

# **El.En. GROUP**

## **BOARD OF DIRECTORS' REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE QUARTER ENDING SEPTEMBER 30<sup>th</sup>, 2003**

(Board of Directors - November 13<sup>th</sup>, 2003)

### **Report on the quarter ending September 30<sup>th</sup>, 2003**

#### **Introduction**

This report covers the El.En. Group consolidated financial statement up to September 30<sup>th</sup>, 2003, prepared and divulged in accordance with article 2.6.2. of the Nuovo Mercato of the Italian Stock Exchange regulations and IA 2.4.1. instructions, and complies with article 82 of Consob rulings ex resolution 11971 and following amendments. The data and the information provided in this report have not been examined by an auditor, because no auditor has been appointed since this is not compulsory.

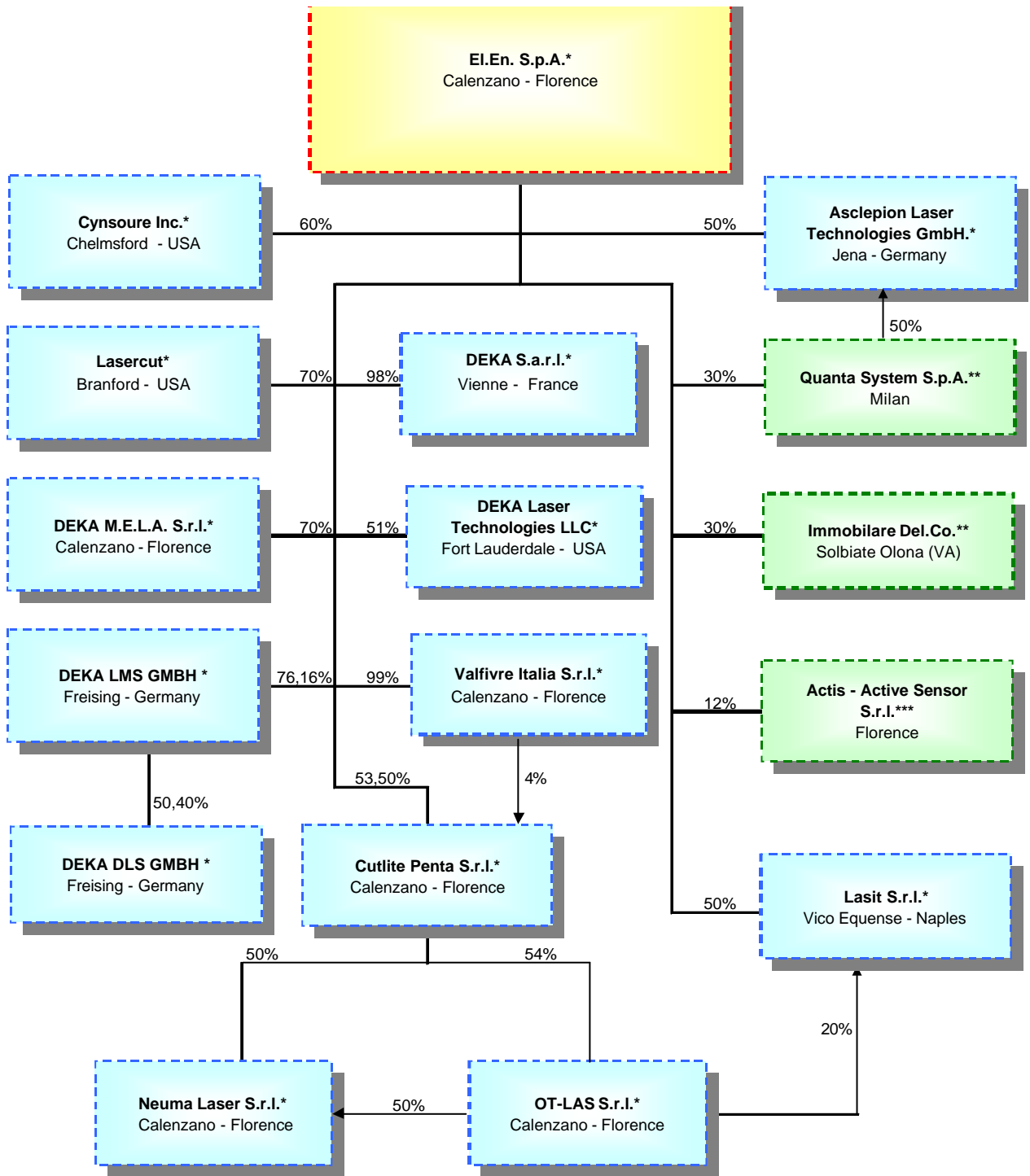
The following information has been prepared on the same principles previously adopted by the El.En. Group for the interim and annual reports.

The results for the quarter ending on September 30<sup>th</sup>, 2003 are shown in comparative form with those for the same financial period last year. All the amounts are expressed in thousands of Euros, if not otherwise stated.

#### **Description of the Group**

El.En. SpA is the holding company of an industrial group operating in the design, production and distribution of laser sources and systems for a variety of applications.

The structure of the group as of September 30<sup>th</sup>, 2003 is represented in the following chart:



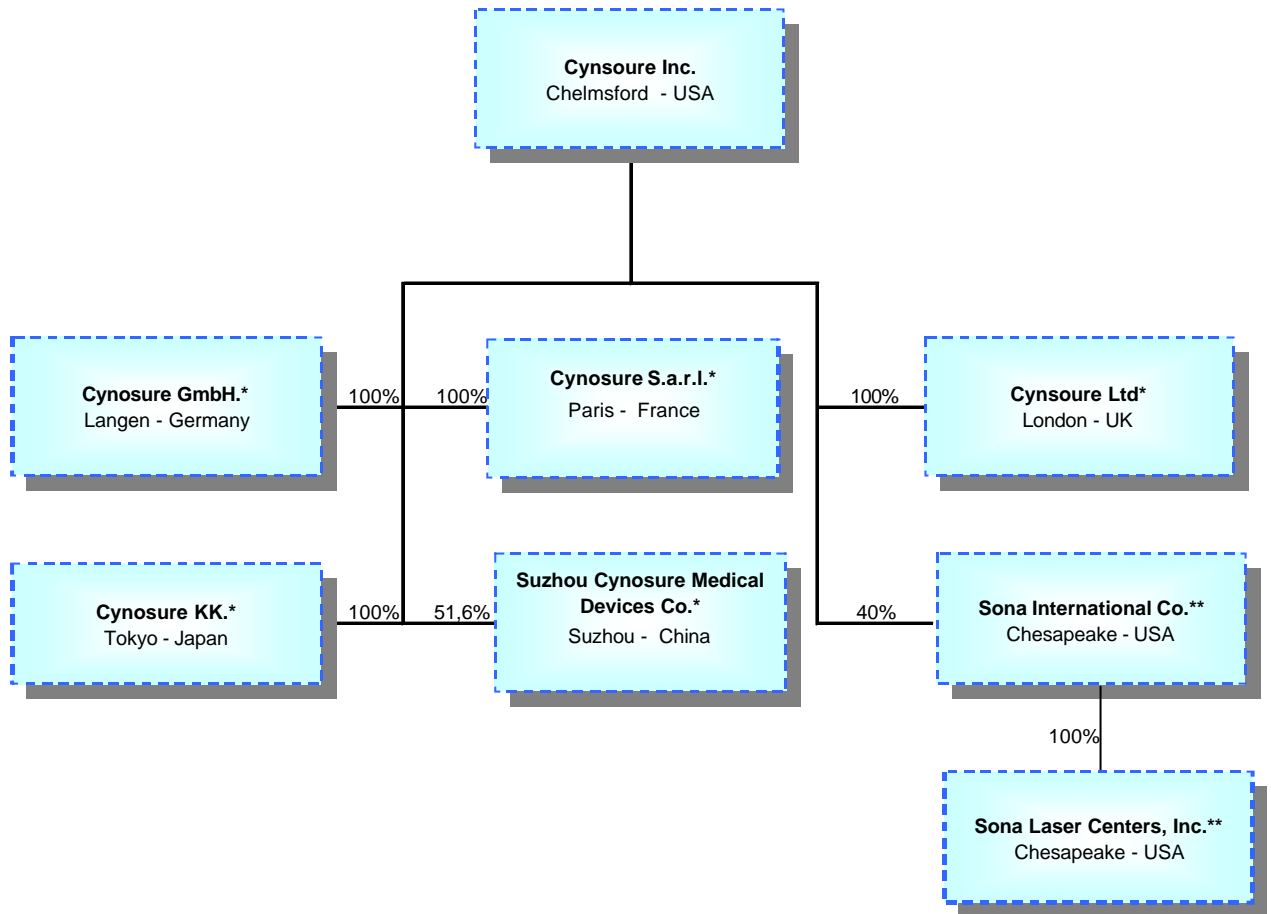
\* Entirely consolidated

\*\* Consolidated in relation to net worth

\*\*\* Kept at cost

El.En. SpA has equities in other companies like Quanta System SpA and Immobiliare Del.Co. Srl which, however, it does not control; for this reason the results for these companies have not been wholly consolidated into the financial statement of the Group, but have been consolidated using the shareholders' equity method.

Cynosure Inc. also controls a group of companies. As of September 30<sup>th</sup>, 2003 the structure of the Cynosure group is the following:



\* Entirely consolidated

\*\* Consolidated in relation to net worth

During the third quarter of 2003 the financial situation in which the Group operated showed no substantial changes with respect to the first months of the financial year.

The growth which has been achieved during this period is derived almost entirely from the acquisition policy pursued by the company with great determination over the last year. The continuing evolution of the area of consolidation provides the Group with further opportunities for business growth and offers the management the challenge of integrating and co-ordinating the company activities on a world-wide level.

One year after being purchased, Cynosure, the American subsidiary which has a fundamental role in the development strategy of the Group, has shown two consecutive quarters without losses, and has definitively confirmed the turn-around which has been tenaciously pursued with the support of El.En. SpA. In the month of September the hiring of Mike Davin who succeeded the retiring company founder, Horace Furumoto, took place in a critical time in the history of the company, and will help place Cynosure back in its position as a market leader also in terms of profitability.

Because of the improvement in the performance of Cynosure, as well as the recovery of profitability achieved through opportune cutting of costs, this quarter has shown a fair profit trend, reversing the operating losses registered during the first six months, and with a sharp improvement over the results shown for the same period last year.

It should be noted that the continuing weakness of the dollar penalises the profitability for the sales of systems which are manufactured in Europe and sold in the United States as well as the consolidated sales volume for the amount

earned in dollars; these effects are only partially compensated for by the increased competitiveness of the products which Cynosure exports to the countries which use the Euro as currency.

## Financial and economic results of the Group

The chart below shows the profit and loss account for the third quarter of 2003 displayed in comparative form with the results for the same period of 2002:

<b>Profit and loss account - 3 months</b>	<b>30/09/2003</b>	<b>Inc.%</b>	<b>30/09/2002</b>	<b>Inc.%</b>	<b>Variazione</b>
Net turnover from sales and services	17.738	97,24%	13.663	100,56%	29,83%
Variation in stock of finished goods and WIP	454	2,49%	(93)	-0,68%	
Other revenues and income	49	0,27%	17	0,12%	189,56%
<b>Value of production</b>	<b>18.241</b>	<b>100,00%</b>	<b>13.587</b>	<b>100,00%</b>	<b>34,25%</b>
Costs for raw materials	7.176	39,34%	5.717	42,08%	25,52%
Variation in stock of raw material	(294)	-1,61%	(1.015)	-7,47%	-70,99%
Other direct services	1.445	7,92%	1.409	10,37%	2,61%
<b>Gross margin</b>	<b>9.914</b>	<b>54,35%</b>	<b>7.476</b>	<b>55,02%</b>	<b>32,61%</b>
Other operating services and charges	3.453	18,93%	2.735	20,13%	26,26%
<b>Added value</b>	<b>6.461</b>	<b>35,42%</b>	<b>4.741</b>	<b>34,89%</b>	<b>36,27%</b>
For staff costs	4.470	24,50%	3.163	23,28%	41,31%
<b>Gross operating profit</b>	<b>1.991</b>	<b>10,92%</b>	<b>1.578</b>	<b>11,61%</b>	<b>26,17%</b>
Depreciation, amortisation and other accruals	840	4,60%	806	5,93%	4,26%
<b>Net operating profit</b>	<b>1.151</b>	<b>6,31%</b>	<b>772</b>	<b>5,69%</b>	<b>49,01%</b>
Net financial income (charges)	(154)	-0,84%	115	0,85%	
<b>Operating profit</b>	<b>998</b>	<b>5,47%</b>	<b>888</b>	<b>6,53%</b>	<b>12,39%</b>
Value adjustments (Devaluations)	(140)	-0,77%	279	2,05%	
Extraordinary income (Charges)	64	0,35%	345	2,54%	-81,58%
<b>Earning before taxes</b>	<b>921</b>	<b>5,05%</b>	<b>1.512</b>	<b>11,13%</b>	<b>-39,05%</b>

The chart below the data of the profit and loss account for the first nine months of 2003, displayed in comparative form with those of the preceding financial period.

<b>Profit and loss account</b>	<b>30/09/2003</b>	<b>Inc.%</b>	<b>30/09/2002</b>	<b>Inc.%</b>	<b>Var.%</b>
Net turnover from sales and services	47.980	89,9%	34.776	97,2%	38,0%
Variation in stock of finished goods and WIP	4.944	9,3%	939	2,6%	426,7%
Other revenues and income	426	0,8%	74	0,2%	475,1%
<b>Value of production</b>	<b>53.350</b>	<b>100,0%</b>	<b>35.789</b>	<b>100,0%</b>	<b>49,1%</b>
Costs for raw materials	23.669	44,4%	15.932	44,5%	48,6%
Variation in stock of raw material	(1.409)	-2,6%	(1.800)	-5,0%	-21,7%
Other direct services	4.871	9,1%	3.878	10,8%	25,6%
<b>Gross margin</b>	<b>26.219</b>	<b>49,1%</b>	<b>17.779</b>	<b>49,7%</b>	<b>47,5%</b>
Other operating services and charges	9.873	18,5%	6.222	17,4%	58,7%
<b>Added value</b>	<b>16.345</b>	<b>30,6%</b>	<b>11.557</b>	<b>32,3%</b>	<b>41,4%</b>
For staff costs	12.654	23,7%	7.395	20,7%	71,1%
<b>Gross operating profit</b>	<b>3.692</b>	<b>6,9%</b>	<b>4.163</b>	<b>11,6%</b>	<b>-11,3%</b>
Depreciation, amortisation and other accruals	2.714	5,1%	1.745	4,9%	55,5%
<b>Net operating profit</b>	<b>978</b>	<b>1,8%</b>	<b>2.418</b>	<b>6,8%</b>	<b>-59,5%</b>
Net financial income (charges)	(58)	-0,1%	290	0,8%	
<b>Operating profit</b>	<b>920</b>	<b>1,7%</b>	<b>2.708</b>	<b>7,6%</b>	<b>-66,0%</b>
Value adjustments (Devaluations)	505	0,9%	318	0,9%	58,7%
Extraordinary income (Charges)	62	0,1%	416	1,2%	-85,0%
<b>Earning before taxes</b>	<b>1.488</b>	<b>2,8%</b>	<b>3.443</b>	<b>9,6%</b>	<b>-56,8%</b>

The chart below illustrates the net financial position of the Group.

<b>Net financial position</b>	<b>30/09/2003</b>	<b>30/06/2003</b>	<b>31/12/2002</b>
Financial mid and long term debts	(1.884)	(2.013)	(1.871)
<i>Financial mid and long term debts</i>	<i>(1.884)</i>	<i>(2.013)</i>	<i>(1.871)</i>
Financial liabilities due within 12 months	(2.231)	(2.320)	(888)
Cash in banks and on hand	16.302	18.510	27.129
<i>Net financial short term position</i>	<i>14.071</i>	<i>16.190</i>	<i>26.241</i>
<b>Total financial net position</b>	<b>12.187</b>	<b>14.177</b>	<b>24.369</b>

## Report on operations

During the third quarter of 2003, the Group operated in the field of design, manufacture and distribution of laser sources and systems; the principal markets for these products, as in preceding years, has been laser equipment for medical and cosmetic uses and laser systems for industrial use. As an adjunct to these two main sectors, the Group has also developed an after-sales technical assistance service which it offers to its clients, and has received revenue related to research and development activities.

To summarise briefly, the sales volume showed an increase of 38% in the first nine months of the financial year, and this statistic confirms the constant growth rate of the Group; during the third quarter, however, the increase in sales volume was 30%.

The following table illustrates the sales volume divided according to sector of activity in the Group for the first nine months of the financial year 2003, compared with the same divisions for the same period last year.

	30/09/2003	Inc%	30/09/2002	Inc%	Var%
Industrial systems and lasers	9.899	20,63%	10.324	29,69%	-4,12%
Medical and cosmetic lasers	30.041	62,61%	19.318	55,55%	55,51%
Research and Development	142	0,30%	152	0,44%	-6,80%
Service	7.898	16,46%	4.982	14,33%	58,54%
<b>Total</b>	<b>47.980</b>	<b>100,00%</b>	<b>34.776</b>	<b>100,00%</b>	<b>37,97%</b>

The products manufactured by the Group have achieved the expected success in the medical and cosmetic sectors, where the sales volume reached was substantially in line with predictions. Excellent results were obtained in the consolidation of the brands which the Group presents in this sector, Deka, Cynosure and most recently, Asclepion. Although operating in a generally stable market, the internal growth and the contribution of Cynosure and Asclepion keep the growth rate well over 50%. In the range of international competition, which is presently characterised by substantial stagnation and the profound crisis of the market leader, Lumenis, the Group was able to gain a significant quota of the market, as did their main competitors, Candela, Laserscope, Palomar and Biolase, however.

Notwithstanding the contribution of the newly purchased companies, Lasit and Lasercut, the sales volume in the industrial sector fell by 4%, mostly as a result of the continuation of the serious crisis in the manufacturing sector which has greatly reduced the tendency to invest on behalf of the clientele.

Sales for technical assistance and accessory services show an increase of about 58%, which is a result of the increased number of systems which have been sold. Towards this increase the contribution of Cynosure has been determining, and in particular, the “revenue sharing” activity, which involves the leasing of their own equipment with rental fees determined in proportion to the amount of revenue generated by the equipment. It should also be noted that, starting in May of 2003, Asclepion, which operates its own very sizeable network of laser systems installed in Germany (more than 500 units just for the Erbium lasers) has contributed with its after-sales service facilities to the components of the sales volume of the Group.

Revenues for R&D projects and the reimbursement allowed by specific contracts signed with the Italian office “MIUR” are not very significant. We must nevertheless call attention to the fact that most of the reimbursements of this kind have been entered into accounting with the “other revenues”, without including the amount within sales. Other revenues generated by R&D projects totalled 288 thousand euros, from payment of the grants issued for Choclab and TRL01 projects.

The sales volume split according to geographic distribution is shown on the following chart:

	30/09/2003	Inc%	30/09/2002	Inc%	Var%
Italy	11.293	23,54%	13.293	38,22%	-15,05%
Europe	13.901	28,97%	7.200	20,70%	93,08%
Rest of the world	22.786	47,49%	14.283	41,07%	59,53%
<b>Total</b>	<b>47.980</b>	<b>100,00%</b>	<b>34.776</b>	<b>100,00%</b>	<b>37,97%</b>

The drop in sales volume in Italy reflects the negative trend of the industrial sector, which, while we wait for the launching of Lasercut in the United States, still has its main base in the Italian market. The sales volume for Europe has doubled, due mainly to the contribution of Asclepion and positive results obtained by the subsidiary companies assigned to the distribution of medical products for Deka and Cynosure. The increase in sales volume for the rest of the world, reflects the entry of Cynosure, Lasercut and Deka Laser Technologies into the area of consolidation.

For the medical and cosmetic sector, which represents about 63% of the sales of the Group, the following chart shows the individual areas of activity and their relative sales volumes:

	30/09/2003	Inc%	30/09/2002	Inc%	Var%
Surgical CO2	1.017	3,39%	1.208	6,25%	-15,80%
Physiotherapy	380	1,27%	385	1,99%	-1,19%
Cosmetic	20.512	68,28%	13.054	67,57%	57,13%
Dental	2.806	9,34%	1.264	6,54%	121,96%
Other medical lasers	5.062	16,85%	3.058	15,83%	65,52%
Accessories	264	0,88%	349	1,81%	-24,28%
<b>Total</b>	<b>30.041</b>	<b>100,00%</b>	<b>19.318</b>	<b>100,00%</b>	<b>55,51%</b>

Growth continues at a good level thanks mainly to the creation of new products and the entry of new companies into the Group.

For this reason, the dental sector, which has shown the greatest vitality of all the sectors with a growth of 121%, has shown a brilliant performance with the new range offered by Deka (Smart File, Diodi A-800 and A-900, US 20 D), but, above all, it has been helped by the sales of Asclepion to its traditional OEM, KaVo, world leader in the field of distribution of equipment to dental offices.

The cosmetic sector, with its Nd:YAG and IPL Deka systems now firmly established on the market, has benefited from the sales of Cynosure's alexandrite systems as well as Asclepion's Mediostar.

The residual sector entitled "Others" includes the Cynosure's Dye Systems and therefore also shows a noticeable increase.

As usual, the Group remained highly competitive through the continuous and rapid introduction of innovative products. At the next international "Medica" Fair in Dusseldorf, along with their traditional range of products, they will be presenting several important novelties: the new CO<sub>2</sub> for dermatology "Smartxide", the compact system for treating psoriasis "excilite micro", the KTP system for dermatology "Smartlite" offered by Deka, and the new "Quadro Star" system for dermatology and the CO<sub>2</sub> "Multipulse II" offered by Asclepion.

The new program of co-operation in the physical therapy sector which has emerged since the acquisition of a minority share in ASA, which will be described further on in this report, will be initiated with the joint presentation of the new HILT system, which promises to be a turning point in the field of laser therapy. Thanks to this new alliance and the opportunity to have a network dedicated exclusively to physical therapy, it is hoped that the laser therapy sector will reach the profit levels shown by the other sectors.

As mentioned above, the new CO<sub>2</sub> system has been developed for the purpose of injecting new vitality into the surgical sector, the most traditional of the medical laser systems, which has shown a drop both in the sales volume and the gross margin. It should be pointed out in any case, that part of the sales for CO<sub>2</sub> surgical systems have been reclassified under the dental sector, since the system is used in dental offices for oral surgery.

For the industrial applications sector, the chart below shows the break-down of sales according to the market sector in which the Group operates.

	30/09/2003	Inc%	30/09/2002	Inc%	Var%
Cutting	3.270	33,03%	5.158	49,96%	-36,60%
Marking	5.472	55,28%	4.464	43,24%	22,58%
Laser sources	935	9,45%	602	5,83%	55,48%
Welding	222	2,24%	101	0,98%	120,12%
<b>Total</b>	<b>9.899</b>	<b>100,00%</b>	<b>10.324</b>	<b>100,00%</b>	<b>-4,12%</b>

The trend in the industrial field, meaning the sector which has manufacturing enterprises as its clients, has experienced a series of difficulties far more serious than those encountered in the medical field; the continuation of the profound crisis which has for years delayed the expected and hoped for return to significant growth rates for industrial production has, in fact, reduced the inclination of potential clients to make investments, with an obvious negative impact on sales volume and profits for the Group in this sector of activity.

The modest drop of 4%, registered for the consolidated sales volume, does not fully represent the seriousness of the situation because in the sales volume figures for 2003 it includes the results of Lasit and Lasercut, consolidated starting from this year; without their contribution, the marking sector would also show a decrease of about 30% like the cutting sector.

On account of the reduction in sales volume of Cutlite Penta, the company in the Group which produces laser systems for flat cutting, the marking sector becomes the most important. In this area, Lasit, with its line of standard Nd:YAG systems, completes the range of products offered by the Group in this sector, where Ot-las is leader in the sector of large surfaces.

The laser source segment confirms its trend of continued growth; this is in large part due to the considerable design and engineering efforts that have made in the past few years with an aim to increasing the average power of the systems installed, which includes, among others, CO<sub>2</sub> 6 Kw. laser sources.

Even in its limited amount, the restoration sector is still relatively dynamic and represents not only a good share of business, but also an excellent showplace for the Group, which is involved in high profile cultural initiatives with important partners like CNR and ICR.

The above represents a brief summary of the profit situation; the paragraphs below contain comments on the trends in revenue.

The incidence on the sales volume of the structure of set costs of the Group has shown a slight increase, both for operating costs and for personnel. This result is due to two main causes. The first, is the continuing crisis in the industrial market and a sales volume which is far inferior to that for which the operating structures are equipped. The second is due to the cost structure of Cynosure, which has a distribution which is different from the rest of the Group with higher margins and greater personnel and operating costs. After the purchase of Cynosure, the company policy has been to expend their efforts towards the goal of recovering the profit level rather than cutting costs, consistent with the Group strategy of continued expansion. During this brief period, although pursuing a program of re-organization of production methods, further expenses have been planned which will weigh on the financial results, but which are absolutely necessary for the growth of the sales volume which we are already witnessing.

During the third quarter, the improved performance of Cynosure and of the activities in the industrial sector, have determined a marked improvement in profits and in the equilibrium between the costs factors with respect to the traditional structure of the group. Although the results obtained on an annual basis do not reach the levels of those of last year, this quarter represents a turning point and shows what our potential will be once all of the activities have been structured to fit the same model which has been responsible for the successes of the Group in the last few years.

The margin of contribution is approximately 26.219 thousand Euros, showing an increase in comparison to the same financial period last year, thanks to the increase in sales volume, with a very slight drop on the incidence on the Value of Production.

What appears to be an unvaried figure in the margins, actually should be read as an algebraic sum of a decrease, registered by the original nucleus of Group activities, and an increase, related to Cynosure, which has traditionally been able to show higher margins. The decrease in margins for the original group of companies is due to pressure from competition, particularly in the industrial sector and the weakness of the dollar. This last factor, which has had a strong impact on international competition in the last few months, limited the profits from sales of El.En. products distributed



by Cynosure in the United States, while at the same time it contributed to the improvement of Cynosure's accounts by facilitating export.

The costs for services and operating expenses was approx. 9.873 thousand Euros with an incidence of 18% on the Value of Production, showing an increase with respect to the 17% registered for the same financial period in 2002. Costs for personnel increased considerably (+71%) and their incidence on the Value of Production, which rises to 24% from the 20% registered for the same period last year. The consolidation of Cynosure, which, in 2003, took place starting on the first of January, while for 2002 it started in the month of May, takes on a major role in the evolution of this aggregate cost and its incidence on the sales volume: in this period, Cynosure shows an incidence of cost of personnel for an amount of 34% of the Value of Production. The other firms acquired during 2003, Asclepion and Lasercut, added respectively 43 and 12 staff members to the Group personnel, which on September 30<sup>th</sup> 2003, registered 374 persons as opposed to 295 persons for December 31<sup>st</sup> 2002 and 272 persons on September 30<sup>th</sup> 2002. At the end of the third quarter of 2003, 191 employees are working in Italy, 51 in the rest of Europe, and 132 in the rest of the world.

A considerable part of the operating and personnel expenses are related to research and development, for which the Group receives grants and reimbursements for specific contracts underwritten by the institutions created for this purpose. These grants make it possible to pursue a wider range of research activities by limiting their impact on the profit and loss account. The delays in payment of the grants and the rigidity of the accounting principles do not always allow for a direct relation between the entering into accounts of the money received and the costs sustained. During the first nine months of 2003, 434 thousand euros were received as a deposit for the NIM02, EUV02, NMED02 projects for which El.En. SpA had already spent more than 334 thousand Euros in expenses, but these payments are entered into accounting as deposits (prepayments) and not as revenue; in fact, they will be entered as revenue only after final approval has been given by the institution issuing the grant for the expenses sustained and the results achieved.

The Gross Operating Margin was 3.692 thousand Euros, showing a decrease of about 11% and an incidence of about 7% on the Value of Production. In this quarter the result obtained for the amount of 1.991 thousand Euros, shows an increase 26% with respect to the same period last year.

The increase in the costs for amortisations and accruals has also shown a considerable increase (+55%). Out of the total of 2.714 thousand Euros, 277 thousand Euros are due to the amortisation of the costs for quotation on the stock market, 693 thousand Euros to the amortisation of the goodwill paid for the acquisition of Cynosure, Deka LMS and Lasercut (in 2002 the corresponding amount was 396 thousand Euros) and 179 thousand Euros for accruals in the product guarantee fund.

The operating result registered is 978 thousand Euros, a decrease of 60% with respect to the first nine months of last year, but showing a sharp recovery (+50%) in this quarter in comparison with the same financial period in 2002, and reaching an incidence on the Value of Production of 6,3%.

The result of the financial management is negative for an amount of 58 thousand Euros. This result, which is unprecedented considering the cash reserves which the Group has had in the last few years, and which it still has, though to a lesser degree, is determined by the fall in interest rates, and, above all, by the negative differences in exchange rates which have occurred on account of the drop in the value of the dollar with respect to the European currency.

Among the value adjustments, which were positive for an amount of about 505 thousand Euros, of major importance is the contribution of the associated company Sona International, the American firm which operates in the cosmetic sector for laser hair removal and for the promotion of these centers as franchises. This entry also includes the Group share of the result for the period of the associated companies, Quanta System SpA and Immobiliare Del.Co. Srl (amounts which refer to data for the semester and which as a cautionary measure have been kept unchanged for the purpose of drawing up this report). During the third quarter heavy losses have been registered by the associated company R.T.M., with the consequent reduction to zero of the value of the equity (156 thousand Euros). El.En. SpA will participate in covering the losses: the R.T.M. research center in fact represents an important partner for experimenting our technology in the field of mechanical machining and the investments made originally, although now extinguished, gave important results which we believe should be followed up.

The extraordinary management does not have any particular points of interest for this quarter.

The result before taxes is 1.488 thousand Euros. Its incidence on the Value of Production is about 3% which is a decrease with respect to the 10% shown for 2002 with a drop in overall value of 57%. The value adjustments and the negative differences in exchange rates mentioned above have caused the result for the third quarter of 2003, with respect to the same quarter last year, to drop from the +49% of the operating result to the -40% for the before-tax result.

## Comments on the evolution of the net financial position

The net financial position remains in the black for an amount of over 12 million Euros.

During the first nine months of this financial year the net financial position decreased by 12 million Euros, mostly as a result of the different transactions of an extraordinary nature which were concluded during this period, while the ordinary management, as a result of the fall in profitability and the increase in net capital in circulation, absorbed further amounts of cash. The main expenses of an extraordinary nature which were sustained during this period are as follows: final payment of the Cynosure shares for about 1.346 thousand Euros; the acquisition of Lasercut Inc. for about 467 thousand Euros besides the payment of a deposit for the purchase of the building where the business is conducted for the amount of 747 thousand Euros, the acquisition of Asclepion Gmb H followed by the purchase of their business activities for an amount of 1.263 thousand Euros of which 513 had already been paid and 750 thousand will be paid at the end of the year, as well as the distribution of dividends by El.En. SpA for 1.144 thousand Euros and by Deka M.E.L.A. Srl for 123 thousand Euros.

## Gross investments made during this quarter

The chart below shows the gross investments made during this financial period.

<i>Progressive</i>	30/09/2003	30/09/2002
Intangible assets	254	174
Tangible assets	2.591	1.236
Equity investments	0	274
<i>Total</i>	2.845	1.685

<i>3 Months</i>	30/09/2003	30/09/2002
Intangible assets	92	38
Tangible assets	582	349
Equity investments	0	0
<i>Total</i>	675	387

During the first nine months of this year a sizeable increase in the overall value of the investments was registered, due for the most part to a generalised rise in investment activity in equipment for sales demonstrations and for clinical experiments for the medical and cosmetic sectors, as well as the replacement of laboratory equipment and new hardware, in particular personal computers which had to be purchased as the number of staff members rose. Cynosure had also capitalised laser equipment to be used for rentals through its associate, Sona, as explained earlier. Two real estate investments also took place, which, for type and amount were different from the types of investments described above: the remodelling of the farmhouse located on the property at the headquarters in Calenzano, which will be used for administrative offices, meeting and conference rooms and for which at this writing 306 thousand Euros have been paid so far, and the building in which Lasercut operates in Branford, Connecticut, consisting of approximately 2.200 square meters of industrial and office space, for which 747 thousand Euros were paid.

## Comments on Research and Development activities

During the third quarter of 2003 the company continued its intense research and development activity for the purpose of introducing innovative new products on the market and finding new applications for lasers in the medical field as well as in the industrial sector.

The world market, especially for high-tech products, requires that competition be met by an almost uninterrupted stream of new products and of new versions of old products with improved performance, and by the use of state-of-the-art technology and components. For this reason it is necessary to organise and maintain a vast research and development program working on short and mid-term projects. Research for obtaining mid-term results generally involve higher risk subjects and are classified on a scale which is determined by management intuition and by the potential which has been

shown in scientific studies conducted in laboratories and experiments in advanced research centers located around the world. The research which is dedicated to short term projects involves subjects for which feasibility studies have already been conducted and for which selection on the basis of information on the market potential has already been obtained through company studies and as a result of the activity of the structures involved as consultants in the preliminary study phase.

Research is, for the most part, applied and, for some specific topics, basic. Both the applied research and the development of prototypes are sustained in part by company financing and in part by grants issued on the basis of research contracts stipulated with the institutions appointed for this purpose by the Ministry of University Instruction and Research and with the European Union, both directly and through the Research Institutions.

A description of some of the research projects conducted in 2003 is contained in the following paragraphs:

The project for CO<sub>2</sub> laser sources up to 6kW for cutting and welding operations in industry was successfully concluded. Another subject on which research activity was conducted involved an excimer laser system to be used for the nano-manufacture of devices for electronics and opto-electronics.

Moreover, for another industrial application, applied research continued for the development of new galvanometers for the movement of the laser beam through the use of mirrors, for the purpose of marking and treating the surfaces of different types of materials for laser decoration of various materials for ornamentation of garments and craft products.

A project is being developed for the creation of a solid state high-powered laser source with active material in an amorphous ceramic support.

Furthermore, a program for the development of a new laser diagnostic system for the conservation of works of art has been activated as part of the "PON" Project (National Operating Plans for the development of strategic activities in Southern Italy).

In the medical laser field we are conducting clinical experiments on lasers for physiotherapy and orthopaedics, and a internships for young researchers who will eventually be hired in order to further consolidate the segment.

Moreover, development of laser systems for invasive microsurgery, assisted by a robot has been initiated, after assignment to the Group, based upon evaluation by international experts, of a MIUR project on the "New Medical Engineering" as a "FIRB" (Fund for Investments in Basic Research) project.

At the same time, clinical trials are being performed in Italy and in other qualified European and American centres, aimed at confirming and providing data on the efficacy of certain therapeutic laser procedures in various medical fields including gastrology, ophthalmology, hyperthermia interstitial laser, dermatology.

A program is now in progress related to the innovative technologies in ophthalmology for the attachment of the cornea by means of a laser.

Another research program that is being conducted involves the development of a diode laser for applications in neurosurgery.

With grants from the European Union, a program for research on mechatronic applications in the bio-medical industry has been initiated.

The following table shows the expenses sustained during this quarter for Research and Development.

<i>thousands of euro</i>	<b>30/09/2003</b>
Costs for personnel and general expenses	3.895
Costs for instruments and equipment	254
Costs for building of prototypes	361
Costs for technological consultants	302
Services provided	123
Intangible assets	7
<b><i>Total</i></b>	<b>4.942</b>

As is the case for the entries in the sales volume and revenue charts, the presence of Cynosure is highly significant also for Research and Development expenses, considering the intense activity conducted in this sector. The amount of expenses for research and development sustained by Cynosure during this quarter was about 525 thousand dollars.

As has always been done in the past, these expenses have been entirely entered under the heading of operating costs.

The amount of expenses sustained corresponds to about 10% of the consolidated sales volume of the Group. The amount relative to Cynosure, which was, as has been stated earlier, 525 thousand dollars, represents about 9% of its sales volume, the remaining part of the expenses has been paid almost entirely by El.En. S.p.A. and is equal to 18% of its sales volume.

### **Other significant events which took place during this quarter**

On September 26<sup>th</sup> 2003 the subsidiary Valvivre Italia Srl acquired 4% of Cutlite Penta, which was already owned by El.En. SpA for 53,5%, for an amount of 150 thousand Euros. No other events worthy of note took place during this quarter.

### **Other events which took place after the closure of the quarter**

On October 13<sup>th</sup> 2003 the subsidiary Deka M.E.L.A. Srl acquired 20% of ASA Srl, a company in Vicenza which is among the main manufacturers of equipment for physical therapy and rehabilitation. The company has 20 employees and closed the financial year 2002 with a sales volume of 2,7 million Euros and a net profit of 45 thousand Euros. The amount paid for the acquisition was 385 thousand Euros.

This transaction will signify the merger of the long traditions of the two companies and will optimise their resources in terms of the technical and selling capacity, in order to offer the market valid products protected by patents which will make it possible to use new Laser therapy technologies for the treatment of pain, muscular and skeletal lesions and for the bio-stimulation used in treating superficial lesions.

The intense research and development activity, the constant and detailed up-dating and the continuous formation work will contribute to the constant growth of the quality of the products which can now be more efficiently placed on the market thanks to the double name of Deka M.E.L.A. - ASA.

### **Expected short term evolution for this financial year**

During the first months of this financial year the forecasts which had been made for the sales volume were confirmed, thanks in part to the unexpected contributions of Asclepion and Lasercut which made up the difference with respect to the budget. The revenue level however did not reach the expected level, mostly due to the difficulties encountered in the industrial sector and to the weakness of the dollar.

Consistent with past trends which have shown that sales reach their peak in the month of December, the goals for sales volume in the fourth quarter are more ambitious; the recovery with respect to the preceding year registered in the industrial sector in the third quarter and the positive results obtained in the medical sector would tend to indicate that these objectives can be reached.

The profit trend showed a reverse in tendency in the third quarter with respect to a disappointing first semester. Even though the gap that has been created between these figures and those forecast seems difficult to overcome, an improvement is expected, and for the fourth quarter we expect to see an improvement in profitability approaching the levels registered last year.

Calenzano, November 13<sup>th</sup>, 2003

For the Board of Directors,

Dr. Ing. Andrea Cangiolì