

A low-angle shot of two surgeons in an operating room. They are wearing blue surgical caps and masks, looking upwards at a large, grid-patterned surgical light fixture. The image has a blue tint.

Exploiting the Potential of Vision Technology

Annual Report 2005

Key Data

Balance Sheet

in € mill*	2005	2004	2003
Balance sheet total	41.2	37.1	23.9
Short-term assets	18.1	19.6	17.4
Tangible assets	2.6	2.2	2.2
Equity	22.0	19.6	7.1
Equity ratio	53%	53%	30%
Debt capital	19.3	17.5	16.7
Debt ratio	47%	47%	70%

* 2005 and 2004 acc. to IFRS, 2003 acc. to US GAAP

Employees

	2005	2004	2003
Number of employees	357	338	265
Employees in research and development	37%	37%	37%
Employees in Germany	318	299	235
Employees outside Germany	39	39	30

Profit and Loss Statement

in € mill*			
	2005	2004	2003
Sales	45.0	52.2	35.7
Change on previous year	-14%	46%	34%
Gross performance	22.2	27.5	21.0
Gross margin	49%	53%	59%
EBITDA	8.9	12.9	2.8
EBIT	4.1	8.9	1.5
Earnings before tax	3.6	8.2	0.7
Number of shares	3.5 Mio.	3.5 Mio.	3.5 Mio.
Income/loss per share	0.68 €	2.58 €	0.85 €
Research and development quota (on a fully absorbed cost basis)	18%	15%	14%

* 2005 and 2004 acc. to IFRS, 2003 acc. to US GAAP

Cash Flow

in € mill*			
	2005	2004	2003
Cash flow from operating activities	7.9	10.0	2.3
Cash flow from investing activities	-9.0	-8.1	-0.9
Cash flow from financing activities	1.2	-2.4	2.0

* 2005 and 2004 acc. to IFRS, 2003 acc. to US GAAP

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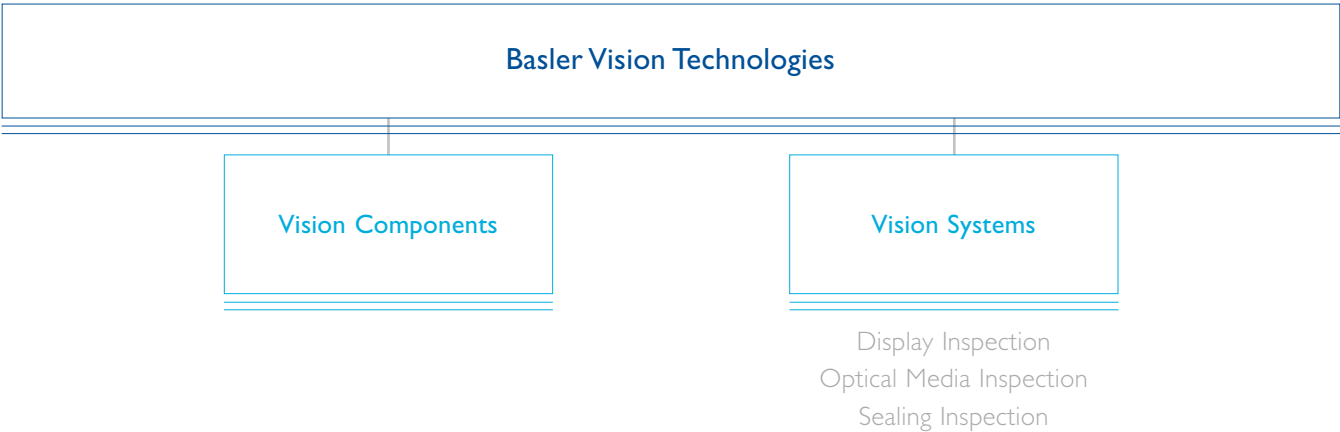
Setting the Standards with Vision Technology

Basler AG is one of the leading players in Vision Technology. Vision Technology consists of computer based vision systems which automatically take decisions on the basis of image data, and cameras (vision components) which in turn are fitted into vision systems.

The company, which was founded by Norbert Basler in 1988, currently employs 357 staff and has a total of six sites in the USA, Europe and Asia, making it an international enterprise. The stock corporation has two divisions reflecting the current structure of our applications using our products: The Vision Systems division develops and sells turn-key quality control solutions in three sectors (flat-screen monitor industry – display inspection, optical storage media production – optical media inspection; and rubber and elastomer industries – sealing inspection). The second business division, Vision Components, develops and sells digital camera solutions for capital goods manufacturers in the market segments of machine vision, medical engineering and intelligent traffic systems.

Lastly, the New Business Development Unit engages in new commercially viable applications of Vision Technology.

On the back of this unique combination of system and component business, we intend to grow into one of the biggest Vision Technology providers in the world. To achieve this aim, we intend to increase sales by an average of 20% per year on a profitable basis involving a two-digit pre-tax margin. The two main factors of our success on this growth path are our multi-sector strategy and sustainable investment in research and technology. Our multi-sector strategy makes us less sensitive to fluctuations in individual markets and puts us in a better position to flatten out demand cycles. Moreover, due to our consistently high investment in research and development, we are meanwhile generating more than half of our sales with products that are less than two years old. This high level of innovation gives us advantages over our competitors and ensures profitability.



PREFACE BY THE MANAGEMENT BOARD

Successful in a Difficult Business Environment

Dear Sir/Madam, dear shareholders,

In the fiscal year just ended we have been able to prove that the strategy and positioning of Basler AG are solid and successful also in times of weak market conditions. Three of our four business divisions were affected by unforeseen market developments which is why the trend of dynamic growth we saw over the past three years with sales volume almost doubling has now been temporarily interrupted. In 2005, sales decreased from € 52.2m to € 45.0m. Despite this decrease in sales, we achieved an acceptable level of profitability, even with the high investments we made in research and development to ensure future growth. With earnings before tax in an amount of € 3.6m (2004: € 8.2m) we generated a pre-tax margin of 8% (2004: 16%). This was possible mainly because we reacted to market trends in good time and were able to quickly adjust our costs to the current situation.

Our expenses on research and development are an important factor for our future sales volume and earnings. As in 2004, more than 15% of this year's sales were spent on the development of new products. As a result, new products that were developed less than 24 months ago now account for over 50% of our sales. This is the basis we need to continue growing again in 2006.

With 357 employees, Basler is one of the biggest Vision Technology providers in Europe. Market-focussed sales units sell our technological know-how in attractive individual markets taking into account the respective market requirements. In the Vision Systems segment, we offer surface inspection systems for the industrial mass production of flat-screen monitors, optical storage media and rubber seals. The Vision Components division develops and sells digital camera solutions and intelligent cameras for industrial (e. g. electronics and semiconductor industry) and non-industrial applications (e. g. in medical industry, traffic industry or security industry). Our positioning provides not only an excellent basis for participating in the respective market growth but also offers numerous connecting points for developing new applications for additional markets. In the fiscal year just ended we made considerable investments in the development of new strategic business segments. With our newly founded New Business Development unit, we investigate the entire market to find potentially attractive user markets for vision technology applications that we can explore either by our own developments or by acquisition of companies. Where own developments are concerned, we operate pilot projects together with end users to get to know these new markets

and their requirements. These projects then become the starting points for potential future business units.

In 2005, our business segments and the product lines they include went through diverse developments. The sales volume of the Vision Systems segment decreased by 19% on last year to reach € 29.1m (2004: € 35.8m). The earnings of the division before interest, taxes and income from investments amounted to € 2.2m in 2005 which is 62% below the previous year's level (2004: € 5.8m).

In the Vision Systems division, the optical storage media inspection business went through a very weak stage of the economic cycle, as already in the second half of fiscal year 2004. The main reason for this is the costs of raw materials which increased considerably compared with 2004, and the decrease in prices of the storage media themselves due to the strong expansion of manufacturing capacities in 2004. All in all, the sales volume and performance were clearly below last year's figures. The division has successfully positioned itself with the future manufacturers of the forthcoming storage medium Blu-ray disc which will offer even higher performance. First sales of Blu-ray manufacturing equipment are to be expected this year after the pilot installations from 2005 have been met with general acceptance by customers. The actual bulk business is expected to commence in 2007 or 2008.

The market of our Sealing Inspection Division which develops and supplies inspection systems for sealing manufacturers surprised with unexpected investment caution in Q4 2005, notably in the USA. The reason for this is the US automotive industry which develops only slowly. By contrast, sales with Asian customers e. g. from China increased. However, looking at the whole year of 2005, this business generated lower sales than in the previous year. A slight reduction of the backlog of investments from the previous year leads us to believe that 2006 is to bring growth again.

Our business with inspection systems for flat-screen monitors (display inspection) continued to flourish in 2005. Once again we succeeded in increasing sales compared with 2004. The main reason for this strong growth rate was a very positive cooperation with global market leaders in the display pane production field. This successful cooperation resulted in more than 50% of the panes produced worldwide for TFT LCD displays now being inspected with Basler equipment. Moreover, we introduced to our customers



f.l.:

John P. Jennings (Chief Commercial Officer)

Dr. Dietmar Ley (Chief Executive Officer)

Peter Krumhoff (Chief Financial Officer)

a new product line for the inspection of so-called colour filters and have already received the first big order in this respect from a Taiwanese manufacturer. Colour filters are applied on the glass pane and are responsible for displaying different colours on the flat screen. We expect this product line to give considerable impetus to growth in 2006.

In 2005, sales in the Vision Components division amounted to € 15.8m (2004: € 16.4m, -4%). The earnings of the division before interest, taxes and income from investments amounted to € 2.3m in 2005 (2004: € 2.2m). This is the first time since its formation in 1997 that the Vision Components division did not see growth. The reason for this stagnation is the investment caution in important target markets of the division such as electronics and semiconductor industry in the course of the first half year. During the second half of the year, the demand from industries increased again so that Vision Components recorded significant increases in incoming orders for the existing portfolio. During the last two months of the year, record heights were achieved for incoming orders. Moreover, we launched a number of new products during the second half of the year. These include, among other things, the new product family of intelligent cameras – Basler eXcite – which combines image generation with image processing by a processor, thereby providing a convenient and high-performing solution for simple image processing tasks. The high interest of customers in this and other new cameras as well as the very good rate of incoming orders in Q4 2005 make us very confident for 2006.

The price of the Basler share performed worse than comparable indices in the fiscal year just ended. In the context of our ongoing comprehensive investor relations work it has become obvious that adjustments to our forecast in the course of the year with respect to the total annual sales and total annual earnings are a burden on the share price because the interest of shareholders and potential shareholders is determined by short-term considerations. We

continue to rely on a high level of activity in the capital market and position the share as a long-term interest and value increasing share. With a view to the sales and revenue increases anticipated for 2006, we expect the share to perform better than the entire market in 2006 – as it did in the past.

As the markets we are currently operating in still offer a considerable potential, we expect to be able to continue our strategic path to profitable growth in 2006. The growth of these markets alone contributes to this, but we also want to gain more market shares in our target markets. In addition, we have identified numerous opportunities to transfer our knowledge to other markets and thereby establish organic growth through new business segments. Moreover, our positioning also offers many starting points for anorganic growth by integrating companies with a suitable focus on an attractive user market.

We appreciate your interest and the trust you have placed in our company. In 2006, we will continue to implement our strategy of profitable growth. We have made it our goal to continue to grow at two-digit rates on fiscal year 2005 again.

Dr. Dietmar Ley

John P. Jennings

Peter Krumhoff

MARKET AND STRATEGY

Exploiting the Potential of Vision Technology

By carrying forward the basic principles of vision technology, we want to explore the full range of potential industrial and non-industrial applications for it. Our customers regard us as a reliable and cooperative partner who accurately satisfies their actual needs by providing them with innovative technology. This ability is the prerequisite for profitable growth. Although some of our target markets were on the decline in 2005 and sales could not be increased, we are confident that our business model will continue to prove successful, as it has in the past. In this context we will benefit from the fact that we supply products for a variety of industries which enables us to balance out temporary fluctuations in demand of individual markets.

Vision technology keeps growing at a fast pace with new applications in industry, medicine and science. The technology is based on fully automated analysis of visual information. Optical sensors take up image data and transmit them to hardware and software systems. These evaluate the images and initiate the necessary reactions quickly and with high precision, which makes them much safer and more economical than a human being could ever be.

Vision technology can be found in many applications. For instance, vision technology enables machines to monitor the quality of products during the manufacturing process, control robots during the manufacturing process, measure objects or shapes and recognise codes and signs. The scope of industrial applications is wide and includes almost every sector.

These applications show that vision technology is not limited to one single target market but can cover a wide range of different markets by providing sector or application specific functions. In some markets, vision technology is already past the introductory stage. In many industries these technologies were introduced in the early 1980s, e. g. in the semiconductor and electronics industry. Thanks to their increasing performance, reliability and user friendliness, vision technology systems are gaining greater acceptance.

Vision technology is in a state of continuous growth in which vision systems and components are becoming an integral part of many products and applications. This applies more and more also to non-industrial applications, e. g. in the field of safety and medical engineering.

The global machine vision market is mainly concentrated in the USA, Europe, Japan, as well as in China and Taiwan. The Automated Imaging Association (AIA), the umbrella organisation of the US vision industry, estimates that the global vision market will grow by 50% between 2005 and 2009.

Being one of the biggest vision technology suppliers, our goal is to grow profitably and even faster than our respective target markets. We can do this by meeting the actual needs of our customers that are underlying the symptoms. With a view to this reliable partnership, we have chosen to focus on two central factors of success in the market: technological expertise and multi-sector orientation.

Coping with the crossover of vision technology

To handle vision technology, a number of fields of expertise, some of which are very diverse, have to be taken into account. These include expertise in the fields of camera technology, lighting, optics, electronics, software/algorithms and mechanical design. A successfully operating vision system is characterised by optimal interaction between the respective fields of expertise with a view to achieving the solution that best fits the customer and the market. For instance, for 100% quality control of a rubber seal we developed a special lighting solution to be able to permanently "keep a close eye" on the ring. By contrast, for the inspection of substrates for flat screen production, not only the lighting matters but also



Digital camera solutions

the ability to process as quickly as possible the large volume of data generated. Therefore it was necessary to develop a special image processing computer for this product that is able to process image data at high speed.

We have over 100 developers who work in the advancement of vision technology and enhance our know-how in the relevant fields of expertise. This enables the respective sales and marketing units to offer products and solutions best tailored to the needs of our customers.

Multi-sector focus

We concentrate on two business segments: On the one hand, these are turn-key systems – “vision systems” – for product quality control in industrial manufacturing. On the other hand, we target manufacturers of machinery and equipment in other industries with our digital camera solutions of the vision components segment. These camera solutions are applied in the products of our customers, e. g. for identification, measuring, recognition or inspection of products.

Vision Systems

The vision systems division develops and sells surface inspection systems. Many thousands of our systems have been successfully installed at our customers since our company was founded in 1988. The surface inspection process is similar for all products: The material or product to be inspected is examined either during the manufacturing process after certain stages of production or after completion. For this purpose, digital images are generated using

high-performance digital cameras and special lighting and optics which are transmitted to a computer unit. Using software algorithms, this data set is searched for defects in the product surface. The defects detected are then classified according to different types of defects and statistically analysed. Defects include holes, scratches, oil stains, dust particles or blisters. For instance, a typical task in the inspection of flat screen substrates is to detect – in a reliable and reproducible manner – defects of less than 20 µm in size on a substrate measuring over 4 m within 20 seconds. To illustrate this, this could be compared with searching for a dust particle on a soccer field. In addition to the detection of local surface defects, also layer thicknesses, large deformations or optical properties can be measured and compared against pre-defined allowances.

On the basis of this analysis, the vision system decides whether or not the product is to be rejected. In addition to the actual inspection, the inspection data are collected and statistically processed. Moreover, the quality data of several production lines can be combined. Based on these quality data, fully automated adjustments can be made to the settings of a manufacturing plant so as to prevent quality defects from the outset. Thereby the efficiency of production is increased while guaranteeing the quality of the products.

Vision Components

Basler has produced and sold digital camera solutions for industrial applications since 1997 and has developed into one of the leading providers in the world for this field. Among the main reasons for



Inspection of sealing rings

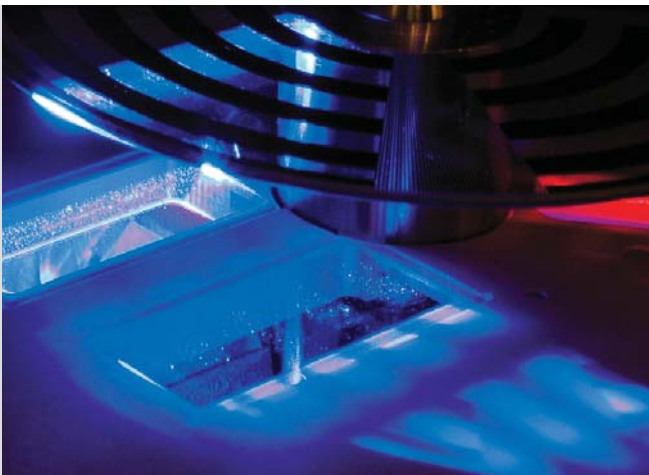
MARKET AND STRATEGY

this dynamic growth are the international distribution network and the ongoing development of the product portfolio. For instance, Basler-Vision Components is one of the very few providers who offer a full range of both line-scan cameras (where the image is generated line by line as the object passes in front of the camera) and area-scan cameras (where all lines of the image are exposed at the same time, like in photography). A new product segment of Vision Components is the family of intelligent cameras. One example of this is the Basler eXcite which combines the camera function with a processor for image processing in a compact housing and can be used for simple image processing tasks such as in measuring or monitoring. Another factor of success of the component business is the reliable quality of products. Each camera is examined in a special inspection process and released individually before being shipped. In addition, a global support team with resources in the US, Europe and Asia ensures that customers can use our products quickly and reliably for their work.

This combination of vision systems and vision components offers many advantages for our customers and for ourselves. On the one hand, the systems business benefits from high-performing cameras while the components segment can make use of the experience gathered in the systems business for its own developments for customers. In addition, the use of our own cameras enables us to keep the production costs of our systems low since the camera margin remains within our own company.

The distribution of sales among our several business segments that has been achieved by now helps us primarily to cope better with temporary fluctuations in demand in individual target markets. To this end, the individual markets should not be related, if possible, because a multi-sector strategy would not make much sense if our different product groups were concentrated in the semiconductor and electronics industry alone, for example. Therefore it has proven right for us to mix product groups into our overall portfolio which aim at industries that are completely uncoupled from these cycles.

For the future, this approach also offers the best opportunities to use the potential of vision technology as efficiently as possible. Due to the fact that investments continue to be made in our target markets, we expect organic growth on a profitable basis in the years to come. Moreover, our technological expertise is a good basis for addressing new markets with our know-how and generating additional growth. Lastly, our positioning offers many starting points for integrating other companies with a focus on a specific user market for vision technology which we do not cover to date.



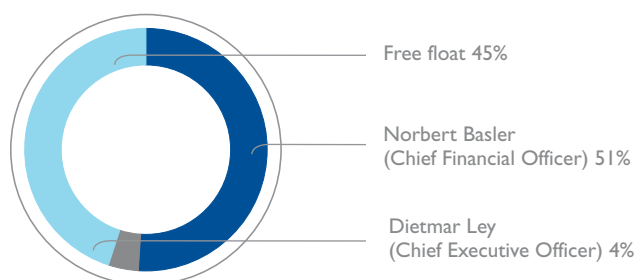
Inspection of optical media



Inspection of flat panel displays

Transparency and Reliability

Shareholding Structure:



Contact:

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Regular Information:

If you would like to receive regular information by fax or e-mail, please use our contact form at www.baslerweb.com or contact our Investor Relations department directly.

Basic Information Regarding the Basler Share

ISIN:	DE0005102008	Nominal value:	€ 1
SE code:	BSL	Price at beginning of 2005:	€ 14,85 (XETRA closing price)
Prime Standard Branche:	Industrials	Year-end price on 30 December 2005:	€ 11,45 (XETRA closing price)
Industry group:	Advanced industrial equipment	Percentage change in 2005:	-23%
Market segment:	Prime Standard/Regulated Market	Market capitalisation as at 30 December 2005:	€ 40,1 million
Designated sponsor:	Seydler AG	Member of the following indices:	CDax, Prime AllShare, Technology AllShare, GEX*
Number of shares issued:	3,500,000		

* GEX is the indicator for the stock-market performance of small and medium-sized enterprises.

Directors' Dealings in 2005

Date	Person subject to disclosure requirements	Position	Transaction	No. of units	Price in €
17/01/2005	Dietmar Ley	CEO	Purchase (redemption of a loan against securities)	20,000	17.15
26/07/2005	Norbert Basler	Chairman of the Supervisory Board	Sale	200,000	13.25

BASLER SHARE INFORMER

Investor Relations Activities in 2005

Date	Activity
09/03/2005	Conference call with analysts and investors announcing the publication of the annual financial statements for 2005
11/03/2005	Roadshow at investors in Frankfurt
21/04/2005	Roadshow at investors in London
28/04/2005	Conference call with analysts and investors announcing the release of the Q1 results in 2005
12/05/2005	Presentation at the analysts and investors conference of UBJ GmbH in Düsseldorf
22/06/2005	Annual General Meeting in Ahrensburg
11/08/2005	Conference call with analysts and investors announcing the release of the Q2 results in 2005
16/08/2005	Roadshow at investors in Frankfurt
23/08/2005	Roadshow at investors in Zurich
20/09/2005	Presentation at the TecDays held by CloseBrothers Seydler AG, Frankfurt
10/11/2005	Conference call with analysts and investors announcing the release of the Q3 results in 2005
23/11/2005	Presentation at the German Equity Forum of Deutsche Börse AG in Frankfurt and roadshow at investors in Frankfurt

Chart – Absolute performance of the Basler share in 2005 in €

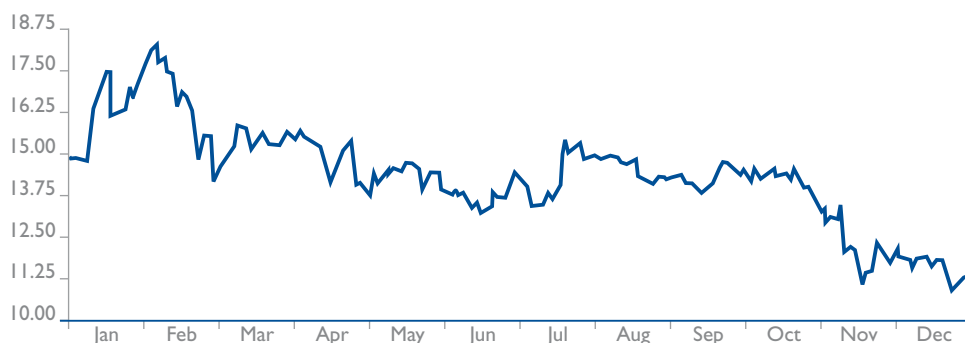


Chart – Relative performance of the Basler share in 2005 compared with TecDax indexed



Statement of Compliance with the German Corporate Governance Code

The Board of Management and the Supervisory Board of Basler AG declare that the recommendations issued by the "Government Commission of the German Corporate Governance Code" published by the Federal Ministry of Justice in the official section of the electronic Federal Gazette (eBundesanzeiger) have been and are being complied with. This Code presents essential statutory regulations for the management and supervision of German listed companies and contains internationally and nationally recognised standards for good and responsible governance. Its purpose is to promote the trust of international and national investors, customers, employees and the general public in the management and supervision of listed German stock corporations.

By their declaration of undertaking, the Board of Management and the Supervisory Board want to demonstrate to the public how they intend to implement responsible corporate management and control so as to increase shareholder value. This measure is to build and enhance trust among current and future shareholders, customers, other interested members of the public and employees.

Commitment to the German Corporate Governance Code is based on the "comply or explain" principle. The contents of the Code are divided into requirements and recommended guidelines. The Board of Management and the Supervisory Board have to declare annually to what extent the company management is in compliance with the requirements and recommendations of the Code. Only the deviations from the Code must be explained. In addition, in the context of the audit of the annual financial statements, implementation of the Code is part of the audit and thus part of the management report.

Declaration of conformity pursuant to Sec. 161 of the German Stock Corporation Act [Aktiengesetz – AktG]

The Board of Management and the Supervisory Board hereby declare that the recommendations of the Government Commission of the Corporate Governance Code as amended on 21 May 2003 have been complied with during fiscal year 2004 from 1 January 2004 to 31 December 2004 and that said recommendations will be complied with in the future. The Board of Management and the Supervisory Board issued a Declaration of Conformity to this effect on 7 January 2006. Conformity includes also the version of the Code as amended on 2 June 2005. The following recommendations are excepted:

Clauses 4.2.3. and 4.2.4. – Compensation of members of the Management Board

The remuneration of the Management Board consists of fixed and variable components. These, together with the overall level of remuneration for the Management Board, are set forth in the Appendix to the Annual Report. Individual Management Board salaries are not disclosed. Both the Management Board and the Supervisory Board strive for the highest degree of transparency vis-à-vis players on the capital market whilst also honouring the company's interests and those of the individuals concerned. In times of increasingly strict data protection regulations, the company considers it inappropriate to disclose personal data which may lead to possible disadvantages for the persons concerned and/or their families.

Clause 5.3.1. – Formation of committees by the Supervisory Board

The Supervisory Board does not form any committees. As appropriate for the size of the company, the Supervisory Board of Basler AG comprises three members. This size enables efficient work to be done whilst the generally accepted minimum size for a committee is a membership of three.

Clause 5.4.7. – Compensation of members of the Supervisory Board

Remuneration of members of the Supervisory Board is set forth in the Articles of Incorporation. Special consideration is given to the remuneration of the chair and deputy chair of the Supervisory Board. However, in the light of the current level of fixed remuneration, the company does not intend to add a variable component to the remuneration of members of the Supervisory Board.




For the Board of Management
Dr. Dietmar Ley (CEO)



For the Supervisory Board
Norbert Basler (Chairman)

Further information on this subject is available on the Internet at www.baslerweb.com



Management report of the Consolidated Annual Financial Statements of Basler AG for 2005

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Management Report of the Consolidated Annual Financial Statements of Basler AG for 2005

I. Business Report

I.1. Corporate Structure

Basler has two divisions that operate in the Vision Technology market:

- Vision Systems develops and markets turn key quality inspection systems for mass production in various industries.
- The second business division, Vision Components, develops and sells digital camera solutions for original equipment manufacturing customers (manufacturers of capital goods) in the market segments of machine vision, medical engineering and intelligent traffic systems.

I.2. Business Environment and Sector Development

I.2.1. Macroeconomic Environment

The upswing of the global economy has become more stable in the course of fiscal year 2005. Despite the sharp rise in oil prices, production has increased since the summer. Its inherent dynamics have become more robust both in the industrial countries and in the rest of the world. This applied also for Euroland which had not recorded any upward development to date. While the recovery is still fragile here, the USA saw a continued upturn. In Japan, the many years of economic weakness seem to be over, even though the speed of expansion has decreased again recently. Moreover, the substantial growth in China, India and other emerging markets in East Asia has continued unchanged. As a whole, the increase in performance figures with respect to global production is estimated

at approx. 3% in 2005 which would be slightly less growth than last year (3.8%).

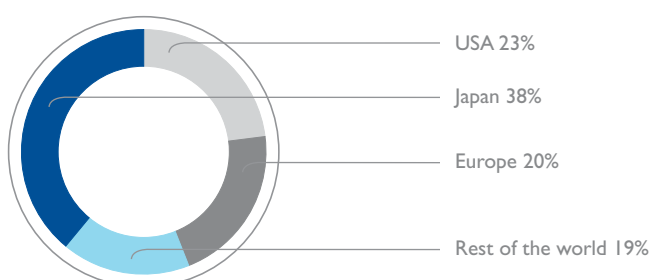
I.2.2. Global Market Development: Machine Vision

The Vision Technology market was able to benefit from the global economic growth also in 2005, although not quite as much as in previous years. The US machine vision umbrella organisation, the Automated Imaging Association (AIA), estimated in 2004 that the total sales generated by all machine vision suppliers would total US\$ 9.2 thousand million in 2005. This would translate into a 14% growth rate for the global machine vision market (2004: US\$ 8.1 million). Back then the AIA expected sales of machine vision products to increase by 71% to US\$ 15.7 thousand million between 2005 and 2009. This would correspond to an average annual growth rate of 18%.

In the course of 2005, however, it became clear that the growth did not materialise as much as originally expected. Latest analyses of the AIA revealed a growth rate of only 6% for the US Vision Technology market in 2005. The German Engineering Association (Verband Deutscher Maschinen- und Anlagenbau e.V. – VDMA) expects a growth rate of 2% for the entire robotics and automation industry in 2005. All in all it appears that 2005 was a year of growth for the entire automation industry, however, not as strong as the previous years.

The global machine vision market is mainly concentrated in the highly industrialized regions such as the USA, Europe, Japan and newly industrialized Asian countries such as Taiwan, South Korea and China. According to AIA statistics, at 38%, Japan is the largest single country market for industrial image processing. At 23% and 20%, the USA and Europe rank second and third, respectively. The rest of the world accounts for approx. 19% of global machine vision sales.

Vision Technology Market to Region 2005



(AIA 2004)

Competition in the Vision Technology market is highly fragmented. In the systems field we focussed on highly specialised niche markets, as did most other vision suppliers. The development of sales volumes in this area in many cases remains unaffected by developments of the global economy and is rather influenced by market-specific business trends. By contrast, the components field addresses a number of target markets at the same time with a wide range of standardised products. For this reason, the overall performance of the global economy generally has a stronger influence on the sales volume and earnings of the sector.

MANAGEMENT REPORT

As yet, less than one-third of all known potential industrial applications for Vision Technology have been exploited. In addition, new applications arise continually and existing markets continue to expand. Consequently, the Vision Technology market still has a large growth potential.

1.3. Trend Analysis of Financial Performance Indicators

1.3.1. Sales Development and Order Levels

14% Decrease in Sales

In fiscal year 2005 which has just ended, Basler Group's sales amounted to € 45.0m, representing a 14% decrease since last year (2004: € 52.2m). Thus the € 43m forecast of last November was fully met.

Broken down by business divisions, sales developed as follows: Vision Components generated € 15.8m with its products in 2005, thereby just narrowly missing last year's level of € 16.4m (-4%). In 2005 sales in the Vision Systems division amounted to € 29.1 million – a 19% decrease compared with the previous year (2004: € 35.8m).

Vision Components Sales Level Maintained

The development of sales volumes in Vision Components is mainly due to the fact that the demand of what is currently the most important market segment - the semiconductors and electronics industry - showed a very weak development during the first half of the year. Thanks to a significant upturn in this target market during the second half of the year and a continued high speed of innovation in this unit including new products, the sales volume for the entire year almost matched last year's level.

Sales volume in Vision Systems units developed differently

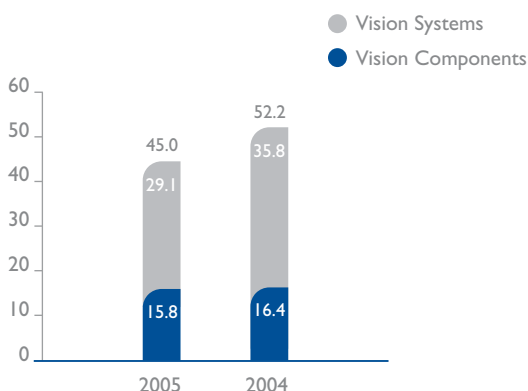
In the Vision Systems division, the situation was different in 2005 for each of the individual product groups: The display inspection unit was able to increase its sales by 17% in 2005, making it the third consecutive year of significant growth in this field. This is due to the continued high capital investments the flat-screen industry is making into manufacturing equipment. The optical media inspection unit recorded a 44% decrease in sales but performed better than the market which as a whole decreased by over 50%. The reason for this slump in the market is the sharp increase in prices for the raw material of optical storage media which increased the material costs of the manufacturers of these media and resulted in a certain amount of reluctance to make further capital investments. Moreover, there is currently a low demand for manufacturing equipment for both DVD and CD formats. The current demand can be met with the existing manufacturing resources. The sales volume of the sealing inspection unit decreased by a total of 29%. Especially during the second half of the year, sales figures showed an unexpected drop which was mainly due to sudden caution with respect to capital investments, notably on the part of the US automotive industry. A breakdown of the group's sales according to regions presents the following picture: The share of Europe in overall sales amounted to 29% (2004: 30%) while the USA accounted for 31% of sales (2004: 22%). The highest sales were generated in Asia with 40% of the overall volume in 2005 (2004: 48%).

Development of sales dominated by deliveries in the display inspection field

Sales figures increased quarter by quarter. On the one hand, this is a result of the initial reluctance to make capital investments in the semiconductors and electronics sector, a primary market for this unit. On the other hand, investment projects for the display inspection

Turnover According to Segments, 2005 und 2004 *

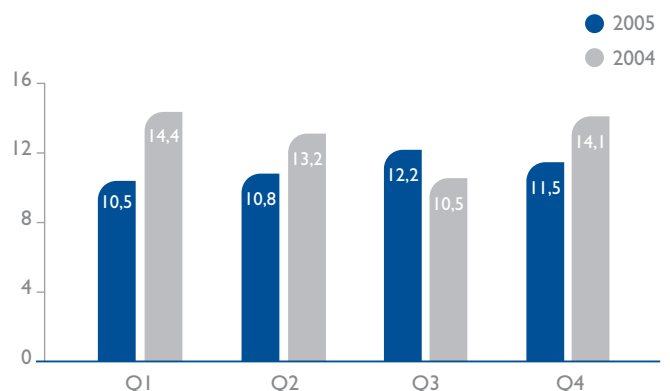
in € m



* sum mistakes relate to rounding differences

Turnover by Quarter 2005 and 2004

in € m



tion field increased significantly in the second half of the year. In the 1st quarter 2005 the sales volume amounted to € 10.5m (Q1/2004: € 14.4m, -27%). In the 2nd quarter 2005, it was € 10.8m (Q2/2004: € 13.2m, -18%). From the 3rd quarter 2005 sales could be increased again. In the 3rd quarter, sales revenues increased by 16% to € 12.2m (Q3/2004: € 10.5m) while sales in the 4th quarter amounted to € 11.5m, 18% less than in the previous year (Q4/2004: € 14.1m).

Well-balanced customer structure

As in 2004, the customer structure was again well-balanced. In 2005, the largest single customer accounted for 11% of sales (2004: 11%). The three largest customers had a share in sales of close to 23% in 2005 (2004: 26%), and the largest ten customers accounted for 33% (2004: 41%).

High level of incoming orders

In 2005, the rate of new orders in the group decreased slightly compared with the previous year. The entire group had incoming orders worth € 47.0m (2004: € 50m, -6%).

The individual segments recorded different trends of incoming orders in 2005. Vision Components accepted orders worth € 16.7m in 2005. This corresponds to a 14% increase compared with 2004 (€ 14.6m). Vision Systems' new orders in 2005 amounted to € 30.3m – 15% less than in the previous year (2004: € 35.5m). The trend in incoming orders fluctuated throughout the year. This is mainly due to larger block orders from the display inspection field which had some effect on the result as at the reporting date. In the 1st quarter 2005, new orders amounted to € 10.1m (Q1/2004: € 13.4m, -25%), in the 2nd to € 13.5m (Q2/2004: € 10.7m, +26%). In the 3rd quarter, this figure amounted to € 11.9m – an 19% decrease over the previous year (Q3/2004: € 14.6m). In

the 4th quarter, incoming orders amounted to € 11.5m, matching the level of the same quarter of the previous year (Q4/2004: € 11.3m) and reaching a record height of € 4.8m in the Vision Components division (+55% compared with € 3.1m in Q4/2004).

1.3.2. Earnings Position

Stable profitability despite declining sales

Due to Basler Group's relatively high gross margin compared with other industries and providers, its earnings capability largely depends on the trend in sales. Despite the significant decline in sales, fiscal year 2005 could still be closed as a profitable year, although the yield was lower than last year.

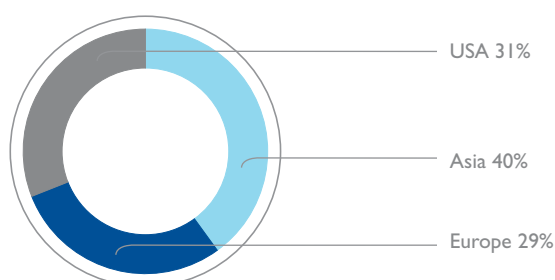
In 2005, the group earnings before taxes amounted to € 22.2m – 19% less than in 2004 (2004: € 27.5m). Thus the gross margin came down from 53% (2004) to 49%. This was due to a change in the product mix and also a result of declining prices for certain products of some business units.

All in all, operating expenses decreased by 1% from € 19.8m (2004) to € 19.6m. With a view to exploiting the potential for future growth, research and development costs increased to € 4.5m (2004: € 4.4m, +2%). Sales and marketing costs amounted to € 7.4m (2004: € 7.8m, -5%). Administrative costs increased slightly by 1% to € 7.7m (2004: € 7.6m).

For the entire year 2005, earnings before tax (EBT) amounted to € 3.6m (2004: € 8.2m). On a quarterly basis, EBT developed as follows, in line with the trend in sales: In the 1st quarter, EBT amounted to € 1.1m (Q1/2004: € 4.1m, -73%), in the 2nd quarter to € 0.6m (Q2/2004: € 1.6m, -63%). In the 3rd quarter, EBT declined to € 1.7m (Q3/2004: € 2.1m, -19%) and in the 4th quarter, it reached € 0.3m (Q4/2004: € 0.3m).

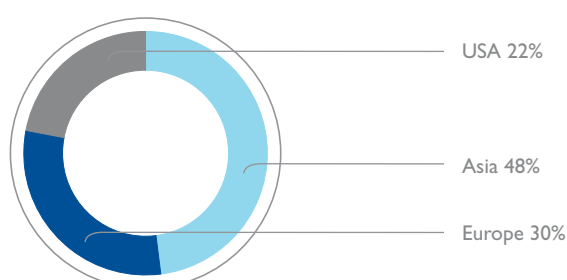
Turnover According to Region 2005

in € m



Turnover According to Region 2004

in € m



MANAGEMENT REPORT

Thus the EBT margin could be maintained at a relatively high level of 8% compared with the market average (2004: 16%). For the entire year 2005, net earnings amounted to € 2.4m (2004: € 9.0m, -73%), corresponding to € 0.68 per share (2004: € 2.58, -73%).

1.3.3. Financial Position

Aims and principles of financial management

The financial management of Basler AG is aimed at satisfying the need for capital so as to keep a reasonable balance between maturity risk, lender assessment and cost of capital. Its financial management is value-orientated and is measured by the level optimisation of the average weighted cost of capital. This is determined by entering debt capital at actual cost and equity capital at 25% in our calculation.

Therefore the operating capital is for the most part financed by short-term debt capital while the fixed assets are fully financed by equity capital, equity equivalents or long-term debt capital.

Sources and costs of financing, rating

For the financing of working capital, loan commitments have been obtained from the primary banks for a total of € 9.9m of which € 4.1 have been utilised (utilisation in 2004: € 3.0m).

As at 31 December 2005, the capital cover of the fixed assets amounted to 151% (previous year: 189%). The equity ratio remained unchanged in 2005 compared with 2004 (53%). With this ratio we are within our target corridor because both our creditworthiness and the financing of assets are secured at reasonable costs.

The average weighted cost of capital amounted to 20% in fiscal year 2005 (2004: 21%).

The internal ratings assigned to us by our banks ranged – if transposed to the Standard & Poor's scale – between A- and BBB.

1.3.4. Net Worth Position

Sound balance sheet

The net worth position of the group was sound in the fiscal year just ended. All in all, the net distributable profit of the group increased by 11% to € 41.2m until 31 December 2005 (31 December 2004: € 37.1m).

Assets: Inventories decreased disproportionately to the trend in sales

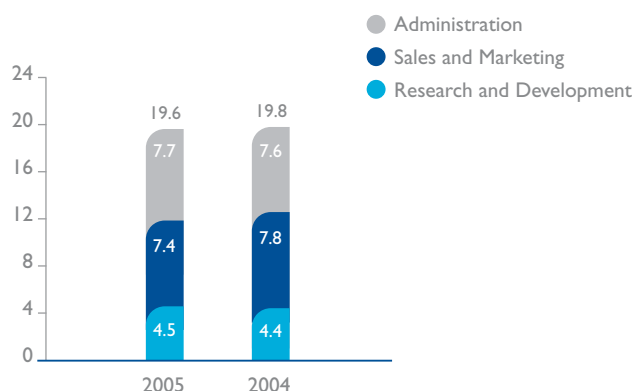
On the asset side of the balance sheet, short-term assets slightly decreased as at 31 December 2005 from € 19.6m (31 December 2004) to € 18.1m (-8%). In this context, inventories decreased disproportionately to the trend in sales by 32% from € 8.9m (31 December 2004) to € 6.1m. The long-term assets increased mainly as a result of increasing development work and due to mandatory capitalisation according to the new accounting standards. In total, they increased from € 17.5m as at 31 December 2004 to € 23.2m as at 31 December 2005 (33%).

Liabilities: stronger equity capital base

As at 31 December 2005, the equity capital rose by 12% to € 22.0m (31 December 2004: € 19.6m). Long-term liabilities as at 31 December 2005 totalled € 10.1m. This corresponds to a 30% increase (31 December 2004: € 7.8m) which was mainly due to the increased formation of deferred tax assets. Due to a decline in advance payments and provisions, short-term liabilities slightly decreased by 5% from € 9.7m as at 31 December 2004 to € 9.2m as at 31 December 2005.

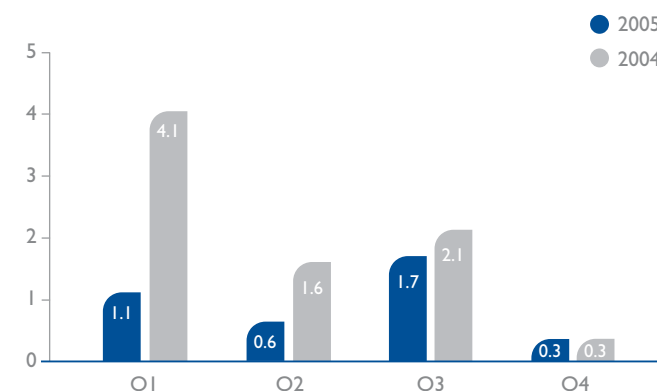
Development in Costs and Profit 2005 and 2004

in € m



Pre-tax Result by Quarter 2005 and 2004*

in € m



*sum mistakes relate to rounding differences

2. Investments and Financing

Investments into development work are for the first time stated separately in the Management Report due to the conversion to IFRS. Development work is stated on the asset side at production cost and depreciated in accordance with the applicable regulations. This capitalisation was performed as conservatively as possible, i. e. only the shortest possible depreciation period of three years was applied. For the annual and quarterly financial statements, all capitalised development work items are examined as to the degree to which they have maintained their value (impairment test). For this purpose, the net present value of the cash flows to be expected from the business divisions are compared with the net value of the assets from own developments. If the cash flows to be expected were lower than the net value stated on the balance sheet, extraordinary valuation adjustments would have to be made. The impairment tests for fiscal year 2005 did not result in any extraordinary valuation adjustments.

In the fiscal year just ended, our capital investments focussed on technical equipment, IT hardware, furniture, fixtures and equipment as well as software. A total of € 1.1m were invested in tangible assets in 2005, which is comparable to the € 0.8m invested in 2004. Investments in intangible assets amounted to € 8.1m (2004: € 7.2m).

3. Trend Analysis of Non-Financial Performance Indicators

3.1. Research and Development

Basler's core business strategy and its resulting success on the market is based on an innovative product portfolio. Our continuous

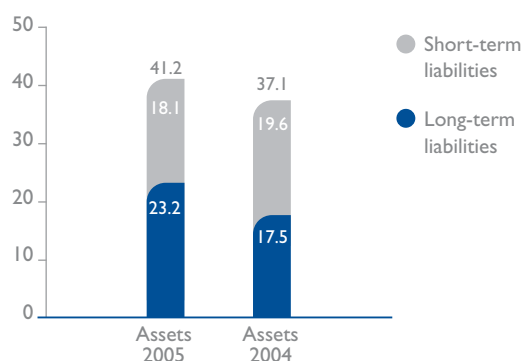
development work is focussed on the needs of our customers and takes into account the most recent technical trends.

In 2005, all of our divisions launched new products on the market. One milestone for the vision components portfolio was the launch of a new products segment with the intelligent camera eXcite. This camera combines the function of a camera with image analysis and is able to perform simple image processing tasks without an additional external computer. The segment of intelligent cameras is growing disproportionately to the vision market in general and therefore offers an excellent basis for further growth of our components business. The Vision Systems division introduced a new system for the inspection of colour filters in the field of display inspection. The colour filters are applied to glass substrates in the early stages of the flat-screen production process and are responsible for the colour quality of the image in the finished flat screen display. Due to its groundbreaking concept and record performance, this inspection system represents an important innovation for the flat-screen industry. A first pilot order from a Taiwanese customer was already acquired in 2005. The optical media inspection unit used the fiscal year just ended to develop surface inspection solutions – so-called scanners – for the manufacturing of the new storage media formats BluRay and HD-DVD. The devices of the pilot series are already successfully being used by key customers. Thus this unit is well-positioned to participate in the mass production of these new formats which is expected from 2007 onward. Sealing Inspection launched the new "Basler Basic", aiming to open up new customer segments in the (Asian) sealing industry with this low-cost product.

In the year under review, the fully absorbed costs for research and development slightly decreased by 3% to € 7.9m (2004: € 8.1m), thereby accounting for 18% of sales (2004: 15%). This puts Basler in the top echelons of Vision Technology companies worldwide.

Balance Sheet 2005 and 2004 *

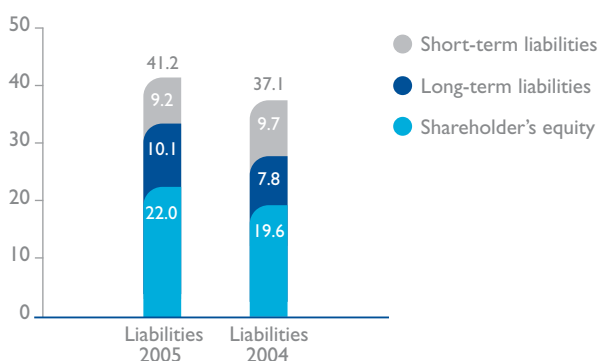
in € m



*sum mistakes relate to rounding differences

Balance Sheet 2005 and 2004 *

in € m



*sum mistakes relate to rounding differences

MANAGEMENT REPORT

The company's innovation speed remained at a high level during the year under review. For instance, the percentage of sales generated with products less than 24 months old amounted to 57% in 2005 (2004: 68%).

Patents secure Basler's innovation activities and form an important part of our technological strategy. At the end of 2005, a total of 15 patents (currently worldwide) had been granted (2004: 15), a further 15 had been applied for (2004: 13) and 3 utility models (so-called "minor patents") had been confirmed (2004: 2).

3.2. Employees

Increase in the number of employees

The number of employees increased during the year under review and amounted to 357 as at 31 December 2005. This corresponds to a 6% increase compared with the previous year (31 December 2004: 338 employees). The average number of staff employed in 2005 amounted to 352 – 14% more than in the previous year (2004: 309 employees).

The turnover of employees continued at a low level of 1.4% in the fiscal year just ended (2004: 1.6%).

The breakdown according to regions is as follows: As at 31 December 2005, 318 members of staff were employed in Ahrensburg (2004: 299), 15 in Exton, USA (2004: 15) and 18 in Taiwan including the representative offices in Shanghai and Korea (2004: 18). As at 31 December 2004, 7 members of staff were employed in Singapore (2004: 6).

Proportionately increase in personnel costs

Personnel costs increased proportionately (by 7%) to the expansion of personnel in 2005 from € 17.7m to € 19.0m. Due to the absence of sales increase in 2005, a cost cutting program was initiated in the 4th quarter of the year which provided for reductions

of personnel costs in a range of € 0.6m in the period from October 2005 to December 2006. These savings are being achieved mainly by part-time agreements.

Staff structure focuses on research and development

As at 31 December 2005, the largest number of Basler's employees were working in research and development (37%) while 21% were working in production and logistics and 11% in sales and marketing, 23% work in administration (including all management functions) and 8% in services (the data from 2004 are not comparable due to different allocation).

The proportion of female employees was 24% (2004: 27%).

Highly qualified employees

The qualification of our employees is an important asset to our success in the market. Expenses on additional training amounted to € 398m per employee in 2005 (2004: € 564).

4. Risk Report

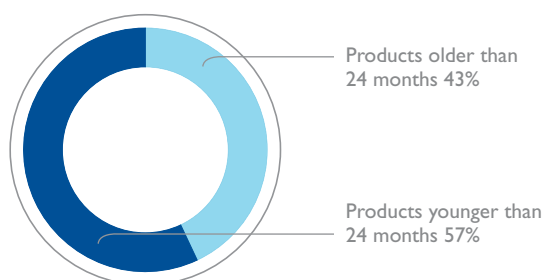
As a technology company, Basler is subject to a number of risks. Medium-sized companies like Basler cannot influence or control general fundamental risks. Consequently, risk management is primarily an entrepreneurial task for us that consists of controlled risk-taking on the one hand and exploiting opportunities on the other. The Management and the employees are responsible for optimizing the probability of occurrence of these two factors for the benefit of the company.

4.1. Integrated Risk Management System

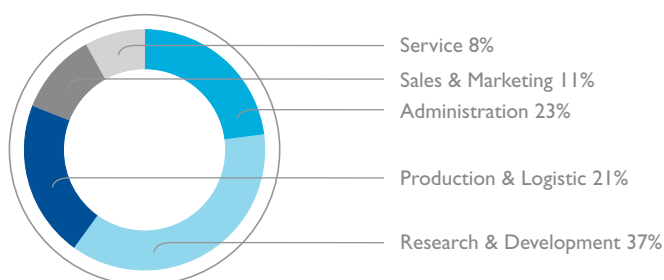
Internal control system

The core of our internal control system is a sensible, impermeable division of functions which is ensured by our organizational structure, job descriptions and procedures. The functions are defined in

Revenue Share of New Products



Staff Structure by Functions 2005



our certified quality management manual and compliance is checked regularly. Given the size of the company and the certified operational control mechanisms, an internal audit department is not required.

Our IT infrastructure security concept is constantly being refined and regularly checked by an external agent. This also applies to compliance with data protection regulations.

Controlling

Strategic, operative and functional controlling is performed in all business divisions. It is based on regular strategy checks and the preparation of balanced scorecards and product road maps. These lead to the systematic formulation of long- and short-term objectives at division level or cost unit level.

The achievement of objectives (target/actual comparison) is checked at all management levels in the context of regular meetings where control measures are agreed upon whose effectiveness is also checked.

Early warning systems

Information regarding future developments is exchanged at all levels in regular meetings, reports and minutes and evaluated where appropriate. This system ensures that the risk relevance of both internal and external information is examined at an early stage and that the results can be translated into action at group level.

4.2. Overall Risk

We have weighted all risks identified to date according to their probability of occurrence and have covered them with compensatory measures. They do not represent obvious challenges to the company's survival. At present, no additional risks jeopardizing the continued existence of the company are discernable.

4.3. Risks of the Legal Environment

Basler's risks arising from its environment consist of the development of its target markets, its competition and the capital market.

In the year just ended, competition on the Vision Technology market remained intense. Basler's 2005 expenditure for innovation, sales, cost reduction and quality improvement and the respective expenses planned for 2006 take this into account. Due to these measures, Basler's competitive position improved during the year under review.

A general slowdown in growth of the Vision Technology market does not seem to be likely in the near future; however, fluctuations in demand in individual client industries which can be substantial in some cases eclipse this general trend. Basler's sector mix, which has

been implemented in the past few years through the company's multi-sector approach, has meanwhile reduced our dependence on individual markets. Consequently, in case sales in one of our divisions decline, no risks challenging the continued existence of our company as a whole have to be expected. Nevertheless, fiscal year 2005 has shown that sales and earnings can decline if more than one business division falls behind in its growth or even shrinks. The high gross income margin which causes sharp increases in earnings when sales are rising results in correspondingly high earnings losses in this event. The company counteracts these individual risks, which cannot be influenced, with flexible cost structures and foresight tools. With respect to target market evaluation, both the management and the sales units make use of all available internal and external sources of information in order to identify imminent changes on the markets at the earliest possible moment and to be able to adequately respond to them.

The Vision Technology sector is in the middle of a concentration process at the moment. Smaller companies are being acquired and bigger companies merge in order to create further market opportunities and growth potential. In this process, Basler will be an actor rather than a target. Given the current shareholder structure, a hostile take-over can almost be excluded. However, we continuously monitor our shareholder structure closely and at all times in order to identify any significant shifts.

4.4. Operating Risks

Customer satisfaction is often an indicator of the existing risk level with respect to declining sales and earnings. Consequently, our marketing and development activities focus on the determination of customer value. Basler regularly carries out customer satisfaction surveys in all divisions and optimizes its marketing mix not least on the basis of the respective results.

The availability of existing or new know-how is particularly important in a growth -orientated enterprise. Basler regularly prepares staff plans in order to cover its demand either internally or through external partners. In addition, development and performance talks are held regularly to strengthen staff loyalty at all levels.

Well-timed high-quality product development represents the backbone of any technology company. In the development field, procedures and responsibilities are clearly defined and we have introduced planning tools which contribute towards the completion of development projects within the planned time and cost frame.

Rapidly changing technology markets challenge companies to adjust capacities swiftly and efficiently to fluctuating requirements. Our flexible working hour model enables us to compensate fluctuations in the level of orders. Consequently, we are – within limits – in a position to "breathe" in unison with the market.

MANAGEMENT REPORT

In individual cases, the availability of high-quality technological components that have to be procured externally plays an important role for the delivery times of our products. Continuous monitoring and analysis of procurement markets is thus a critical competence for technology companies. In addition, we need to know which external components must be available when and in what quantity. In the past few years, we have developed procedures to deal with these two tasks and have thereby shortened our delivery times and enhanced our compliance with delivery schedules. However, increasing expectations among our customers require us to continually improve key figures in these areas.

It has become a standard requirement among our customers that the quality of our products and procedures has to be checked and ensured according to an integrated quality management system. Since 2001, we have had DIN ISO 9000/2000 certification and are audited once every year by external auditors. In addition, we carry out internal audits in the course of a year to check and improve our procedures.

An essential component of successful product policy is the establishment and maintenance of a brand image. Basler Vision Technologies' name and logo are registered trademarks and are thus protected against illegal use.

4.5. Financial Risks

In the case of export-orientated companies, fluctuations in foreign exchange rates affect market performance and earnings before taxes. Approx. 20% of our sales volume is generated outside the euro zone. Consequently, the Euro/US Dollar exchange rate has an influence on our corporate result. In order to limit the risks associated therewith, the transaction volume generated in foreign currencies is appropriately secured by hedging the foreign exchange risk.

Liquidity is ensured by strict receivables management. Basler's distinctly formulated and strictly administered receivables management system enables the company to ensure the availability of the required liquid funds as well as the ability to plan forthcoming investments.

Transparent monthly reporting and a stable balance sheet structure also contribute towards the limitation of financial risks. These two factors are supported by an early detection system in the form of continuous 52-week sales and financial planning for all divisions as well as an extensive system of key figures. These measures facilitate successful and well-timed discussion of financial requirements with our lenders who generally proceed to provide the required funds. Our banking partners are also involved in our

partnership concept for suppliers and service providers. These are subject to certain selection criteria and evaluations as well as permanent monitoring of their performance and suitability for partnership. This reduces the risk of loans being called in at short notice by credit institutions who are frequently subject to strategic changes.

4.6. Strategic Risks and Opportunities

Basler's corporate strategy focuses on the further development of the growth market of Vision Technology which continues to expand. Since replacement technologies are currently not to be seen, the corporate strategy risk is deemed to be low.

In the context of a group-wide checking and planning procedure, business models are reviewed on a regular basis in each division. The result of these reviews forms the basis for a balanced scorecard system (BSC) which defines assessable strategic goals for each unit and measures to achieve them. Corporate and division strategies as well as the BSC system form the starting point for the development of a four-year plan as well as the budget for the forthcoming fiscal year. A group-wide planning clock ensures efficiency in all planning processes. This system ensures that strategic risks are identified in due time and enables the company to implement counter-measures at an early stage.

An essential element of risk management is to early identify opportunities that are opening up in the field of Vision Technology, to check their viability and to quickly submit them for decision on the measures to be taken on the basis of financial key figures. This is additionally being done in the New Business Development unit which examines, selects and develops future fields of business. This includes both organic development and the acquisition of new fields of business.

5. Forecast Report

Outlook

The German government's Council of Experts for the Assessment of Overall Economic Development estimates that the global economy will remain stable in 2006 despite high oil prices. The increase in world production will weaken only slightly. In connection therewith, economic dynamics in the United States will lose some of their power while economic activity in Euroland and notably in China will regain or continue to gain momentum.

Recent analyses by the US American Automated Imaging Association and by the German Engineering Association VDMA indicate that the global Vision Technology market will show a

stronger growth again in 2006 than it did in 2005. In important sales markets for Vision Technology, such as the semi-conductors and electronics industries, investment activity in machinery and equipment is expected to increase again.

The strategy pursued by the Vision Components division is based on gaining further market shares by launching new versions of existing products as well as completely new products. Special emphasis will be laid in this context on sales markets which show a dynamic growth. In addition, distribution in promising peripheral markets is to be intensified.

Within the Vision Systems division, we intend to expand our market share in the TFT display inspection equipment field. In 2006, besides further developing our current core business, we intend to approach new customer groups with our new solution for the inspection of colour-filter coated glass panes which was launched and tested in 2005. From today's point of view, the optical storage media market is expected to maintain its current investment caution throughout the first six months of 2006. We expect the first sales in inspection systems for the manufacturing of the new BluRay disc or HD-DVD formats to be generated in the course of the year. These formats have a storage capacity of up to 47 GByte and will be used to archive new data-intensive content for high-resolution television (HD-TV) in the future. Independent of the demand development, we intend to significantly increase our market share compared with 2005 by expanding our distribution efforts. In the sealing inspection unit, we expect a sales increase in 2006 after unexpected losses in sales had to be recorded in the fiscal year just ended mainly as a consequence of the investment caution of the US automotive industry. The planned growth is to be achieved by enhancing our distribution efforts and by offering new products.

All in all we expect sales to increase significantly due to the planned launches of new products and the enhancement of distribution efforts.

Despite unchanged high expenses on development to ensure future growth, this increase in sales is to result in a higher profitability with a pre-tax margin of at least 10%. Earnings are to be increased through higher earnings before tax with the increase in costs continuing on a disproportionately low level. Besides the increase in earn-

ings before taxes due to a growth in sales, we also intend to cut manufacturing costs from their 2005 level in this context. In this context, we will combine cost-cutting measures in the development field with an optimisation of supply management and manufacturing processes. To this end, a cost reduction program in a volume of € 1m was already launched in the fiscal year just ended while the majority of these savings will materialise in 2006.

Our planned business development will go hand in hand with a stable liquidity situation. In 2006, a positive net cash flow is to be achieved.

Expenditure on fixed assets will continue to focus on furniture, fixtures and equipment, infrastructure and intangible assets. The investment volume will be slightly lower than in 2005.

In 2006, we will continue to pursue our management's strategy of serving the growth market of Vision Technology with systems, components and services, thereby growing profitably and faster than the market. Basler is well-prepared in 2006 to successfully implement this strategy.

6. Report According to Section 312 AktG

In accordance with Section 312 of the German Stock Corporation Act [Aktiengesetz – AktG], we have prepared a report concerning our relationships with affiliated companies. The following declaration by the Management Board concludes this report:

"We hereby declare that, with respect to the legal transactions listed in the report regarding the company's relationships with affiliated companies and persons, Basler AG, Ahrensburg received adequate consideration given the circumstances we were aware of at the time when these legal transactions were entered into. The company neither implemented nor failed to implement other measures as defined by Section 312 AktG."

Ahrensburg, January 2006
Basler AG

Management Board

FINANCIAL STATEMENTS

Consolidated Profit and Loss Statement (IFRS)

in € thousand, result per share in €			
	Note	01.01. – 31.12.2005	01.01. – 31.12.2004
Sales revenues	5	44,973	52,215
Cost of sales		-22,808	-24,674
Gross profit on sales		22,165	27,541
Sales and marketing expenses		-7,380	-7,840
General and administrative expenses		-7,721	-7,601
Research and development			
Fully absorbed costs		-7,860	-8,049
Capitalization of intangible assets		7,184	6,673
Depreciation for wear and tear of capitalized intangible assets		-3,823	-3,011
Research and Development expenses balanced		-4,499	-4,387
Total operating expenses		-19,600	-19,828
Other operating income	7	1,567	1,204
Operating income/loss		4,132	8,917
Net interest income/loss		-503	-748
Net profit for the year before income taxes		3,629	8,169
Income taxes	8	-1,249	848
Net profit for period		2,380	9,017
Number of shares		3,500,000	3,500,000
Income/loss per share (€)		0.68	2.58
Number of shares (diluted)		3,714,285	3,714,285
Dilution effect out of corporate bond		75	38
Fully diluted income/loss per share (€)		0.66	2.44

Consolidated Cash Flow Statement (IFRS)

in € thousand		
	01.01. – 31.12.2005	01.01. – 31.12.2004
Net profit for period	2,380	9,017
Deprecation of fixed assets	4,798	3,935
Payments for interests	440	425
Increase/decrease in provisions	-1,099	1,036
Change in deferred taxes	1,105	-1,826
Equity changes not affecting liquidity	9	176
Income/loss from the disposal of fixed assets	26	795
Increase/decrease in inventories	2,729	-1,019
Increase/decrease in trade receivables	-1,217	-1,293
Increase/decrease in other assets not attributable to investing or financing activities	65	-99
Increase/decrease in advance payments received	-1,000	-1,805
Increase/decrease in trade liabilities	-121	157
Increase/decrease of interest liabilities from shareholder loans	0	62
Increase/decrease of other liabilities not attributable to investing or financing activities	-254	457
Cash flow from operating activities	7,861	10,018
Proceeds from disposal of property, plant and equipment/intangible assets	168	0
Payments for purchase of property, plant and equipment/intangible assets	-9,154	-8,082
Cash flow from investing activities	-8,986	-8,082
Proceeds from bank borrowing	1,600	0
Payments for the repayment of shareholder loans	0	-4,960
Payments for interests	-440	-425
Proceeds from convertible bond	0	3,000
Cash flow from financing activities	1,160	-2,385
Changes in cash and cash equivalents affecting liquidity	35	-449
Cash and cash equivalents at beginning of period	3,291	3,740
Cash and cash equivalents at end of period	3,326	3,291
Cash and cash equivalents at end of fiscal year		
Cash and cash equivalents	3,326	3,291
Payments for taxes	38	0

FINANCIAL STATEMENTS

Consolidated Balance Sheet (IFRS)

Assets in € thousand			
	Notes	as at 31.12.2005	as at 31.12.2004
Long-term assets			
Fixed assets	10		
Tangible assets		2,643	2,246
Other intangible assets		1,117	557
Capitalization of development		10,785	7,568
Total fixed assets		14,545	10,371
Deferred tax assets	11	8,613	7,083
Total long-term assets		23,158	17,454
Short-term assets			
Cash and cash equivalents	12	3,326	3,291
Short-term receivables	13		
Trade receivables		4,908	6,517
PoC receivables		3,104	277
Total short-term receivables		8,012	6,794
Inventories	14		
Finished goods and commodities		1,282	1,505
Work in process and semi-finished goods		736	1,687
Raw materials and supplies		3,859	5,029
Merchandise		253	639
Total inventories		6,130	8,860
Other receivables and other financial assets	15	615	691
Total short-term assets		18,083	19,636
Total assets		41,241	37,090

Consolidated Balance Sheet (IFRS)

Liabilities in € thousand			
	Notes	as at 31.12.2005	as at 31.12.2004
Equity	17		
Subscribed capital		3,500	3,500
Capital reserve		1,268	1,268
Exchange equalisation		97	90
Net distributable profit		17,106	14,726
Total equity		21,971	19,584
Debt capital			
Long-term debt capital			
Silent partnership		1,023	1,023
Convertible bond		2,727	2,727
Long-term liabilities to banks		526	511
Long-term liabilities to shareholders		30	0
Long-term provisions	18	0	421
Deferred tax liabilities	16	5,751	3,115
Total long-term debt capital		10,057	7,797
Short-term debt capital			
Short-term liabilities to banks	19	4,100	2,500
Notes payable to shareholder's equity		136	97
Advance payments received		528	1,528
Trade liabilities		1,592	1,713
Other liabilities	20	884	1,220
Tax provisions	18	436	694
Provisions	18	1,537	1,957
Total short-term debt capital		9,213	9,709
Total debt capital		19,270	17,506
Total liabilities		41,241	37,090

FINANCIAL STATEMENTS

Fixed Assets (IFRS)

in € thousand	Acquisition costs				
	As at 01.01.2005	Additions	Disposals	Rebookings	Differences from currency conversion
Tangible assets					
Land and buildings on third-party land	297	88	0	0	0
Technical equipment and machinery	3,623	372	-308	24	14
Other furniture, fixtures and equipment	2,358	194	-85	12	34
Assets under construction	62	442	0	-36	0
Total tangible assets	6,340	1,096	-393	0	48
Intangible assets					
Software, trademark rights, patents and licences	1,602	444	-133	8	2
Finished own developments	7,975	2,257	-3,767	3,018	0
Own developments in progress	3,978	4,927	0	-3,018	0
Payments for third-party developments	134	431	0	-8	0
Total intangible assets	13,689	8,059	-3,900	0	2
	20,029	9,155	-4,293	0	50

Consolidated Statement of Changes in Shareholders' Equity (IFRS)

in € thousand	Subscribed capital	Capital reserve	Exchange equalisation
Equity as at 1 Jan. 2004	3,500	995	-87
Difference from currency conversion			177
Net profit for the year			
Issue of convertible bond		273	
Equity as at 31 Dec. 2004	3,500	1,268	90
Difference from currency conversion			7
Net profit for the year			
Equity as at 31 Dec. 2005	3,500	1,268	97

Depreciation					Net book values		
As at 31.12.2005	As at 01.01.2005	Additions	Disposals	Differences from currency conversion	As at 31.12.2005	As at 31.12.2005	Previous year
385	99	31	0	0	130	255	198
3,725	2,659	385	-300	9	2,753	972	964
2,513	1,336	253	-53	29	1,565	948	1,022
468	0	0	0	0	0	468	62
7,091	4,094	669	-353	38	4,448	2,643	2,246
1,923	1,179	306	-124	2	1,363	560	423
9,483	4,385	3,823	-3,623	0	4,585	4,898	3,590
5,887	0	0	0	0	0	5,887	3,978
557	0	0	0	0	0	557	134
17,850	5,564	4,129	-3,747	2	5,948	11,902	8,125
24,941	9,658	4,798	-4,100	40	10,396	14,545	10,371

Income generated	Total
5,709	10,117
	177
9,017	9,017
	273
14,726	19,584
	7
2,380	2,380
17,106	21,971

FINANCIAL STATEMENTS

Notes to the Consolidated Financial Statements as at 31.12.2005

I. GENERAL INFORMATION

1. The Company

Ahrensburg, Germany-based Basler AG and its subsidiaries develop, manufacture and sell artificial vision technology. The company's quality assurance systems and components play a key role in the optimization of industrial manufacturing processes.

The Group operates in five different markets: optical media, rubber and elastomer, flat-screen display, foils and vision components. It has subsidiaries in the USA (Basler Inc.), Taiwan (Basler Vision Technologies Inc.) and Singapore (Basler Asia Pte. Ltd.). Besides its domestic turnover, Basler predominantly generates sales in the USA and in Asia. The company's main customers are industrial undertakings.

Since 23 March 1999, Basler AG has been listed at the Frankfurt stock exchange.

2. Compliance with IFRS

The consolidated financial statements of Basler AG have been prepared for the first time according to the IFRS rules taking into account all standards and interpretations.

Unless otherwise specified, all amounts are stated in thousand Euros (k€).

3. Consequences of the Conversion from US GAAP to IFRS

3.1. Reconciliation of Equity

	1 January 2004	31 December 2004
Equity according to US GAAP	7,135	14,408
Capitalisation of own developments	4,508	7,571
Recognition of revenues according to the percentage-of-completion method	245	226
Recognition of equity component of convertible bond	0	273
Deferred tax assets	263	161
Deferred tax liabilities	-2,047	-3,086
Other	13	31
Equity according to IFRS	10,117	19,584

Main changes

- According to IAS 38, own developments which will result in positive cash flows in the future have been stated on the asset side.
- Unfinished customer orders have been valued according to their percentage of completion.
- According to IAS 32, the equity component of convertible bonds has to be stated.
- Due to the different adjustments between the tax balance sheet and IFRS, deferred tax assets and deferred tax liabilities have been formed.

3.2. Reconciliation of Balance Sheets as at 1 January and 1 December 2004

1 January 2004	US-GAAP	IFRS	Difference
Cash and cash equivalents	3,741	3,741	0
Trade receivables	4,741	5,502	761
Inventories	8,357	7,841	-516
Other receivables	588	588	0
Tangible fixed assets	2,161	2,174	13
Intangible assets	342	4,850	4,508
Deferred tax assets	3,931	4,194	263
Assets:	23,861	28,890	5,029
Equity	7,135	10,117	2,982
Silent partnership	1,023	1,023	0
Long-term liabilities	511	511	0
Long-term provisions	413	413	0
Deferred tax liabilities	7	2,054	2,047
Short-term liabilities	14,772	14,772	0
Liabilities:	23,861	28,890	5,029

31 December 2004	US-GAAP	IFRS	Difference
Cash and cash equivalents	3,291	3,291	0
Trade receivables	6,517	6,794	277
Inventories	9,289	8,860	-429
Other receivables	690	691	1
Tangible fixed assets	2,216	2,246	30
Intangible assets	554	8,125	7,571
Deferred tax assets	6,922	7,083	161
Assets:	29,479	37,090	7,611
Equity	14,408	19,584	5,176
Silent partnership	1,023	1,023	0
Convertible bond	3,000	2,727	-273
Long-term liabilities	511	511	0
Long-term provisions	421	421	0
Deferred tax liabilities	29	3,115	3,086
Short-term liabilities	10,087	9,709	-378
Liabilities:	29,479	37,090	7,611

FINANCIAL STATEMENTS

Main changes

- Pursuant to IFRS, receivables calculated according to the percentage-of-completion method are also stated under **trade receivables**.
- Unfinished customer orders have been deducted from **inventories** because they are stated under receivables.
- Slightly different depreciation parameters have been applied for **tangible fixed assets**.
- The own developments stated on the asset side pursuant to IAS 38 have been included in the **intangible assets**.
- The extended differences to the tax balance sheet are stated under **deferred tax assets and deferred tax liabilities**.
- For the differences in **equity**, reference is made to section 3.1 Reconciliation of equity.
- The **convertible bond** has been reduced by its equity component.
- Advance payments for which a receivable has been stated according to the percentage-of-completion method have been deducted from **short-term liabilities**.

3.3. Reconciliation of the Net Profit for the Year

	2004
Net profit for the year according to US GAAP	7,133
Recognition of revenues according to the percentage-of-completion method	-49
Capitalization of company-produced intangible assets	3,059
Deferred taxes	-1,150
Other	24
Net profit for the year according to IFRS	9,017

4. Scope and Method of Consolidation

4.1. Scope of Consolidation

All major subsidiaries directly or indirectly controlled by Basler AG pursuant to IAS 27 have been included in the consolidated financial statements.

Companies under common control within the meaning of IAS 31 (joint ventures) are accounted for using proportional consolidation.

Significant associates are accounted for using the equity method according to IAS 28 if significant influence can be exercised on them.

An overview of subsidiaries and shareholdings is provided under no. 28 below.

4.2. Harmonisation

The financial statements to be consolidated of Basler AG as parent company and the subsidiaries included in the consolidation have been prepared using uniform accounting and valuation methods.

4.3. Use of Estimates

The preparation of consolidated financial statements in accordance with IFRS requires the management to make estimates and assumptions regarding the recognition and amount of assets and liabilities, the disclosure of contingent assets and liabilities as at the reporting date and regarding the amount of turnover and expenses reported during the period under review. The actual results may deviate from these assessed values.

4.4. Currency Conversion

The functional currency of the subsidiaries is the currency of the respective country, except for Basler Asia PTE LTD whose balance sheet is prepared in Euros. Consequently, on the balance sheet date, assets and liabilities were converted into Euros using the applicable exchange rate on the reporting date. Turnover and expenses were converted using the average exchange rate of the reporting period. Accumulated exchange rate gains and losses are reported as a separate component of the equity capital.

Business transactions denominated in foreign currencies in the individual financial statements of the consolidated companies were converted at the exchange rate applicable on the reporting date of the transaction. In 2005 and 2004, gains amounting to € 285 thousand and € 299 thousand and losses of € 202 thousand and € 346 thousand arose respectively. These gains and losses are reported under General Administrative Expenses in the respective annual financial statements.

Transactions within the European Union are recorded using the applicable fixed Euro exchange rates. Further relevant exchange rates are listed below:

Exchange rate as per		
	31/12/2005	31/12/2004
Euro I	US Dollars 1.1797	US Dollars 1.3621
Euro I	New Taiwan Dollars 39.02881	New Taiwan Dollars 43.63351

Average exchange rates		
	2005	2004
Euro I	US Dollars 1.24410	US Dollars 1.2439
Euro I	New Taiwan Dollars 40.0674	New Taiwan Dollars 41.6154

Source: All exchange rates from the European Central Bank with the exception of the new Taiwan Dollar which is based on the Interbank spot rate.

4.5. Capital Consolidation

Capital consolidation is performed according to the purchase method which provides for the acquisition costs of the shareholding to be applied against the proportionate equity capital at the time of acquisition. Assets and debts of the subsidiaries are stated at their fair value, provided the fair values to be applied are higher than the respective book values.

4.6. Intra-group Balances

All intra-group profits and losses, sales revenues, expenses and income as well as accounts payable and receivable and/or provisions are eliminated. Tax deferrals according to IAS 12 are applied on consolidation adjustments impacting the revenue results.

FINANCIAL STATEMENTS

5. Accounting and Valuation Methods

Income and expenses are recorded in the period in which they arose. Customer production contracts (construction contracts) are reported according to the percentage-of-completion method (PoC method). The applicable percentage of completion is determined on the basis of the cost-to-cost method. Contracts are either recorded on the asset side under "Receivables from PoC" or under the liability side under "Liabilities from PoC". Where the accumulated performance exceeds the advance payments, contracts are recorded on the asset side; in the opposite case, they are recorded on the liability side.

Accounts receivable and other financial assets are recorded on the asset side at acquisition costs as at the settlement date. Should the recoverability of an account receivable be at risk, specific valuation adjustments are made to it.

Where the fair value of **financial assets** and debts is applied or stated, it is generally determined on the basis of the market or stock-exchange value. Should no active market exist, the fair value is determined on the basis of acknowledged methods of financial mathematics.

Raw materials and supplies, merchandise as well as unfinished and finished products are stated under **inventories**, unless they are attributable to a customer order. They are stated at acquisition cost on the basis of average prices or at production cost. In addition to the prime costs, the production costs include appropriate portions of the necessary material and indirect production costs as well as depreciation due to manufacturing which is directly attributable to the production process. Lower net selling prices will be written down on. Interest on borrowed capital is not stated on the asset side.

All inventories at the Ahrensburg site and the accounts receivable have been pledged to the banking consortium.

Tangible assets are generally valued at acquisition or production cost reduced by scheduled straight-line depreciation. The useful life applied for this purpose corresponds to the expected period of use of the assets within the company. Residual values have been neglected in the calculation of depreciations due to insignificance. Revaluations of the tangible fixed assets have not been performed.

Scheduled depreciation of tangible fixed assets is mainly based on the following useful lives:

Asset	Useful life in years
Fixtures installed by the lessee	3 to 14 years (end of the lease agreement)
Technical equipment and machinery	3 to 5, 7 and 10
EDP equipment and systems	3 to 5

Intangible assets acquired against remuneration, mainly software, are stated on the asset side and depreciated over their scheduled useful life of three years.

Development costs for future products from which Basler will probably receive a benefit in the future are stated on the asset side at production cost and depreciated as scheduled over their useful life of three years using the straight-line method. In accordance with IAS 36, the value maintained by the company-produced intangible assets is monitored.

Liabilities from financing lease agreements are stated at the net present value of the lease payments at the time of conclusion of the contract while other liabilities are reported at the repayment value and/or at amortised costs.

A **lease** is classified as operating lease if essentially all risks and opportunities associated with ownership therein remain with the lessor.

Deferred taxes are formed pursuant to IAS 12 for valuation differences between the tax balance sheets of the individual companies and the consolidated financial statements. Tax-loss carry-forwards which are likely to bring a benefit in the future are stated on the asset side in the amount of the deferred tax claim.

The **cash flow statement** is prepared in compliance with the provisions of IAS 7. The cash flow statement is divided into operating, investing and financing activities. The cash-flow statements are prepared in accordance with the indirect method.

Convertible bonds are divided into their equity and their debt capital component pursuant to IAS 32.31 et seq. and reported accordingly.

The operating cash flow comprises the cash flows from the operating business and the investing activities.

II. ITEMS OF THE ANNUAL FINANCIAL STATEMENTS

PROFIT AND LOSS STATEMENT

6. Sales Revenues

The sales revenues amounting to € 44,973 thousand (previous year: € 52,215 thousand) include revenues from customer orders determined according to the PoC method in the amount of € 3,894 thousand (previous year: € 103 thousand).

7. Other Operating Income

Other operating income comprises:

€ thousand	2005	2004
Rental income	847	648
Currency exchange gains	439	299
Income from the release of provisions	208	39
Income from allowance for accounts	0	39
Other	73	179
	1,567	1,204

7a. Interests

€ thousand	2005	2004
Interest income	15	25
Interest expenses	-518	-773
	-503	-748

FINANCIAL STATEMENTS

8. Earnings Taxes

Both taxes paid or owed on income/revenues and deferred taxes are stated as earnings taxes.

Any income obtained is stated as negative amount.

€ thousand	2005	2004
Current taxes from consolidated companies	170	384
Deferred taxes from consolidated companies (income-)	1,079	-1,232
Tax expense/income	1,249	-848

€ thousand	2005	2004
Deferred taxes from losses carried forward	-857	-2,914
Deferred taxes from temporary differences	1,936	1,682
Deferred tax expense/income	1,079	-1,232

As at 31 December 2003, the deferred tax assets were reduced by a valuation adjustment because their realization was in doubt. Due to the fact that the turnaround target has been achieved, the tax-loss carry-forwards are expected to be utilised in the future. Consequently, a reason for valuation adjustments no longer exists.

9. Additional Information

9.1. Production Contracts

The accumulated costs of production contracts in progress on the reporting date amount to € 2,189 thousand (previous year: € 429 thousand), the accumulated profits reported amount to € 2,362 thousand (previous year: € 228 thousand).

9.2. Unscheduled Depreciation/Amortisation of Fixed Assets

€ thousand	2005	2004
Tangible assets	0	23
Intangible assets	295	0
	295	23

The valuation adjustment for intangible assets refers to capitalised developments no longer used.

9.3. Personnel Costs

€ thousand	2005	2004
Wages and salaries	15,986	15,035
Social security contributions	2,981	2,686
	18,967	17,721

9.4. Cost of Materials

€ thousand	2005	2004
Expenses on raw materials and supplies, purchased goods	14,369	17,058
Expenses on purchased services	463	732
	14,832	17,790

BALANCE SHEET

10. Development of Fixed Assets

As at 31 December 2005, Basler used fully depreciated fixed assets representing an acquisition value of € 3,062 thousand (previous year: € 3,640 thousand).

For more details on the development of fixed assets, reference is made to the separate explanation.

11. Deferred Taxes

€ thousand	31.12.2005	31.12.2004
Deferred tax assets		
from tax-loss carry forwards	7,440	6,583
Inventories	817	369
Receivables	0	77
Other	356	54
	8,613	7,083
Deferred tax liabilities		
Capitalization of development	4,027	2,826
Receivables	1,700	256
Other	24	33
	5,751	3,115

FINANCIAL STATEMENTS

The following is a breakdown of the effective tax burden which is calculated using the German corporate income tax rate of 26.38% plus trade tax taking into account the respective deduction of tax relief, thereby resulting in a combined statutory tax rate of 37.34%:

	2005	2004
Tax reconciliation		
Net profit for the year before income taxes	3,629	8,159
Applicable tax rate	37.34%	37.34%
Tax expense expected	1,355	3,047
Tax rate deviations		
Effects of tax rate changes	0	201
Release of valuation adjustment	0	-4,004
Effects from foreign subsidiaries	3	-56
Other	-109	8
Actual tax expense/income	1,249	-848
Effective tax rate	34.42%	-10.40%

As per 31 December, the following tax loss carry forward existed (in € thousand):

	As per 31.12.2005	As per 31.12.2004
Germany	19,940	17,700
USA, federal level	187	348
Singapore	0	0
Taiwan	0	0
Total	20,127	18,048

The tax loss carry forward in Germany refers to corporate income tax and municipal trade tax and applies for an indeterminate period of time. Due to the statutory situation, out of the total loss carry forward, a maximum of € 1,000 thousand plus 40% of the excess tax profit can be utilised per year.

The tax loss carry forwards from the USA are limited until 2023.

12. Cash and Cash Equivalents

Cash and cash equivalents comprise cash on hand and in banks in an amount of € 3,326 thousand (previous year: € 3,291 thousand).

13. Receivables

Receivables include € 4,551 thousand (previous year: € 657 thousand) of receivables arising from PoC. Advance payments received total € 1,975 thousand (previous year: € 1,908 thousand) from which € 1,447 thousand (previous year: € 380 thousand) have been deducted under receivables arising from PoC.

The value of receivables was adjusted by € 56 thousand (previous year: € 120 thousand). In fiscal year 2005, valuation adjustments credited to income amounted to € 91 thousand (previous year: € 16 thousand).

14. Inventories

As per 31 December 2005, inventories included valuation adjustments of € thousand 1,698 (previous year: € thousand 1,247), including € thousand 452 for fiscal year 2005 (previous year: € thousand 140).

Finished products and merchandise are devices made available to customers temporarily for testing and demonstration purposes or on a loan basis worth € thousand 558 (previous year: € thousand 1,192). This manner of reporting facilitates the handling of the future sale to the customer. Devices used for demonstration purposes over an extended period of time, e. g. for trade fairs and exhibitions, are stated under fixed assets and are written off over their useful life which amounts to three years.

15. Other Assets

Other assets are composed as follows:

€ thousand	31.12.2005	31.12.2004
Tax receivables	315	368
Deferred charges	119	86
Derivative financial instruments	0	49
Other	181	188
	615	691

16. Operating Leasing

The company building and parts of the furniture, fixtures and equipment are used under operating leases. The future annual rental and leasing payments based on non-cancellable operating leases and rentals amount to a minimum of:

Fiscal year	€ thousand
2006	2,354
2007 – 2010	8,995
From 2011	17,526

During the year under review, the rent/leasing expenses amounted to € thousand 2,590 (previous year: € thousand 2,795).

Basler will receive at least the following rental payments per year from subleasing the office building in Ahrensburg under contracts that have been concluded and are non-cancellable:

Fiscal year	€ thousand
2006	686
2007 – 2010	847
From 2011	11

FINANCIAL STATEMENTS

17. Equity

17.1. Subscribed Capital

The registered share capital of the company amounts to € 3,500,000 and is divided into 3,500,000 no-par-value shares. The shares are in bearer form.

The shares of Basler AG have been listed at the Frankfurt stock exchange since 23 March 1999.

17.2. Capital Reserve

The capital reserve contains mainly the share premium from the capital increase carried out in the context of the IPO in 1999.

17.3. Employee Participation Scheme

The company has set up employee participation schemes. Inter alia, these schemes aim to recruit and retain personnel and to promote corporate success by offering the staff an opportunity to acquire ordinary shares.

According to the 1999 share option plan ("1999 Plan"), the company was authorised to issue 80,094 options for the subscription of Basler shares to employees of Basler AG in Ahrensburg and its affiliates by 22 March 1999. This option plan has been realized. The subscription rights entitle holders to acquire company shares at a price of € 57 and can be exercised in four tranches after approx. two, three, four and five years.

The options offered under the "1999 Plan" can only be exercised if the value increase on the Basler share at least corresponds to the performance of the Nemax at certain fixed points in time (contractual condition). This performance is determined on the basis of the average share price in the five trading days preceding the first exercise period compared to the first listed price.

The 2000 share option plan ("2000 Plan") authorizes the company to issue 78,000 options for the subscription of Basler shares to employees of Basler AG in Ahrensburg and its affiliates. This option plan has been realized. The subscription rights entitle holders to acquire company shares at a price of € 75 (the average price of the last five trading days in October; the time the scheme was launched) and can be exercised in four tranches after approx. two, three, four and five years.

The options offered under the "2000 Plan" can only be exercised if the value increase on the Basler share at least corresponds to the performance of the Nemax at certain fixed points in time (contractual condition). This performance is determined on the basis of the average share price in the five trading days preceding the first exercise period compared to the exercise price of the subscription rights. All options from these schemes that have not been exercised after the end of the last exercise period will expire.

The following table presents the status of the company's share option schemes as at 31 December 2005:

	2005		2004	
	Number of options	Average exercise price	Number of options	Average exercise price
In circulation on 1 Jan.	41,590	75,00	76,808	67,40
Granted	—	—	—	—
Exercised	—	—	—	—
Expired	41,590	75,00	35,218	58,43
In circulation on 31 Dec.	—	—	41,590	75,00
Exercisable at the end of the year	—	—	—	—

17.4. Authorised Capital

According to § 4 (3) of the Basler Articles of Association, the Management Board is authorised, subject to approval by the Supervisory Board, to increase the registered share capital of the company by 16 June 2008 by issuing up to 1,750,000 new non-par value bearer shares against cash and/or non-cash contributions either once or several times by a total of € 1,750,000.00. The shareholders shall be granted a subscription right for this purpose. However, the Management Board is authorised, subject to approval by the Supervisory Board, to exclude subscription rights of the shareholders for fractional amounts.

17.5. Contingent Capital

- The registered capital is increased by a nominal amount of up to € 350,000.00, divided into up to 350,000 non-par bearer shares (Contingent Capital). This contingent capital increase is intended for the granting of subscription rights to members of the Management Board and employees of the company as well as members of the management and employees of affiliates.
- The registered capital is increased contingently by a nominal amount of up to € 215,000.00, divided into up to 215,000 non-par bearer shares (Contingent Capital II). This contingent capital increase is intended for the granting of refunding rights to the holders of the convertible bond that was issued.

18. Development of Provisions

	01.01.2005	Differences from currency conversion	Allocation	Accumulation	Utilisation	Releases	31.12.2005
Personnel costs	1,086	-19	776	0	1032	35	776
Impending losses, building	451	0	0	0	451	0	0
Taxes	694	-10	86		203	131	436
Warranty	182	0	139	0	182	0	139
Legal and consultancy costs	136		42		70	13	95
Other	523		219		186	29	527
	3,072	-29	1,262	0	2,124	208	1,973

The provisions for personnel costs were made mainly for profit-participation bonuses for the reporting year, for holiday leave carried forward and for flexi-time balances.

The tax provisions were made for the tax burden on the profit/loss for the reporting year and any previous years. They could be reduced due to a tax-loss carry back.

19. Financial Liabilities

Basler reports the following financial liabilities (€ thousand):

Description	Interest condition	Interest rate	End of term	Repayment sum
Silent partnership	Fixed	12%	31.12.2011	1,023
Convertible bond	Fixed	4%	31.07.2007	2,727
Loans	Fixed	12%	30.03.2012	511
Fixed-rate loan advances	Fixed	3.93% – 4.65%	09.01.2006 – 27.06.2006	4,100

The fair values to be applied do not substantially deviate from the book values stated.

FINANCIAL STATEMENTS

20. Derivative Financial Instruments

As a company acting on global markets, Basler is exposed to a number of market risks. In order to reduce currency risks, Basler uses forward exchange dealings. As these dealings are intended as security for underlying operating transactions, their term is less than one year in each case.

The following items existed as at the respective balance-sheet dates (in € thousand):

	31.12.2005	31.12.2004
Nominal volume	2,000	2,400
Fair value		
Positive	–	49
Negative	30	–

Positive fair values are stated under short-term other assets and negative fair values under short-term other financial liabilities.

The maximum risk of default corresponds to the book values entered in the balance sheet (reduced by the valuation adjustments taken into account as at the balance sheet date, if any) of each financial asset, including derivative financial instruments. As the contractual partners for derivatives are renowned financial institutions, it can be assumed that the liabilities under derivative transactions will be met.

CASH FLOW STATEMENT

21. Credit Lines

Credit lines in an amount of € thousand 9,900 were available to Basler as at the balance-sheet date. € thousand 4,100 of these had been utilised in the form of fixed-rate loan advances.

III. ADDITIONAL INFORMATION

22. Type and Management of Financial Risks

22.1. Derivative Financial Instruments

As at the balance sheet date, US Dollar forward transactions in an amount of k€ 2,000 with a residual term of less than one year were in place for exchange hedging. The negative fair value stated under other assets amounted to k€ 30 according to market evaluation.

22.2. Risk of Counter-party Default

Basler continuously monitors its customers' credit standing using internal and external assessments. In addition, the risk associated with trade receivables is reduced to some degree by the fact that the company's regular customers are highly diversified. Furthermore, the company operates a clearly defined process to follow up on outstanding receivables. A credit-line structure supported by the ERP system with documented escalation levels is used to limit the risk even further.

23. Segment Report

23.1. Primary Segmentation

Basler has two divisions that operate in the Vision Technology market:

- Vision Systems develops and markets turn key quality inspection systems for mass production in various industries.
- The second business division, Vision Components, develops and sells digital camera solutions for original equipment manufacturing customers (manufacturers of capital goods) in the market segments of machine vision, medical engineering and intelligent traffic systems.

The company's products are mainly developed on its premises in Ahrensburg and are sold through a direct distribution structure, through the subsidiaries (USA, Singapore and Taiwan) and through independent distributors in Europe, North America, Australia, Japan and Asia.

The information contained in the overviews has been taken directly from the internal reports that are used for management purposes by the company's highest operative decision-makers. The company does not evaluate individual segments on the basis of financial liabilities and respective interest expenses for internal control purposes; consequently, the segment reports do not include such evaluations.

Segment assets are direct operating receivables, inventories and the fixed assets used for the company's business operations. Segment liabilities are the advance payments received attributable to business operations, trade liabilities as well as provisions.

The business developed as follows during the reporting year (all amounts stated in € thousand):

	Vision Systems		Vision Components		Reconciliation		Whole Group	
	2005	2004	2005	2004	2005	2004	2005	2004
Segment revenues	29,133	35,794	15,840	16,421	0	0	44,973	52,215
Segment results (EBIT)	2,219	5,818	2,255	2,196	-344	904	4,130	8,918
Segment assets	17,398	15,850	8,873	6,863	2,416	3,313	28,687	26,026
Segment liabilities	503	1,947	72	7	3,518	4,358	4,093	6,312
Segment investments	5,212	4,317	2,982	2,926	961	839	9,155	8,082
Segment depreciations	2,765	2,399	1,255	821	778	715	4,798	3,935

23.2. Secondary Segmentation

Basler's secondary segmentation is based on the place of production.

	Europe		Reconciliation		Group	
	2005	2004	2005	2004	2005	2004
Segment revenues	44,973	52,215	0	0	44,973	52,215
Segment assets	26,271	22,713	2,416	3,313	28,687	26,026
Segment investments	8,194	7,243	961	839	9,155	8,082

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24. Number of Employees

The average number of employees in each functional area is shown in the table below:

	2005	2004
Manufacturing	68	59
Distribution	100	91
Development	114	95
Administration	70	64
	352	309

25. Remuneration of Auditors

In 2005, the company paid its auditors, BDO Deutsche Warentreuhand Aktiengesellschaft, a fee of € 77,228.53 (previous year: € 52,069.70).

26. Related Persons

26.1. Loans from Shareholders and Affiliated Persons:

In fiscal year 2004, the company repaid loans amounting to € thousand 4,960 that had been extended in 2001/2003 by the following three shareholders/affiliated persons:

	Amount in € thousand	p.a. interest rate 2004
Monika Proske-Ley	204.5	9%
Monika Proske-Ley	90.0	9%
Nicola-Irina Basler	1,840.7	9%
Norbert Basler	780.0	9%

26.2. Convertible Bond

The following affiliated persons hold shares in the convertible bond issued in 2004:

	Amount in €
Nicola-Irina Basler	1,496,698.00
Monika Proske-Ley	333,200.00
Peter Krumhoff	63,798.00

The applicable conditions are the same as those applying to third parties.

27. Management Board and Supervisory Board

27.1. Management Board

In 2005, the Management Board consisted of the following members:

- **Dr. Dietmar Ley**, Ahrensburg
CEO, Product Development and Personnel
- **Axel Dancker**, Ahrensburg
Operations (until 31 January 2005)
- **John P. Jennings**, Ambler, USA
Product Distribution and foreign subsidiary (since 1 February 2005)
- **Peter Krumhoff**, Großhansdorf
Finance and Production

Mr. Krumhoff is the Deputy Chairman of the Supervisory Board of TETENAL AG of Norderstedt.

27.2. Supervisory Board

The Supervisory Board consisted of the following members in 2005:

Norbert Basler

Chairman of the Supervisory Board (since 1 July 2004)
Deputy Chairman of the Supervisory Board (until 1 July 2004)
Master's degree in engineering

Konrad Ellegast

Deputy Chairman of the Supervisory Board (until 22 June 2005)
Consultant

Bernd Piske

Master's degree in business studies, Member of the Management Board of M.A.X. Automation AG, Düsseldorf

Further assignments of the Supervisory Board members in 2005 pursuant to Sec. 285 No. 10 of the German Commercial Code [Handelsgesetzbuch – HGB]

Norbert Basler

Member of the Supervisory Board of Kuhnke GmbH, Malente
Deputy Chairman of the Supervisory Board of Plato AG, Lübeck

Konrad Ellegast

Member of the Supervisory Board of Phoenix AG, Hamburg
Member of the Supervisory Board of Technotrans AG Sassenberg
Member of the Supervisory Board of Feuerkasse AG, Hamburg
Member of the Advisory Board of C. Mackprang Jr. GmbH & Co. KG, Hamburg
Member of the Advisory Board of RIBE Richard Bergner Verbindungstechnik GmbH, Schwabach

FINANCIAL STATEMENTS

27.3 Remuneration of the Management Board and Supervisory Board members

In fiscal year 2005, the total remuneration of the Management Board members amounted to € 475 thousand (previous year: € 668 thousand), including € thousand 0 (previous year: € 207 thousand) variable; the Supervisory Board members received emoluments in the amount of € 39 thousand (previous year: € 40 thousand).

28. Breakdown of Participating Interests

In addition to Basler AG, the following companies have been included in the consolidated financial statements through full consolidation:

	Interest held [%]	Equity [€ thousand]	Net profit for the year [€ thousand]
Basler Inc., Exton/USA	100	447	155
Basler Asia Pte. Ltd., Singapore/Singapore	100	988	383
Basler Vision Technologies Taiwan Inc., Taipei/Taiwan	100	-341	-71

Further participating interests are not held.

29. Corporate Governance

The company has made its Declaration of Compliance with the German Corporate Governance Code which is mandatory under Section 161 of the German Stock Corporation Act [Aktiengesetz – AktG]. The declaration is available to shareholders on the company's Internet site at www.baslerweb.com.

We have audited the consolidated financial statements of Basler Aktiengesellschaft, Ahrensburg, consisting of the balance sheet, income statement, notes, cash flow statement and schedule of movement in consolidated equity, as well as the management report, for the financial year 1 January to 31 December 2005. The preparation of the consolidated financial statements and management report in accordance with the International Financial Reporting Standards (IFRS) as applicable in the EU and the supplementary provisions under Section 315a Par. 1 HGB (German Commercial Code) are the responsibility of the company's legal representatives. It is our responsibility to prepare an evaluation of the consolidated financial statements and the management report based on our audit. In addition, we were commissioned to assess whether the consolidated financial statements have generally been prepared in accordance with IFRS.

Our audit of the consolidated financial statements according to Section 317 HGB has been conducted in compliance with German audit regulations and the generally accepted standards set forth by the Institute of Accountants (Institut der Wirtschaftsprüfer (IDW)). These standards require that we plan and perform the audit such that errors and misstatements materially affecting the presentation of the net assets, financial and earnings position in the annual financial statements in accordance with the applicable principles of proper accounting and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the group and evaluations of possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the management report are examined primarily on a test basis within the framework of the audit. The audit involves an evaluation of the financial statements of the companies included in the consolidated financial statements, the definition of the consolidated group, the accounting and consolidation principles applied and material statements made by the company's legal representatives as well as an overall appraisal of the consolidated financial statements and the management report. We are of the opinion that our audit provides a sufficient and solid basis for our evaluation.

Our audit has not led to any reservations.

In our opinion, the consolidated financial statements comply with the IFRS as applicable in the EU, the supplementary provisions under Section 315a Par. 1 HGB and the IFRS in general and provide a true and fair view of the net assets, financial and earnings positions of the group. The management report is consistent with the consolidated financial statements and, on the whole, provides an accurate understanding of the group's position as well as suitably presenting the opportunities and risks of future development."

We have prepared the above report in compliance with the applicable legal provisions and the principles of orderly audit reporting.
Lübeck, 10 February 2006

BDO Deutsche Warentreuhand

Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Dr. Probst
Certified Accountant

ppa. Beecker
Certified Accountant

REPORT OF THE SUPERVISORY BOARD

Dear Sir/Madam, dear shareholders,

During fiscal year 2005 which has just ended, the Supervisory Board fulfilled the tasks incumbent on it by law and the company's articles of association which consisted of monitoring and advising the Management Board in its management activities. The Management Board regularly provided the Supervisory Board with written and oral reports on the economic position of Basler AG, its foreign subsidiaries and its divisions and discussed the business and economic situation in detail. In fiscal year 2005, four scheduled meetings took place which were attended by all Supervisory Board members (with one exception): On 24 February 2005, 22 June 2005, 12 September 2005 (which was not attended by Mr. Priske) and 9 December 2005.

Due to the limited size of the Supervisory Board (three members), committees as defined by Section 171 Par. 2 Sentence 2 of the German Stock Corporation Act were not formed.

The Management Board and the Supervisory Boards cooperate closely for the benefit of the company. This cooperation is based on open discussions and mutual trust. The Management Board consulted with the Supervisory Board on the company's strategic orientation and kept it informed on the progress of implementation. The Supervisory Board participated in all decisions of fundamental importance to the company. The Management Board regularly informed the Supervisory Board of all relevant issues concerning business development and the company's risk situation. The Chairman of the Supervisory Board is in regular contact with the CEO and was informed by him of all current developments and extraordinary events. The Supervisory Board approved all transactions that were subject to its approval according to the law and the articles of association. This involved decisions and measures of fundamental importance to the company's net asset, financial and income position. Inter alia, the following issues were dealt with:

- Discussion and adoption of the 2004 annual financial statement and of the proposals for the general shareholders' meeting
- Cyclical and market-specific developments and their effects on the company's earnings and turnover situation
- Identification and exploitation of further potential in the vision technology market in order to implement the growth strategy
- Planning and budgeting for the segments and the entire group
- Commitment to the Corporate Governance Code

BDO Deutsche Warentreuhand Aktiengesellschaft Wirtschaftsprüfungsgesellschaft which was appointed auditor of the annual financial statements by the general shareholders' meeting on 22 June 2005 was instructed by the Chairman of the Supervisory Board to carry out the audit by a letter of 9 May 2005. The auditor attended the Supervisory Board meeting on 23 February 2006 during which the annual financial statements presented were discussed and delivered a report regarding the main results of his audit.

The auditors BDO Deutsche Warentreuhand AG, Lübeck, audited the accounting records, the annual financial statements as at 31 December 2005 and the management report of Basler AG as well as the consolidated financial statements as at 31 December 2005 and the consolidated management report, found them in conformity with the law and the articles of association and issued them with an unqualified audit certificate. The Supervisory Board took note of the audit results and approved them.

Within the scope stipulated by law, the Supervisory Board also reviewed the annual financial statements, the consolidated financial statements, the management report and the consolidated manage-



Norbert Basler (Chairman of the Supervisory Board)

ment report. No objections were raised. The Supervisory Board approved and thereby adopted Basler AG's annual financial statements as prepared by the Management Board.

In accordance with the Corporate Governance Code, the Supervisory Board regularly reviewed the efficiency of its work and enhanced it in connection with useful changes to the preparation and design of documents of these meetings.

The Supervisory Board members do not act as consultants to, or hold officer positions in, executive bodies of clients, suppliers, lenders or other business partners. Consequently, conflicts of interest did not arise during the past fiscal year.

The auditor of the annual financial statements audited the management report concerning relationships to affiliated companies which had been prepared in accordance with Section 312 of the German Stock Corporation Act, and issued the following audit certificate: "Having carried out our audit and evaluation in accordance with the applicable regulations, we hereby confirm that

- the actual information given in the report is correct and
- with respect to the legal transactions recorded during the year under review, the company's performance was not inadequately high."

The Supervisory Board also took note of and approved this audit report as prepared by the auditor. After drawing the final conclu-

sion of its own audit, it declared that no objections had arisen as to the explanations by the Management Board regarding the relationships to affiliated companies.

In the fiscal year just ended, the composition of the Supervisory Board changed. At the meeting on 22 June 2005, Mr. Bernd Priske, CEO of M.A.X. Automation AG in Düsseldorf, resigned from his office as deputy chairman and remained in the Supervisory Board as ordinary member. Thereupon Mr. Konrad Ellegast of Ötjendorf was appointed as the new deputy chairman of the Supervisory Board.

In the fiscal year just ended, the company achieved a good result in a difficult business environment and created promising potential for the future. This was made possible by strong performance and a high level of commitment among the employees, the management and Management Board of Basler AG. The Supervisory Board would hereby like to thank the entire staff, the management and the Management Board of Basler AG for their excellent work during the past fiscal year.

Ahrensburg, February 2006
For the Supervisory Board

Norbert Basler
Chairman of the Supervisory Board

DATES

Financial Events

Date	Veranstaltung
1 March 2006	Release of full year results 2005 Annual results press conference Conference call for analysts and investors
4 May 2006	Release of Q1 results 2006 Conference call for analysts and investors
8 May 2006	Annual general meeting, Hamburg, Germany
10 August 2006	Release of Q2 results 2006 Conference call for analysts and investors
8 November 2006	Release of Q3 results 2006 Conference call for analysts and investors

Tradeshows and Conferences

Optical Media Inspection	
30 May – 1 June 2006	MediaTech Expo - Frankfurt, Germany
13 – 15 September 2006	Replication Expo - Shanghai, China
10 – 11 October 2006	Media-Tech Showcase - Long Beach, USA
Sealing Inspection	
19 – 23 June 2006	NPE (International Plastics Showcase) – Chicago, USA
3 – 6 July 2006	DKT (German Rubber Conference) – Nuremberg, Germany
Display Inspection	
14 – 16 June 2006	FPD Taiwan – Taipei, Taiwan
Vision Components	
4 – 6 April 2006	Vision Show East – Boston, USA
13 – 16 June 2006	Nepcon Penang – Malaysia
11 – 13 July 2006	Semicon West – San Francisco, USA
7 – 9 November 2006	Vision - Stuttgart, Germany

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This Annual Report is also available in German. In the event of conflicts the German version shall prevail.

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