Consolidation Principles

Method and scope of consolidation

December 31 is the uniform closing date for all companies included in the consolidated financial statements. All companies in which OC Oerlikon Corporation AG, Pfäffikon has either a direct or indirect interest exceeding 50 percent of the shareholders' voting rights and companies over which control is assured through contractual arrangements are consolidated. Using the full consolidation method the assets, liabilities, income and expenses of these consolidated subsidiaries are included in their entirety. Minority interests are recorded under equity in the consolidated financial statements. Group companies acquired or sold during the course of the financial year are included in or, respectively, eliminated from, the consolidated financial statements as of the date of purchase or sale. All consolidated investments held are shown in the organization chart at the end of this report.

Changes in scope of consolidation and group structure

Acquisition of the Saurer Group, Switzerland

The Saurer group was included in the consolidation as from November 1, 2006. As at December 31, 2006 Oerlikon Group held 85.9% of the shares of Saurer AG, Arbon. A liability has been recognized in respect of the outstanding shares to be acquired after the year-end under the terms of the public tender offer. This acquisition adds two new segments: Oerlikon Saurer Textile and Oerlikon Graziano Drive Systems. The Oerlikon Saurer Textile segment is a provider of yarn processing solutions for the textile industry - natural and synthetic fibers. The Oerlikon Graziano Drive Systems segment develops and manufactures transmission systems for motor vehicles (see also Note 1).

Oerlikon Balzers Coating segment
Acquisition of Gold Star Coatings, USA

On May 1, 2006 Oerlikon Group acquired the assets and the PVD coating business of Gold Star Coatings (see also Note 1).

Oerlikon Components segment, business unit Space
Acquisition of Snecma Moteurs, France

On January 23, 2006 Oerlikon Group acquired from the French Snecma Moteurs their business in developing and manufacturing high-precision machinery for use in spacecraft. Their main activity is manufacture of Solar Array Drive Mechanisms (SADM), a key component of energy provision for spacecraft (see also Note 1).

Oerlikon Components segment, business unit Optics
Acquisition of Exitech Ltd., GB

On November 14, 2006 Oerlikon Group acquired the assets of Exitech Ltd. Exitech specializes in sale of nano and micro laser systems worldwide (see also Note 1).

Acquisition of associated company

On June 13, 2006 Oerlikon Group acquired 21% of the shares of Novalux Inc., USA. Novalux specializes in development of semiconductor laser technology. With this contract Oerlikon acquired two non-exclusive worldwide trading licenses, and agreement was reached on joint future development of Novalux's solid state laser technology.

Business combinations and goodwill

The equity consolidation follows the purchase method. At the time of their initial consolidation the assets, liabilities and contingent liabilities of subsidiaries are restated to fair value. The difference between the purchase price and the equity of the acquired company at fair value is capitalized in the books of the subsidiary company. Goodwill denominated in foreign currencies is translated into Swiss francs at the rates prevailing at the balance sheet date. Since January 1, 2005, capitalized goodwill may no longer be systematically amortized, but instead is tested annually for possible value impairment.

Translation of foreign currencies

Assets and liabilities of foreign subsidiaries are translated into Swiss francs at the exchange rate prevailing on the balance sheet date; income and expenses of foreign subsidiaries are translated into Swiss francs using average rates for the year. Differences resulting from the application of different exchange rates are added to or deducted from equity with no impact on the income statement. Exchange gains and losses as recorded in the individual company accounts of subsidiaries are included in the income statement. Excluded from this rule are specific long-term inter-company monetary items that form part of the net investment in a foreign subsidiary, whose exchange translation differences are also credited or charged directly to equity. In the year that a foreign company is divested, the cumulative translation differences recorded directly in equity are included in the income statement as part of the gain or loss on sales of investments.

Elimination of inter-company profits

Profits on inter-company sales not yet realized through sales to third parties, as well as profits on transfers of fixed assets and investments in subsidiaries, are eliminated.

Valuation principles

The group accounts are prepared on a historical cost basis, with the exception of monetary assets available for sale and certain financial assets and liabilities which are held at market values (in particular financial instruments).

Cash and cash equivalents are placed with various financial institutions with top-quality international ratings. Time deposits included therein mature in three months or less.

Receivables are valued at the original invoiced amount less any necessary value adjustments for default risks. These risks are insured with third parties only in exceptional cases.

Financial instruments are recorded at fair value on their respective settlement dates. Exceptions to this are financial investments held to maturity as well as receivables, credits and financial liabilities, which are carried at amortized cost using the effective interest method. Gains and losses from changes in the fair value of financial investments available for sale are temporarily recorded in equity until such investments are sold or dis-posed of, at which time the gains or losses are transferred to the income statement. Any loss from value impairment is immediately recorded in the income statement.

Derivative financial instruments: forward contracts and options are utilized systematically and mainly for the purpose of reducing business-related foreign currency and interest rate risks. These transactions are concluded with first-rate financial institutions and, as a general rule, have a term to maturity of up to 12 months. These derivative financial instruments are stated at fair values. If all requirements are fulfilled with regard to documentation, probability of occurrence, effectiveness and reliability of valuation, hedge accounting is applied in accordance with IAS 39, i. e. until the hedged underlying business transactions are accounted for, the unrealized profits and losses resulting from the valuation of derivative financial instruments at fair value are recorded in equity with no impact on the income statement.

Securities: these are assets of high price volatility. They are held at fair values, with their values adjusted as required through profit and loss. For the valuation of unquoted securities, standard methods are used, with value adjustment also through profit and loss.

Inventories: inventories of raw materials, purchased components and trade merchandise are carried at the lower of cost or net realizably value, using FIFO and weighted average cost valuation methods. Self-made components, work in progress and finished goods are carried at production cost. This includes all related material and labor costs as well as a reasonable allocation of overhead. Recognizable reductions in value resulting from excess inventory, declines in replacement cost or sales price and the like are taken into account through appropriate write-downs of inventory items. Customer advances are credited proportionally to inventory.

Investments: investments in associated companies (20 to 50 percent ownership of voting rights) are accounted for in accordance with IAS 28 (Accounting for Investments in Associates) using the equity method. The book value of the investment, initially its acquisition cost, is increased or reduced in response to the development in equity value of the associate, in proportion to the percentage held by OC Oerlikon Corporation AG, Pfäffikon. Unrealized changes in fair value of other investments (under 20 percent ownership of voting rights) that have been classified as available for sale are recorded in equity and transferred to financial income/loss upon the sale or disposal of the given investment.

Property, plant and equipment: fixed assets are recorded at historical purchase or production costs, less necessary depreciation. Components of PP&E that have a differing useful life are recorded separately and depreciated accordingly (component approach). Depreciation is calculated on a straight line basis according to the expected useful life of the asset, as follows:

– IT hardware	3–7 years
– Company cars	4–7 years
– Trucks and electrically powered vehicles	5–10 years
– Technical installations and machines	5–15 years
– Other operating and business equipment	3–15 years
– Central building installations	10–25 years
– Leasehold improvements	Duration of the rental contract (max. 20 years) or, if shorter, individual useful life
– Plant and administrative buildings used in Group operations	20–60 years

Estimated useful life and residual worth are examined annually.

Fixed assets under financial lease agreements are treated identically to fixed assets owned. Non-operating properties available for sale are carried at the lower of their net book value or estimated net realizable value (less sale-related costs).

Intangible assets (excluding goodwill): intangible assets are identifiable non-monetary assets without physical substance from which future economic benefits are expected to flow to the Group. Intangible assets are amortized on a straight line basis over their useful lives, when the useful lives can be clearly determined. For example software over two to three years, development costs generally over five years. If the useful life cannot be determined, an annual impairment test of the intangible asset is conducted as at the balance sheet date.

Impairment of assets: assets are tested for potential impairment of value at least once per annum, to establish whether a value impairment is indicated. Should this be the case, possibly as a result of a triggering event, and regarding assets of significant value, an impairment test is carried out in order to determine if and to what extent an adjustment might be needed to reduce the asset to its value in use. The test uses estimates of future cash flows to be expected from use of the assets concerned, or from their possible sale, if such is intended. If a value adjustment is called for, the impairment loss is recorded against the assets concerned and charged to the income statement. In cases where a previously recorded impairment loss is no longer justified (with the exception of impairment losses on goodwill), it is reversed and credited to the income statement.

Goodwill and other intangible assets with an indeterminate useful life are subjected to an annual impairment test as at the balance sheet date.

Discontinued operations and long-term assets held for sale: a business unit or segment is reclassified into "discontinued operations" if it is sold, or at an earlier date, if it fulfills the criteria for being classified as "held for sale". Long-term assets held for sale are carried at the lower of their carrying amount or fair value less cost to sell, and any value impairments are booked to the income statement.

Provisions: provisions are set up if the future outflow of resources is likely and reliably predictable for obligations arising from past events. In this regard, the "more likely than not" principle is applied. Other provisions represent uncertainties, for which a best estimate is made in arriving at the amount reserved. The value of provisions whose expected maturity exceeds one is discounted at normal market rates.

- Restructuring provisions: provisions are set up in cases where a detailed restructuring plan exists and the Group has informed those concerned, or the restructuring process has started.
- Onerous customer contracts: provisions are set up when estimated costs to fulfill a contract exceed the related contract revenues. The difference between the two is calculated and provided against income in the current period. When accounts are prepared the related risks are reassessed systematically by all business units and all costs are adjusted as required. This reassessment is based on the so-called "most likely outcome", which uses assumptions regarding technical feasibility and timely realization of the projects and includes a quantification of the risks. The actual future obligation can vary from these estimates.
- Warranty provisions: provisions are set up for known customer claims and also for latent warranty exposure.
- Product liability: provisions are set up for known claims; latent exposure is not provided.
- Employee Benefits: provisions are set up in accordance with IAS 19. The interest component of pension costs for unfunded plans is shown as financial expense.

Contingent liabilities: these represent potential obligations whose impact depends on the occurrence of one or more future events which cannot be influenced. Contingent liabilities are also existing obligations which are not expected to result in a future outflow of benefits, or where the outflow of benefits can not reliably be quantified. IAS 37 states that such obligations should not be set up as liabilities on the balance sheet.

Participation plans: OC Oerlikon Corporation AG, Pfäffikon offers members of the Board of Directors and Executive Board, as well as senior managers, options to purchase shares of the company under various participation plans. The fair value is determined on the day such share-based remuneration is granted and charged to the income statement on a straight line basis until the option vests. The fair value is recorded as personnel expense, with a corresponding increase in equity (equity settlement), or as financial debt (cash settlement). The company holds treasury shares that were acquired in accordance with a share buyback program and may be used in the future for employee option plans and potential acquisitions. The acquisition cost of these treasury shares is deducted directly from equity.

Post-employment benefit plans: Oerlikon companies operate various plans for providing employees with post-employment benefits, which conform to local circumstances and practice in the countries concerned. These include defined benefit and defined contribution plans, under which benefits are provided through separate funds, insurance plans or unfunded arrangements. For defined benefit plans, the amount charged to the income statement consists of current service cost, which includes the normal cost of financing benefits in respect of future years of service, as well as net interest on the assets or obligations. Contributions to defined contribution pension schemes are charged to the income statement as incurred. For funded plans, plan assets are held separately from those of the group in independently administered funds. The group's liability to pay future post-employment benefits is determined using the "projected unit credit method" in accordance with IAS 19 (revised), and is provided in the Group's balance sheet.

As from 2006, all actuarial gains and losses (and the related deferred income taxes) are recognized immediately in the balance sheet and reported as an equity movement in the statement of recognized income and expenses. The restatement of opening balances as at January 1, 2005 called for recognition of actuarial losses for defined benefit plans in the amount of CHF 38 million, increasing the provision for post-employment benefits and reducing equity. The related deferred taxes amounted to CHF 9 million. In the 2006 income statement a cost reduction of CHF 6 million was recorded (2005: CHF 6 million), with a deferred tax expense of CHF 3 million (2005: CHF 2 million). In accordance with IAS19 §58(b) the amount of net assets from pension plans recognized in the balance sheet may not exceed the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. The effect of this limit in IAS19 §58(b) is also recorded as an equity movement in the statement of recognized income and expenses. Previously it was recorded in the income statement.

Assets and liabilities shown in the balance sheet for defined-benefit pension plans are based on statistical and actuarial calculations. The present value of the future benefit obligation depends on assumptions concerning the discount rate used to arrive at the present value, future salary expectations and possible increases in social costs of employment. Other factors included in the calculation are statistical data for employee turnover and life expectancy. These actuarial assumptions can vary substantially from reality as a result of market forces (e.g. higher or lower turnover rates or life expectancy of employees, changes in the economic or regulatory environment etc.). Such variances could affect the assets and liabilities shown in the balance sheet for defined-benefit pension plans in future periods. Actuarial calculations are performed generally on an annual basis.

Financial Liabilities: the financial liabilities consist mainly of loans with floating interest rates. Bonds are valued at cost, whereby the difference between the nominal amount repayable on maturity and the fair value less transaction costs of the bond when issued is recognized over the life of the bond as additional interest expense.

Income statement
Sales of goods and services are recognized when the transaction occurs, when the amounts involved are reliably known and when it is considered likely that the related economic benefit will flow to Oerlikon Group.

Operating expenses are recognized as a charge to income as they are incurred.

Sales of goods: sales of goods, after deduction of sales taxes and credits for returns and rebates, are recorded when the utility and risks of the sold goods have essentially transferred to the customer. In the business unit Oerlikon Solar (Oerlikon Balzers Coating segment) and the business unit Oerlikon Space (Oerlikon Components segment) revenue accruals for long-term manufacturing and services contracts are accomplished via the percentage of completion method. For Oerlikon Solar, the percentage of completion is determined on the basis of direct contract-related costs, after factoring out cost of materials. The Oerlikon Space business unit uses the milestone method.

Services rendered: revenues from services that have been rendered are recorded on the income statement according to the level of completion at the balance sheet date.

Interest on financial debt: interest expense is charged to the income statement without restriction. Borrowing costs of construction are not capitalized.

Research and development: development costs are recognized as intangible assets if they meet the criteria for such recognition set forth in IAS 38. A new system for control of development costs has been introduced throughout Oerlikon group, under which development costs may be recognized as assets when it can be shown that all IAS 38 criteria have been met. The cost thus capitalized comprises all costs directly attributable to the development process. After the development phase is complete the asset is amortized over its estimated useful life.

Taxes: current-year income taxes (Note 9) are accrued on the basis of income reported locally for the financial year by the individual Group companies in keeping with the current-year taxation principle. The valuation of assets and liabilities pertaining to both current and deferred taxation calls for extensive use of judgement and estimation. The value of deferred tax assets deriving from tax losses carried forward is subject to annual review. Tax losses are only recognized as assets if they are expected to be realized within the next few years, by offset against taxable profits of group companies individually or in tax pools. In countries or companies where realization of the losses is not probable, no asset is recognized. Management believes that its estimates are appropriate and that uncertainties in the valuation of tax assets and liabilities have been appropriately addressed.

Wherever local company tax values differ from Group values (temporary differences), deferred taxes are determined and recorded by applying current effective local tax rates to the differences (liability method). Taxes on dividends from subsidiaries are only accrued when distributions are contemplated. In the case of goodwill, investments in subsidiaries, and other assets and liabilities which do not affect taxable profits, no deferred taxes are set up.

Earnings per share: earnings per share (EPS) is based on the portion of consolidated net profit/loss attributable to equity holders of OC Oerlikon Corporation AG, Pfäffikon, divided by the weighted average number of shares outstanding during the reporting period. Fully diluted earnings per share takes into account additionally all potential equity securities that could have come into existence as the result of an exercise of option rights.

Financial risk management/financial instruments
Due to its international activities, the Group is faced with various financial risks, such as those associated with fluctuations in foreign exchange and interest rates. Management continuously monitors and steers such risks with the support of Corporate Treasury. As a fundamental rule, no speculative transactions are conducted in the areas of foreign exchange or interest rates.

Foreign exchange risks: the Group's consolidated financial statements are reported in Swiss francs. Due to its most significant markets, the Group is primarily exposed to price risks versus the US dollar and Euro. When the expenses and revenues of Group companies are incurred in differing or non-local currencies, the underlying business transactions are hedged on a centrally coordinated basis by means of commonly used financial instruments (see "Derivative financial instruments").

Liquidity risks: on the basis of a consolidated, rolling liquidity plan, Corporate Treasury determines the Group's required liquidity and is responsible for ensuring its availability as well as the centralized financing of Group companies.

Interest rate risks: risks related to fluctuations in interest rates are monitored by Corporate Treasury and in certain instances hedged at the Group level.

Default risks: as a fundamental principle, the Group places funds only with first-rate domestic and foreign banking institutions.

The credit or default risk associated with operating receivables is monitored locally by the individual Group companies (see "Receivables"). Generally, these risks are reduced by means of customer prepayments, letters of credit and other instruments.

Related-party transactions
Members of the Board of Directors or Executive Board, significant shareholders and companies or associated companies controlled by any of those individuals are deemed to be related parties.

Segment reporting
The primary segment reported corresponds to the operational and management-related structure of the Group. Secondary segment reporting is geographic, based on the group's principal locations and markets. The segments were realigned in 2006 as part of the Oerlikon Group re-branding program and also to integrate Saurer. These changes led to a re-grouping of core competencies and business units into five segments. Group reporting has been adjusted to reflect the new structure.

The individual segments of the Group are managed separately because the products they produce and market are clearly distinct from one another.

Intersegment sales are transacted at normal market conditions, and the related cost allocations are made systematically to the Group company that incurred the costs. The net operating assets of the business units consist of the operating assets such as receivables, inventories, PP&E and intangible assets, less any operating liabilities.

Oerlikon Balzers Coating: this segment consists of the business units Coating Services, Coating Systems and Solar. Coating Services (Balzers) is a global leader in the coating of precision components, especially for the automotive industry, as well as tools used in metal and plastics processing. The most important business field for Coating Services is contract coating services, which are offered via a continually growing network of coating centers in Europe, the Americas and Asia. Coating Services also operates in-house coating centers at customer sites and markets coating equipment. Coating Systems includes the previous business units Data Storage and Wafer Processing. These cover the market sectors optical storage media, hard discs, mask etching and wafer coating. The business unit Solar is active in the photovoltaic market and among other things is the only global provider of turnkey production equipment for volume manufacture of large surface thin-film coated solar panels made from amorphous Silizium.

Oerlikon Leybold Vacuum: the segment is divided into the two business units Oerlikon Leybold Vacuum Systems and Oerlikon Leybold Vacuum Services. Systems offers vacuum solutions used in a broad range of modern production and analytical processes as well as for research purposes. Services offers consulting services and individual service for complete vacuum systems. The segment's core competency lies in the development of systems for making vacuum and conveying process gases.

Oerlikon Components: is a segment comprising Oerlikon Optics, Oerlikon Assembly Equipment (previously Oerlikon ESEC Semiconductor), Oerlikon Solutions (previously Mecanovis) and Oerlikon Space. Oerlikon Optics is specialized in the area of optical components and modules. Highly precise optical thin film depositions, as well as complex optomechanical and optoelectronic modules, represent the business unit's core competencies. Oerlikon Assembly Equipment offers chip bonding equipment and system solutions for the semiconductor industry. Their machines are used in the back-end area of chip manufacturing. Oerlikon Solutions builds specialized turnkey equipment, mechanical component and high-vacuum systems, with the main focus on supplies to other business units within Oerlikon. Space Technology is the world's leading provider of payload fairings made of composite materials for space launch vehicles. Additional products produced by the unit are structures and precision mechanisms for satellites, instruments used in space exploration, and laser terminals for optical data transmission between telecommunications satellites.

Oerlikon Saurer Textile: this segment offers total solutions in the area of textile machinery and equipment, covering the complete textile value chain. The range of products and services offered includes plant design, equipment for manufacture of chemical fibers and non-wovens, ring-spinning, rotor-spinning and winding.

Oerlikon Graziano Drive Systems: this segment develops and manufactures transmission systems for motor vehicles. Oerlikon Graziano Drive Systems offers complete transmission systems, synchronizer units and gearboxes all over the world. Its product portfolio includes gearboxes for high-performance cars, components for all-wheel drive transmissions and agricultural vehicles and also heavy-duty planetary transmissions.