be centred on adapting the sales network, bearing in mind the geographic shift of the markets, the completion and opening of the Techno Centre for our clients and the different types of research into innovation and flexibility.

# THE STRATEGIC VISION OF TORNOS



Tornos strategy is essentially based on permanently improving the following:

## **In-depth knowledge of markets**

We have to identify our clients clearly in order to be able to serve them with maximum efficiency. Innovations and technological developments must be governed by an accurate knowledge of market trends and their specific requirements, on the basis of on-going observations of the market.

## **Offering clients a good quality product**

Only an in-depth knowledge of the client's parameters allows us to offer a product that is fully compatible with his requirements and operating procedures. In this light, Tornos develops products that are specifically dedicated to certain industrial sectors, such as electronics, horology, automotive and, in particular, the medical sectors, where we have already established ourselves as a leader.

Apart from supplying machines, it is the ambition of Tornos to become a production «systems» provider, including all the necessary peripherals required for the complete finishing and handling of completed parts.

These services include efficient, rapid and good quality customer care. Consequently, Tornos does not hesitate to regard the «After-Sales Division» as an integral part of its product portfolio.

## **Research and development**

The technological projects carried out by Tornos are based on the above principles. With a view to constantly upgrading our technical skills, we are looking to stimulate the inventive ability of our engineering team with the overriding principle of «technology serving simplicity».

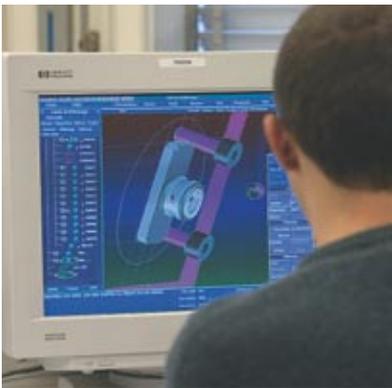
R&D activities are also carried out externally with strategic partnerships with top companies or institutions in their respective sectors.

## **Operational excellence**

Proximity to the client, project management, feasibility studies, reliability, cost analysis, development of skills and quality are the factors we pay overriding attention to. Mastering them leads to operational excellence which is our permanent goal.

Last, but not least, it goes without saying that good communication management is essential to Tornos – both vis-a-vis its clients, shareholders and employees – so that its image is recognisable and remains a symbol for quality and performance across the world.

# SINGLE SPINDLE BUSINESS UNIT



## Single spindle Business Unit

Customer requirements are changing rapidly. In order to satisfy them, we are constantly launching new technical developments and modular solutions adapted to customers' production. Innovations are the result of constant dialogue with our clients in all areas of precision turning.

### Medical

We are the leaders in the medical sector – a sector that is enjoying strong growth. The technological progress of our machines coupled with mastering specific processes, now means that dental implants, bone screws and spinal hooks can be produced.

Our collaboration with the leading companies in these high-tech sectors means that we can provide them with the best and most efficient innovative and productive solutions.

### Electronics

The exceptionally high output of our machines has made them the standard in machining electronic contacts. With the aim of gaining new market opportunities and increasing market share, we successfully launched a brand new, innovative machine that can produce parts for hard disc drives (HDD) with tolerances of  $\pm 1$  micron, very cheaply. The 8sp can replace the use of three machines.

### Watch industry

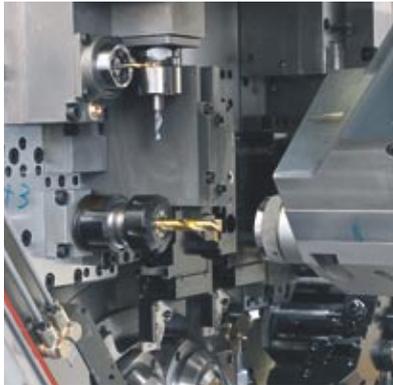
2005 was marked by very strong sales growth in the watch sector. Our machines can produce very high quality parts, such as mechanical movement parts as well as watch exteriors. In 2006, it is our intention to reinforce our market presence with the launch of a new, flexible and extremely precise machine.

### Automotive and general sub-contracting

We reached our target with the highly remarkable launch of the 20s at EMO 2005 by offering a medium-range, economic and highly efficient machine. This machine can execute precise parts with the power and strength to remove vast quantities of swarf. The modular design of this lathe, coupled with its ease of use, makes this the ideal product for manufacturing small series or pre-series runs.

# MULTISPINDLE BUSINESS UNIT

## MULTIDECO



### Enlarged range

Faced with the pressure on prices, our clients are constantly looking for innovative machining solutions. The new multispindle machines unveiled by Tornos in 2005 expanded our range in two main directions: simple machines for machining low-value parts and fully integrated systems for complex applications.

### CNC technology for producing simple parts

Even for simple parts, developments in materials that lead to increased machining difficulties, coupled with the requirements of even better surface qualities and tighter tolerances, mean that other solutions must now be found apart from the cam-operated machines normally used for this purpose. In April 2005, we launched the MULTIDECO 20/6be, a CNC machine dedicated to executing simple to reasonably complex parts. This machine combines high output with precision.

### Integrated systems

During April 2005, we unveiled the MULTIDECO 32/6c with 6 spindles and a fully integrated palletization system in Moutier. At the EMO exhibition in Hanover, we launched the new MULTIDECO 20/8d with 8 spindles and fitted it with powerful motorised spindles. These two world class innovations offer integrated machining systems for machining complex parts in only one industrial process.

### Automotive market

For MULTIDECO products, the automotive sector is the most important. It generates a vast volume of precision-turned parts with a high level of precision, which are frequently machined from difficult materials. These requirements relate particularly to the manufacture of safety components, such as airbags and the latest generation of injectors or gear boxes.

### Serving many industrial sectors

Our CNC multispindle technology responds to a growing demand from sectors other than the automotive sector. The properties of ultimate precision and impeccable surface qualities are important criteria that additional market sectors are

# BOARD OF DIRECTORS



F.I.t.r.

## **Michel Rollier (1959), Switzerland**

Member since 2002 | Elected until 2008 | Previous / current activities for Tornos: none | Training – last grade on completion of studies: EPFL engineer (Ecole Polytechnique Fédérale), Lausanne, 1985 | Current list of board membership mandates: Rollomatic Holding SA, Chairman of the Board of Directors | Previous professional activities: Rollomatic SA, various management functions in the Group since 1989, R&D Manager

## **François Frôté (1953), Switzerland**

Chairman of the Board | Member since 2002 | Elected until 2008 | Previous / current activities for Tornos: authority to act as legal adviser | Committees: Nomination and Compensation Committee and Audit Committee | Training – last grade on completion of studies: lawyer, law degree at the University of Bern 1979 | Current list of board membership mandates: Rollomatic Holding SA: Board director, Nugerol Holding SA: Board director, Esco SA: Board director | Professional activities from 1996 to the present: Lawyers' offices of Frôté & Partner: lawyer and board director

## **Claude Elsen (1947), Luxembourg**

Deputy chairman of the board | Member since 2002 | Elected until 2008 | Previous activities for Tornos: none | Committees: Nomination and Compensation Committee and Audit Committee | Training – last grade on completion of studies: MBA, Insead, Fontainebleau 1974: graduate engineer from the RWTH (Rheinisch-Westfälische Technische Hochschule), Aachen, Germany, 1972 | Previous professional activities: Daimler Chrysler AG since 1996: Senior Vice-President, (from 1998 to 2002): Consilux: Managing Partner (since 2002)

## **Raymond Stauffer (1954), Switzerland**

Managing Director and Chief Executive Officer since November 2002 | Member since 2002 | Elected until 2008 | Previous activities for Tornos: none | Training – last grade on completion of studies: ETS engineering (Engineering College), Le Locle, 1975 | Current list of board membership mandates: none | Previous professional activities: Ismecca Holding SA: different functions in the Group since 1976, COO (from 1993 to 2001): CTO (2001)

## **Hans-Otto Stenzel (1941), Germany**

Member since 2002 | Elected until 2008 | Previous activities for Tornos: Chairman and managing director of Tornos Holding, France (from 1993 to 1996) | Training – last grade on completion of studies: Graduate engineer TU (Technical University) Berlin, 1968 | Current list of board membership mandates: Wirth & Gruffat SA: Board director | Previous professional activities: UNICUM SA (GROUPE): Chairman and MD (from 1996 to 1999), ELB – SCHLIFF-WERKZEUG-MASCHINEN GmbH: General Manager (since 2000)

## **Paul Haering (1957), Switzerland**

Member since 2001 | Elected until 2007 | Previous activities for Tornos: none | Committees: Chairman of the Audit Committee | Training – last grade on completion of studies: MBA University of California, Los Angeles, 1989, BA – Golden Gate University, San Francisco, 1987 | Current list of board membership mandates: Ruag Holding AG: Board director, member of the Audit Committee, Alu Menziken Holding AG: Board director, Aebi Holding AG: Board director | Previous professional activities: Feintool International Holding: CFO (from 1996 to 2003) AWR AG für Wirtschaft und Recht: Partner (since 2003), Aebi Holding AG: CFO (a.i) (since 2004)

# GENERAL MANAGEMENT



## **Michael Op de Hipt (1966), Germany**

Head of R&D | Appointed in May 2005 | Training – last grade on completion of studies: Dr. in sciences RWTH (Rheinisch-Westfälische Technische Hochschule), Aachen, Germany, 1997; MBA, HTA, Bern, 2003. | Current list of board membership mandates: none | Previous professional activities: RWTH at Aachen, Germany: scientific assistant (from 1993 to 1997); CSEM SA: Project Manager (from 1997 to 1999); Feintool Technologie SA: R&D Manager (from 1999 to 2005)

## **Bernard Seuret (1947), Switzerland**

Head of production | Appointed in 2000 | Training – last grade on completion of studies: ETS engineer (Engineering college) Freiburg, 1968 | Current list of board membership mandates: none | Previous professional activities: Tornos SA: Various positions in the Group since 1969; R&D project manager (from 1990 to 1998), Production manager since 1999

## **Carlos Cancer (1959), Spain**

Head of Business Unit Single Spindle | Appointed in 2003 | Training – last grade on completion of studies: HES engineer (Ecole Technique Supérieure, Bienne, 1982) | Current list of board membership mandates: none | Previous professional activities: Tornos Technologies Italia SRL: Manager (from 1993 to 2002), Gildemeister Italiana S.p.A.: Marketing / Sales Manager (from 2002 to 2003)

## **Sandor Sipos (1952), Switzerland**

Head of Customer Service | Appointed in 2004 | Training – last grade on completion of studies: ETS engineer (Engineering college) St. Gallen, 1976 | Current list of board membership mandates: none | Previous professional activities: Kodak SA: Technical Services Manager (from 1988

to 1996); Danka Suisse SA: Technical Services Manager Switzerland (from 1997 to 1998), Ismeca Semiconducteur SA: Technical Services Manager (from 1998 to 2004)

## **Philippe Maquelin (1951), Switzerland**

Chief Operating Officer & Chief Financial Officer | Appointed in 2002 | Training – last grade on completion of studies: Economist (degree in economic science) University of Neuchâtel, 1976 | Current list of board membership mandates: none | Previous professional activities: Portescap: CFO (from 1991 to 1997), API: Vice-President administration and finance (from 1997 to 1998), Ismeca Holding SA: CFO (from 1998 to 2002)

## **Willi Nef (1960), Switzerland**

Head of Business Unit Multispindle | Appointed in 2003 | Training – last grade on completion of studies: HTL Engineer (Technicum), Rapperswil, 1985; DBA, Singapore, 2005 | Current list of board membership mandates: none | Previous professional activities: Mikron PVT Ltd, India: General Manager (from 1997 to 1999), Mikron Lugano / Agno: Sales Manager (from 1999 to 2001), Bodine Europe SA: Manager (from 2001 to 2002); Lascor S.p.A. Italy: Managing Director (from 2002 to 2003)

## **Francis Koller (1948), Switzerland**

Head of sales | Appointed in 2002 | Training – last grade on completion of studies: Design engineer (Tornos Training Centre), Moutier, 1968 | Current list of board membership mandates: none | Professional activities from 1996 to the present: Tornos SA, Various positions in the group since 1974, Head of sales since 1992

F.I.t.r.

# CORPORATE GOVERNANCE AND COMMUNICATIONS

The Board of Directors and the Group Management place great value on responsible and transparent corporate management and control in the interest of the shareholders, customers and staff. The disclosure of Corporate Governance takes its model from the Swiss Stock Exchange and takes account of the best practice rules of the Swiss economy. At Tornos, corporate governance is based on the articles of association and, for the Board of Directors and its committees, on the rules of organisation.

## 1 Group structure and shareholding

### 1.1 Group structure

#### 1.1.1 Organisational structure of the Group

For a description of the Group's organisational structure, please refer to pages 14 to 15.

#### 1.1.2 Company quoted on the stock exchange

Tornos Holding S.A., is the only consolidated company of the group to be quoted on the stock exchange. The subsidiaries are not quoted. Tornos shares are traded on the Swiss SWX Stock Exchange Zurich, under securities number TOHN / 001160768 (symbol ISIN CH0011607683). The market capitalisation value as on the balance sheet date amounted to CHF 139.8 million.

The consolidated companies of the group are shown below:

| Name  | Purpose                | Share capital  | % retained |       |
|---|------------------------|----------------|------------|-------|
|   |                        |                | 2005       | 2004  |
| ■ Tornos Holding S.A., Moutier                          | Holding                | CHF 67,887,525 |            |       |
| ■ Tornos S.A., Moutier                                  | Manufacturing and sale | CHF 65,000,000 | 100.0      | 100.0 |
| ■ Tornos Services S.A. en liquidation, Moutier          | <i>in liquidation</i>  | CHF 1,000,000  | 100.0      | 100.0 |
| ■ Tornos Technologies Deutschland GmbH, Pforzheim       | Support services       | EUR 511,292    | 100.0      | 100.0 |
| ■ Tornos Technologies Iberica SA, Granollers            | Support services       | EUR 60,200     | 100.0      | 100.0 |
| ■ Tornos Technologies Italia Srl, Opera/MI              | Support services       | EUR 93,600     | 100.0      | 100.0 |
| ■ Tornos Technologies UK Ltd., Coalville                | Support services       | GBP 345,000    | 100.0      | 100.0 |
| ■ Tornos Holding France SA, St Pierre-en-Faucigny       | Holding                | EUR 12,496,800 | 100.0      | 100.0 |
| ■ Tornos Technologies France SAS, St Pierre-en-Faucigny | Support services       | EUR 762,250    | 100.0      | 100.0 |
| ■ Tornos Technologies U.S. Corp. Brookfield CT          | Sales and services     | USD 2,400,000  | 100.0      | 100.0 |
| ■ Tornos Technologies Asia Limited, Hong Kong           | Sales and support      | HKD 10,000     | 100.0      | N/A   |

## KEY FIGURES

| <b>Tornos Group</b><br>(in MCHF unless otherwise stated) | <b>2005</b> | <b>2004</b> | <b>2003</b> | <b>2002</b> | <b>2001</b> |
|--|-------------|-------------|-------------|-------------|-------------|
| Bookings   | 212.5       | 225.0       | 170.6       | 154.1       | 213.4       |
| Gross sales*   | 222.6       | 213.0       | 174.7       | 180.6       | 372.8       |
| EBITDA   | 23.2        | 19.4        | 9.7         | -85.1       | 11.4        |
| Gross sales %  | 10.4        | 9.1         | 5.6         | -47.1       | 3.1         |
| EBIT   | 14.2        | 11.0        | 0.4         | -176.3      | -8.4        |
| Gross sales %  | 6.4         | 5.1         | 0.2         | -97.6       | -2.2        |
| NET profit (loss)  | 12.8        | 6.8         | -2.8        | -121.4      | -29.9       |
| Gross sales %  | 5.8         | 3.2         | -1.6        | -67.2       | -8.0        |
| Net debt   | 10.8        | 28.0        | 44.9        | 42.2        | 113.7       |
| Equity   | 100.2       | 83.5        | 78.4        | 81.9        | 135.6       |
| Total Balance sheet %                                    | 60.4        | 48.5        | 43.7        | 39.9        | 36.4        |
| Total Balance Sheet                                      | 165.8       | 172.3       | 179.5       | 205.2       | 372.8       |
| Capital expenditures                                     | 2.9         | 3.6         | 1.6         | 6.5         | 14.2        |

\*In 2005 certain amounts have been reclassified in determining the amount of Gross sales compared to the method previously applied. The comparative information for the year 2004 has been adjusted accordingly. The net impact of the reclassification on previously reported Gross sales for 2004 is an increase of CHF 7.3 million. For the years 2001 to 2003 the effect of the change cannot be accurately computed.



### **1.2. Major shareholders**

The list of shareholders with a share of votes exceeding 5% is mentioned in the financial report under paragraph 18.5.

Credit Suisse and Doughty Hanson & Co, the two major shareholders in Tornos Holding S.A., respectively holding 24.7% and 27.4% of the nominal capital as at 31<sup>st</sup> December 2004, gave their backing to Group recapitalisation in 2002. Given the fact that these shareholders always intended to sell their shares on completion of the restructuring operation, which is now completed, all the shares held by these two institutions were allocated in 2005 to institutional investors and to a group of shareholders comprising members of the Board of Directors and Management Board of Tornos. As at 31<sup>st</sup> December 2005 this group held 1,392,240 shares (10.3%) in the company, as well as 113,645 share subscription options in Tornos Holding S.A. granted as part of the shareholding plan for members of the Board of Directors and Management Board in 2004. This group of shareholders concluded a shareholding agreement.

### **1.3. Cross participations**

The holding company has no cross participations.

## **2 Capital structure**

### **2.1 Capital structure as on the balance sheet date**

The ordinary share capital of Tornos Holding S.A. amounted to CHF 67,887,525 as at 31<sup>st</sup> December 2005. As at the close of the financial year, the company had a contingent capital of CHF 7,281,250. It has no authorised capital.

### **2.2 Contingent and authorised share capital**

The following information relates to the changes in contingent and authorised capital for the year 2005. Regarding the changes that occurred during the years 2003 and 2004, please refer to note 23 of the consolidated accounts 2004, which are available on the website on: <http://www.tornos.ch/dnld/invest-pdf/tornos-2004cfs-conso-finan-statement-uk.pdf>.

#### **Contingent capital**

For serious reasons (restructuring of the company) the share capital was increased to CHF 7,281,250 and, in the case of paragraph a), under the exclusion of the subscription right or priority subscription right of the shareholders, by issuing fully paid up registered shares, with a par value of CHF 5.00, of which:

**a)** Up to 1,106,250 shares with a par value of CHF 5.00 each, to a maximum amount of CHF 5,531,250, by exercising option rights granted to the creditor banks and specific creditors under the restructuring concept as part of the consideration for a partial waiver of debt repayments in connection with outstanding loans or as part of a settlement of a pending legal dispute, thus complying with the market conditions at the time the restructuring took place. Each of these options gives entitlement to subscribe to a registered share at an issue price of CHF 6.00. The options must be exercised within a maximum period of five years, i.e. by July 2007.

**b)** Up to 350,000 shares with a par value of CHF 5.00 each, to a maximum amount of CHF 1,750,000, for shares to be issued by the Board of Directors to satisfy the plans to buy shares or options on behalf of individuals defined by the Board of Directors (see section 5.4 regarding the methods and periods during the financial year).

The detailed terms of the options will be defined by the Board of Directors, taking into account the above-mentioned requirements.

#### Authorised share capital

The company has no authorised share capital.

#### 2.3 Capital changes during the last three years under review (statutory statement of Tornos Holding S.A.)

| in T CHF                       | Share capital | Premium       | Balance sheet profit | Total         |
|--------------------------------|---------------|---------------|----------------------|---------------|
| <i>Equity as at 31.12.2002</i> | <i>66,919</i> | <i>13,943</i> | <i>77</i>            | <i>80,939</i> |
| Annual result 2003             |               |               | 452                  | 452           |
| <i>Equity as at 31.12.2003</i> | <i>66,919</i> | <i>13,943</i> | <i>529</i>           | <i>81,391</i> |
| Increase in capital            | 250           | 12            |                      | 262           |
| Annual result 2004             |               |               | –                    | –             |
| <i>Equity as at 31.12.2004</i> | <i>67,169</i> | <i>13,955</i> | <i>529</i>           | <i>81,653</i> |
| Increase in capital            | 719           | 101           |                      | 820           |
| Annual result 2005             |               |               | 834                  | 834           |
| <i>Equity as at 31.12.2005</i> | <i>67,888</i> | <i>14,056</i> | <i>1,363</i>         | <i>83,307</i> |

#### 2.4 Shares

Tornos Holding S.A. has only one type of share. These shares are not subject to any restrictions of sale; «nominee» registrations are not permitted. There are no privileged shares or limitation with regard to voting right. Each share corresponds to one vote («one share, one vote»). As at 31<sup>st</sup> December 2005, the ordinary share capital of Tornos Holding S.A. amounted to CHF 67,887,525 and was divided into 13,577,505 fully paid up registered shares with a par value of CHF 5.00.

There are no participation certificates and no outstanding convertible loan.

#### 2.5 Call options issued to shareholders as part of the reduction in capital and to creditor banks and certain creditors with regard to restructuring

The following call options on shares of Tornos Holding S.A. issued to creditor banks and certain creditors, as part of the restructuring plan, in exchange for waiving part of their claims and as part of a conciliation on a pending legal dispute, in accordance with market conditions at the time of restructuring, were issued as at 31<sup>st</sup> December 2005 and guaranteed by contingent capital of up to CHF 5,531,250:

| Number    | Type   | Due date  | Exercise price |
|-----------|--|-----------|----------------|
| 1,081,250 | in favour of the banking syndicate and other creditors, subscription ratio 1:1 | July 2007 | CHF 6.00       |

During the financial year 2005, 93,750 options were exercised.

#### 2.6 Shareholding plan for individuals designated by the Board of Directors

See section 5.4 «Assignment of shares and options during the financial year» with regard to the provisions of the shareholding plan in favour of individuals designated by the Board of Directors

### 3 Board of Directors

#### 3.1 Members of the Board of Directors

The Board of Directors has remained unchanged for the period under review (see page 12). The only

executive member is Mr. Raymond Stauffer who, in his capacity as Managing Director, holds the position of Chief Executive Officer.

### **3.2 Election and term of office**

The Board of Directors of Tornos Holding S.A. is made up of at least 3 members (currently 6), the majority of which are independent, non-executive members. There are no cross-participations within the meaning of the Corporate Governance guideline (see page 12 regarding the other activities and groups of interest). The Board of Directors is elected by the General Assembly for a term specified by the latter but may not exceed 3 years. The members can be re-elected. The age limit is 70 years. The Chairman is elected by the Board of Directors.

In order to form a quorum, the majority of the members of the Board of Directors must be present at a meeting. If the votes are equal, the Chairman has the casting vote.

### **3.3 Internal organisation**

The rules of organisation of Tornos Holding S.A. lay down the responsibilities of the Board of Directors and Group Management. The Board of Directors is responsible for the overall management of the company and Group, in particular, for establishing the objectives, the Group strategy, approving the business plan, for organising the principles of accounting, financial control and financial planning, appointing and dismissing the CEO and Group Management members, convening the general meeting, deciding on and amending the organisation of the company and notifying the judge in the event of insolvency. It supervises the individuals entrusted with the management of the business. As far as is legally permitted and subject to the responsibilities mentioned above, the Board of Directors delegates the overall management to the Managing Director as CEO and Chairman of the Group Management.

With the efficient allocation of duties in mind, in October 2002 the Board of Directors appointed François Frôté as chairman, Claude Elsen as vice-chairman and Raymond Stauffer as Managing Director and CEO. It also set up the following committees:

**Nomination and Compensation Committee:** *F. Frôté (chairman), C. Elsen, R. Stauffer / from 18<sup>th</sup> June 2005: F. Frôté (chairman), C. Elsen, M. Rollier and H.-O. Stenzel*

In the period under review, the Nomination and Compensation Committee met 3 times. The CEO and CFO attended these meetings as consultants. During these meetings, the Committee studied the Management reports and worked out proposals to be put before the Board of Directors for its decision.

The following subjects were covered:

- Appointment of the R&D Manager
- Assessment and remuneration of the directors and top management for 2005
- Fees payable to the Board of Directors
- Salary policy
- Contribution levels to the pension fund.

**Audit Committee:** *P. Häring (chairman), F. Frôté, C. Elsen*

In the year under review, the Audit Committee met six times and held one conference call. These meetings were attended by the CEO and CFO in their consultative capacity and, where required, by the auditors.

The Audit Committee dealt with the following main subjects:

- Review of the financial statements 2004
- Discussion of the financial statements with the Group auditors
- Annual report 2004
- Review of the Group auditor's management letter
- Interim audit 2005

- Tax audit 2005
- Risk assessment and production of a risk management map
- Restructuring the pension fund of Tornos S.A.
- Refinancing the Tornos Group
- Executive stock option plan of the Tornos Group
- Investor relations.

The Audit Committee also reviewed the quarterly reports, forecasts, the budget for 2006 and the information to the financial community. It reviewed some specific financial and accounting issues as well as the interpretation and implementation of accounting principles and standards (IFRS). The Committee also assessed the performance of the auditors as well as its own work.

At each Board Meeting, the chairman of the Audit Committee gave an account of its work and elaborated decision-making fundamentals for the Board of Directors. The minutes of the Committee meetings were given to the Board Members.

**Strategy and Innovation Committee** (previously referred to as the Strategy and Product Committee):  
R. Stauffer (chairman), M. Rollier, H.O. Stenzel

This Committee was dissolved on 1<sup>st</sup> January 2005 and its skills transferred to the Group management.

The Board of Directors meets as required, but at least four times a year. During the financial year 2005, it held eight meetings lasting on average four hours and also participated in five conference calls. The Board of Directors regularly called in members of the management and outside consultants, where necessary, if the agenda came within their spheres of responsibility. The Committees also met together with members of the management.

### **3.4 Information and control instruments vis-a-vis the management**

At its meetings, the Board of Directors is regularly kept verbally informed by the management on the progress of business. In addition, a periodic management information system is in place, whereby the most important key indicators are compared on a weekly basis (orders received) or monthly (profit and loss account and balance sheet) against the budget. The Audit Committee also oversees the work of the auditors.

## **4 General management**

### **4.1 Members of the Management**

The Group management consists of seven members plus Raymond Stauffer who, as the Managing Director, also acts as Chief Executive Officer (see page 13). None of the members performs any activity for other major organisations.

### **4.2 Management contracts**

There are no management contracts with companies or individuals outside of the group.

## **5 Remunerations, shareholdings and loans**

### **5.1 Content and procedure for definition**

The remuneration of the members of the Group Management is fixed by the Nomination and Compensation Committee. The fees of the Board of Directors are fixed by the entire Board of Directors on the proposal of the Nomination and Compensation Committee. Since 2004, a shareholding plan for individuals nominated by the Board of Directors has been in place.

The board directors are given a lump sum remuneration for their work and participation on the Board and in Committees. If they are also involved in project work, then this work will be remunerated on a time basis. The same applies to the work of the chairman of the Audit Committee, which is paid for separately.

### ***5.2 Remuneration paid to officiating officers of the company***

In the year under review, the total amount paid to non-executive members of the Board of Directors amounted to CHF 378,899. The executive members of the Board of Directors and members of the Group Management received a total of CHF 2,162, 941 for the year under review.

In the year under review, the member of the Board of Directors with the highest remuneration was entitled to payments of CHF 432,753. This member acquired 3,889 registered shares according to the guidelines of the shareholding plan for Board members and Group management, 2004 and, in consideration of the same plan, he also received 7,735 options for the subscription of shares.

### ***5.3 Remuneration to former officers of the company***

No remuneration was paid to former executive officers of the company during 2005.

### ***5.4 Assignment of shares during the period under review***

The General Meeting convened on 13<sup>th</sup> April 2004, agreed on the issue of 450,000 contingent shares, which could be issued by the Board of Directors with respect to a shareholding plan for individuals designated by the Board of Directors. The conditions of this shareholding plan are as follows:

#### **Share purchase plan**

According to the shareholding plan for members of the Board of Directors and Management Board 2004, the individuals designated by the Board of Directors have the opportunity to purchase 150,000 registered shares at a price of CHF 5.30 each, in three equal tranches, within a period of three years. The purchase price corresponded to the market value at the time the elected individual made his decision to purchase. During the financial year 2005, 50,000 registered shares were issued under this plan, of which 19,444 were in favour of non-executive members of the Board of Directors and 30,556 in favour of executive members of the Board of Directors and Group Management. As at 31<sup>st</sup> December 2005, 100,000 registered shares were issued under this plan, of which 41,112 shares were in favour of non-executive members of the Board of Directors and 58,888 in favour of the executive members of the Board of Directors and Group Management. 43,329 registered shares, to be issued on 1<sup>st</sup> May 2006 were also issued as at 31<sup>st</sup> December 2005, of which 16,665 are for non executive members of the Board of Directors and 26,664 for executive members of the Board of Directors and Group Management. The 6,671 shares still available under this plan will be offered to eligible members on 1<sup>st</sup> May 2006. A non-disposal period of two years after the effected transfer of shares is planned.

#### **Share purchase option plan**

In order to satisfy the obligations under the Shareholding Plan for members of the Board of Directors and Group Management 2004, the individuals designated by the Board of Directors were given options in 2004 and 2005, to allow them to purchase registered shares. Each registered share subscribed for, gives entitlement to an option to purchase at a price of CHF 6.00 (Option A). In addition, each individual designated by the Board of Directors is entitled to his share of 50,000 additional options (Option B). The conditions of issue of these options have been determined by the Board of Directors of the company, managing the plan. These options can only be realised in the third year of their validity. Unredeemed options will be reassigned when the board member terminates his mandate or on the last working day of the designated individual. This regulation does not apply in the event of the Board member's or designated individual's death, invalidity or retirement or in the case of a change to the controlling majority. The reassignment will take place on the last day of the mandate or on the last working day. 300,000 registered shares may be issued under this plan.

During the financial year 2005, 100,000 options were issued under this plan, of which 38,675 were in favour of non-executive members of the Board of Directors and 61,325 in favour of the executive members of the Board of Directors and Group Management.

As at 31<sup>st</sup> December 2005, 200,000 options were issued under this plan, of which half will expire on 30<sup>th</sup> April 2007 and the other half on 30<sup>th</sup> April 2008. 81,175 options were issued in favour of non-executive members of the Board of Directors and 118,825 in favour of executive members of the Board of Directors and the Group Management.

The 43,329 registered shares to be issued on 1<sup>st</sup> May 2006, which were likewise subscribed for on 31<sup>st</sup> December 2005 give entitlement to 86,658 options, which will be issued on 1<sup>st</sup> May 2006, and expire on 30<sup>th</sup> April 2009. The 6,671 shares still available under the share purchasing plan will be offered to eligible members on 1<sup>st</sup> May 2006 and if these are subscribed, will give rise to 13,342 options under the same conditions as mentioned above.

#### ***5.5 Ownership of shares and options***

As stated in paragraph 1.2 above, 1,392,240 shares in Tornos Holding S.A. were held as at 31<sup>st</sup> December 2005 by a group of shareholders made up of members of the Tornos Board of Directors and Group Management. Apart from this group of shareholders, the members of the Board of Directors and Tornos Group Management held 57,954 shares in Tornos Holding S.A. In total, this represents 1,450,194 shares that are held by members of the Board of Directors and Tornos Group Management. Of this total, which includes those shares purchased through the shareholding plan for members of the Board of Directors and Group Management 2004, 840,442 shares were held by non-executive members of the Board of Directors and 609,752 by executive members of the Board of Directors and members of the Group Management. In addition, at the reference date, the non-executive members of the Board of Directors held 81,175 share subscription options in Tornos Holding S.A. and the executive members of the Board of Directors and Group Management members retained 118,825. These share options were granted as part of the shareholding plan for members of the Board of Directors and Group Management 2004. This group of shareholders signed a shareholding agreement.

#### ***5.6 Additional fees and remuneration***

Apart from the board director acting as chairman of the Audit Committee, who receives separate remuneration (see section 5.1) and who received fees amounting to CHF 63,161 in addition to his lump sum fees as board director, no additional remuneration and fees in excess of half the agreed remuneration, was paid to the members of the Board of Directors and Group Management.

#### ***5.7 Loans to board members and management***

The company has no outstanding loans to members of the board and management.

## **6 Auditors**

Since the financial year 2003, the auditors of the holding company and Group have been BDO Visura, Bern. Mr. René-Marc Blaser, graduate accountant, has been the senior auditor responsible since the year 2005. The auditors are elected annually by the General Meeting. The auditing fees invoiced by BDO Visura for the year under review and for auditing the annual statement, amount to CHF 169,640. BDO Visura did not provide additional services in the year under review.

The Audit Committee monitors the external auditors on behalf of the Board of Directors. BDO Visura attended one meeting of the Audit Committee and provided information about its work. Otherwise, the auditors submitted a management letter to the Committee. On completion of the year under review, the Audit Committee will examine, together with the auditors and in the presence of the CEO and CFO, the annual accounts of the group and holding company together with the report (see section 3.3).

## **7 Information and disclosure policy**

Tornos keeps its shareholders informed of the state of business and events relevant to the stock exchange through the annual, half-yearly and quarterly report, or as required by way of press-releases to the media. All important information can be consulted on the company's Internet site on [www.tornos.ch](http://www.tornos.ch).

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## **8 Participation rights of shareholders**

### ***8.1 Voting restriction and proxy voting***

In accordance with Article 10 of the articles of association, there are no voting restrictions, with each share giving rise to one vote. Only shareholders whose names appear in the share register may vote by proxy. The articles of association provide that the shareholders may only be represented at the General Meeting by their legal representative, another shareholder with voting right, the independent proxy, the company representative or a securities representative. Under certain conditions, fiduciary-managed shares may also be entered in the share register with a voting right.

### ***8.2 Statutory quorum***

Apart from the quorums specified in Article 704 CO, article 11, the articles of association provide for a qualified quorum of at least 2/3rds of the votes represented and an absolute majority of the nominal value of the shares represented, for limiting the exercise of the voting right and any change and cancellation of such limitation.

### ***8.3 Convening the General Meeting and producing the agenda***

Convening the General Meeting according to article 8 of the articles of association must comply with statutory prescriptions. Shareholders representing a nominal value of CHF 1,000,000 or more may demand that an item to be discussed be entered on the agenda. This must be done at least 45 days before the meeting, in writing, quoting the items to be discussed and the motions.

### ***8.4 Entries in the share register***

Entries in the share register (register closing date) must be made at least 11 days before the General Meeting.

## **9 Controlling and warding-off mechanisms**

### ***9.1 Obligation to provide an offer***

The legal thresholds apply with regard to the obligation to submit a public offer. No special controlling or warding off mechanism exists.

### ***9.2 Takeover clauses***

In the event of a takeover, the time limits provided with respect to the shares and options in the shareholding plan for members of the Board of Directors and Management 2004, will become null and void and a «Take-me-along» clause shall apply. There are no clauses relating to taking control in favour of members of the Board of Directors and members of the Group Management.

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