# Corporate Governance Report 2006

In 2006 Sabaf S.p.A. adopted the 2006 Corporate Governance Code published by Borsa Italiana (hereinafter, the "Code") and initiated the process of assessing and implementing its recommendations.
The Board of Directors confirmed the Company's adoption of the Code by adopting a Corporate Governance Manual. This manual sets forth the principles, rules, and operating procedures that will enable the Company to receive its recommendations. The Corporate Governance Manual, which can be consulted in the Corporate Governance section of the Company website at www.sabaf.it, was adopted by resolution of the Board of Directors on December 19th 2006. It is complete with a number of operating guidelines designed to assist the Sabaf Board of Directors, Board of Statutory Auditors, Internal Control and Audit Committee, and Compliance Program Supervisory Committee in properly discharging their duties.

This report has been prepared in accordance with the guidelines set forth in the Code and is organized in accordance with the instructions found in the Guide to Preparation of the Corporate Governance Report published by Assonime and Emittenti Titoli in February 2004.

# PART I – THE SABAF GOVERNANCE STRUCTURE

Sabaf's entrepreneurial model is rendered explicit in our corporate "vision", i.e. to combine business decisions and results with ethical values by going beyond family capitalism and opting for a managerial rationale oriented towards not only the creation of value – but also towards the respect of values

The model adopted is based, in the first place, on the decision to achieve strict separation of the interests and choices of the key shareholder (the Saleri family) from the interests and choices of the Company and Group, consequently entrusting corporate management to managers not forming part of the key shareholder. In order to reinforce this decision, the Saleri family (which, as at December 31st 2006, owned 53.81% of Sabaf SpA's share capital via its holding Company Giuseppe Saleri SapA) has undertaken, also via signature of an accompanying agreement, not to hold, executive offices (e.g. departmental head) within Sabaf Group companies.

Expansion of the shareholder base following listing on the stock exchange, admission to the STAR segment (and consequently the Company's voluntary acceptance of stricter transparency and disclosure rules), and the Company's desire to comply consistently with applicable corporate governance recommendations and best practices represent the subsequent steps taken by Sabaf towards compliance of its corporate governance system with a model whose benchmark is that directors act in the Company's interest and in view of creating value for all shareholders.

As a further step along this path, Sabaf's management believes that ethics founded on the centrality of the individual and respect of shared values, set at the head of the creation of value, are able to orient decisions in a manner consistent with corporate culture and contribute significantly to assuring the Company's sustainable long-term growth. To this end Sabaf has created and published a Charter of Values (available in the Sustainability section of the website, www.sabaf.it) which is considered to be the governance tool via which the Board of Directors renders explicit the Company's values, standards of conduct, and commitments vis-à-vis all stakeholders – shareholders, employees, customers, suppliers, financiers, the public administration, the community, and the environment.

## The Sabaf Management and Control Model

Sabaf has chosen a traditional management and control model, consisting of:

- a Board of Directors responsible for management of Company operations;

- a Board of Statutory Auditors responsible for supervising: (i) compliance with the law and Articles of Incorporation and adherence to principles of proper management in the performance of corporate activities; (ii) the adequacy of the Company's organizational structure, internal control system, and administrative/accounting system; (iii) the procedures for effective implementation of the corporate governance rules envisaged in the Code;

- the Shareholders' Meeting, which is responsible for resolving:
  - on an ordinary basis, approval of the annual report and accounts, appointment and dismissal of directors and statutory auditors, their compensation, and their responsibilities;
  - on an extraordinary basis, amendments to the Articles of Association, and the appointment, substitution, and powers of liquidators.

An independent auditing firm satisfying legal requirements is commissioned to audit the Company accounts. The independent auditor is appointed by the Shareholder Meeting after consultation with the Board of Statutory Auditors.

# PART II – INFORMATION ON IMPLEMENTATION OF THE CORPORATE GOVERNANCE CODE

This section presents a description of the procedures for and degree of application of the recommendations set forth in the Code. In accordance with the general "comply or explain" rule, this section also gives the reasons why any of the application principles and criteria were only partially applied or not at all.

## 1. ROLE OF THE BOARD OF DIRECTORS

The Board of Directors is the core body of the Sabaf corporate governance system. It has the power and duty to manage the Company, pursuing the primary objective of creating shareholder value over the long term, while complying with the values, standards of conduct, and commitments stated in the Sabaf Charter of Values. The Board of Directors accordingly takes all decisions necessary or useful for accomplishing the Company's corporate purpose.

Without prejudice to the exclusive responsibilities and prerogatives envisaged by law and the Articles of Association, the Board of Directors has the following responsibilities:

a) examining and approving the Company's and Group's strategic, business, and financial plans and budgets, taking into account information received from executive directors, as well as the Sabaf corporate governance system and the organization of the Group headed by the Company;

b) delegating and revoking the authority of executive directors, defining the limits, terms and conditions for exercise of their powers, and the frequency (at least once quarterly) with which the delegated officers must report to the Board of Directors on the activities they performed pursuant to their delegations of authority;

c) establishing committees within the Board of Directors, defining their membership and operating procedures, as well as assigning their duties and responsibilities;

d) assessing the Independent Directors' satisfaction of requirements for independence at the time they are appointed and twice annually thereafter;

e) assessing the overall adequacy of the general organizational, administrative, and accounting structure of Sabaf and its core subsidiaries as established by the Chief Executive Officers, with special reference to the internal control system and management of conflicts of interest; in particular, the Board of Directors shall consider the information received from the corporate officers and departments responsible for audit and control of the Company and its core subsidiaries;

f) assessing the Company's general operating performance and underlying corporate risks in light of the information received from executive directors, as well as comparing actual results with what had been forecasted;

g) upon examination of the proposals submitted by the Compensation Committee and consultation with the Board of Statutory Auditors, determining the compensation of directors holding specific offices and individual allocation of the overall compensation owed to members of the Board of Directors, unless the Shareholder Meeting has not already done so;

h) examining and approving on a prior basis those transactions by Sabaf and its subsidiaries that would have a significant impact on its operations, assets, and financial position, especially if they are to be carried out with related parties or involve a potential conflict of interest (in this regard, the Board of Directors adopted Guidelines on February 13th 2007 that define the procedures for approval and execution by the Company and its subsidiaries of significant transactions with related parties or in which a director has a vested interest; reference is made to Section 9 hereunder);

i) reviewing and approving the periodic reports envisaged by applicable laws and regulations;

j) defining the principles for implementation of the Company's social responsibility;

k) at least once a year, assessing the size, membership, and operation of the Board of Directors and its committees, as well as establishing criteria for selection of the specialized professionals whom the Board deems appropriate as new members. Accordingly, on February 13th 2007 the Sabaf Board of Directors approved Guidelines for implementation of the Corporate Governance Manual. After considering various approaches to improving the performance of directors, the Board of Directors decided that the individual directors would evaluate themselves, by filling out and returning specific questionnaires, and then discussing the results with the Board as a whole. The first Board of Directors evaluation will be conducted in 2007.

In regard to the internal control system, which is better described in Section 8 hereunder, the Board of Directors is responsible for:

l) defining and approving the guidelines for the internal control system, so that the principal strategic risks confronting Sabaf and its subsidiaries are properly identified and adequately measured, managed, and monitored;

m) assigning the Sabaf Chief Executive Officer (or another executive director) the task of supervising the performance of the internal control systems of the Company and its core subsidiaries;

n) on motion by the director assigned to supervise performance of the internal control system and after consulting with the Internal Control & Audit Committee, appointing and dismissing one or more Chief Internal Auditors, defining their compensation in accordance with Company policies;

o) approving decisions to establish the internal audit function either within the Company or outsourcing it to external organizations, after assessing their professional qualifications and independence;

p) as part of its responsibilities for assessing the adequacy of the general organizational, administrative, and accounting structure mentioned hereinabove at subsection e), assessing the adequacy, effectiveness, and actual performance of the internal control system at least once annually;

q) adopting the Company Charter of Values, Corporate Governance Manual, Organization Operation and Control Model pursuant to Legislative Decree 231/2001, and the other corporate governance procedures of Sabaf, making the relevant changes and additions, as well as extending these documents and procedures to subsidiaries when deemed appropriate;

r) appointing the Compliance Program Supervisory Committee envisaged in Legislative Decree 231/2001.

The Company Corporate Governance Manual states that core subsidiaries are those subsidiaries that represent at least 25% of the Group's total assets, shareholders' equity, or pre-tax income, as well as those subsidiaries identified by the Board of Directors that, even if they fall short of those thresholds, contribute to development and realization of the Group's policies and strategic plans. None of the subsidiaries of Sabaf S.p.A. was considered a core subsidiary in FY2006.

To ensure that directors would be able to dedicate the time necessary to perform their assigned duties diligently, the Board of Directors passed a resolution on April 28th 2006 that defines the maximum number of positions that each director may hold on the board of directors or board of statutory auditors of companies listed on regulated markets inside and outside Italy, as well as at financial, banking, insurance, or other large companies:

a) executive directors: a maximum of three offices, not counting the positions held within the Group;

b) non-executive directors: a maximum of seven offices, not counting the positions held in the financial companies envisaged in Article 113 of the Italian Consolidated Banking Act ("Testo Unico Bancario").

Except as otherwise envisaged in the Articles of Association, the Board of Directors shall meet periodically, and at least once every quarter, as well as whenever the Chairman deems necessary or appropriate. It shall also meet upon request by the directors and statutory auditors, as envisaged by law and the Articles of Association (i.e. upon request by at least one director or at least two statutory auditors). During FY2006 the Board met eight times.

## 2. MEMBERSHIP OF THE BOARD OF DIRECTORS

The Company Articles of Association envisage that the Shareholder Meeting may determine the number of directors, between a minimum of three and a maximum of fifteen. The high maximum number of directors reflects the need to dispose of a Board of Directors that best meets the needs of the Company. It also allows Sabaf to draw on professionals with different backgrounds and to bring their different skills and expertise together in such a way as to address current and future needs more effectively, while maximizing shareholder value.

The Board of Directors designates the executive and non-executive directors from amongst the directors appointed by the Shareholder Meeting. Executive directors are those who are:

(a) the Chief Executive Officers of Sabaf or its core subsidiaries, including the Chairmen with individual delegations of operating authority or those having a specific role in the development of Company strategies;

(b) directors with management positions at Sabaf or its core subsidiaries.

So that the opinions of non-executive directors carry significant weight in the Board of Directors decision-making process, it is envisaged that a majority of director seats be held by non-executive directors. Sabaf believes that a Board of Directors with a high proportion of highly qualified non-executive and independent directors attests to its concern for the interests of minority shareholders and represents an additional step forward towards assuring the long-term sustainability of Company development.

In order to prevent excessive concentration of power in any one person within the Company, the office of Chairman is kept separate from that of the Chief Executive Officer, who has primary responsibility for management of the Company.

The Annual General Meeting of shareholders held on April 28th 2006 appointed the Board of Directors that holds office until shareholders' approval of the FY2008 annual report and accounts.

The size of Board membership was increased to 11 members, of which the majority (6) are non-executive directors. The following individuals were confirmed as executive directors: Chairman Giuseppe Saleri, Vice Chairman Gianbattista Saleri, Chief Executive Officer Angelo Bettinzoli, and the Chief Financial Officer, Alberto Bartoli. Ettore Saleri, a member of the family that controls the Company, was also designated as executive director. The following individuals were confirmed as non-executive directors: Leonardo Cossu (business expert), Raffaele Ghedini (an expert in scientific and technological research, training, and consulting), Franco Carlo Papa (an expert on corporate governance, finance, and business development, as well as former chairman of AIAF-Associazione Italiana Analisti Finanziari), and Flavio Pasotti (businessman and chairman of Apindustria Brescia). Newly appointed members to the Board of Directors are Salvatore Bragantini (former commissioner at CONSOB) and Alberto Federico Giua (Professor of Product Innovation and Development at the Università Cattaneo in Castellanza). Elio Borgonovi (full professor at the Università Bocconi in Milan) was director until April 28th 2006.

Directors' professional résumés are available on our website www.sabaf.it in the Corporate Governance section.

Below we disclose the offices held by Sabaf directors as directors or statutory auditors of other listed companies, in financial, banking and/or insurance companies, and/or in large companies:

- Giuseppe Saleri is Chairman of Giuseppe Saleri SapA, the financial Company that controls Sabaf SpA;
- Angelo Bettinzoli is a director of Gefran SpA;

- Leonardo Cossu is a director of Leonessa Fiduciaria Srl, Chairman of the Board of Statutory Auditors of Guido Berlucchi & C. SpA, and a statutory auditor of Banca Valori SpA, Bossini SpA, Brawo SpA, Finber SpA, and Infracom Italia SpA;

- Franco Carlo Papa is an independent director of DMT S.p.A., director of IGI SGR S.p.A., Chairman of the Board of Statutory Auditors of Gecofin S.p.A. and Metalwork S.p.A., and statutory auditor of Arnoldo Mondatori Editore S.p.A.

- Salvatore Bragantini is Chairman of APEI SGR S.p.A. and PROMAC S.p.A., Vice Chairman of IW Bank S.p.A., director of Unicredit Banca Mobiliare S.p.A., Interpump Group S.p.A., Aeroporto G. Marconi di Bologna S.p.A., and member of the Supervisory Board of KME (Germany).

*The Chief Executive Officer*

The Chief Executive Officer (CEO), Angelo Bettinzoli, is responsible for running the Company according to the strategic guidelines defined by the Board of Directors. The CEO co-ordinates all corporate functions, assuring a swift decision-making process, together with efficient and transparent management. The CEO is vested with ample delegated powers concerning all operational areas of the Company, with separate powers of signature, within the limit of €1 million per individual transaction.
The CEO reports to the Board at least on a quarterly basis on activities performed and provides a qualitative and quantitative description of any significant, atypical, unusual, or related-party transactions.

*The Chairman and Vice Chairmen*

The Chairman calls meetings of the Board, co-ordinates Board activity and guides proceedings in its meetings. In the case of his impediment, a Vice Chairman performs his functions.
The Chairman and Vice Chairmen are vested with ample delegated powers within the limit of € 500,000 per individual transaction. These powers have been delegated to the Chairman and Vice Chairmen to assure more streamlined management and are specifically designed to ensure that there are never any management "hiatuses" if the CEO is unable to exercise his functions.

*The Lead Independent Director*

Since the Chairman of the Board of Directors is the person in charge of Sabaf, the Board of Directors meeting held on April 28th 2006 designated Franco Carlo Papa as Lead Independent Director. The Lead Independent Director holds this office for the entire term of the Board of Directors and is the principal point of contact and co-ordination for the requests and contributions made by non-executive directors, and in particular independent directors.

The Lead Independent Director collaborates with the Chairman in order to ensure that the Directors receive complete and prompt information regarding adoption of resolutions by the Board of Directors and exercise of its powers of direction, co-ordination, and supervision of Company and Group activities.

In preparation for Board meetings, the Lead Independent Director assists the Chairman in reviewing the documents to be sent in advance to directors and statutory auditors, so that they may offer effectively participate on an informed basis at those meetings, as well as assessing cases where unexpected needs or urgent situations limit the amount of information that can be provided in advance.

The Lead Independent Director also co-ordinates the Board of Directors self-evaluation process.

## 3. INDEPENDENT DIRECTORS

An adequate number of non-executive directors are independent, in the sense that they do not have nor have recently had direct or indirect relationships with Sabaf or parties connected with Sabaf such as to influence their independent judgement.

To ensure the presence of an adequate number of independent directors, Sabaf has adopted the following proportions (which are more restrictive than those required by Borsa Italiana for companies listed in the STAR segment):

(i) when there are up to five members on the Board: at least two independent directors;

(ii) when there are between six and ten members on the Board: at least three independent directors;

(iii) when there are between eleven and fifteen members on the Board: at least four independent directors.

The Sabaf Board of Directors evaluates satisfaction of the requirements for independence by focusing more on substance than on form. Accordingly, a director's independence is compromised when he:

a) owns – directly, indirectly (through subsidiaries, trustees, intermediaries, or otherwise) or on behalf of third parties – equity interests in Sabaf such as to enable him to exercise control or considerable influence over the Company, or is a participant in shareholders agreements for the control or exercise of considerable influence over Sabaf;

b) holds, or has held in the previous three fiscal years, a significant position at Sabaf, one of its core subsidiaries, or a joint venture of Sabaf, or at a Company or organization that, either singly or with others through a shareholders agreement, controls Sabaf or is able to exercise considerable influence over it. In this context, a "significant position" at Sabaf means the office of Chairman, Vice Chairman, executive director, or executive with strategic responsibilities (hereinafter, "key managers");

c) has or has had – directly, indirectly (e.g. through subsidiaries or in which he holds a significant position, as defined hereinabove, or as partner in a professional or consulting firm), or on behalf of third parties – a commercial, financial, or professional relationship with Sabaf, one of its subsidiaries, or with any of its key managers, or with the majority shareholder or group of shareholders that control it, such as to influence his independence of judgement, or has been an employee of one of the aforementioned parties. The Board of Directors assesses the relevance of the commercial, financial, or professional relationship on a case-by-case basis, according to the specific situations. Nevertheless, the Board always considers the following types of relationships to be "significant":

- commercial or financial transactions carried out during the current and previous year, as well as professional services provided during the current and previous year either directly or indirectly (e.g. through subsidiaries or in which the director holds a significant position, or is the partner of a professional or consulting firm), if these transactions:

    - were not carried at arm's length market conditions, or
    - even if they were carried out at arm's length market conditions, exceed 5% of the revenues of the supplier or beneficiary enterprise (in the case of commercial or financial transactions) or

exceed 5% of the director's income or €100,000 (for professional services);

- employment relationships with Sabaf in the previous three fiscal years;

d) is a close relative of a person who is in one of the situations described hereinabove. For this purpose, "close relative" means the spouse, cohabiting partner, and cohabiting relatives, blood relatives and relatives by marriage to the fourth degree (i.e. cousins);

e) receives or has received in the previous three fiscal years significant compensation in addition to the "fixed" compensation as a non-executive director from Sabaf or from a subsidiary or parent company, including participation in incentive schemes linked to Company performance, including share-based incentive schemes;

f) is a shareholder or director of a Company or organisation belonging to the network of the firm retained as the issuer's independent auditor;

g) was a director of Sabaf for more than nine years in the last twelve years;

h) is an executive director at another Company where a Sabaf executive director was director.

The Board of Directors may periodically define other situations that could compromise a director's independence.

With the abstention of those concerned, the Board of Directors reviews satisfaction by independent directors of the requirements for independence after they have been appointed and then twice annually thereafter, upon approval of the draft annual report and the half-year report.

Satisfaction of these requirements, as defined in the Corporate Governance Manual, was reviewed for the first time on December 19th 2006, following adoption of the Manual. In accordance with the new criteria, Salvatore Bragantini, Raffaele Ghedini, Alberto Federico Giua, Franco Carlo Papa and Flavio Casotti were confirmed as independent directors. However, following the application of the new criteria, Leonardo Cossu, until then an independent director of the Company, was no longer considered as such since he had been a director of Sabaf S.p.A. for more than nine years.

The independent directors meet whenever necessary and at least once annually. The other directors may not attend these meetings. They shall discuss and exchange views on issues deemed of interest for management of the Board of Directors or the Company. This may include the sharing of strategic, general, and technical experiences, and experiences outside the Company that might be useful to Sabaf itself. In particular, the independent directors shall exchange views on potential conflicts (or divergence) between the interests of shareholders and the interests of all or some directors. The meetings might conclude with suggestions for improving the governance of Sabaf. The Lead Independent Director shall bring those suggestions to the attention of the Board of Directors at its first meeting thereafter.

The independent directors met once in 2006.

## 4. HANDLING OF CONFIDENTIAL INFORMATION AND INTERNAL DEALING

### *Confidential Information*

The CEO manages the processing of confidential information in accordance with a specific procedure for internal management and external disclosure of documents and information concerning the Company. This procedure must be proposed by the CEO and approved by the Board of Directors. Special attention is devoted to the management of inside information, as defined in Article 181 of the Consolidated Law on Finance (i.e. information that has not been made public and, if it were made public, would be likely to have a significant effect on the price of relevant listed financial instruments).

This procedure pursues the aims of careful, secure, and confidential management of this type of information, as well as disclosure of symmetrical, non-selective, prompt, complete, and adequate inside information. Corporate officers are obliged to maintain the confidentiality of information and documents acquired in the performance of their tasks and to comply with the procedure referred to in this section.

*Internal dealing*

The Company has adopted an Internal Dealing Code that defines disclosure obligations and mandatory conduct in transactions involving financial instruments that are executed by "relevant persons," as envisaged by law and regulatory requirements. This Code was adopted in 2006, superseding the previous one, and receives recent statutory and regulatory amendments.

For the purposes of the Code, "relevant persons" at the Sabaf Group are:

- the directors and statutory auditors of Sabaf S.p.A.;
- The administrative & finance manager, the commercial manager, and the investor relations manager of Sabaf SpA;
- the directors and general managers (if appointed) of the principal subsidiaries of Sabaf S.p.A.; principal subsidiaries are construed to be those companies that are consolidated on a line-by-line basis and that meet at least two of the following conditions, on the basis of their last approved financial statements: total assets exceeding €7.5 million, shareholders' equity exceeding €7.5 million euros, total revenues exceeding €15 million. None of the subsidiaries currently satisfies these conditions.

In 2006, 15 internal dealing transactions were disclosed and reported to the public, as required by law. Details on these transactions can be found at www.sabaf.it, in the Investor Relations/Internal Dealing section.

The Code prohibits relevant persons from executing any transaction seven or fewer days prior to the date of Sabaf S.p.A. Board of Directors meetings called to approve financial statements or budgets.

## 5. INTERNAL BOARD COMMITTEES

At the first meeting it held after being appointed on April 28th 2006, the Board of Directors established a Compensation Committee and Internal Control & Audit Committee. Both committees may make proposals and offer advice but do not have decision-making authority. These Committees had also been established by the previous Board of Directors whose term expired on April 28th 2006.

The Corporate Governance Manual adopted on December 19th 2006 specifies that the Committees have a minimum of three members. Their members shall be chosen from among those directors considered qualified in terms of their personal skills, expertise, and availability to discharge the duties and functions assigned to the Committee. The Manual also envisages that each Committee be allotted funds upon their formation, to be used exclusively in order to defray the expenses incurred in discharging their assigned duties. The Committees must account for these expenditures to the Board of Directors. This last measure was not applied in 2006 but will be implemented in 2007.

At beginning of 2007, the Committees appointed one of their members to act as Chairman, with the responsibility of co-ordinating and organizing work and communicating with the Board of Directors.

The Committees meet whenever their Chairman deems appropriate or on request by one of their members and, in any event, at least twice a year. The Company makes available its own facilities and conference call or videoconference equipment for use by the Committees.

Minutes shall be drafted and signed by the participants of each Committee meeting. The minutes shall be transcribed in a minute book kept together with other corporate documents in a room with limited, controlled access at the Company's registered office.

The Committees must report on their activities at least once annually to the Board of Directors, offering suggestions and recommendations on the matters for which they are responsible.

In performing their assigned duties, the Committees shall have free access to corporate information and functions as necessary. They may retain the assistance of qualified external consultants within the limits of their assigned budgets.

## 6. APPOINTMENT OF DIRECTORS

The voting list system for the appointment of directors is not currently used. The Company will amend its Articles of Association by June 30th 2007 in compliance with new statutory (Article 147-ter of the Consolidated Law on Finance) and regulatory requirements and introduce the voting list system. The purpose of this change is to ensure that at least one member of the Board of Directors represents minority shareholders.

The Shareholder Meeting held on April 28th 2006 elected the directors for 2006-2008. The directors designated by the majority shareholder Giuseppe Saleri S.a.p.A. were unanimously elected by the meeting participants in a secret vote, as envisaged by law. When the vote was held, and after expressing his own reservations in regard to the voting procedures, the Chairman of the Shareholder Meeting informed the attending shareholders that while the secret voting procedure would be followed, they had the right to declare their vote openly in order to render the proceedings more transparent and productive.

Since the Company is legally controlled by a single shareholder, a Nominations Committee was not set up inside the Board of Directors.

The Corporate Governance Manual adopted on December 19th 2006 envisages that the call of meeting for the Shareholder Meeting must be sent out at least 30 days prior to the scheduled date of the meeting. Furthermore, this call of meeting must also ask the shareholders to deposit their list of candidates for a director's seat, including the curriculum vitae of each candidate with complete personal information and summary of his professional qualifications and experience, as well as certification that he would qualify as an independent director, if applicable. The shareholders must deposit their candidate lists at the registered office of the Company at least 15 days before the Shareholder Meeting. The candidate lists and information about the candidates shall be promptly published on the Sabaf website.

## 7. DIRECTORS' COMPENSATION

The compensation of individual directors is set at a level sufficient to attract, retain, and motivate directors possessing the professional qualifications necessary for successful performance of their duties.

When it appointed the Board of Directors, the Shareholder Meeting held on April 28th 2006 defined the amount of compensation to be paid to directors during the three-year period 2006-2008.

At the meeting held to delegate authority and duties, the Board of Directors then allocated the overall compensation approved by the Shareholder Meeting to the individual directors.

The Corporate Governance Manual envisages that the compensation of executive directors be decided by the Board of Directors upon examination of proposals by the Compensation Committee (as illustrated hereunder) and consultation with the Board of Statutory Auditors. This rule came into effect on the date that the Manual was approved (December 19th 2006).

The Company Corporate Governance Manual also envisages that:

- part of the compensation of executive directors (as well as that of key managers) be tied to the operating results realized by Sabaf and/or achievement of specific targets previously set by the Board of Directors or, in the case of key managers, by the CEO;

- executive directors and key managers may be the beneficiaries of share-based inventive schemes;

- the compensation of executive directors be commensurate with the commitment each one is asked to make, taking any membership on one or more internal committees into account. Their compensation is not tied either to the operating results achieved by Sabaf or to the share-based incentive schemes, unless decided with cause by the Shareholder Meeting.

On May 6th 2003 the Sabaf S.p.A. Shareholder Meeting resolved in favour of a capital increase to service a stock option plan reserved for certain directors and employees. The stock option plan in place had the following characteristics:
- Number of options granted: 666,500
- Vesting date: 15 April 2006
- Exercise period: 1 July – 31 October 2006
- Strike price: € 14.38 per share

A total of 199,950 stock options accrued on the basis of the Group's operating performance and in accordance with the conditions for exercise envisaged in the plan (achievement of pre-set EBITDA and EBIT targets). This resulted in the subscription of 199,950 shares by the beneficiaries in 2006. The remaining 466,550 options, which cannot be exercised, have expired.

No stock option plan exists at the date of this report. The Compensation Committee is reviewing the incentive system for the CEO, directors holding specific positions, and key managers in view of making relevant recommendations and proposals to the Board of Directors.

The Notes to the Financial Statements contain specific information on the compensation paid to each director, including stock options.

*Compensation Committee*

The Board of Directors Compensation Committee has four non-executive members (Cossu, Ghedini, Giua, and Pasotti), a majority of whom are independent.

The Compensation Committee is responsible for:

- making proposals to the Board of Directors, in the absence of the persons directly concerned, for compensation of the CEO and directors holding specific positions, monitoring application of the decisions taken by the Board. Specifically in regard to the portion of compensation tied to the Company's operating results, the relevant recommendations are accompanied by suggestions for the associated targets and evaluation criteria, in order to align the compensation of the CEO and directors holding specific positions with the shareholders' medium-long term interests and the growth targets set by the Board of Directors;

- evaluating the criteria for compensation of key managers, overseeing their proper application (on the basis of information provided by the CEO) and making general recommendations on the subject to the Board.

In making recommendations to the Board concerning directors compensation and evaluation of compensation policies for key managers, the Compensation Committee must consider all the roles, offices, and responsibilities assigned to the director or key manager, as well as all compensation accorded at the Group level.

## 8. INTERNAL CONTROL SYSTEM

The internal control system of the Company and its core subsidiaries is comprised by a set of rules, procedures, and organizational structures designed to prevent or reasonably curtail business risks and achieve the following objectives: effective, efficient business operating processes; protection of corporate assets; complete, reliable, and timely accounting and financial reporting; and compliance of business conduct with laws, regulations, and corporate directives and procedures.

The internal control system of Sabaf and its core subsidiaries involves all Company employees. Its proper functioning is assured by the contribution of a series of persons that are assigned different roles and responsibilities.

The Company **Board of Directors** bears ultimate responsibility for the internal control system, defining its guidelines, periodically reviewing its adequacy within the scope of the Company's business, and providing periodic disclosures to the market. It does so by drawing on the support of Company personnel and officers, particularly the Internal Control & Audit Committee and the Chief Internal Auditor. The Board's specific responsibilities in regard to the internal control system are described in Section 1 hereinabove.

Within the scope of the responsibilities assigned to him by the Board of Directors for supervision of the internal control system, the **Chief Executive Officer** issues guidelines for implementation of the internal control system, overseeing: (a) the design, realization, and operation of the system, constantly monitoring its overall adequacy, effectiveness, and efficiency with the support of the Chief Internal Auditor and the Internal Audit Department; (b) updates of the internal control system according to operating conditions and the statutory and regulatory context; (c) identification of the principal risks faced by the Company, to be presented periodically for examination by the Board of Directors.

The **Internal Control & Audit Committee** is responsible for making proposals and providing advice to the Board of Directors that will support it in discharging its responsibilities for the internal control system. In particular, this involves assessments and decisions regarding the internal control system, approval of the annual and half-year accounts, and relations between the Company and the independent auditor. The Internal Control & Audit Committee has specific responsibility for the following duties:

a) together with the Chief Administrative Officer and the independent auditors, verify whether accounting standards and policies are properly applied and uniform for preparation of the consolidated financial statements;

b) on request by the CEO, issue opinions on specific aspects concerning identification of the principal business risks as well as the design, realization, and management of the internal control system;

c) examine the work plan and periodic reports prepared by the Chief Internal Auditor;

d) assess the proposals made by accounting firms to become the Company's independent auditor, the work plan prepared for audits, and the results set forth in its report and any letter of suggestions;

e) monitor the effectiveness of the independent auditing process;

f) on request by the Board of Directors, issue opinions prior to and regarding transactions with related parties or in which a director might have an interest, either on his own account or that of others;

g) perform any other tasks that are assigned to it by the Board of Directors;

h) report on its activity and the adequacy of the internal control system to the Board of Directors at least once every six months, upon approval of the annual accounts and half-year reports.

The Internal Control & Audit Committee has three non-executive members (Bragantini, Cossu, and Papa), a majority of whom are independent. All members of the Committee have adequate experience in accounting and financial matters.

The Internal Control & Audit Committee meetings are attended by the Chairman of the Board of Statutory Auditors or another statutory auditor designated by him, as well as the Chief Internal Auditor, who shall act as secretary.

In 2006, the Committee expressed opinions on:
- planning of the internal control activities, particularly the decision to outsource the internal auditing function;
- compliance with corporate disclosure and market abuse obligations;
- analysis of the Organization, Operation and Control Model pursuant to Legislative Decree 231/2001;
- analysis of the draft Corporate Governance Manual;
- documentation of outstanding hedges of financial risks and their recognition in Company accounts.

The **Chief Internal Auditor** is appointed by the Board of Directors upon recommendation by the CEO, in the latter's capacity as supervisor of the internal control system. The Chief Internal Auditor assists the Board of Directors, the Internal Control & Audit Committee, the CEO, and departmental heads in discharging their duties regarding internal control and risk management systems. In particular, the Chief Internal Auditor: a) assists the CEO and department heads with the design, management, and monitoring of the internal control system; b) plans audits of the adequacy and operation of the internal control system implemented according to a risk-based approach; c) verifies compliance with the procedures implemented for management of significant risks, issuing an assessment of the ability of the internal control system to achieve an acceptable level of overall risk.

In performing these tasks, the Chief Internal Auditor reports directly to the CEO and reports on his work at least every six months to the Internal Control & Audit Committee and the Board of Statutory Auditors.

The Chief Internal Auditor has direct access to all information useful for performance of his assigned duties. In order to assess the assess the adequacy and actual operation of the internal control system, he relies on an **internal auditing** organization outsourced to external service providers. Consequently, he is allocated a budget by the Board of Directors that is adequate for performing his assigned duties.

Pursuant to the guidelines issued by the Board of Directors and the directives received to implement them, the **departmental heads** are responsible for managing, implementing, and monitoring the effective operation of the internal control system within the scope of their respective purviews, ensuring that adequate procedures are adopted for management of the risks posed by the activities in their areas of responsibility.

Within the structure of the internal control system, certain organizational units perform different types of control monitoring activities, including the activities of the **Quality, Safety, & Environment Service**, and other activities performed by the **Human Resources Department** and the **Information Systems Service**. A continuous flow of information amongst the heads of these services and departments is assured in support of the internal control system evaluation process.

Within the limits of their respective roles, all **employees** contribute to effective operation of the internal control system.

***Organization, Operation and Control Model pursuant to Legislative Decree 231/2001***

Sabaf adopted the Organization, Operation and Control Model pursuant to Legislative Decree 231/2001 (hereinafter, the "Model") in 2006. The Model is designed to thwart the possibility that criminal offences falling under the scope of Legislative Decree 231/2001 be committed. This decree envisages the administrative liability of the Company in the case of certain types of criminal offences committed by employees or outside staff in the Company's interest. The general part of the Model is available in the Investor Relations / Corporate Governance section of the website www.sabaf.it.

The Model is a set of general principles, rules of conduct, means of control and organizational, training and information activity, and disciplinary system design to prevent the commission of criminal offences.

The Model also envisages the mandatory creation of a **Supervisory Committee** (SC), which is responsible for assessing the adequacy of the Model (i.e. its real ability to prevent offences); supervising application and compliance with the Model by means of ongoing audits; auditing individual acts, compliance with adopted protocols, the level of familiarity with the Model in the organization, and specific reports of infractions; updating the Model. The Model envisages that the SC have at least two members, with general legal and labour law, accounting, inspection, and internal audit expertise. At least one of the members of the Supervisory Committee must be selected from within the Company (namely, the head of Internal Control), while at least one must be independent of the Company, be particularly qualified and have experience in the sector in which Sabaf S.p.A. operates.

On August 2nd 2006 the Sabaf S.p.A. Board of Directors appointed the Supervisory Committee for the three-year period 2006 – 2008. The members of the Supervisory Committee are the Chief Internal Auditor and an independent legal counsel.

*Components of the internal control system*

The essential components of the internal control system of Sabaf and its core subsidiaries consist of the documentation that is constantly produced and updated by the Company to define rules of Conduct, assignment of duties and delegations of responsibility, objectives and methods for assessment of risks and performance of the entire organization and of individuals. They include the following:

- the Charter of Values;
- rules concerning the corporate and organizational structure and delegations of authority;
- the mechanisms for segregation of functions within the organization (as reflected in the corporate information systems), designed to prevent over-concentration of decision-making and authorization, implementation/executive, accounting, and audit/control powers and functions;
- policies for development and professional growth of human resources;
- systems for the definition of corporate objectives and auditing and monitoring of business performance;
- management and financial reporting systems, as well as systems for internal and external communication;
- the body of corporate procedures as a whole, including those envisaged in the Organization, Operation and Control Model adopted by Sabaf pursuant to Legislative Decree 231/2001 and those introduced pursuant to Law 262/2005 concerning administrative and accounting procedures for the preparation of financial statements.

The internal control system also includes the auditing and continuous monitoring processes carried out at the various levels of the organization by internal Company entities and external organizations (internal auditing, Supervisory Committee, etc.). In particular, corporate risks and controls are monitored:

a) by the individual departmental and unit heads within the scope of their responsibilities (line control); these managers implement mechanisms for continuous supervision on a daily basis in order to detect any irregularities in the performance of activities on a timely basis;

b) by the Administration and Finance Department; as part of its budget control activities, it audits Company performance and achievement of operational cost, effectiveness, and efficiency targets;

c) by the Chief Internal Auditor on an independent basis and through Internal Audit, to assess the adequacy and actual operation of the internal control system based on a work plan defined starting from a review of corporate risks and other available information. These monitoring activities are also carried out as support for the Supervisory Committee pursuant to Legislative Decree 231/2001.

*Exchange of information between bodies and officers responsible for control at Sabaf*

Sabaf sets up meetings and exchanges of information amongst the various bodies and officers responsible for auditing and monitoring the organizational, administrative, accounting, and internal control systems of the Company and its core subsidiaries.

More specifically, without prejudice to statutory provisions regarding statutory auditors and the independent auditor, the Corporate Governance Manual envisages that a joint meeting be held by the following bodies and officers at least ten days before the Board of Directors approves the draft annual report and half-year report of Sabaf:

- Internal Control & Audit Committee
- Board of Statutory Auditors
- Supervisory Committee pursuant to Legislative Decree 231/2001
- Internal Auditor
- Independent Auditor

During this meeting, exchanges of information are envisaged concerning the principal findings and/or problems revealed during audits of the organizational, administrative, accounting, and internal control structures.
The internal control bodies and officers held their first meeting in accordance with the Corporate Governance Manual on March 8th 2007.

*Assessment of the internal control system*

In light of the Board of Director's duty to assess the adequacy, effectiveness, and actual operation of the internal control system at least once annually, and on the basis of the information and material collected with the support of the Internal Control & Audit Committee and other internal and external bodies and offices assigned responsibility for control of the Group, the Board of Directors holds that the existing internal control system as a whole is adequate considering the nature of the business, that it will permit achievement of corporate objectives, and that it was functional as a whole in 2006.

This assessment, which refers to the general system of internal control, reflects the inherent limits of that system. Although it was well conceived and functioning, the internal control system can assure achievement of company objectives only within the limits of "reasonable certainty."

Guidelines implementing the Corporate Governance Manual, which were approved on February 13th 2007, set forth detailed rules governing the disclosure an evaluation processes that the Sabaf Board of Directors uses to assess the Group's internal control system. The process involves all individuals and bodies responsible for the design, implementation, and/or monitoring of the Group's internal control system. This procedure will be adopted beginning with the FY2007 assessment of the internal control system.

## 9. INTERESTS OF DIRECTORS AND TRANSACTIONS WITH RELATED PARTIES

Guidelines implementing the Corporate Governance Manual, which were approved by the Board of Directors on February 13th 2007, define what are considered transactions with related parties and those in which a director has an actual or potential interest on his own behalf or of someone else, whether or not that interest conflicts with the Company's interest.

These Guidelines also set forth the rules for properly identifying, approving, and executing these transactions. In particular, the document defines the measures designed to ensure that these transactions are executed transparently, in accordance with formal and substantial rules of fairness, and specifies the operating rules for identification and adequate management of situations where a director has an interest on his own behalf or of someone else.

## 10. STATUTORY AUDITORS

The statutory auditors are appointed in accordance with a transparent procedure regulated by the Company Articles of Association. However, this procedure is subject to revision by June 30th 2007 in compliance with statutory and regulatory amendments.

The current mechanism for appointing statutory auditors is based on lists submitted by the shareholders who either singly or together with others own at least three per cent of the voting shares at the Ordinary Shareholder Meeting.

The lists must be deposited at the registered office of the Company at least ten days prior to the date scheduled for the Shareholder Meeting on its first call. This rule shall be mentioned in the call of meeting. The deposited lists shall be promptly published by the Company on its website.

Each list must be deposited together with the curriculum vitae of the candidates, certification by the individual candidates that they accept their candidacy, certification under their own responsibility that they are not legally ineligible or unqualified (pursuant to Article 148(3) TUF), and certification that they satisfy legal integrity requirements (Article 148(4) TUF).

This procedure was followed for election of the Board of Statutory Auditors by the Shareholder Meeting on April 28th 2006, which appointed the Board of Statutory Auditors for the three-year period 2006 – 2008 (Italo Lucchini, Eugenio Ballerio, and Giovannimaria Seccamani Mazzoli). The Consolidated Law on Finance (TUF), as amended by Law 262/2005, envisages that the Chairman of the Board of Statutory Auditors be appointed by the Shareholder Meeting but chosen from among the statutory auditors elected by the minority shareholders. Italo Lucchini was consequently elected Chairman, as he had been nominated on a minority shareholder list.

The Board of Statutory Auditors verifies that the independent directors actually satisfy the requirements for independence after their appointment and then at least once annually thereafter, forwarding the results of this audit to the Sabaf Board of Directors in time for preparation of the Corporate Governance Report.

The first such audit, which confirmed that the independent directors satisfied the additional requirements of independence, was carried out on March 8th 2007.

The Company adopted a series of measures to facilitate and assure effective performance of the Board of Statutory Auditors' duties. The Company defined inter alia the internal information flows necessary to assure prompt and complete disclosures to the Board of Statutory Auditors pursuant to Article 150(1) of the

Consolidated Law on Finance. The Company also encourages exchanges of information amongst its own control bodies and officers.

The Board of Statutory Auditors systematically meets with the statutory auditors of the parent company and subsidiaries in order to exchange information.

## 11. INVESTOR RELATIONS

The Sabaf Board of Directors makes every effort to establish an ongoing and transparent dialogue with shareholders and foster the fullest possible attendance of shareholders at Shareholder Meetings.

Accordingly, the following measures are taken:

- Shareholder Meetings are normally attended by all directors;

- during Shareholder Meetings, directors – through the Chairman and/or CEO – provide information to shareholders on the Company and Group, in compliance with regulations governing disclosure of inside information. More specifically, the Board of Directors reports to the Shareholder Meeting on activities that it has performed and those that are planned, with special reference to significant transactions and transactions with related parties. It also endeavours to ensure that shareholders receive adequate information as necessary for them to make informed decisions on matters falling under the purview of the Shareholder Meeting;

- a Shareholder Meeting Regulation is in effect, having the purpose of governing the orderly proceedings of ordinary and extraordinary Shareholder Meetings, while also fostering shareholder participation and exercise of their voting rights. The Regulation is available on the website www.sabaf.it, in the Investor Relations/Corporate Governance section;

- a specific section dedicated to shareholders is set up within the Company's official website. The section provides information about Sabaf and the Group of relevance for shareholders, so that they can exercise their rights on a knowledgeable basis. It also publishes the procedures envisaged for attendance at and exercise of voting rights at the Shareholder Meeting, as well as documents regarding the topics listed on the agenda, including the lists of director and statutory auditor candidates, complete with their personal information and professional qualifications;

- an Investor Relations Manager is available;

- if there are significant changes in the market capitalization of Sabaf stock or its shareholding structure, the Board of Directors considers the possibility of proposing that the Shareholder Meeting amend the Articles of Association in regard to the percentages established for exercise of the actions and prerogatives established to protect minority shareholders.

During 2006 Sabaf met analysts and fund managers in Milan, London, Paris, Helsinki, Stockholm and Copenhagen. A total of over 100 meetings took place. The Company also took part in presentation of annual and midyear interim results by STAR (high-quality small/medium caps) companies in Milan and London.

Sabaf's financial communication policy adheres to the standards set in the Guide to Market Disclosure of Information (Guida per l'Informazione al Mercato) published by the Ref. Forum on corporate information in June 2002.

## Preparation of Company financial statements

The Company will amend its Articles of Association by June 30th 2007 to comply with legal requirements governing the preparation of its financial statements and reports (Article 154-bis of the Consolidated Law on Finance) and appoint the manager in charge of doing so.
In 2006 the Company initiated the process of compliance with these measures. Specifically, it performed a specific analysis of the financial reporting processes (closing of accounts and preparation of annual and interim statutory and consolidated financial statements) in order to assess and document existing controls to assure the reliability of its accounting and financial data.

## Independent auditor

On April 28th 2006 the Shareholder Meeting retained the firm AGN Serca as independent auditor of its financial statements for FY2006, FY2007, and FY2008.

## Share capital and major shareholders

Sabaf SpA's share capital consists of 11,533,450 ordinary shares with a par value of € 1.00 each.

As at December 31st 2006 the following shareholders owned equity interests in excess of 2%:

| | |
|---|---|
| Giuseppe Saleri S.a.p.A. | 53.81% |
| Nazionale Fiduciaria S.p.A. | 3.97% |
| Sycomore Asset Management SA | 3.36% |
| Columbia Wanger Asset Management LP | 2.37% |
| Bestinver Gestion SGIIC SA | 2.01% |

The Company Giuseppe SapA, which controls Sabaf SapA, does not perform activities of direction and co-ordination of the latter pursuant to Sections 2497 et seq. of the Italian Civil Code.

Ospitaletto, March 23rd 2007

Attachment 1

Structure of Board of Directors and internal committees for the period January 1st 2006 – April 28th 2006

| Board of Directors | | | | | | | Internal Control & Audit Committee | | Compensation Committee | |
|---|---|---|---|---|---|---|---|---|---|---|
| Office | Members | Executive | Non-executive | Independent | **** | No. of other offices** | *** | **** | *** | **** |
| Chairman | Saleri Giuseppe | x | | | 100% | 1 | | | | |
| Vice-Chairman | Saleri Gianbattista | x | | | 100% | 0 | | | x | |
| Chief Executive Officer | Bettinzoli Angelo | x | | | 100% | 1 | | | | |
| Director | Bartoli Alberto | x | | | 100% | 0 | | | | |
| Director | Cossu Leonardo | | | x | 100% | 7 | x | 100% | x | |
| Director | Papa Franco Carlo | | | x | 100% | 5 | x | 100% | | |
| Director | Borgonovi Elio | | | x | 100% | 0 | x | 100% | | |
| Director | Ghedini Raffaele | | | x | 100% | 0 | | | x | |
| Director | Pasotti Flavio | | | x | 50% | 0 | | | x | |

* An asterisk beside the name indicates that the director was designated via lists submitted by minority shareholders.
** This column shows the number of offices held by the person concerned as director or statutory auditor in other companies listed in regulated Italian and international markets; in financial, insurance or banking companies; or in companies of major size.
*** In this column an "x" indicates the director's committee membership.
**** This column shows directors' percent attendance of meetings.

Attachment 2

Board of Statutory Auditors for the period January 1st 2006 – April 28th 2006

| Office | Members | Percent attendance of BoSA meetings | No. of other offices** |
|---|---|---|---|
| Chairman | Nobolo Alberto | 100% | 0 |
| Statutory auditor | Ghisoni Sergio | 100% | 0 |
| Statutory auditor | Cisotto Angelo* | 10% | 0 |
| Substitute statutory auditor | Guidetti Paolo | - | 0 |
| Substitute statutory auditor | Mattei Marco* | - | 0 |

Number of meetings held in period: 2

* The asterisk shows that the statutory auditor was designated via lists submitted by minority shareholders.
** This column shows the number of offices held by the person concerned in other companies listed in Italian regulated markets.

Attachment 3

Structure of Board of Directors and internal committees for the period April 28th 2006 – December 31st 2006

| Board of Directors | | | | | | | Internal Control & Audit Committee | | Compensation Committee | |
|---|---|---|---|---|---|---|---|---|---|---|
| Office | Members | Executive | Non-executive | Independent | **** | No. of other offices** | *** | **** | *** | **** |
| Chairman | Saleri Giuseppe | x | | | 100% | 1 | | | | |
| Vice-Chairman | Saleri Gianbattista | x | | | 100% | 0 | | | | |
| Vice-Chairman | Saleri Ettore | x | | | 83% | 0 | | | | |
| Chief Executive Officer | Bettinzoli Angelo | x | | | 100% | 3 | | | | |
| Director | Bartoli Alberto | x | | | 100% | 0 | | | | |
| Director | Cossu Leonardo | | x | | 100% | 7 | x | 100% | x | 100% |
| Director | Papa Franco Carlo | | | x | 83% | 5 | x | 100% | | |
| Director | Bragantini Salvatore | | | x | 67% | 7 | x | 50% | | |
| Director | Giua Alberto Federico | | | x | 67% | 0 | | | x | 100% |
| Director | Ghedini Raffaele | | | x | 100% | 0 | | | x | 100% |
| Director | Pasotti Flavio | | | x | 100% | 0 | | | x | 100% |

* An asterisk beside the name indicates that the director was designated via lists submitted by minority shareholders.

** This column shows the number of offices held by the person concerned as director or statutory auditor in other companies listed in regulated Italian and international markets; in financial, insurance or banking companies; or in companies of major size.

*** In this column an "x" indicates the director's committee membership.

**** This column shows directors' percent attendance of meetings.

Attachment 4

Board of Statutory Auditors for the period April 28th 2006 – December 31st 2006

| Office | Members | Percent attendance of BoSA meetings | No. of other offices** |
|---|---|---|---|
| Chairman | Lucchini Italo * | 100% | 3 |
| Standing statutory auditor | Ballerio Eugenio | 100% | 1 |
| Standing statutory auditor | Seccamani Mazzoli Giovannimaria | 75% | 2 |
| Substitute statutory auditor | Guidetti Paolo | - | 0 |
| Substitute statutory auditor | Bellini Pierluigi* | - | 0 |

Number of meetings held in period: 4

* The asterisk shows that the statutory auditor was designated via lists submitted by minority shareholders.

** This column shows the number of offices held by the person concerned in other companies listed in Italian regulated markets.