

Financial statements



2005

Consolidated financial statements
Financial statements of the Holding

TABLE OF CONTENTS**Consolidated financial statements**

121	Financial review
125	Consolidated income statement
126	Consolidated balance sheet
128	Consolidated statement of cash flows
129	Consolidated statement of changes in equity
130	Notes to the consolidated financial statements
163	Report of the Group auditors

Financial statements of the Holding

165	Income statement of the Holding
166	Balance sheet of the Holding
168	Notes to the financial statements
172	Proposed appropriation of available earnings
173	Report of the statutory auditors
174	The Swatch Group Ltd securities
175	Evolution of The Swatch Group Ltd registered shares and the Swiss Market Index

KEY FINANCIAL DEVELOPMENTS IN 2005

• Gross sales	Record gross sales with increase of 8.3% to CHF 4.5 billion (net sales: +7.8%)
• Segments	Brilliant performance of the Group's main segment Watches and Jewelry
• Operating profit	Record operating profit of CHF 735 million with strong operating margin of 17.1%
• Net income	Climbs by 21.3% to CHF 621 million, best result in Swatch Group's history
• Earnings per share	Significant rise of 23% compared to 2004
• Cash flow	Strong operating and free cash flow
• Dividend	Dividend proposed to shareholders increased by 42.9% (bearer shares CHF 2.50, registered shares CHF 0.50)
• Share buyback	New share buyback program of CHF 300 million in 2006
• Outlook	Promising start in 2006, optimistic outlook for current year

Financial review

1. Operating results

Group overview

(CHF million)	2005	2004	Change in %		Total
			in local currency	currency effect	
Gross sales	4 497	4 152	+7.7%	+0.6%	+8.3%
Net sales	4 292	3 981			+7.8%
Operating profit	735	645			+14.0%
– in % of net sales	17.1%	16.2%			
Net income	621	512			+21.3%
– in % of net sales	14.5%	12.9%			
Equity	4 603	4 276			+7.6%
– as % of total assets	69.9%	71.1%			
Average return on equity (ROE)	14.0%	12.3%			

2005 was a record year for the Group in almost every respect, mainly in terms of sales, operating profit and net income. All Group segments reported higher sales, and most of them improved their operating margins. The most substantial increase in sales and operating profit occurred in the luxury watches segment, which continues to enjoy very strong demand. Group operating profit achieved a record level of CHF 735 million, representing an operating profit margin of 17.1%.

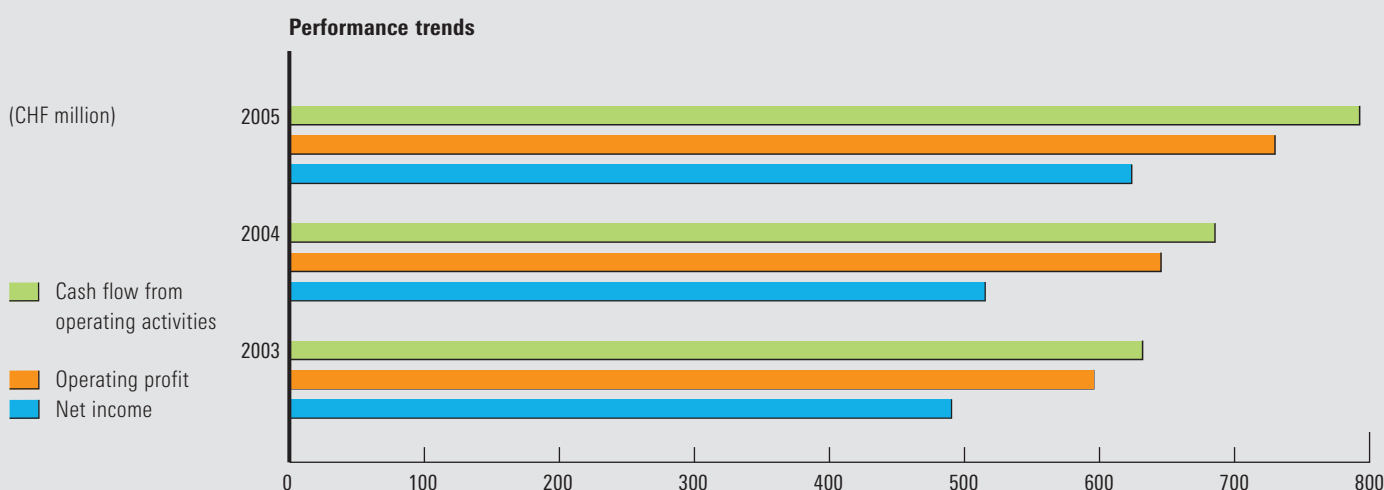
In contrast to the last few years, the currency effect was slightly positive in 2005, due in particular to positive developments in the second half of the year. Our very selective hedging strategy with regard to foreign currency risks proved to be the right decision in 2005.

Total unit sales of watches, movements and stepping motors decreased from 127.2 million in 2004 to 107.5 million in the current year. This development can be attributed to two main factors: on the one hand, to the planned and already announced reduction in the amount of movements in the lowest price category manufactured and sold in the Far East, and on the other hand, to the considerable fall in sales of stepping motors due to the decline in the US automobile market.

Restatements

The adoption of the new IFRS and revised IAS standards with effect from 1 January 2005 did not have a major impact on the Group's financial statements. The Group's operating profit for 2004 decreased by CHF 6 million to CHF 645 million while the net income remained unchanged at CHF 512 million. The preceding and following tables show the 2004 figures after the restatements. All related details are described on page 131 of this annual report.

FINANCIAL REVIEW



Segment performance

Watches and Jewelry

(CHF million)	2005	2004	Change in %		Total
			in local currency	currency effect	
Gross sales					
– Third parties	3 437	3 140			
– Group	0	1			
– Total	3 437	3 141	+8.6%	0.8%	+9.4%
Net sales	3 272	3 007			+8.8%
Operating profit	626	552			+13.4%
– in % of net sales	19.1%	18.4%			

The Group's core business grew more than the other Group divisions, with a sales growth of 9.4%. The luxury segment, particularly the Breguet, Blancpain and Jaquet Droz brands as well as the Omega brand, saw substantial double-digit growth, with the Group winning significant market shares and strengthening its already solid market position. The Group also achieved strong growth in the premium and mid-price segment, particularly with the Longines, Rado and Tissot brands. In the mid-price segment, Calvin Klein made pleasing progress. In the low price segment, headed up by the Swatch brand, the Group succeeded in achieving its targeted increase in sales thanks to measures realized to scale down its range of products. This was bolstered by pleasing developments in the jewelry division and good progress with the retail activities.

The operating margin in this segment increased remarkably to 19.1%, despite higher marketing expenses for some Group brands. Asia, especially China, proved to be the major driver for growth. An encouraging trend is also underway in the US, Japan and the Middle East. Overall, the targeted sales growth for 2006 should lead to a further rise in profitability in the segment. All brands of the Group still possess significant growth potential.

Production

(CHF million)	2005	2004	Change in %		Total
			in local currency	currency effect	
Gross sales					
– Third parties	537	509			
– Group	767	736			
– Total	1 304	1 245	+4.7%	0.0%	+4.7%
Net sales	1 229	1 164			+5.6%
Operating profit	47	49			–4.1%
– in % of net sales	3.8%	4.2%			

The Production segment achieved a solid growth in sales of 4.7%. This positive result was achieved despite the reduction in the activities in the lowest price category (movements manufactured and sold in the Far East) due to the closure of production facilities in Malaysia and China. While this had a negative impact on sales and operating profit in 2005, it will positively influence the results in 2006.

The Production segment should be able to further increase sales growth in 2006, provided the demand for watches and jewelry remains at the current high level. The number of units sold however will further decrease, given the reduced activities in the production of low-price watch movements. However, this strategy should lead to improved profitability of the segment. This is supported by the first trends in 2006 which show a high order intake and a continuous trend towards more complex and more expensive mechanical watch movements.

Electronic Systems

(CHF million)	2005	2004	Change in %		Total
			in local currency	currency effect	
Gross sales					
– Third parties	517	494			
– Group	31	49			
– Total	548	543	+0.9%	+0.1%	+1.0%
Net sales	542	536			+1.1%
Operating profit	78	74			+5.4%
– in % of net sales	14.4%	13.8%			

This division of the Group saw an increase in sales particularly in the second half of 2005. In an environment characterized by continued falling prices and relentless price pressure, the divisions Quartz with Micro Crystal (as supplier to the mobile phone market) and EM Microelectronic (with its Radio Frequency Identification technology RFID) divisions posted particularly pleasing growth. Rising demand for mobile phones in the second half of the year was the primary factor for the sales increase.

The Electronic Systems segment posted an operating margin of 14.4% compared to 13.8% in 2004. This positive trend should continue, considering the strong demand in all activities of the Group in general and the recovering markets for microelectronics and mobile phones in particular.

General Services

The General Services division includes the service, finance, research and real estate companies of the Group. Income recognized as sales in this segment relates mainly to research contracts as well as real estate management and consulting fees.

Revenue from timekeeping activities for the Olympic Games and other sporting events is recognized in "Other operating income" and not in sales.

Financial result

The positive performance of stock markets in 2005 led to significant profits on the marketable securities position. Besides that, the general development and active management of foreign currencies produced strong foreign exchange profits. These two main factors enabled the Group to achieve a positive net financial result of CHF 49 million which compares to a net financial loss of CHF 27 million in 2004.

Income tax

An analysis of the income tax charge is set out in Note 7 to the consolidated financial statements. The income tax charge as a percentage of profit before tax was 20.7% in the current year compared to 17.1% in the previous year. The effective tax rate increased mainly as a result of a change in the profitability of the Group's subsidiaries in the respective countries as well as changes in applicable statutory tax rates.

Proposed dividends

At the General Meeting on 19 May 2006 a dividend for the financial year 2005 of CHF 0.50 (2004: CHF 0.35) for registered shares and CHF 2.50 (2004: CHF 1.75) for bearer shares will be proposed. This dividend has not been recognized as a liability in the consolidated financial statements at 31 December 2005.

Earnings per share

Basic earnings per share have increased in the current year by 23% to CHF 2.15 for registered shares and CHF 10.74 for bearer shares respectively. The increase in net income compares to a reduced number of shares which is due to the shares bought back in 2005. As in previous years, dilution of earnings is not material. Detailed information can be found in Note 8.

FINANCIAL REVIEW

2. Financial condition

Liquidity and financial resources

The Group further strengthened its financial position in 2005. The consolidated cash flow evidences an important increase in cash and cash equivalents of CHF 490 million (2004: CHF 84 million). The main reason was once again a strong cash flow from operating activities, driven by continued growth in EBITDA. Investing activities were considerably lower than in 2004, mainly due to the sale of financial investments and reduced investments in property, plant and equipment. The increased share buyback was the main factor in financing activities. Free cash flow further improved from CHF 306 million in 2004 to CHF 499 million in the current year.

Asset and capital structure

The balance sheet continues to remain extremely solid, with an equity ratio of 69.9% (compared to 71.1% in 2004). Current liabilities are covered by current assets by a factor of 4.3 (4.7 in 2004).

3. Analysis of value added

The breakdown of total operating revenues, more commonly referred to as total Group performance in calculations of value added (using standard methods), is as follows:

(CHF million)	2005		2004	
Overall Group performance	4 637	100.0%	4 336	100.0%
Material and services	2 317	50.0%	2 195	50.6%
Depreciation	199	4.3%	218	5.0%
Net added value	2 121	45.7%	1 923	44.4%
% change	10.3		3.1	

The breakdown of value added between the different beneficiaries is as follows:

(CHF million)	2005		2004	
Employees	1 315	62.0%	1 283	66.7%
Public authorities	163	7.7%	106	5.5%
Lenders	21	1.0%	25	1.3%
Shareholders	102	4.8%	85	4.4%
Company	520	24.5%	424	22.1%
Total	2 121	100.0%	1 923	100.0%

4. Outlook

The Board of Directors and Group Management are confident that all the divisions of the Group will post further growth in 2006. The recovery in the global economy in conjunction with improved consumer confidence should help increasing sales around the globe. All brands will present new products at the 2006 Watch and Jewelry Show in Basel. This event will reveal market trends that will impact the near future of the Group.

The Group's strong net liquidity offers plenty of scope for organic growth via the launch of new products and the development of new markets. External growth opportunities – mainly in the jewelry sector – will also be examined as and when they arise.

CONSOLIDATED INCOME STATEMENT

	Notes	2005		2004	
		CHF million	%	CHF million	%
Gross sales		4 497	104.8	4 152	104.3
Sales reductions		-205	-4.8	-171	-4.3
Net sales	(5)	4 292	100.0	3 981	100.0
Other operating income		57	1.3	125	3.1
Changes in inventories and work in progress		84	2.0	146	3.7
Capitalized expenditures		28	0.7	30	0.8
Material purchases		-1 007	-23.5	-921	-23.1
Personnel expense	(6a)	-1 315	-30.6	-1 283	-32.2
Other operating expenses	(6b)	-1 205	-28.1	-1 215	-30.5
Depreciation, amortization and impairment charges		-199	-4.7	-203	-5.2
Amortization of goodwill		0	0.0	-15	-0.4
Operating profit		735	17.1	645	16.2
Financial income	(6d)	71	1.7	-4	-0.1
Interest expense	(6d)	-22	-0.5	-23	-0.6
Profit before taxes		784	18.3	618	15.5
Income taxes	(7)	-163	-3.8	-106	-2.6
Net income		621	14.5	512	12.9
Attributable to equity holders of The Swatch Group Ltd		614		506	
Attributable to minority interests		7		6	
Earnings per share (EPS) – expressed in CHF per share:	(8)				
Registered shares					
Basic EPS		2.15		1.74	
Diluted EPS		2.13		1.74	
Bearer shares					
Basic EPS		10.74		8.72	
Diluted EPS		10.66		8.70	

CONSOLIDATED BALANCE SHEET

Assets	Notes	31.12.2005		31.12.2004	
		CHF million	%	CHF million	%
Non-current assets					
Property, plant and equipment	(10)	1 153	17.5	1 161	19.3
Investment property	(11)	23	0.3	27	0.4
Intangible assets	(12)	263	4.0	256	4.3
Investments in associated companies	(13)	5	0.1	4	0.1
Financial long-term assets	(15)	51	0.8	43	0.7
Deferred income tax assets	(7)	136	2.1	120	2.0
Total non-current assets		1 631	24.8	1 611	26.8
Current assets					
Inventories	(16)	1 724	26.2	1 615	26.9
Trade receivables	(17)	707	10.7	646	10.7
Other receivables and prepayments	(18)	345	5.2	335	5.6
Current income tax assets	(7)	3	0.0	3	0.0
Marketable securities	(19)	307	4.7	426	7.1
Cash and cash equivalents	(20)	1 871	28.4	1 375	22.9
Total current assets		4 957	75.2	4 400	73.2
Total assets		6 588	100.0	6 011	100.0

CONSOLIDATED BALANCE SHEET

Equity and liabilities	Notes	31.12.2005		31.12.2004	
		CHF million	%	CHF million	%
Equity					
Capital and reserves attributable to Swatch Group shareholders	(21)	4 580	69.5	4 261	70.9
Minority interests		23	0.4	15	0.2
Total equity		4 603	69.9	4 276	71.1
Non-current liabilities					
Borrowings	(22)	396	6.0	395	6.6
Deferred income tax liabilities	(7)	344	5.2	344	5.7
Retirement benefit obligations	(23)	32	0.5	30	0.5
Provisions	(24)	49	0.7	34	0.6
Total non-current liabilities		821	12.4	803	13.4
Current liabilities					
Trade payables		240	3.7	209	3.5
Other payables and accrued expenses	(25)	405	6.1	381	6.4
Borrowings	(22)	329	5.0	224	3.7
Current income tax liabilities	(7)	140	2.1	56	0.9
Provisions	(24)	50	0.8	62	1.0
Total current liabilities		1 164	17.7	932	15.5
Total liabilities		1 985	30.1	1 735	28.9
Total equity and liabilities		6 588	100.0	6 011	100.0

CONSOLIDATED STATEMENT OF CASH FLOWS

		2005	2004
	Notes	CHF million	CHF million
Operating activities			
Cash generated from operations	(28)	877	774
Interest paid		-19	-20
Interest received		25	14
Tax paid		-93	-85
Cash flow from operating activities		790	683
Investing activities			
Investments in tangible assets		-187	-292
Proceeds from sale of tangible assets		15	12
Investments in intangible assets		-19	-15
Proceeds from sale of intangible assets		1	3
Investments in financial assets		-15	-8
Proceeds from sale of financial assets		1	2
Sale/purchase of marketable securities		142	-93
Cash flow from investing activities		-62	-391
Financing activities			
Dividend paid to shareholders		-101	-85
Dividend paid to minority interests		-1	0
Purchase/sale of treasury shares	(21)	-247	-148
Change in non-current borrowings		-1	-3
Change in current borrowings		96	27
Cash flow from financing activities		-254	-209
Net impact of foreign exchange rate differences on cash		16	1
Increase in cash and cash equivalents		490	84
Change in cash and cash equivalents			
- At beginning of year		1 373	1 289
- At end of year	(20)	1 863	1 373

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Attributable to The Swatch Group Ltd shareholders					Total	Minority interest	Total equity
	Share capital	Capital reserves	Treasury shares	Other reserves	Retained earnings			
(CHF million)	(Note 21)		(Note 21)	(Note 21)				
Balance at 01.01.2004/Published	137	213	-369	-97	4 122	4 006		4 006
Reclassification of minority interests							10	10
Restatement fair value reserve				84	-84			
Balance at 01.01.2004/Restated	137	213	-369	-13	4 038	4 006	10	4 016
Net income for the year					506	506	6	512
Translation differences and other changes				-23		-23	-1	-24
Total recognized income 2004				-23	506	483	5	488
Dividends paid					-85	-85		-85
Share-based compensation								
– Value of employee services					5	5		5
– Proceeds from shares					1	1		1
Share buyback			-149			-149		-149
Balance at 31.12.2004/Restated	137	213	-518	-36	4 465	4 261	15	4 276
Net income for the year					614	614	7	621
Translation differences and other changes				47		47	2	49
Total recognized income 2005				47	614	661	9	670
Dividends paid					-101	-101	-1	-102
Share-based compensation								
– Value of employee services					6	6		6
– Proceeds from shares					1	1		1
Share buyback			-248			-248		-248
Share capital reduction	-2		149		-147			
Balance at 31.12.2005	135	213	-617	11	4 838	4 580	23	4 603

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. General information

The Swatch Group Ltd (the Company) and its subsidiaries (collectively the Group) is active worldwide and represented in the finished watches and jewelry sector with 18 brands in all market and price brackets. In addition, it holds an outstanding industrial position with a high degree of verticalization in the sector of watch movements and components production as well as in the electronic systems sector. During the year, no major changes occurred in the Group structure.

The Company is a limited company incorporated and domiciled in Switzerland. Its registered office is located in Neuchâtel, Faubourg de l'Hôpital 3. The administrative headquarters are in Biel, Seevorstadt 6.

The shares of The Swatch Group Ltd are listed in Switzerland, under the security numbers 1 225 514 (registered shares) and 1 225 515 (bearer shares), and traded on virt-x, an Exchange for pan-European blue chip stocks.

These consolidated financial statements were approved for issue by the Board of Directors on 22 March 2006 and will be submitted to the Annual General Meeting of Shareholders for approval on 19 May 2006.

2. Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

A. Basis of preparation

The Group's consolidated financial statements have been prepared on a historical cost basis, except for certain items such as assets held for sale and financial instruments, as disclosed in the accounting policies below. The consolidated financial statements are presented in Swiss francs (CHF) and all values are rounded to the nearest million, unless otherwise stated.

The consolidated financial statements of the Swatch Group have been prepared in accordance with International Financial Reporting Standards (IFRS) and its interpretations adopted by the International Accounting Standards Board (IASB).

The preparation of consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.

The annual closing date for all the individual company accounts is 31 December. For all the companies consolidated, the financial year corresponds to the calendar year.

B. Consolidation policy

The subsidiaries are those entities controlled directly or indirectly by The Swatch Group Ltd, where control is defined as the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. This control is generally evidenced by the holding of more than one half of the voting rights of a company's share capital. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Companies are fully consolidated from the date on which control is transferred to the Group, and subsidiaries to be divested are included up to the date on which control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries of the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of an acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the income statement.

Minority interests in equity and net income are disclosed separately in the consolidated balance sheet and the consolidated income statement.

Intercompany transactions, balances and unrealized gains on transactions between Group companies are eliminated in full. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

Associates are all entities over which the Group has significant influence but not control. This is generally evidenced when the Group owns 20% to 50% of the voting rights or potential voting rights of the company. Investments in associates are accounted for using the equity method and are initially recognized at cost. Balances and transactions with associates that result in unrealized income are eliminated to the extent of the Group's interest in the associate.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Interests in joint ventures are reported using the line-by-line proportionate consolidation method. At 31 December 2005, none of the companies consolidated in the Group's financial statements were classified as joint ventures (none in 2004). At the end of 2005, the Group's consolidated financial statements included 140 legal entities (compared with 135 in the previous year), of which five were associates (five in 2004). A full list of consolidated companies is provided in Note 32.

C. Changes in accounting policies

The accounting policies used are consistent with those of the previous financial year except that the Group has adopted those new/revised IAS/IFRS standards mandatory for financial years beginning on or after 1 January 2005.

The main changes in accounting policies result from adoption of the following new or revised standards:

- IFRS 2 Share-based Payment
- IFRS 3 Business Combinations, IAS 36 (revised) Impairment of Assets and IAS 38 (revised) Intangible Assets
- IAS 1 (revised) Presentation of Financial Statements
- IAS 21 (revised) The Effects of Changes in Foreign Exchange Rates
- IAS 39 (revised) Financial Instruments: Recognition and Measurement

The principal effects of these changes in policies are discussed below. The overall impact on restated 2004 figures was not material. While the operating profit decreased by CHF 6 million to CHF 645 million, net income remained unchanged at CHF 512 million. Basic Earnings per Share for 2004 was restated from CHF 1.77 to CHF 1.74 for registered shares and from CHF 8.83 to CHF 8.72 for bearer shares.

IFRS 2 Share-based Payment

The new accounting policy for share-based payment transactions is described on page 137. The main impact of IFRS 2 on the Group is the recognition of an expense and a corresponding entry to equity for employee stock option plans.

The Group has applied IFRS 2 retrospectively and has taken advantage of the transitional provisions of IFRS 2 in respect of equity-settled awards. As a result, the Group has applied IFRS 2 only to equity-settled awards granted after 7 November 2002 that had not vested on 1 January 2005.

The effect of the revised policy has decreased consolidated current year profits by CHF 7 million (net of tax CHF 6 million), and in 2004 by CHF 6 million (net of tax CHF 5 million) due to an increase in the employee benefits expense with an equal increase in equity.

IFRS 3 Business Combinations, IAS 36 Impairment of Assets and IAS 38 Intangible Assets

IFRS 3 has been applied for business combinations for which the date of acquisition is on or after 31 March 2004. The adoption of IFRS 3 and IAS 36 (revised) has resulted in the Group ceasing annual goodwill amortization and commencing annual testing for impairment at the cash-generating unit level as of 1 January 2005. The Group's goodwill amortization amounted to CHF 15 million in 2004. No impairment of goodwill had to be recognized in the current year. For further information regarding the impairment testing of goodwill refer to Note 12.

IAS 1 Presentation of Financial Statements

The revised IAS 1 requires that minority interests are included in the Group's equity instead of in a separate category in the consolidated balance sheet, and that they are no longer deducted in arriving at the Group's net income. The adoption of this requirement resulted in the reclassification of CHF 15 million to equity in the balance sheet as at 31 December 2004. The Group's 2004 net income increased by CHF 6 million.

IAS 39 Financial Instruments: Recognition and Measurement

From 1 January 2005, the Group classifies its investments in the new category "designated at fair value through profit or loss". All realized and unrealized gains and losses arising from fair value changes are recognized in the income statement. Previously, financial assets were classified as available-for-sale investments. Unrealized gains and losses arising from fair value changes were recorded in equity. When securities were sold or impaired, the accumulated fair value adjustments were included in the income statement.

The 2004 figures have been restated accordingly. The fair value reserve as at 01.01.2004 has been reclassified to retained earnings. The financial result for 2004 has been reduced by CHF 1 million due to the restatements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

IAS 21 The Effects of Changes in Foreign Exchange Rates

As of 1 January 2005, the Group adopted IAS 21 (revised). As a result, any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated prospectively as assets and liabilities of the foreign operation and translated at the closing rate.

Furthermore, a small number of subsidiaries changed their functional currency in order to comply with the new requirements, with no material effect on consolidated financial statements.

IFRS standards and IFRIC interpretations not yet effective

The Group has not applied in these consolidated financial statements the IFRS standards and IFRIC interpretations that have been issued but were not yet effective on 31 December 2005.

The Group expects that adoption of these pronouncements will have no major impact on the Group's financial statements in the period of initial application. However, in certain areas (such as IAS 19 "Employee Benefits" and IFRS 7 "Financial Instruments: Disclosures") disclosures will have to be expanded.

Restatement of the segments

In 2004, the company Nouvelle Lémania SA was merged with Montres Breguet SA. As of 1 January 2005 the activity of Nouvelle Lémania SA is no longer consolidated within the Production segment but is now part of the Watches and Jewelry segment. The resulting prior year changes do not have a material impact on the operating profit of the segments. At Group level, sales and results are not affected by this restatement.

D. Segment reporting

The Group's primary format for segment reporting is business segments and the secondary format is geographical segments. The risks and returns of the Group's operations are primarily determined by the different products rather than their geographical location. This is reflected by the Group's divisional management and organizational structure and the Group's internal financial reporting systems.

The Group's activities are organized into four separately reportable business segments:

– Watches and Jewelry	Sale of finished watches and jewelry
– Production	Manufacture of watches, watch movements and jewelry
– Electronic Systems	Design, production and marketing of electronic components
– General Services	Service, finance, research and real estate companies

Sales to third-party clients are presented separately from sales to other operating divisions, and internal Group sales are recognized at fair value. Segment expenses are those that can be directly attributed to the segment.

The assets of the segments mainly consist of land and buildings, equipment and machinery, intangible assets, inventories, trade accounts receivable and cash and cash equivalents. However, they exclude consolidated investments in subsidiaries. Segment liabilities include operating commitments.

In line with common practice in the Watch segment, the geographical presentation of sales is broken down by continent. Turnover is reported according to the destinations that appear on the invoices. Total third-party assets are broken down by location.

E. Foreign currency translation

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in Swiss francs, which is the Company's functional and presentation currency.

Transactions in foreign currencies are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Any gains and losses resulting from these transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the consolidated income statement.

Income statements of Group entities with a functional currency different from the Swiss franc are translated at average exchange rates as an approximation of exchange rates prevailing at the date of the transaction; balance sheets are translated at the year-end exchange rate. All resulting exchange differences are recognized as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities are taken to shareholders' equity. When a foreign operation is sold, such exchange differences are recognized in the income statement as part of the gain or loss on the sale.

In the reporting periods, none of the Group entities has the currency of a hyperinflationary economy.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the year-end rate.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The main exchange rates used are:

	Average rates	Prevailing rates	Average rates	Prevailing rates
	2005	31.12.2005	2004	31.12.2004
	CHF	CHF	CHF	CHF
1 AUD	0.9525	0.9650	0.9151	0.8850
1 CNY	0.1536	0.1635	0.1506	0.1370
1 EUR	1.5498	1.5565	1.5463	1.5450
1 GBP	2.2702	2.2700	2.2786	2.1850
1 HKD	0.1614	0.1700	0.1599	0.1460
100 JPY	1.1335	1.1200	1.1573	1.1050
1 SEK	0.1665	0.1655	0.1693	0.1710
1 SGD	0.7523	0.7920	0.7370	0.6950
100 TWD	3.9063	4.0150	3.7608	3.6000
1 USD	1.2558	1.3190	1.2457	1.1350

F. Revenue recognition

Net sales comprise the fair value for the sale of goods and services, net of value-added tax, rebates and discounts. Intercompany sales are eliminated on consolidation. Revenue is recognized as follows:

Sales of goods

Sales of goods are recognized when a Group entity has delivered products to the customer and the collectibility of the related receivables is reasonably assured. Accruals for discounts granted to clients are established during the same period as the sales which gave rise to the discounts under the terms of the contract.

Rendering of services

Revenue from services is recognized in the accounting period in which the services are rendered, by reference to completion of the specific transaction assessed on the basis of the actual service provided.

Interest income

Interest income is recognized on a time-proportion basis using the effective interest method.

Dividend income

Dividend income is recognized when the right to receive payment is established.

G. Property, plant and equipment

Property, plant and equipment are stated at historical cost less accumulated depreciation and any impairment in value. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits will flow to the Group and the cost can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Land is not depreciated. Depreciation on other assets is calculated on a straight-line basis over the estimated useful life of the asset, as follows:

– Furniture, office machinery, motor vehicles:	5 to 8 years
– IT equipment and software:	3 to 5 years
– Measuring instruments, tools, equipment for non-mechanical processing automation components:	5 to 9 years
– Machines and mechanical production systems, workshop equipment:	9 to 15 years
– Factories and workshop buildings:	30 years
– Administrative buildings:	40 years

The assets' residual values and useful lives are reviewed and adjusted, if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount. These are included in the income statement.

The position "construction in progress" includes buildings under construction, down payments on land and buildings as well as attributable borrowing costs.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

H. Investment property

Investment properties comprise mainly residential properties. They are held for long-term rental yields and are not occupied by the Group. Some land reserves are held with undetermined use. Investment property is carried at historical cost less accumulated depreciation and any impairment in value. The useful life of residential properties is estimated at 50 years. Fair values are disclosed in Note 11. They are determined by capitalization of rental income for rented buildings plus an estimated market value of land reserves.

I. Intangible assets

Intangible assets are stated at historical cost less accumulated depreciation and any impairment in value.

Goodwill

Goodwill represents the excess of the acquisition price over the fair value of the Group's share of net identifiable assets of the acquired company at the date of acquisition. Goodwill is tested annually for impairment and in addition, when indications of impairment exist, and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units (CGU) for the purpose of impairment testing. The CGU represents the lowest level within the Group at which the goodwill is monitored for internal management purposes and is not larger than a business segment (see Note 12).

Research and development costs

Costs linked to development projects are recognized as intangible assets provided future economic benefits are anticipated. Other research and development costs are recognized as expenses. Once a product enters into commercial production, the capitalized development costs are amortized over the period of anticipated earnings. The amortization period applied does not exceed five years.

Software development costs

Costs associated with developing or maintaining computer software programs are recognized as an expense as incurred. Costs that are directly associated with the production of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits extending beyond one year, are recognized as intangible assets. Direct costs include software development employee costs and an appropriate portion of relevant overheads.

Costs associated with improving software or extending its performance beyond the original specifications are capitalized as an asset and added to the original cost of the software. The capitalized costs associated with the development of software are amortized over their estimated useful lives using the straight-line method over a period not exceeding five years.

In addition to the items mentioned separately, the heading intangible assets also includes:

- Licenses purchased granting rights to use new state-of-the-art technologies. Related lump-sum payments have been capitalized and amortized over a period of five years;
- Key money paid for strategically located retail shops. If their value can be demonstrated by the presence of a market, they are not amortized but tested for impairment. Key money that is not refundable or refundable only upon certain conditions being met is treated as prepaid rent.

J. Impairment of assets

Assets that have an indefinite useful life are not subject to amortization and are tested annually for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. The latter is calculated by estimating the future cash flows generated by the asset and discounting them with a risk-adjusted interest rate. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

K. Financial assets

The Group classifies its financial assets, principally investments, in the following categories: financial assets designated at fair value through profit or loss, loans and receivables, held-to-maturity investments and available-for-sale investments. The classification depends on the purpose for which the investments were acquired.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Financial assets designated at fair value through profit or loss

All the Group's current investments are classified in the category designated at fair value through profit or loss. Financial assets classified as held for trading are included in this category. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorized as held for trading unless they are designated as hedges. All realized and unrealized gains and losses arising from changes in the fair value are recognized in the income statement.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable.

Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities, not designated at fair value through profit or loss, that the Group's management has the positive intention and ability to hold to maturity. During the year, the Group did not hold any investments in this category.

Available-for-sale investments

Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date. As of 1 January 2005, the Group reclassified all investments from the category available-for-sale to the category financial assets designated at fair value through profit or loss.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length market transactions.

L. Inventories

Inventories are stated at the lower of cost and net realizable value. Cost is determined using the weighted average price method. Some companies, particularly those in the Production segment, value their inventories using the standard cost method. As these costs are regularly reviewed and adjusted, this method approximates the results of the weighted average price method. The valuation of spare parts for customer service is confined to those units that are considered likely to be used, based on historical demand.

Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the applicable variable selling expenses.

M. Non-current assets held for sale

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification. Non-current assets (and disposal groups) classified as held for sale are measured at the lower of the assets' previous carrying amount and fair value less costs to sell.

N. Trade receivables

Trade receivables are recognized and carried at the original invoice amount less an allowance for any uncollectible amounts, which corresponds to their fair value. Provision is made when there is objective evidence that the Group will not be able to collect the receivables. Bad debts are written off when identified.

O. Cash and cash equivalents

Cash and cash equivalents in the balance sheet comprise petty cash, cash at banks and short-term deposits with an original maturity of three months or less. For the purpose of the cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of short-term bank overdrafts.

P. Share capital and treasury shares

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Own equity instruments that are reacquired (treasury shares) are deducted from equity. No gain or loss is recognized in profit or loss on the purchase, sale, issue or cancellation of the Group's own equity instruments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Q. Borrowings

Borrowings are initially recognized at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortized cost.

The fair value of the liability component of a convertible bond is determined using a market interest rate for an equivalent non-convertible bond. This amount is recorded as a liability on an amortized cost basis until extinguished on conversion or maturity of the bonds. The remainder of the proceeds is allocated to the conversion option. This is recognized and included in shareholders' equity, net of income tax effects. Transaction costs are apportioned between the liability and equity components of the convertible bonds, based on the allocation of proceeds to the liability and equity components when the instruments are first recognized. Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

R. Taxes

Current tax

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the balance sheet date.

Deferred tax

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. If the deferred tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for.

Deferred tax is determined using tax rates and laws that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realized or the deferred tax liability is settled.

Income tax relating to items recognized directly in equity is recognized in equity and not in the income statement.

Deferred tax assets are recognized for all deductible temporary differences, tax loss carryforwards and tax credits to the extent that it is probable that future taxable profits will be available against which they can be utilized.

Deferred tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

S. Pensions and other post-employment benefits

Pension obligations

Group companies operate various pension schemes. The schemes are generally funded through payments to insurance companies or trustee-administered funds, determined by periodic actuarial calculations. The Group has both defined benefit and defined contribution plans. A defined benefit plan is a pension plan that defines the amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. A defined contribution plan is a pension plan under which the Group pays fixed contributions into a separate entity. The Group has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods. Group pension plans in Switzerland are accounted for as defined benefit plans.

Actuarial gains and losses are recognized as income or expense when the net cumulative unrecognized actuarial gains and losses for each individual plan at the end of the previous reporting year exceeded 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. These gains or losses are recognized over the expected average remaining working lives of the employees participating in the plans.

Past service costs are recognized immediately in income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortized on a straight-line basis over the vesting period.

The liability recognized in the balance sheet in respect of defined benefit plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets, together with adjustments for unrecognized actuarial gains or losses and past service costs. The defined benefit obligation is calculated annually by independent actuaries, using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Other post-employment benefits

A small number of Group companies provide post-retirement medical care benefits to their employees. The entitlement to these benefits is usually conditional on the employee remaining in service up to retirement age and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment, similar to the accounting for defined benefit plans.

Termination benefits

Termination benefits are payable when employment is terminated before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognizes termination benefits when it is demonstrably committed to either terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal, or providing termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after the balance sheet date are discounted to present value.

T. Provisions

Provisions are recognized:

- when the Group has a present legal or constructive obligation as a result of past events
- when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and
- when a reliable estimate can be made of the amount of the obligation

Where the Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset, but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement, net of any reimbursement. If the effect of the time value of money is material, provisions are discounted, using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as a borrowing cost.

U. Share-based payment transactions

The Group operates an equity-settled, share-based compensation plan. Under the terms of this plan, managers are granted a certain number of share options. The attribution of these options is based on assessments and proposals for managers and staff who have distinguished themselves throughout the year by a particularly strong commitment to the company or an above-average performance. The fair value of the employee services received in exchange for the grant of the options is recognized as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted (calculated using the "Black-Scholes" model), excluding the impact of any non-market vesting conditions (for example, profitability and sales growth targets). Non-market vesting conditions are included in assumptions about the number of options that are expected to vest. At each balance sheet date, the entity revises its estimates of the number of options that are expected to become exercisable. It recognizes the impact of the revision of original estimates, if any, in the income statement, and a corresponding adjustment to equity over the remaining vesting period.

A tranche of treasury shares has been specifically reserved for this stock option plan. No new shares were issued under this plan. Equity increases by the corresponding amounts over the vesting period.

The dilutive effect of outstanding options is reflected as additional share dilution in the computation of earnings per share (see Note 8).

V. Leases

Finance leases

A finance lease is where the lessor transfers to the lessee substantially all the risks and rewards incidental to ownership of the leased item. At the inception of the lease, finance leases are capitalized at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Each lease payment is apportioned between the finance charges and the reduction of the lease liability, so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income statement. Capitalized leased assets are depreciated over the shorter of the lease term and the estimated useful life of the asset.

Operating leases

An operating lease is where a significant portion of the risks and rewards of ownership are retained by the lessor. Operating lease payments are recognized as expenses in the income statement on a straight-line basis over the lease term.

W. Dividends

Dividends are recorded in the Group's financial statements in the period in which they are approved by the Group's shareholders.

X. Comparatives

Certain prior year balances have been reclassified or extended from the previously reported results to take into account current year presentational changes. The changes are mentioned in the respective notes.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

3. Financial risk management

A. Financial risk factors

In view of the global and varied nature of its activities, the Group is exposed to financial market risk (including foreign currency risk, fair value interest rate risk and price risk), credit risk, liquidity risk and cash flow interest rate risk.

The Group's risk management is essentially focused on identifying and analyzing exchange rate risk, with the aim of minimizing its impact on Group earnings before taxes and net income. In order to hedge exchange rate risk, the Group uses derivative financial instruments such as forward currency contracts or currency hedging options.

Risk management is conducted by the central treasury department (Group Treasury), which follows the directives issued by the Group's management bodies. Risks are assessed in collaboration with the operating units and the hedging methods are decided and implemented under supervision of the Finance Committee.

1. Market risk

The Group is exposed to market risk, primarily related to foreign exchange, interest rates and the market value of investments of liquid funds. The Group actively monitors these exposures. To manage the volatility relating to these exposures, the Group uses a variety of derivative financial instruments. The Group's objective is to reduce, where it deems appropriate to do so, fluctuations in earnings and cash flows associated with changes in interest rates, foreign currency rates and market rates of investments of liquid funds. It is the Group's policy and practice to use derivative financial instruments to manage exposures and to enhance the yield on the investment of liquid funds.

1.1 Foreign exchange risk

The Group's consolidated financial statements are published in Swiss francs and are therefore mainly exposed to fluctuations in the euro, the US dollar and the Japanese yen. Consequently, it enters into various contracts that reflect the changes in the value of foreign exchange rates to preserve the value of assets, commitments and anticipated transactions. The Group also uses forward contracts and foreign currency option contracts to hedge certain anticipated net revenues in foreign currencies. Group companies enter into special exchange rate contracts with the Group's treasury department guaranteeing a standard exchange rate for a term of one month. The treasury department, for its part, is responsible for hedging net positions in foreign currencies with external counterparties.

1.2 Price risk

1.2.1 Commodities

The Group has a limited exposure to price risk related to anticipated purchases of certain commodities used such as gold, platinum or gems. A change in those prices may alter the gross margin of a specific business, but generally below materiality level. Accordingly, the Group does not enter into significant commodity futures, forward and option contracts to manage fluctuations in prices of anticipated purchases.

1.2.2 Equity investment risk

The Group purchases equities as investments of its liquid funds. Potential investments are thoroughly analyzed in respect to their past financial track record (mainly cash flow return on investment), their market potential, their management and their competitors. Call options are written on equities that the Group owns, and put options are written on equities that the Group wants to buy and for which cash has been reserved.

2. Credit risk

The Group's client credit policy necessitates periodic reviews of the credit standing of our commercial partners.

In purchasing securities, the Group guards against the risk of default by implementing directives that impose minimum credit ratings for investments in tradable securities. The Group's management regularly monitors strict compliance with these directives. Counterparty risk is also minimized by ensuring that all derivative financial instruments, money market investments and current account deposits are placed with financial institutions whose credit standing has been verified by our treasury department beforehand. Exposure to this type of risk is closely monitored by Group management and is contained within strict and pre-determined limits.

Given the very high standards of creditworthiness applied to our commercial and financial partners, the default risks to which the Group is exposed are limited.

3. Liquidity risk

The close monitoring of liquidity at Group level and of the allocation of resources allows the Group's treasury department to maintain adequate levels of liquidity at all times. In order to meet any exceptional liquidity requirements, the Group maintains lines of credit with a number of financial institutions.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

4. Interest rate risk

Borrowings issued at variable rates expose the Group to cash flow interest rate risk. Borrowings issued at fixed rates expose the Group to fair value interest rate risk. The Group manages its net exposure to interest rate risk through the proportion of fixed rate debt and variable rate debt in its total debt portfolio. In the current monetary environment, interest rate fluctuations do not have a major impact on the Group's financial results.

In the context of balance sheet liabilities management, the Group has not used interest rate swaps during the two years under review, and there are no outstanding positions relating to interest rate swaps in the Group's financial statements.

B. Accounting for derivative financial instruments and hedging activities

Derivatives are recognized at their cost at inception either as cash flow hedges or as fair value hedges, depending on the nature of the underlying transaction. Any subsequent remeasurements to fair value are either taken to the income statement (fair value hedges) or recognized in shareholders' equity (cash flow hedges).

In the case of cash flow hedges, a distinction is made between time value and intrinsic value when calculating the premium and the replacement value at a given date.

The time value paid is recognized as soon as the position is taken. When a contract is valued at a given date, the adjustment of the time value is taken to the income statement while the adjustment in the intrinsic value is recognized in shareholders' equity. As soon as the hedge of the underlying asset becomes active, and may be considered effective, the time values of the hedged item and the hedging transaction are determined. Any difference between the two values is taken to the income statement. In the case of cash flow hedges, any value adjustment recorded in the previous period under shareholders' equity will be transferred to the income statement.

Details of hedging operations are disclosed in Note 27.

C. Fair value estimation

The fair value of quoted investments is deemed to be their corresponding stock market closing prices on the balance sheet date. Derivatives and forward rate contracts are also recognized at their market value on the account closure date. The fair value of financial instruments that are not traded in an active market is determined by making assumptions that are based on prevailing market conditions and on recent arm's length market transactions.

4. Critical accounting estimates and judgements

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

A. Critical accounting estimates and assumptions

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The key estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Impairment of goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use and therefore of the expected future cash flows of the cash-generating units to which the goodwill is allocated. Furthermore, a suitable discount rate is chosen in order to calculate the present value of those cash flows. More details are given in Note 12.

Income taxes and custom duties

The Group is subject to taxes, levies and duties in numerous jurisdictions. In this respect the Group and its subsidiary companies are regularly exposed to audits by the various governmental bodies and authorities, where the outcome of findings particularly in the area of transfer pricing depends very often on individual judgements. Considerable judgement is required in determining tax provisions. Liabilities for anticipated tax audit issues are recognized based on estimates of whether additional taxes will be due. These estimates could prove to be too pessimistic, or in a negative scenario, additional tax liabilities would have to be recorded in the future.

Furthermore, the capitalization of deferred tax assets is based on assumptions about the future profitability of certain Group companies. There is an inherent risk that these estimates made by management turn out to be too optimistic.

Provision for bad debts

To cover any shortfalls from current trade receivables, the Group records a provision for bad debts based on historical information and on estimates in regard to the solvency of customers. Unexpected financial problems of major customers could lead to the situation where the recorded provision is insufficient.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Warranty claims

The Group generally offers a two year warranty for watches. Management estimates the related provision for future warranty claims mainly based on historical warranty claim information. Factors that could impact these estimates include the success of the Group's quality initiatives, parts and labour costs as well as customer behaviour. Any material change of these factors could result in higher or lower warranty costs for the Group.

Legal claims

Some Group companies are involved in litigation arising from the ordinary course of their business. Management estimated the outcome of these lawsuits and booked adequate provisions in line with IAS 37. However, there is an inherent risk that – against all odds – these legal claims are successful and cause a significant outflow of economic benefits. Moreover the Group being listed on the Swiss Stock Exchange market finds itself also under permanent review regarding the observation of all rules and regulations. Despite the considerable effort to comply with the increasing number of laws, rules and regulations at all times and on all levels in all countries in which the Group develops activities, there remains a certain risk of oversight which could impact future earnings.

B. Critical judgements in applying the entity's accounting policies

In the process of applying the Group's accounting policies, management has made the following judgements, apart from those involving estimations, which have the most significant effect on the amounts recognized in the financial statements:

Inventory abatements

In determining net realizable values of inventory, management had to use judgement as to whether or not inventory abatements are necessary. Especially for spare parts used in customer service, but also for some watch components and finished goods, judgement calls were made in order to determine a realistic value for these inventory items. Unexpected changes in fashion, technology and customer needs could lead to situations where the actual inventory abatements would need to be increased.

Impairment of assets

Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Management determines the amount of impairment losses by applying judgement in regard to the recoverable amount and the future use of an impaired asset. In 2005 the closure of a production line in the Far East caused an impairment of assets. If external factors such as market, technology, etc. change in a way not anticipated by management, there is a risk that additional impairment losses will have to be recorded.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

5. Segment information and sales

A. Primary segment information (by business segment)

Income statement

2005	Watches & jewelry	Production	Electronic systems	General services	Consolidation adjustment	Total
(CHF million)						
– Third parties	3 437	537	517	6		4 497
– Group		767	31	2	–800	0
Gross sales	3 437	1 304	548	8	–800	4 497
– Third parties	3 272	503	511	6		4 292
– Group		727	31	2	–760	0
Net sales	3 272	1 230	542	8	–760	4 292
Operating profit	626	47	78	–16		735
– As a % of net sales	19.1	3.8	14.4			17.1
– As a % of total	85.2	6.4	10.6	–2.2		100.0

2004	Watches & jewelry	Production	Electronic systems	General services	Consolidation adjustment	Total
(CHF million)						
– Third parties	3 140	509	494	9		4 152
– Group	1	736	49	2	–788	0
Gross sales	3 141	1 245	543	11	–788	4 152
– Third parties	3 006	479	487	9		3 981
– Group	1	685	49	2	–737	0
Net sales	3 007	1 164	536	11	–737	3 981
Operating profit	552	49	74	–30		645
– As a % of net sales	18.4	4.2	13.8			16.2
– As a % of total	85.6	7.6	11.5	–4.7		100.0

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Balance sheet and other information

2005 (CHF million)	Watches & jewelry	Production	Electronic systems	General services	Total
Balance sheet					
– Segment assets	3 099	1 177	404	1 903	6 583
– Equity in associated companies		4		1	5
Total assets	3 099	1 181	404	1 904	6 588
Total liabilities	1 006	275	69	635	1 985
Net assets	2 093	906	335	1 269	4 603

Other information

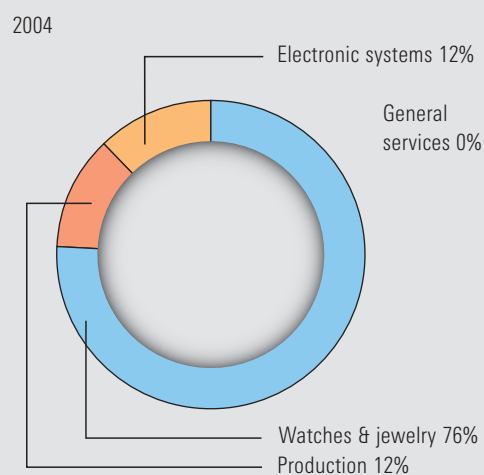
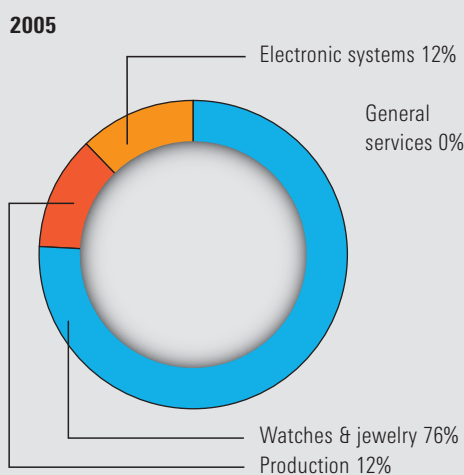
Investments (including capitalized expenditure)	87	101	27	6	221
Depreciation on tangible assets	34	105	34	3	176
Amortization on intangible assets	3	4	3	1	11
Impairment		8	4		12

2004 (CHF million)	Watches & jewelry	Production	Electronic systems	General services	Total
Balance sheet					
– Segment assets	2 775	1 198	412	1 622	6 007
– Equity in associated companies		3		1	4
Total assets	2 775	1 201	412	1 623	6 011
Total liabilities	804	261	70	600	1 735
Net assets	1 971	940	342	1 023	4 276

Other information

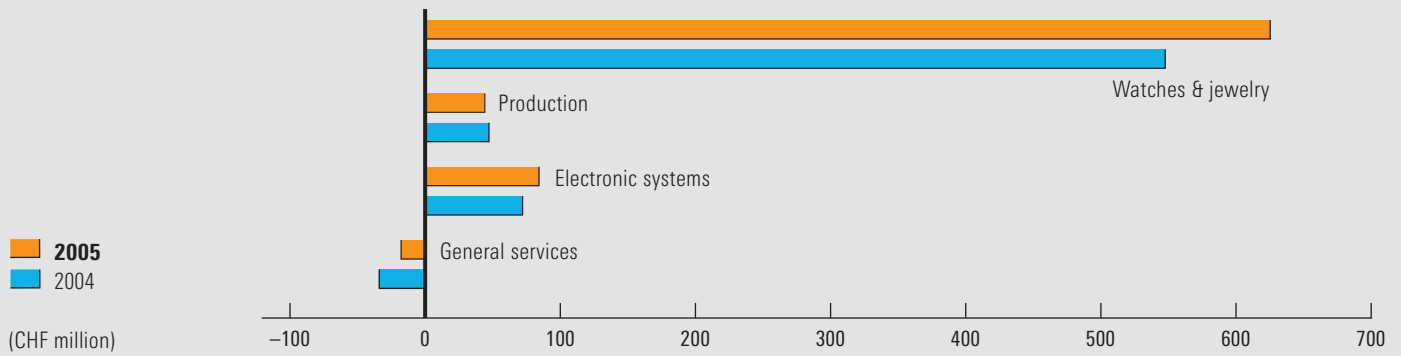
Investments (including capitalized expenditure)	208	79	20	8	315
Depreciation on tangible assets	31	107	43	3	184
Amortization on intangible assets	14	6	4	4	28
Impairment		2	4		6

Segment share of net sales



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Segment share of operating profit

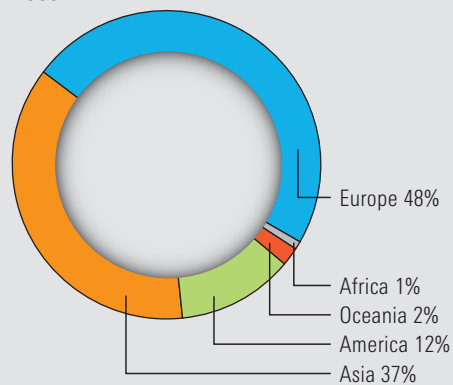


B. Secondary segment information
(by geographic area)

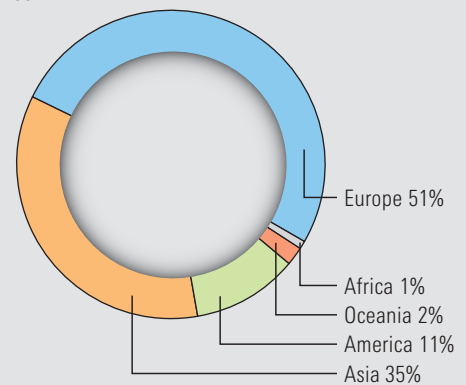
(CHF million)	2005			2004		
	Net sales	Total assets	Investments	Net sales	Total assets	Investments
Europe	2 090	5 509	179	2 033	5 137	153
America	494	259	10	453	200	5
Asia	1 597	786	31	1 394	648	156
Oceania	68	34	1	63	26	1
Africa	43			38		
Total	4 292	6 588	221	3 981	6 011	315

Net sales by geographic area

2005



2004



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

6. Revenues and expenses

a. Personnel expense	(CHF million)	2005	2004
	Wages and salaries	1 067	1 049
	Social security costs	178	171
	Share-based compensation (Note 29)	7	6
	Pension costs – defined benefit plans (Note 23)	57	56
	Pension costs – defined contribution plans (Note 23)	4	1
	Other post-employment benefits (Note 23)	2	0
	Total personnel expense	1 315	1 283

The development of the headcount is summarized in the following table:

	2005	2004
Average annual headcount	20 730	20 831
Total headcount at 31 December	20 650	20 949
– Men	9 172	9 187
– Women	11 478	11 762
– Swiss contracts	10 830	10 832
– Non-Swiss contracts	9 820	10 117

Headcount is expressed as the number of employment contracts. The number of employees includes home workers, trainees and auxiliary staff. The decrease in total headcount is mainly due to the closure of production facilities in Asia. Overall, 52% of personnel had a Swiss employment contract (2004: 51%).

b. Other operating expenses	(CHF million)	2005	2004
	Marketing, sales and administration	665	621
	Subcontracting and other direct costs of sales	233	216
	Maintenance, rents and energy	249	247
	Other operating expenses	58	131
	Total other operating expenses	1 205	1 215

Due to the structure of the income statement by nature, operating expenses only represent third-party costs. In 2004, other operating expenses included the costs for the Olympic Games in Athens.

c. Research and development costs		2005	2004
	R&D costs diminished from CHF 153 million in 2004 to CHF 144 million in 2005, representing 3.4% of net sales (compared with 3.8% in 2004).		

d. Net financial result	(CHF million)	2005	2004
	Interest income	25	16
	Income from marketable securities	22	16
	Foreign exchange differences on financial transactions	24	–36
	Financial income	71	–4
	Interest on convertible bond	–14	–14
	Other interest	–8	–9
	Interest expense	–22	–23
	Net financial result	49	–27

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

7. Income taxes

Income tax expenses	(CHF million)	2005	2004
Current income taxes		168	105
Adjustments recognized for current taxes of prior periods		5	0
Deferred income taxes		-10	1
Total income taxes		163	106

Since the Group operates worldwide, it is subject to income taxes in many different tax jurisdictions. The Group calculates its average expected tax rate as a weighted average of tax rates in the relevant tax jurisdictions. The increase of the average expected tax rate from 18.3% in 2004 to 21.8% in 2005 is mainly caused by a change in the profitability of the Group's subsidiaries in the respective countries as well as changes in applicable statutory tax rates.

Reconciliation of the Group's effective tax rate	2005	2004 ¹⁾
	%	%
Group's average expected tax rate	21.8	18.3
Tax effect of		
– Change in the applicable tax rate on temporary differences	-1.4	0.3
– Capitalization of tax assets from previous years and utilization of tax losses/ unused tax credits	0.0	-0.7
– Non-taxable income/non-deductible expenses	0.3	0.5
– Items taxable at reduced rates	-0.8	-0.9
– Other items	0.8	-0.4
Group's effective tax rate	20.7	17.1

¹⁾ The prior year presentation has been adapted to include the effect of tax rate differences and tax privileges of holding companies within the average expected tax rate.

Current income tax	(CHF million)	31.12.2005	31.12.2004
Current income tax assets		3	3
Current income tax liabilities		-140	-56
Net current income tax liability		-137	-53

Deferred income tax

Deferred tax assets and liabilities are offset within legal entities when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred taxes relate to the same fiscal authority.

The deferred tax asset and liability amounts (shown in the following table) are calculated after set-offs and were presented on the consolidated balance sheet as follows:

(CHF million)	31.12.2005	31.12.2004
Deferred tax assets	136	120
Deferred tax liabilities	-344	-344
Net total	-208	-224

The gross movement on the deferred income tax account is as follows:

(CHF million)	2005	2004
Balance at 1 January	-224	-221
Translation differences and other movements	6	-2
Income statement	10	-1
At 31 December	-208	-224

Deferred tax assets resulting from deductible temporary differences, tax credits or tax loss carryforwards are recognized only to the extent that realization of the related tax benefit is probable. The Group has unrecognized tax losses of CHF 97 million at 31 December 2005 (CHF 113 million at 31 December 2004). In 2005, 35% of total recognized and unrecognized carryforward tax losses expire within six years (33% in 2004). The remaining tax losses expire after six years or more.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The deferred tax assets and liabilities relate to the following balance sheet items:

Deferred tax assets		
Source (CHF million)	31.12.2005	31.12.2004
Carryforward tax losses/tax credits	13	13
Non-current assets	31	35
Current assets	103	89
Short-term debt	20	13
Long-term debt	9	11
Total	176	161
Set-off	-40	-41
Total deferred tax assets on the balance sheet	136	120

Deferred tax liabilities		
Source (CHF million)	31.12.2005	31.12.2004
Non-current assets	-96	-111
Current assets	-160	-167
Short-term debt	-5	-3
Long-term debt	-123	-104
Total	-384	-385
Set-off	40	41
Total deferred tax liabilities on the balance sheet	-344	-344

8. Earnings per share

	2005	2004
Basic		
Net income attributable to equity holders of The Swatch Group Ltd (CHF million)	614	506
Percentage of registered shares outstanding in comparison with the share capital outstanding	42.7%	42.7%
Percentage of bearer shares outstanding in comparison with the share capital outstanding	57.3%	57.3%

Registered shares		
Net income attributable to registered share holders (CHF million)	262	216
Average number of shares outstanding	122 004 798	123 787 740
Basic earnings per share, in CHF	2.15	1.74

Bearer shares		
Net income attributable to bearer share holders (CHF million)	352	290
Average number of shares outstanding	32 788 496	33 211 158
Basic earnings per share, in CHF	10.74	8.72

	2005	2004
Diluted		
Net income attributable to equity holders of The Swatch Group Ltd (CHF million)	614	506
Interest expense on convertible debt (net of tax) (CHF million)	14	14
Net income used to determine diluted EPS (CHF million)	628	520
Percentage of diluted registered shares outstanding in comparison with the diluted share capital outstanding	44.3%	44.4%
Percentage of diluted bearer shares outstanding in comparison with the diluted share capital outstanding	55.7%	55.6%

Registered shares		
Net income attributable to registered share holders (CHF million)	279	231
Average number of shares outstanding	130 646 179	132 447 448
Diluted earnings per share, in CHF	2.13	1.74

Bearer shares		
Net income attributable to bearer share holders (CHF million)	349	289
Average number of shares outstanding	32 788 496	33 211 158
Diluted earnings per share, in CHF	10.66	8.70

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

9. Dividends paid and proposed

On 18 May 2005, the Annual General Meeting approved the distribution of a dividend of CHF 0.35 per registered share and CHF 1.75 per bearer share. The distribution to holders of outstanding shares totaled CHF 101 million (2004: CHF 85 million) and has been recorded recording against retained earnings in 2005.

At the Annual General Meeting on 19 May 2006, the payment of the following dividends for 2005 will be proposed:

	Registered	Bearer
Dividend per share	CHF 0.50	CHF 2.50
Total dividend	CHF 67 455 664	CHF 82 643 625

The financial statements ending 31 December 2005 do not take into account this proposed dividend. Dividends will be treated as a distribution of available earnings during the financial year 2006.

10. Property, plant and equipment

Changes in tangible assets with reference to their relevant acquisition values are summarized in the following table:

(CHF million)	Land and buildings	Plant and machinery	Other fixtures and fittings	Advances and construction in progress	Total 2005	Total 2004
Historical cost, 1 January	897	2 216	286	28	3 427	3 298
Translation differences	6	18	4		28	-17
Acquisitions					0	1
Investments	14	89	37	24	164	274
Capitalized expenditure		21	1		22	17
Disposals	-3	-80	-11		-94	-104
Transfers	4	14	-6	-24	-12	-42
Historical cost, 31 December	918	2 278	311	28	3 535	3 427
Accumulated depreciation, 1 January	-420	-1 620	-203	-23	-2 266	-2 213
Translation differences	-1	-11	-3		-15	9
Annual depreciation	-17	-135	-23		-175	-183
Impairment		-10			-10	-5
Depreciation on disposals		68	8		76	94
Transfers	-2	-21	8	23	8	32
Accumulated depreciation, 31 December	-440	-1 729	-213	0	-2 382	-2 266
Net book value, 31 December	478	549	98	28	1 153	1 161

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At 31 December 2005, total non-current assets pledged to guarantee the commitments of the Group companies represented CHF 3 million (CHF 3 million at end-2004).

At end-2005, fixed assets financed by leasing contracts and recognized as assets on the balance sheet amounted to less than CHF 2 million (less than CHF 2 million at end-2004).

Impairment in the amount of CHF 10 million (CHF 5 million at end-2004) was charged on assets whose book value was greater than their net recoverable value.

Fire insurance values

Tangible fixed assets were insured against fire for the following amounts:

(CHF million)	31.12.2005	31.12.2004
Buildings	1 419	1 414
Equipment	3 104	3 052
Total	4 523	4 466

The net value of tangible fixed assets (including investment property and land) shown on the balance sheet at 31 December 2005 represented 26.0% (2004: 26.6%) of the insured value.

11. Investment property

Investment properties are valued at historical cost less accumulated depreciation and impairment in value. Gross and net values as well as the movements during the year are disclosed in the following table, which also shows the amounts that have been recognized in the income statement:

(CHF million)	2005	2004
Historical cost, 1 January	52	25
Investments	1	1
Disposals	-1	0
Transfers	-6	26
Historical cost, 31 December	46	52
Accumulated depreciation, 1 January	-25	-9
Annual depreciation	-1	-1
Impairment	-1	-1
Depreciation on disposals	1	0
Transfers	3	-14
Accumulated depreciation, 31 December	-23	-25
Net book value, 31 December	23	27
Rental income	3	3
Direct operating expenses arising from investment properties that did generate rental income	-2	-2
Direct operating expenses arising from investment properties that did not generate rental income	0	0

Based on capitalized rental income for rented buildings plus an estimated market value for land reserves, the fair value of the investment properties is estimated at CHF 51 million at 31 December 2005 compared to CHF 57 million at 31 December 2004. Given the relatively immaterial amounts of investment property, no external independent valuation has been performed.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

12. Intangible assets

Changes in intangible assets with reference to their relevant acquisition values are summarized in the following table:

	Capitalized development costs	Other intangible assets	Goodwill	Total 2005	Total 2004
(CHF million)					
Historical cost, 1 January	27	90	274	391	397
Translation differences		1		1	-1
Investments	1	13		14	2
Capitalized expenditure	5			5	13
Disposals		-2		-2	-20
Transfers		10	-67	-57	0
Historical cost, 31 December	33	112	207	352	391
Accumulated amortization, 1 January	-18	-50	-67	-135	-125
Translation differences		-1		-1	1
Annual amortization	-3	-8		-11	-28
Amortization on disposals		1		1	17
Transfers		-10	67	57	0
Accumulated amortization, 31 December	-21	-68	0	-89	-135
Net book value, 31 December	12	44	207	263	256

There are no accumulated impairment losses in goodwill. Within intangible assets, only goodwill is supposed to have an indefinite life.

Goodwill impairment testing

Goodwill is allocated to the Group's cash-generating units (CGUs), which correspond to the profit centers for the segment "Watches and Jewelry" and the reportable segments for the business segments "Production" and "Electronic Systems".

A segment-level summary of the goodwill allocation is presented below:

(CHF million)	31.12.2005	31.12.2004
Watches & jewelry	151	151
Production	22	22
Electronic systems	34	34
Total	207	207

The recoverable amount of a cash-generating unit is determined based on value-in-use calculations. These calculations use cash flow projections based on financial budgets approved by management covering a five-year period. Cash flows beyond the five-year period are extrapolated using conservatively estimated growth rates. The discount rates used (6.2%–7.5%) are derived from a capital asset pricing model using data from Swiss capital markets and reflect specific risks relating to the relevant segments. This is then adjusted to a pre-tax rate (8.25%–10.1%).

No impairment charge for goodwill had to be recorded in 2005. Management believes that any reasonably possible change in any of the key assumptions would not cause the carrying value of goodwill to exceed the recoverable amount.

13. Investments in associated companies

Investments in associated companies are essentially investments in other companies, resulting in the ownership of 20-50% of their voting rights. In 2005, five such investments, Danyack SA, François Golay SA, Terbival SA, HiPoint Technology Inc., and S.I. Les Corbes SA, were recognized using the equity method, since the Group exercised a significant influence over their activities. The carrying value of investments in associates was CHF 5 million in 2005 (CHF 4 million in 2004). The Swatch Group's share in these companies generated after-tax income of CHF 1 million in 2005 (2004: less than CHF 1 million). This income is recognized in the net financial result (Note 6d).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

14. Business combinations

Effective as of 1 January 2004, the Swatch Group acquired the remaining 50% of the capital of Time Flagship SA in Lucerne, and the remaining 46% of the capital of the real estate company S.I. L'Etang SA in Le Locle. Before this acquisition, Time Flagship SA was proportionally consolidated as a joint venture. Goodwill resulting from these immaterial transactions was less than CHF 1 million. In 2005 no business combinations occurred.

In early 2006, the Group acquired two entities (refer to Note 31 Events after the balance sheet date for further information). For information in respect of the existing goodwill from past acquisitions, refer to Note 12 Intangible assets.

15. Financial long-term assets

	Key money	Guarantees, deposits	Other financial assets	Total 2005	Total 2004
(CHF million)					
Balance at 1 January	36	5	2	43	43
Investments	6	5	4	15	8
Disposals			-1	-1	-2
Transfers to "Other receivables"	-6			-6	-6
Balance at 31 December	36	10	5	51	43
Term 1–5 years	19	8	5	32	22
Term > 5 years	17	2		19	21
Balance at 31 December	36	10	5	51	43

Key money that the Group pays when renting shops in strategic locations is recognized as prepaid rent when recovery at the end of the contract is not certain. The long-term portion is recognized under "Financial long-term assets", while the short-term component is transferred to "Other receivables and prepayments".

16. Inventories

(CHF million)	31.12.2005	31.12.2004
Raw materials and components	528	535
Work in progress	507	465
Finished goods	565	477
Spare parts for customer service	124	138
Total	1 724	1 615

Inventories were 6.7% higher at 31 December 2005 than at end-2004. This increase resulted from exceptionally strong sales growth in the luxury watches segment, notably Breguet and Omega. In addition, the expansion strategy pursued in the "retail" arm has also raised the volumes of inventories.

Inventories with risk of obsolescence have been adjusted to their net realizable value. Adjustments of this nature accounted for CHF 24 million in 2005 (CHF 19 million in 2004).

17. Trade receivables

(CHF million)	31.12.2005	31.12.2004
Gross receivables	738	680
Allowance for bad and doubtful debts	-31	-34
Net receivables	707	646

The allowance for bad and doubtful debts represents 4.2% (5.0% in 2004) of receivables outstanding and covers all risks identified at closing date. The average payment term for trade receivables was nearly unchanged in 2005. Calculated on the basis of actual monthly gross sales, the corresponding figure decreased slightly from 49 days at end-2004 to 48 days at end-2005.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

18. Other receivables and prepayments

This heading covers numerous items and can be summarized as follows:

(CHF million)	31.12.2005	31.12.2004
Advances	27	20
VAT to be refunded	125	134
Other taxes to be refunded	2	6
Accrued financial expenses	2	3
Prepaid advertising expenses	10	41
Assets held for sale	8	3
Key money	6	6
Sundry receivables and other accrued income	165	122
Total	345	335

Current income tax assets are reported on a separate balance sheet line and are also included in Note 7 Income taxes.

19. Marketable securities

Marketable securities amounted to a total value of CHF 307 million in 2005 (CHF 426 million in 2004). The decrease is due to the sale of an important part of the shares portfolio.

As mentioned in changes in accounting policies, previously, financial assets were classified as available-for-sale investments. Since the beginning of 2005, they have been entirely allocated to the category "financial assets designated at fair value through profit or loss". These assets have an active market, and all realized and unrealized gains and losses arising from fair value changes are recognized in the income statement.

The Swatch Group holds only short-term financial assets (i.e. that can be liquidated within 12 months).

20. Cash and cash equivalents

(CHF million)	31.12.2005	31.12.2004
Current accounts and liquid assets	627	353
Short-term deposits with financial institutions	1 244	1 022
Total	1 871	1 375

The average yield on short-term bank deposits corresponds to the average interest rate on an investment on the capital and money markets with a term of up to three months.

For the purposes of the consolidated statement of cash flows, cash and cash equivalents include the following items:

(CHF million)	31.12.2005	31.12.2004
Cash and cash equivalents	1 871	1 375
Bank overdrafts (Note 22)	-8	-2
Total	1 863	1 373

21. Share capital and reserves

Over the past three years, the share capital of The Swatch Group Ltd has changed as follows:

Balance sheet date	Registered shares	Bearer shares	Share capital in CHF
31.12.2002	137 051 327 at CHF 0.45	33 506 950 at CHF 2.25	137 063 734.65
31.12.2003	137 051 327 at CHF 0.45	33 506 950 at CHF 2.25	137 063 734.65
31.12.2004	137 051 327 at CHF 0.45	33 506 950 at CHF 2.25	137 063 734.65
31.12.2005	134 911 327 at CHF 0.45 ¹⁾	33 057 450 at CHF 2.25 ¹⁾	135 089 359.65

¹⁾ Buyback of shares on the Group's 2nd trading line and cancellation following the decision of the AGM of 18 May 2005: 2 140 000 registered shares and 449 500 bearer shares.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

At year-end 2005 as well as 2004, there was no authorized or conditional capital. All issued shares are fully paid. Shares of The Swatch Group Ltd held by the Group are recognized in the consolidated financial statements at their historical cost. The value of these shares is charged against consolidated shareholders' equity. In July 2005, the Swatch Group launched a new share buyback program. During the year ended 31 December 2005, the Group acquired own shares representing a market value of CHF 248 million. At the beginning of 2006, the Board of Directors of the Swatch Group Ltd approved a new share buyback program corresponding to a market value of CHF 300 million. Equity increased by CHF 7 million in 2005 (net of taxes) (2004: CHF 6 million), due the stock option plan. Details to the share options issued in connection with the employee stock option plan are given in Note 29. After the reclassification of fair value reserves at 1 January 2004, other reserves only include the equity component of the convertible bond as well as cumulative translation differences. Other reserves can be summarized as follows:

(CHF million)	31.12.2005	31.12.2004	01.01.2004 (restated)
Equity component of convertible bond	16	16	16
Translation and other differences	-5	-52	-29
Total other reserves	11	-36	-13

22. Borrowings

(CHF million)	31.12.2005	31.12.2004			
Long-term borrowings					
Convertible loan	396	393			
Other long-term debt	0	2			
Total long-term borrowings	396	395			
Short-term borrowings					
Current account overdrafts	8	2			
Short-term bank debt	321	222			
Total short-term borrowings	329	224			
	6 months	7-12	1-5	more than	
(CHF million)	or less	months	years	5 years	Total
At 31.12.2005	262	67	396	0	725
At 31.12.2004	157	67	2	393	619

At 31 December 2005, the weighted average interest rate on financial debt was below 2% (below 2% at end-2004) for maturities of less than 12 months, and 3.5% (3.5% at end-2004) for long-term financial debt (i.e. more than one year).

Convertible bond

On 15 October 2003, The Swatch Group Finance (Luxembourg) SA issued convertible bonds valid from 15 October 2003 to 15 October 2010 and a coupon of 2.625%, for a total of CHF 411 600 000. During the conversion period, these bonds with a nominal value of CHF 5 000 may be converted into registered shares of The Swatch Group Ltd at CHF 49.00 each.

The bond issue has been split into an equity and a liability component, recognized on the balance sheet under the corresponding headings. The fair value of the liability component, recognized as long-term debt, was determined by reference to the market rate (3.248% per year) of an equivalent non-convertible bond. The residual value (the conversion option) was recognized as shareholders' equity.

Until conversion or redemption of the bond issue, the liability component and all related adjustments will be accounted for using the effective interest rate method. The equity portion was determined at the time of issue and will not be modified at a later date.

The convertible bond issue is recognized as follows:

(CHF million)	2005	2004
Liability component at 1 January	393	390
Coupon interest at market rate	14	14
Coupon interest at 2.625%	-11	-11
Liability component at 31 December	396	393

At 31 December 2005, no bonds had been converted. The closing rate of the convertible bond on the Swiss Stock Exchange at end-2005 was 109.00% (107.42% at end-2004).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

23. Retirement benefit obligations

Defined benefit plans

The Group has numerous independent pension plans. Defined benefit pension plans cover a significant number of the Group's employees. The Group's Swiss pension fund is also treated as a defined benefit pension plan. The defined benefit obligations and related assets are reassessed annually by independent actuaries. The following is a summary of the status of the main pension plans:

	2005	2004
	CHF million	CHF million
Present value of funded obligations	-2 994	-2 719
Fair value of plan assets	2 990	2 720
Liability/asset surplus at 31 December	-4	1
Unrecognized actuarial difference	27	21
Present value of unfunded obligations	-3	0
Unrecognized past-service cost	-1	1
Unrecognized surplus due to IAS 19.58 B	-38	-39
Net liability in the balance sheet at 31 December	-19	-16
Amounts recognized in the income statement		
Current service cost	-70	-67
Interest cost on obligations	-91	-100
Expected return on plan assets	111	106
Net actual losses recognized current year	-52	-12
Past service cost	-1	0
Employee contributions	45	45
Impact of IAS 19.58 B	1	-28
Total recognized in personnel expense	-57	-56
Change in the net liability recognized in the balance sheet		
Net liability at 1 January	-16	-17
Net expense recognized in the income statement	-57	-56
Employer contributions paid	54	57
Net liability at 31 December	-19	-16
Actual return on plan assets		
Expected return on plan assets	111	106
Actuarial difference on plan assets	210	43
Actual return on plan assets	321	149
Principal actuarial assumptions used		
	2005	2004
	%	%
	Weighted average	Weighted average
Discount rate	3.25	3.75
Expected return on plan assets	4.00	4.00
Salary increases due to inflation	1.00	1.00
Pension index	0.00	0.00

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

In addition to the defined benefit pension plans, this heading includes liabilities for other post-employment benefit plans for employees working abroad. The split of the balance sheet amount of retirement benefit obligations is as follows:

(CHF million)	31.12.2005	31.12.2004
Net liability for defined benefit plans	19	16
Other post-employment benefit plans	13	14
Total retirement benefit obligations	32	30

Defined contribution plans

Amounts recognized in the consolidated income statement relating to contributions to defined contribution plans represent the employer's future contributions and are calculated according to the regulations of various pension institutions. In 2005, these contributions amounted to CHF 4 million (CHF 1 million in 2004).

24. Provisions

(CHF million)	Warranties	Litigation	Other	Total
At 31 December 2004	59	11	26	96
Translation differences	1	1		2
Additional provisions	60	4	13	77
Reversal of provisions	-3	-4	-11	-18
Provisions used during the year	-56	-1	-5	-62
Other movements		2	2	4
At 31 December 2005	61	13	25	99

Analysis of total provisions (CHF million)	31.12.2005	31.12.2004
Provisions for more than one year	49	34
Current provisions	50	62
Total	99	96

Warranty

In the majority of cases, the Group offers a two-year warranty covering the repairs or replacement of products that do not perform to customers' satisfaction. The provision made at year-end to cover future warranty costs is based on past experience with respect to the volume of repairs and returns.

Legal risks

Provisions have been allocated to cover lawsuits against the Group arising from the normal conduct of business. It is the view of Group Management, supported by appropriate legal advice, that none of the existing lawsuits will entail costs that significantly exceed the amounts set aside at 31 December 2005.

Other

Other provisions relate to various commitments of the Group companies toward third parties. The term and amount of payments made from these provisions cannot be determined.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

25. Other payables and accrued expenses

The position "Other payables and accrued expenses" rose by CHF 24 million to CHF 405 million. "Accrued expenses" includes all charges relating to the period yet to be invoiced by third parties to Group companies. These liabilities include the following debt and accruals:

(CHF million)	31.12.2005	31.12.2004
Purchases of goods and services	24	27
Wages and social security costs	102	85
Sales reductions	24	21
Advertising	81	101
VAT due	31	27
Capital taxes	3	4
Advance payments	14	5
Other debt and accrued expenses	126	111
Total other payables and accrued expenses	405	381

Current income tax liabilities are reported on a separate balance sheet line and are also included in Note 7 Income taxes.

26. Commitments and contingencies

Guarantees and sureties

At 31 December 2005, guarantees to third parties as security for commitments of Group companies amounted to less than CHF 2 million (less than CHF 2 million at end-2004).

Total current assets pledged by Group companies to guarantee their commitments amounted to CHF 6 million at 31 December 2005 (CHF 5 million at end-2004).

Leasing, rental and other commitments

Operating leasing commitments for the Group not recognized in the balance sheet are as follows:

(CHF million)	31.12.2005	31.12.2004
Less than 1 year	71	54
Between 1 and 5 years	190	147
Over 5 years	127	107
Total	388	308
Proportion of contracts with renewal option (% of total amount)	71.9	56.4
Maximum risk (% of total amount)	90.3	90.7

The figures in the preceding table include all rental contracts for buildings, a major part of which relate to the Group's retail business, and to all other standard rental contracts existing at 31 December 2005. Leasing costs amounting to CHF 74 million were recognized in the 2005 income statement (CHF 54 million in 2004). A sublease clause is included in a large number of rental contracts for retail shops. Moreover, if the need arises, the Group may negotiate early termination of a lease contract with exit terms considerably more favorable than the payment of the entire commitment specified in the initial contract.

Other commitments relating to investments in financial and tangible fixed assets entered into by the Group, and ongoing at 31 December 2005, amounted to CHF 7 million (CHF 8 million in the previous year).

Contingent liabilities

Some Group companies are involved in litigation arising from the ordinary course of business and they may be liable to pay compensation. The effect of these lawsuits, not all of which are covered by insurance, on future operations and earnings is not predictable. The Group's best estimate of future payments for such commitments is CHF 5 million (2004: CHF 6 million).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

27. Derivatives

The table below gives an overview of the contract and replacement values of derivative financial instruments on positions in precious metals or denominated in foreign currency.

The notes to the financial statements of the Holding on page 171 set out the contract and replacement values of the parent company's financial derivatives. Only third-party values are used for the Group accounts.

Type (CHF million)	Contract value	Positive replacement value	Negative replacement value
Forward contracts	531	0	-1
Options	0	0	0
Total at 31.12.2005	531	0	-1
Total at 31.12.2004	528	1	-2

As in the prior year, the Group had no open option position and no cash-flow hedges outstanding in the current year. At 31 December 2005, the contract value of open forward transactions increased by CHF 3 million versus the previous year.

28. Cash generated from operations

	Notes	2005 CHF million	2004 CHF million
Net income		621	512
Result from associated companies		-1	0
Taxes	(7)	163	106
Depreciation of tangible assets		176	184
Amortization of intangible assets		11	28
Impairment charge		12	9
Loss/profit on sale of fixed assets		3	-3
Fair value gains on marketable securities		-22	-14
Interest income	(6d)	-25	-16
Interest expense	(6d)	22	23
Expenses for equity-settled equity compensation plan		7	6
Changes in working capital (without liquid funds):			
– Inventories		-86	-152
– Trade and other receivables		-27	12
– Trade payables and other current liabilities		22	67
Changes in provisions		0	8
Changes in pensions and other retirement benefits		1	4
Cash generated from operations		877	774

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

29. Employee stock option plan

When the Hayek Pool acquired control of the Swatch Group, a block of shares was reserved in 1986 for a management stock option plan.

Under the terms of this plan, managers have the right to subscribe, in the future, for registered shares at a preferential price. The attribution of these option rights is based on assessments and proposals for managers and staff who have distinguished themselves throughout the year by a particularly strong commitment to the company or an above-average performance. One-third of the options attributed can be subscribed, paid up and disposed of immediately, another third in one year, and the remaining third in two years. A tranche of treasury shares has been specifically reserved for this stock option plan. Equity increases by the corresponding amounts over the vesting period.

At the end of 2005, this portfolio comprised 3 259 613 registered shares (3 499 632 at the end of 2004). In 2005, 240 019 registered shares were awarded at a preferential price of CHF 4.00 per registered share (see details below).

Year of award to employees	Number of options exercised	Number of beneficiaries	Year of subscription/payment
2003	76 760	183	2005
2004	83 156	207	2005
2005	80 103	196	2005
Total	240 019		

In addition, eligible members of management were granted the following options to subscribe for further registered shares at a preferential price in the future:

Year of award to employees	Number of options	Number of beneficiaries	Year of subscription/payment
2004	82 724	196	2006
2005	79 906	193	2006
2005	78 751	192	2007
Total outstanding	241 381		

The movement in the number of options was:

	2005	2004
Options outstanding at 1 January	259 707	245 135
Granted	238 760	273 094
Forfeited or lapsed	-17 067	-15 954
Exercised	-240 019	-242 568
Outstanding at 31 December	241 381	259 707

The fair value of the options granted during the period was determined by using the Black-Scholes option pricing model. The following table shows the assumptions on which the valuation of share options granted during the period was based:

	Tranche exercisable in in 1 year	Tranche exercisable in in 2 years
Grant date	5 August 2005	5 August 2005
Expiration date	5 August 2006	5 August 2007
Closing share price on grant date	CHF 37.75	CHF 37.75
Exercise price	CHF 4.00	CHF 4.00
Volatility	25.7%	25.7%
Expected dividend yield	CHF 0.35	CHF 0.35
Interest rate	0.9%	1.15%
Market value of option at grant date	CHF 33.40	CHF 33.50

The personnel expense recorded in the 2005 income statement as a result of applying IFRS 2 calculation amounted to CHF 7 million (2004: CHF 6 million).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

30. Related party transactions

Principal shareholders

On 31 December 2005, the Hayek Pool and its companies and related entities held 62 019 456 registered shares and 293 250 bearer shares, equivalent to 37.1% of the shares issued (previous year: 36.5%) of The Swatch Group Ltd, which is the parent company of the Group.

In the context of the pool, the group of Mr N. G. Hayek and related parties controlled in total 36.4% of the shares issued compared with 35.8% at the end of year 2004.

As of the same date, Mrs Esther Grether's group controlled 6.7% of the shares issued (compared with 8.0% a year earlier).

In 2005, the Hayek Group, owned by a member of the Hayek Pool, invoiced an amount of CHF 8.7 million to the Swatch Group (compared with CHF 12.4 million in 2004). This amount primarily covered support for Group Management in the following areas of activity:

(CHF million)	2005	2004
– Audit, feasibility studies and process optimization	2.4	3.8
– Provision of managers and filling important, vacant functions	0.9	3.6
– Project management in the construction sector	2.6	1.7
– Introduction of cost accounting systems in manufacturing companies	0.5	0.6
– Support for projects in the materials and surface treatment technology sector	0.1	0.6
– Leasing a store in the centre of Cannes (France) in a building of a subsidiary of the Hayek Group	0.4	0.4
– Various services relating to the assessment of investment projects, cost control, IT consulting, etc.	1.8	1.7
Total	8.7	12.4

Key management personnel

In addition to the executive members of the Board of Directors, the members of the Group Management Board and of the Extended Management Board are considered as key management personnel (according to IAS 24.9).

The total compensation for key management personnel using IFRS 2 rules for accounting for share-based compensation was as follows:

(CHF million)	2005	2004
Short-term employee benefits	18.6	17.7
– of which in salaries	7.6	7.4
– of which in bonus	11.0	10.3
Post-employment benefits	0	0
Termination benefits	0	0
Share-based compensation (Note 29)	4.3	3.2
Total	22.9	20.9

In 2005, CHF 0.8 million (2004: CHF 0.8 million) was paid to non-executive members of the Board of Directors (not including Mr N. G. Hayek, Chairman and Delegate of the Board of Directors).

No remuneration was paid to former members of management bodies.

Share ownership

At 31 December 2005, the executive members of the Board of Directors and the members of the Management Board of the company as well as the persons close to them held directly or indirectly a total of 54 871 740 registered shares and 80 090 bearer shares, representing 32.7% of the voting rights (previous year: 32.2%).

In addition, at 31 December 2005, all the non-executive members of the Board of Directors as well as the persons close to them held 12 932 712 registered shares and 223 000 bearer shares, representing 7.8% of the voting rights (previous year: 9.1%).

Loans to members of the governing bodies

The employees of the company may take out a mortgage loan with the Swatch Group Pension Fund for the construction or acquisition of property in Switzerland (primary residence).

The conditions for these mortgage loans are set by the Swatch Group Pension Fund Foundation Board. These conditions are applied in the same manner to all employees. At the end of 2005, two such loans had been granted to members of the Group Management Board for a total of CHF 1.2 million (in 2004, three loans for a total of CHF 1.6 million).

At the end of 2004, Swatch Group USA Inc. granted a loan for USD 0.1 million to the managing director of the subsidiary. This loan was fully repaid in 2005.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Associated companies and other related parties

The Group has transactions with associates and other related parties. A listing of the associated companies is included in the list of the Swatch Group companies (Note 32). A Group of companies owned by a minority shareholder in Singapore are considered as other related parties.

(CHF million)	2005		2004	
	Purchases	Sales	Purchases	Sales
Associates	6	0	5	0
Other related parties	1	6	3	8

At the end of 2005, receivables from related parties amounted to CHF 1 million (2004: less than CHF 1 million), and payables to related parties were CHF 1 million (2004: less than CHF 1 million).

31. Events after the balance sheet date

In February and March 2006, the Swatch Group acquired two companies (WIGE Data GmbH, Leipzig, and The Swatch Group [RUS], Moscow). The total consideration paid amounted to CHF 23 million. At the time of preparing this annual report, the allocations of net assets and goodwill relating to these business combinations were not yet finalized.

Other than that, there were no significant events after the balance sheet date.

32. THE SWATCH GROUP COMPANIES — as at 31.12.2005

Company name, Registered offices	Field of Activity	Capital in millions	Swatch Group Shareholdings %	Consoli- dation	Segment
EUROPE					
SWITZERLAND					
The Swatch Group SA, Neuchâtel	Holding	CHF 135.09			▼
Asulab SA, Marin-Epagnier	Research and development	CHF 0.10	100	●	▼
Atlantim Immobilien AG Bettlach, Bettlach	Real estate	CHF 0.70	100	●	▼
Blancpain SA, Le Chenit	Watches	CHF 0.10	100	●	■
Blancpain Les Boutiques SA, Le Chenit	Retailing	CHF 0.10	100	●	■
Breguet Les Boutiques SA, L'Abbaye	Retailing	CHF 0.50	100	●	■
Certina SA, Le Locle	Watches	CHF 3.50	100	●	■
Chronométrage Suisse SA, Corgémont	Sports timing	CHF 0.10	100	●	▼
cK Montres & Bijoux Co. SA, Bienne	Watches	CHF 5.00	90	●	■
Comadur SA, Le Locle	Products in hard materials	CHF 7.86	100	●	▲
Compagnie des Montres Longines, Francillon SA, Saint-Imier	Watches	CHF 10.00	100	●	■
Danyack SA, La Chaux-de-Fonds	Real estate	CHF 0.06	29	○	▼
Dernier Batz SA, Neuchâtel	Real estate	CHF 4.50	100	●	▼
Diantus Watch SA, Mendrisio	Watches, movements	CHF 10.00	100	●	▲
Distico SA, Torricella-Taverne	Distribution	CHF 3.00	100	●	■
Dress your body SA, Bienne	Jewelry	CHF 0.10	100	●	▲
EM Microelectronic-Marin SA, Marin-Epagnier	Microelectronics	CHF 25.00	100	●	◆
Endura SA, Bienne	Watches	CHF 2.00	100	●	■
ETA SA Manufacture Horlogère Suisse, Grenchen	Watches, movements and components	CHF 6.20	100	●	▲
Farco SA, Le Locle	Real estate	CHF 2.00	100	●	▼
François Golay SA, Le Chenit	Manufacture of watch wheels	CHF 0.10	35	○	▲
Frédéric Piguet SA, Le Chenit	Movements	CHF 0.30	100	●	▲
Groupe Habillage Haute Horlogerie SA, Saint-Imier	Assembly	CHF 0.10	100	●	▲
Hamilton International AG, Lengnau	Watches	CHF 3.00	100	●	■
ICB Ingénieurs Conseils en Brevets SA, Marin-Epagnier	Patents	CHF 0.20	100	●	▼
Jaquet Droz Les Boutiques SA, La Chaux-de-Fonds	Retailing	CHF 0.10	100	●	■
Lasag AG, Thun	Lasers for industrial applications	CHF 1.00	100	●	◆
Léon Hatot Les Boutiques SA, Bienne	Retailing	CHF 0.10	100	●	■
Léon Hatot SA, Bienne	Watches	CHF 0.10	100	●	■
Louis Jeanneret-Wespy SA, La Chaux-de-Fonds	Real estate	CHF 0.05	100	●	▼
Maeder-Leschot SA, Bienne	Real estate	CHF 0.70	100	●	▼
Manufacture Favre et Perret SA, La Chaux-de-Fonds	Watch cases	CHF 0.60	100	●	▲
Manufacture Ruedin SA, Bassecour	Watch cases	CHF 2.40	100	●	▲
Meco SA, Grenchen	Watch crowns	CHF 0.48	100	●	▲
Meseltron, Corcelles-Cormondrèche	Real estate	CHF 2.00	100	●	▼
Microcomponents AG, Grenchen	Components for the automobile industry	CHF 14.00	100	●	◆
Mido SA, Le Locle	Watches	CHF 1.20	100	●	■
Montres Breguet SA, L'Abbaye	Watches	CHF 10.00	100	●	■
Montres Jaquet Droz SA, La Chaux-de-Fonds	Watches	CHF 12.00	100	●	■
Nivarox-FAR SA, Le Locle	Watch components and thin wires	CHF 4.00	100	●	▲
Omega Electronics SA, Bienne	Sports timing equipment, information display systems	CHF 1.50	100	●	◆
Omega SA, Bienne	Watches	CHF 50.00	100	●	■
Oscilloquartz SA, Neuchâtel	High-stability frequency sources	CHF 2.00	100	●	◆
Rado Uhren AG, Lengnau	Watches	CHF 2.00	100	●	■
Record Watch Co. SA, Tramelan	Inactive	CHF 0.10	100	●	▼
Renata AG, Itingen	Miniature batteries	CHF 0.50	100	●	◆
Rubattel et Weyermann SA, La Chaux-de-Fonds	Watch dials	CHF 0.15	100	●	▲
S.I. Grand-Cernil 2, Les Brenets, SA, Les Brenets	Real estate	CHF 0.12	100	●	▼
S.I. Grand-Cernil 3, Les Brenets, SA, Les Brenets	Real estate	CHF 0.12	100	●	▼
S.I. Les Corbes SA, Savagnier	Real estate	CHF 0.10	34	○	▼
S.I. L'Etang SA, Les Brenets, Les Brenets	Real estate	CHF 0.05	100	●	▼
S.I. Rue de la Gare 2, Les Brenets, SA, Les Brenets	Real estate	CHF 0.24	100	●	▼
SMH Engineering AG, Grenchen	Real estate	CHF 1.00	100	●	▼
SSIH Management Services SA, Bienne	Services and licences	CHF 0.05	100	●	▼
Swatch SA, Bienne	Watches	CHF 2.00	100	●	■
Swatch Telecom SA, Bienne	Communication	CHF 0.10	100	●	■
Swatch Timing SA, Bienne	Inactive	CHF 0.10	100	●	▼
Technocorp Holding SA, Le Locle	Holding	CHF 6.00	100	●	▼
The Swatch Group Distribution SA, Bienne	Logistics and distribution	CHF 1.00	100	●	■
The Swatch Group Immeubles SA, Neuchâtel	Real estate project and property management	CHF 0.50	80	●	▼
The Swatch Group Les Boutiques SA, Lausanne	Retailing	CHF 3.00	100	●	■
The Swatch Group Management Services SA, Bienne	Services and licences	CHF 0.05	100	●	▼
The Swatch Group Recherche et Développement SA, Bienne	Research and development	CHF 0.10	100	●	▼
Terbival SA, Courchapoix	Watch case polishing	CHF 0.10	45	○	▲
Time Flagship AG, Luzern	Retailing	CHF 0.50	100	●	■
Tissot SA, Le Locle	Watches	CHF 5.00	100	●	■
Universo SA, La Chaux-de-Fonds	Watch hands	CHF 0.67	100	●	▲
Valdar SA, Le Chenit	Watch components	CHF 0.05	100	●	▲

Legend: ● Fully consolidated
○ Equity method

■ Watches & jewelry
▲ Production
◆ Electronic systems
▼ General services

32. THE SWATCH GROUP COMPANIES – as at 31.12.2005

Company name, Registered offices	Field of Activity	Capital in millions	Swatch Group Shareholdings %	Consoli- dation	Segment
EUROPE					
GERMANY					
Altweiler Grundstücks-GmbH, Lörrach	Real estate	EUR 0.03	95	●	▼
ETA Uhrwerke GmbH, Pforzheim	Tools	EUR 0.03	100	●	▲
Glashütter Uhrenbetrieb GmbH, Glashütte	Watches	EUR 0.51	100	●	■
Sokymat Automotive GmbH, Reichshof-Wehnrath	Transponders	EUR 0.10	100	●	◆
Swiss Prestige Uhren Handel GmbH, Eschborn	Inactive	EUR 0.08	100	●	■
The Swatch Group Customer Service (Europe) GmbH, Glashütte	After sales service	EUR 0.50	100	●	■
The Swatch Group (Deutschland) GmbH, Eschborn	Distribution (Breguet, Blancpain, Omega, Rado, Longines, Tissot, Certina, Hamilton, Pierre Balmain, cK Watch, Swatch, Flik Flak, Lasag, Renata, EM Marin, Micro-Crystal)	EUR 1.28	100	●	■
The Swatch Group (Deutschland) Les Boutiques GmbH, Eschborn	Retailing	EUR 0.20	100	●	■
Union Uhrenfabrik GmbH, Glashütte	Watches	EUR 0.05	100	●	■
AUSTRIA					
The Swatch Group (Oesterreich) GmbH, Wien	Distribution (Breguet, Blancpain, Glashütte, Omega, Rado, Longines, Tissot, Certina, cK Watch, Swatch, Flik Flak)	EUR 0.04	100	●	■
BELGIUM					
The Swatch Group (Belgium) SA, Bruxelles	Distribution (Breguet, Blancpain, Omega, Rado, Longines, Tissot, Certina, Hamilton, Pierre Balmain, cK Watch, Swatch, Flik Flak, Omega Electronics)	EUR 1.75	100	●	■
The Swatch Group Participation SA, Bruxelles	Holding	EUR 2.09	100	●	▼
SPAIN					
The Swatch Group (España) SA, Madrid	Distribution (Breguet, Blancpain, Glashütte Jaquet Droz, Omega, Rado, Longines, Tissot, Certina, Hamilton, Pierre Balmain, cK Watch, Swatch, Flik Flak)	EUR 0.45	100	●	■
FRANCE					
Breguet SA, Paris	Distribution	EUR 6.10	100	●	■
Fabrique de Fournitures de Bonnétage FFB SAS, Villers-le-Lac	Watch components and precision parts	EUR 0.29	100	●	▲
Frésard Composants SAS, Charquemont	Watch components	EUR 1.80	100	●	▲
Société Européenne de Fabrication d'Ebauches d'Annemasse (SEFEA) SAS, Annemasse	Watch components and electronic assembly	EUR 0.67	100	●	▲
Tech Airport SAS, Paris	Retail	EUR 3.80	100	●	■
The Swatch Group (France) SAS, Paris	Distribution (Breguet, Blancpain, Glashütte, Jaquet Droz, Léon Hatot, Omega, Rado, Longines, Tissot, Hamilton, Pierre Balmain, cK Watch, Swatch, Flik Flak, Endura, Renata)	EUR 2.47	100	●	■
The Swatch Group (France) Les Boutiques SAS, Paris	Retailing	EUR 11.41	100	●	■
Universo France SARL, Besançon	Watch hands	EUR 0.28	100	●	▲
GREAT BRITAIN					
The Swatch Group (UK) Ltd, Eastleigh	Distribution (Breguet, Blancpain, Glashütte, Omega, Rado, Longines, Tissot, Hamilton, cK Watch, Swatch, Flik Flak, Omega Electronics)	GBP 2.00	100	●	■
GREECE					
Alkioni SA, Athens	Retailing	EUR 0.06	100	●	■
The Swatch Group (Greece) SA, Athens	Distribution (Breguet, Glashütte, Omega, Rado, Longines, Tissot, Certina, Hamilton, cK Watch, Swatch, Flik Flak)	EUR 0.06	100	●	■
ITALY					
Lascor S.p.A, Sesto Calende	Watch cases and bracelets	EUR 1.00	100	●	▲
The Swatch Group Europe Services S.r.l., Milano	Administration	EUR 0.01	100	●	▼
The Swatch Group (Italia) S.p.A., Rozzano	Distribution (Breguet, Blancpain, Glashütte, Jaquet Droz, Léon Hatot, Omega, Rado, Longines, Tissot, Hamilton, Pierre Balmain, cK Watch, Swatch, Flik Flak, Renata)	EUR 23.00	100	●	■
The Swatch Group (Italia) Les Boutiques S.p.A., Rozzano	Retailing	EUR 0.12	100	●	■
LIECHTENSTEIN					
Etablissement Voltax (in liquidation), Vaduz	Inactive	CHF 0.03	100	●	▼
LUXEMBOURG					
The Swatch Group Finance (Luxembourg) SA, Alzingen	Finance company	CHF 1000.00	100	●	▼
The Swatch Group Re (Luxembourg) SA, Alzingen	Reinsurance	EUR 1.23	100	●	▼
NETHERLANDS					
Breguet Investments BV, Rotterdam	Holding	EUR 0.02	100	●	▼
The Swatch Group (Netherlands) BV, Maastricht	Distribution (Omega, Rado, Longines, Tissot, Certina, Pierre Balmain, cK Watch, Swatch, Flik Flak)	EUR 0.70	100	●	■
POLAND					
The Swatch Group (Polska) Sp.z.o.o., Warszawa	Distribution (Omega, Rado, Longines, Tissot, Certina, cK Watch, Swatch, Flik Flak)	PLN 5.00	100	●	■
PORTUGAL					
The Swatch Group (Europa) – Sociedade Unipessoal SA, Funchal	Distribution	EUR 24.14	100	●	■
The Swatch Group (Europa II) Retail – Sociedade Unipessoal SA, Funchal	Retail	EUR 0.10	100	●	■
RUSSIA					
Swiss Watch Le Prestige 000 Russia, Moscow	Distribution	RUR 0.20	100	●	■
SWEDEN					
The Swatch Group (Nordic) AB, Stockholm	Distribution (Breguet, Omega, Rado, Longines, Tissot, Certina, cK Watch, Swatch, Flik Flak)	SEK 0.50	100	●	■
CZECH REPUBLIC					
ASICentrum, Praha	Microelectronics	CZK 2.01	51	●	◆

32. THE SWATCH GROUP COMPANIES — as at 31.12.2005

Company name, Registered offices	Field of Activity	Capital in millions	Swatch Group Shareholdings %	Consoli- dation	Segment
AMERICA					
BERMUDA					
The Swatch Group Finance (Bermuda) Ltd, Hamilton	Finance company	CHF	0.02	100	● ▼
BRAZIL					
The Swatch Group do Amazonas SA, Manaus	Assembly	BRL	4.93	100	● ■
The Swatch Group do Brasil Ltda, São Paulo	Customer service	BRL	14.05	100	● ■
CANADA					
The Swatch Group (Canada) Ltd, Toronto	Distribution (Breguet, Blancpain, Glashütte, Omega, Rado, Longines, Tissot, Hamilton, cK Watch, Swatch, Flik Flak)	CAD	4.50	100	● ■
UNITED STATES					
EM Microelectronic-US Inc., Colorado	Microelectronics	USD	0.04	100	● ◆
e-swatch-us Inc., Delaware	e-Commerce	USD	0.00	100	● ■
HiPoint Technology Inc., Colorado Springs	Microelectronics	USD	0.17	20	○ ◆
The Swatch Group (U.S.) Inc., Dover, Delaware	Distribution (Breguet, Blancpain, Glashütte, Jaquet Droz, Léon Hatot, Omega, Rado, Longines, Tissot, Hamilton, Pierre Balmain, cK Watch, Swatch, Flik Flak, Lasag, Micro-Crystal, Renata, Oscilloquartz)	USD	168.90	100	● ■
The Swatch Group Les Boutiques (U.S.) Inc., Dover, Delaware	Retail	USD	0.00	100	● ■
Unitime Industries Inc., Virgin Islands VI	Inactive	USD	0.13	100	● ▲
BRITISH VIRGIN ISLANDS					
Endura Services (Asia) Inc, British Virgin Islands	Distribution	USD	0.01	100	● ■
MEXICO					
Prestadora de Servicios Relojeros SA de CV, Mexico DF	Watch services	MXN	0.05	100	● ■
The Swatch Group (Mexico) SA de CV, Mexico DF	Distribution (Breguet, Omega, Rado, Longines, Tissot, Mido, cK Watch, Swatch, Flik Flak)	MXN	43.65	100	● ■
ASIA					
GREATER CHINA					
Lanco Watches Ltd, Hong Kong	Inactive	USD	0.07	100	● ■
Shanghai Rui Jing Retail Co., Ltd., Shanghai	Retail	CNY	4.05	100	● ■
Shanghai SMH Watch Service Center Co. Ltd, Shanghai	Customer service	CNY	3.50	100	● ■
SMH International Trading (Shanghai) Co. Ltd, Shanghai	Distribution (Breguet, Blancpain, Glashütte, Omega, Rado, Longines, Tissot, Mido, Hamilton, cK Watch, Swatch, Flik Flak)	CNY	1.66	100	● ■
SMH Les Boutiques (Shanghai) Co. Ltd, Shanghai	Retail	CNY	4.14	100	● ■
SMH Swiss Watch Trading (Shanghai) Co. Ltd, Shanghai	Distribution (Omega, Rado)	CNY	1.66	90	● ■
The Swatch Group (Asia) Inc. Ltd, Hong Kong	Commercial services	HKD	0.00	100	● ■
The Swatch Group (Hong Kong) Ltd, Hong Kong	Distribution (Breguet, Blancpain, Glashütte, Jaquet Droz, Léon Hatot, Omega, Rado, Longines, Tissot, Mido, Hamilton, Pierre Balmain, cK Watch, Swatch, Flik Flak, ETA)	HKD	5.00	100	● ■
The Swatch Group (Taiwan) Ltd, Taipei	Distribution (Breguet, Blancpain, Glashütte, Jaquet Droz, Léon Hatot, Omega, Rado, Longines, Tissot, Hamilton, cK Watch, Swatch, Flik Flak)	TWD	28.00	100	● ■
Zhuhai SMH Watchmaking Co. Ltd, Zhuhai	Watches, movements, components	CNY	72.61	100	● ▲
SOUTH KOREA					
The Swatch Group (Korea) Ltd, Seoul	Distribution (Breguet, Léon Hatot, Omega, Rado, Longines, Tissot, cK Watch, Swatch, Flik Flak)	KRW	3300.00	100	● ■
INDIA					
Swatch Group (India) Private Ltd, New Delhi	Distribution (Breguet, Omega, Rado, Longines, Tissot, Swatch, Flik Flak)	INR	0.47	100	● ■
JAPAN					
The Swatch Group (Japan) KK, Tokyo	Distribution (Breguet, Blancpain, Glashütte, Jaquet Droz, Léon Hatot, Omega, Rado, Longines, Tissot, Hamilton, cK Watch, Swatch, Flik Flak, Endura)	JPY	200.00	100	● ■
MALAYSIA					
Micromechanics (Malaysia) Sdn Bhd, Ipoh	Assembly, watch components	MYR	35.00	100	● ▲
The Swatch Group (Malaysia) Sdn Bhd, Kuala Lumpur	Distribution (Omega, Rado, Longines, Tissot, cK Watch, Swatch, Flik Flak)	MYR	0.50	51	● ■
SINGAPORE					
The Swatch Group S.E.A. (S) Pte Ltd, Singapore	Distribution (Breguet, Blancpain, Glashütte, Omega, Rado, Longines, Tissot, Hamilton, Pierre Balmain, cK Watch, Swatch, Flik Flak)	SGD	4.00	51	● ■
THAILAND					
ETA (Thailand) Co. Ltd, Bangkok	Movements and components	THB	504.50	100	● ▲
The Swatch Group Trading (Thailand) Ltd, Bangkok	Distribution (Breguet, Glashütte, Jaquet Droz, Omega, Rado, Longines, Tissot, cK Watch, Swatch, Flik Flak)	THB	6.00	49	● ■
Wachirapani Co. Ltd, Bangkok	Holding	THB	3.06	49	● ▼
OCEANIA					
AUSTRALIA					
The Swatch Group (Australia) Pty Ltd, Prahran	Distribution (Breguet, Omega, Rado, Longines, Tissot, Certina, cK Watch, Swatch, Flik Flak, Omega Electronics, Renata)	AUD	0.40	100	● ■

Legend: ● Fully consolidated
○ Equity method

■ Watches & jewelry
▲ Production
◆ Electronic systems
▼ General services

REPORT OF THE GROUP AUDITORS

Report of the group auditors
to the general meeting of
The Swatch Group Ltd
Neuchâtel

As auditors of the group, we have audited the consolidated financial statements (consolidated income statement, consolidated balance sheet, consolidated statement of cash flows, consolidated statement of changes in equity and notes – pages 125 to 162) of The Swatch Group Ltd for the year ended 31 December 2005.

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

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

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

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

PricewaterhouseCoopers AG

Th. Brüderlin G. Siegrist

Basel, 22 March 2006

Financial statements of the Holding

2005

INCOME STATEMENT OF THE HOLDING

		2005	2004
	Notes	CHF million	CHF million
Income from investments in subsidiaries	(1)	416	330
Financial income	(2)	66	43
Other income		7	7
Total income		489	380
Personnel expense		-35	-32
General expense		-12	-10
Depreciation and impairment		-7	-1
Interest expense	(3)	-13	-14
Exchange differences and other financial expenses	(4)	-21	-26
Taxes		-3	-2
Total expenses		-91	-85
Net income		398	295

BALANCE SHEET OF THE HOLDING

Assets	Notes	31.12.2005		31.12.2004	
		CHF million	%	CHF million	%
Non-current assets					
Property, plant and equipment		10	0.4	10	0.4
Financial assets					
– Long-term loans to Group companies		51	1.9	51	1.9
– Investments in subsidiaries	(5)	1 770	65.6	1 738	65.8
Total non-current assets		1 831	67.9	1 799	68.1
Current assets					
Receivables from Group companies		264	9.8	369	14.0
Other receivables and accrued income		5	0.2	6	0.2
Marketable securities and precious metals	(6)	356	13.2	431	16.3
Cash and cash equivalents		239	8.9	37	1.4
Total current assets		864	32.1	843	31.9
Total assets		2 695	100.0	2 642	100.0

BALANCE SHEET OF THE HOLDING

Equity and liabilities	Notes	31.12.2005		31.12.2004	
		CHF million	%	CHF million	%
Equity					
Share capital		135	5.0	137	5.2
General reserve		67	2.5	67	2.5
Reserve for treasury shares		617	22.9	518	19.6
Special reserve		813	30.2	859	32.5
– Profit brought forward		13		19	
– Net profit for the year		398		295	
Available earnings		411	15.2	314	11.9
Total equity	(7)	2 043	75.8	1 895	71.7
Liabilities					
Provisions		119	4.4	114	4.3
Bank debts		65	2.4	65	2.5
Payables to Group companies		441	16.4	544	20.6
Other liabilities		10	0.4	9	0.3
Accrued expenses		17	0.6	15	0.6
Total liabilities		652	24.2	747	28.3
Total equity and liabilities		2 695	100.0	2 642	100.0

NOTES TO THE FINANCIAL STATEMENTS

General

The financial statements of The Swatch Group Ltd comply with the requirements of the Swiss law for companies, the Code of Obligations (SCO).

Valuation principles

On the balance sheet, assets and liabilities are recorded at net realizable values. Exceptions to this rule are investments in subsidiaries, which are shown at their acquisition cost less appropriate write-downs, and treasury shares reserved for the management stock option plan (valued "pro memoria") as well as shares bought back by the company that are shown at the lower of cost or market value.

All assets and liabilities denominated in foreign currencies are translated according to the exchange rates applicable on the balance sheet date. Income and expenses denominated in foreign currencies and all foreign exchange transactions are translated at the exchange rates prevailing on their respective transaction dates. Resulting foreign exchange differences are recognized in the income statement.

Details to specific items

1. Income from investments in subsidiaries	(CHF million)	2005	2004
	Dividends	374	291
	Other income	42	39
	Total	416	330

This item includes dividends from Group companies and other income from investments in associates as well as management fees from Group companies.

2. Financial income	(CHF million)	2005	2004
	Interest income	11	9
	Income and gains on securities	55	34
	Total	66	43

The company recorded capital gains on its investment portfolio of CHF 55 million. This figure was partially offset by losses of CHF 16 million (see Note 4). The net result reflects the stronger performance of the financial markets in 2005.

3. Interest expense In 2005, interest expense decreased by CHF 1 million compared with 2004. In general, the low interest expense reflects the low interest rates prevailing in the capital markets during the year.

4. Exchange differences and other financial expenses This item remained relatively stable compared with the previous year. Despite currency hedging contracts taken out to protect the Group's companies, the currency translation item was negative by CHF 5 million (2004: CHF 13 million). The significant increase in the price of gold led to a reduction in the overall loss from exchange differences. The loss recorded on the securities portfolio amounted to CHF 16 million (2004: CHF 13 million). However, this was more than offset by gains on marketable securities of CHF 55 million (see Note 2) (2004: CHF 34 million).

5. Investments in subsidiaries The list of 139 legal entities, including minority investments, held directly or indirectly by the company and consolidated at Swatch Group level is published in Note 32 of the consolidated financial statements in this report. Investments in subsidiaries accounted for 65.7% of total assets at 31 December 2005 versus 65.8% at end-2004. In absolute terms, the value of investments in subsidiaries amounted to CHF 1 770 million at end-2005. This amount corresponds exclusively to consolidated investments, and is CHF 32 million higher than in 2004. The main differences in 2005 relate to the set-up of new Group companies, a number of capital increases of subsidiaries and internal transfers of participations.

NOTES TO THE FINANCIAL STATEMENTS

6. Marketable securities and precious metals

(CHF million)	31.12.2005	31.12.2004
Marketable securities	80	239
Own shares	248	149
Precious metals	28	43
Total	356	431

Marketable securities decreased in 2005 by CHF 159 million, mainly due to the sale of a large proportion of shares in the portfolio. There was a corresponding increase in cash and cash equivalents.

In the year under review, own shares that were bought back in 2004 amounting to CHF 149 million were cancelled. Furthermore, in 2005 treasury shares amounting to CHF 248 million were bought back on a second trading line. Also included were the registered treasury shares destined for the special management stock option plan which, as in the previous year, were valued "pro memoria".

The precious metals item included gold and other precious metals intended to meet the industrial needs of the Group's subsidiaries. At 31 December 2005 this item represented a total value of CHF 28 million (CHF 43 million at end-2004).

7. Equity

The total value of treasury shares held by The Swatch Group Ltd and its subsidiaries at 31 December 2005 corresponded to 6.2% (versus 5.4% at end-2004) of the nominal value of total share capital.

See table on page 170 showing changes in The Swatch Group Ltd's treasury stock.

The table below shows the changes in equity:

(CHF million)	Share capital	General reserve	Reserve for treasury shares	Special reserve	Available earnings	Total equity
Balance at 31.12.2004	137	67	518	859	314	1 895
Allocated in 2005				200	-200	0
Dividend paid out					-101	-101
Share capital reduction (cancelled shares)	-2		-149	2		-149
Allocation to reserve for the buyback of own shares			248	-248		0
Net income for the year					398	398
Balance at 31.12.2005	135	67	617	813	411	2 043

Compared with end-2004, equity increased by CHF 148 million to CHF 2 043 million in 2005, accounting for 75.8% of total assets at 31 December 2005 (versus 71.7% in the previous year).

In 2005, the Swatch Group cancelled the shares repurchased under its share buyback program which reduced share capital by CHF 1 974 375. A new buyback program commenced on 1 July 2005.

In order to comply with Swiss legislation requiring that all the treasury shares held by a group be covered by an equivalent reserve, a proportion of the special reserve was transferred to the treasury share reserve to make up the full required amount.

Share capital

At 31 December 2005, share capital consisted of 134 911 327 registered shares each with a nominal value of CHF 0.45, and of 33 057 450 bearer shares each with a nominal value of CHF 2.25. The decrease compared with the previous year relates to the repurchased shares that were cancelled.

Balance sheet date	Registered shares	Bearer shares	Share capital in CHF
31.12.2004	137 051 327 at CHF 0.45	33 506 950 at CHF 2.25	137 063 734.65
Shares cancelled	2 140 000 at CHF 0.45	449 500 at CHF 2.25	1 974 375.00
31.12.2005	134 911 327 at CHF 0.45	33 057 450 at CHF 2.25	135 089 359.65

NOTES TO THE FINANCIAL STATEMENTS

Principal shareholders at 31 December 2005

At 31 December 2005, the Hayek Pool, its companies and related entities held 62 019 456 registered shares and 293 250 bearer shares, equivalent to 37.1% of the shares issued at this date (previous year: 36.5%). The Hayek Pool comprises the following members:

Name/Company	Location	Beneficial owner
Mr. N. G. Hayek	Meisterschwanden	N. G. Hayek
WAT Holding AG	Meisterschwanden	N. G. Hayek
Ammann Group Holding SA	c/o Ernst & Young AG, Bern	J.N. Schneider-Ammann (Chairman and Delegate) U.A. Ammann (Board Member)
Swatch Group Pension Fund	Neuchâtel	–

The companies and institutions associated with the Hayek Pool, but which do not formally belong to the Hayek Pool are as follows:

Name/Company	Location	Beneficial owner
Hayek Holding AG	Meisterschwanden	N. G. Hayek
Mr. N. G. Hayek and family members		N. G. Hayek
Personalfürsorgestiftung der Hayek Engineering AG	Meisterschwanden	–
Ammann families (pension funds, foundations and individuals, Madisa AG)	c/o Ernst & Young AG, Bern	Represented by J.N. Schneider-Ammann
Fondation d'Ébauches SA et des maisons affiliées	Neuchâtel	–
Caisse de pension des cadres du Swatch Group	Neuchâtel	–

In the context of the pool, the group of Mr. N. G. Hayek and related parties controlled in total 36.4% of the shares issued at end-2005 (35.8% at end-2004), of which 3.9% were represented by the Hayek Pool (3.8% at end-2004).

At the same date, Mrs. Esther Grether's group controlled 6.7% of the shares issued (compared with 8% a year earlier).

At 31 December 2005, the Swatch Group was not aware of any other group or individual shareholder having an interest of more than 5% of the total share capital.

On 25 January 2006, The Capital Group Companies, Inc., Los Angeles and its subsidiaries notified of holdings of 6 150 596 registered shares and 2 335 548 bearer shares, equivalent to 5.05% of the shares issued as of this date.

Reserve for treasury shares

The reserve for treasury shares was valued using the weighted average purchase price method. On the Holding balance sheet, it amounted to CHF 617 million on 31 December 2005 (previous year CHF 518 million), and thereby covers the treasury shares recognized as assets on the balance sheets of Group companies at year-end.

The number of treasury shares held directly or indirectly by The Swatch Group Ltd changed in 2005 as shown in the table below:

Shares held by:	Registered shares	Bearer shares
	Quantity*	Quantity
The Swatch Group Ltd		
Balance at 31.12.2004	5 654 471	449 500
Acquisitions in 2005	3 356 347	688 450
Disposals in 2005	-240 019	0
Cancellations in 2005	-2 140 000	-449 500
Balance at 31.12.2005	6 630 779	688 450
Other consolidated companies		
Balance at 31.12.2004	8 405 714	44 000
Acquisitions in 2005	0	0
Disposals in 2005	0	0
Balance at 31.12.2005	8 405 714	44 000
Total balance at 31.12.2005	15 036 513	732 450

* of which 3 259 613 registered shares were reserved for the management stock option plan at 31 December 2005 (3 499 632 registered shares in 2004).

NOTES TO THE FINANCIAL STATEMENTS

Except for movements related to the special funds, all transactions involving treasury shares were recognized at fair value. The average price per registered share exchanged in 2005 was CHF 36.98 and the average price per bearer share was CHF 179.99.

Available earnings

In compliance with the resolution approved at the Annual General Meeting of 18 May 2005, a dividend of CHF 0.35 per registered share and of CHF 1.75 per bearer share was appropriated from available earnings as at 31 December 2004. The total dividend amount paid to shareholders in 2005 came to CHF 43 046 893 on the registered shares and CHF 57 773 537 on the bearer shares. In accordance with the resolution relating to the use of available earnings approved by the above-mentioned AGM, no dividends were paid on the treasury shares held by the Swatch Group. This amount, which would have totaled CHF 5 784 697, thus constituted an integral part of shareholders' equity at 31 December 2005. Finally, CHF 200 million was appropriated from available earnings at 31 December 2004 and allocated to the special reserve.

Off-balance-sheet items

Contingent liabilities

At end-2005, guarantees provided by The Swatch Group Ltd amounted to CHF 466 530 500 (compared with CHF 477 301 000 a year earlier). This item includes:

- A guarantee of CHF 465 622 500 (vs. CHF 476 427 000 in 2004) relating to the convertible bond of CHF 411 600 000 at 2.625%, issued by The Swatch Group Finance (Luxembourg) SA on 15 October 2003 and maturing on 15 October 2010. At end-2005, none of these bonds had been converted into shares;
- As in 2004, a guarantee of GBP 400 000 (equivalent to CHF 908 000 at 31 December 2005; CHF 874 000 at 31 December 2004) to cover a commitment relating to a lease taken out by one of the Group's companies.

Fire insurance values

At 31 December 2005, the fire insurance value of property, plant and equipment amounted to CHF 33 191 100 (CHF 32 069 100 at 31 December 2004).

Assets pledged

None of the company's assets are pledged.

Commitments

Other commitments entered into by the company and open at 31 December 2005 amounted to CHF 5 million (vs. CHF 6 million in the previous year), corresponding to investment commitments in financial assets.

Financial derivative instruments

The following table shows the contract and replacement values of derivative financial instruments at 31 December 2005.

Type (CHF million)	Contract value			Positive replacement value			Negative replacement value		
	Third party	Group	Total	Third party	Group	Total	Third party	Group	Total
Forward contracts	531	316	847	0	1	1	-1	-1	-2
Options	0	0	0	0	0	0	0	0	0
Total at 31.12.2005	531	316	847	0	1	1	-1	-1	-2
Total at 31.12.2004	528	384	912	1	1	2	-2	-2	-4

Derivative financial instruments are recognized at fair value. Positions outstanding at 31 December 2005 serve to hedge operations relating to exchange rate risk and market volatility. Forward contracts outstanding at 31 December 2005 relate to positions held in precious metals and in 14 foreign currencies (previous year: 14). Intra-group contracts relate to agreements between The Swatch Group Ltd and Group companies for the hedging of risks associated with intra-group financial transactions. At 31 December 2005, there were no options outstanding. Replacement values are recognized under accrued income and accrued expenses.

Liabilities to pension plans

The balance sheet as at end-2005 contained pension liabilities for less than CHF 1 million to pension plans (no liability in 2004).

PROPOSED APPROPRIATION OF AVAILABLE EARNINGS

The Board of Directors proposes to the Annual General Meeting that available earnings be appropriated as follows:

	2005	2004
	CHF	CHF
Net income for the year	398 050 766	294 688 643
Profit brought forward from previous year	13 267 505	19 399 292
Available earnings	411 318 271	314 087 935
Allocation to special reserve	– 250 000 000	– 200 000 000
Dividend payment for 2004 on share capital of CHF 137 063 734.65:		
– CHF 0.35 per registered share with a par value of CHF 0.45		– 47 967 964
– CHF 1.75 per bearer share with a par value of CHF 2.25		– 58 637 163
Payment on share capital of CHF 135 089 359.65 *) of a 2005 dividend, i.e.:		
– CHF 0.50 per registered share with a par value of CHF 0.45	– 67 455 664	
– CHF 2.50 per bearer share with a par value of CHF 2.25	– 82 643 625	
Dividends not paid out on own shares held by the Group **)		5 784 697
Balance carried forward	11 218 982	13 267 505

*) It is planned not to pay dividends on own shares held by the Group.

**) Based on the decision of the Annual General Meeting of 18 May 2005, the dividend due on own shares held by the Group was not paid out.

REPORT OF THE STATUTORY AUDITORS

Report of the
statutory auditors to the
general meeting of
The Swatch Group Ltd
Neuchâtel

As statutory auditors, we have audited the accounting records and the financial statements (income statement, balance sheet and notes – pages 165 to 172) of The Swatch Group Ltd for the year ended 31 December 2005.

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

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

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

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

PricewaterhouseCoopers AG

Th. Brüderlin G. Siegrist

Basel, 22 March 2006

THE SWATCH GROUP LTD SECURITIES

Average number of shares outstanding/ Average share capital	2005 basic	2005 diluted	2004 basic	2004 diluted	2003 basic	2003 diluted	2002 basic/ diluted	2001 basic/ diluted
Number of registered shares of CHF 0.45	122 004 798	130 646 179	123 787 740	132 447 448	124 732 274	126 832 274	124 543 989	127 710 075
Number of bearer shares of CHF 2.25	32 788 496	32 788 496	33 211 158	33 211 158	33 462 950	33 462 950	33 462 467	34 047 207
Total average number of shares outstanding	154 793 294	163 434 675	156 998 898	165 658 606	158 195 224	160 295 224	158 006 455	161 757 282
Share capital registered shares of CHF 0.45	54 902 159	58 790 780	55 704 483	59 601 351	56 129 523	57 074 523	56 044 795	57 469 534
Share capital bearer shares of CHF 2.25	73 774 116	73 774 116	74 725 106	74 725 106	75 291 638	75 291 638	75 290 550	76 606 216
Total average share capital	128 676 275	132 564 896	130 429 589	134 326 451	131 421 161	132 366 161	131 335 345	134 075 750

Key data per registered share

(nom CHF 0.45) in CHF	2005	2005	2004	2004	2003	2003	2002	2001
Consolidated net income	2.15	2.13	1.74	1.74	1.69	1.68	1.69	1.69
Cash flow from operating activities	2.76	2.68	2.36	2.29	2.15	2.13	1.94	2.09
Consolidated shareholders' equity	16.02	15.53	14.70	14.27	13.72	13.62	12.19	10.94
Dividend	0.50 *	0.50 *	0.35	0.35	0.29	0.29	0.22	0.20

Key data per bearer share

(nom CHF 2.25) in CHF	2005	2005	2004	2004	2003	2003	2002	2001
Consolidated net income	10.74	10.66	8.72	8.70	8.43	8.41	8.47	8.46
Cash flow from operating activities	13.82	13.43	11.79	11.45	10.73	10.66	9.70	10.45
Consolidated shareholders' equity	80.09	77.80	73.51	71.37	68.58	68.09	60.97	54.72
Dividend	2.50 *	2.50 *	1.75	1.75	1.45	1.45	1.10	1.00

Stock price of registered shares

(adjusted)		2005	2005	2004	2004	2003	2003	2002	2001
High		40.15	40.15	36.50	36.50	30.60	30.60	36.85	43.50
Low		30.90	30.90	27.20	27.20	19.15	19.15	20.45	19.40
End of year		39.75	39.75	33.80	33.80	29.50	29.50	23.40	32.90

Stock price of bearer shares

(adjusted)		2005	2005	2004	2004	2003	2003	2002	2001
High		197.30	197.30	180.50	180.50	152.75	152.75	173.00	214.00
Low		152.40	152.40	130.00	130.00	93.70	93.70	99.25	91.00
End of year		195.00	195.00	166.90	166.90	148.50	148.50	115.00	149.25

Market capitalization

(CHF million)		2005	2005	2004	2004	2003	2003	2002	2001
End of year		11 809	11 809	10 225	10 225	9 019	9 019	7 060	9 747

Key ratios (year-end)

		2005	2005	2004	2004	2003	2003	2002	2001
Average return on equity	%	14.0	14.3	12.3	12.7	13.0	13.1	14.5	15.7
Dividend yield registered shares	%	1.3 *	1.3 *	1.0	1.0	1.0	1.0	0.9	0.6
Dividend yield bearer shares	%	1.3 *	1.3 *	1.0	1.0	1.0	1.0	1.0	0.7
Price/earnings ratio – registered shares		18.5	18.7	19.4	19.4	17.5	17.6	13.8	19.4
Price/earnings ratio – bearer shares		18.2	18.3	19.1	19.2	17.6	17.7	13.6	17.6

Securities

	Securities no.	Reuters Symbol
The Swatch Group Ltd registered shares	1 225 514	UHRN.VX
The Swatch Group Ltd bearer shares	1 225 515	UHR.VX

The securities are listed on the Swiss Stock Exchange (SWX) and traded on the virt-x.

* Board of Directors' proposal.

Evolution of the Swatch Group Ltd registered shares and the Swiss Market Index

(indexed weekly from 01.07.1988 to 31.12.2005 – adjusted)

