

**JUSTIFIED RECOMMENDATION OF THE BOARD OF STATUTORY AUDITORS OF TESMEC S.P.A. FOR GRANTING THE ENGAGEMENT TO PERFORM THE STATUTORY AUDIT OF THE ACCOUNTS FOR THE FINANCIAL YEARS 2019–2027**

**Introduction**

With the approval of the financial statements for Tesmec S.p.A. (“**Tesmec**” or the “**Company**”) and the consolidated financial statements for the Tesmec Group for the year ended on 31 December 2018, the engagement to perform the statutory audit of the accounts for the nine-year period of 2010–2018 that was granted on 23 February 2010 by Tesmec’s shareholders at the Shareholders’ Meeting to EY S.p.A. (formerly Reconta Ernst & Young S.p.A.) (“**EY**”) is coming to an end.

That engagement may not be renewed, since the year 2018 will complete the maximum nine-year term for public-interest entities like Tesmec set forth in Article 17, paragraph 1 of Italian Legislative Decree No. 39 of 27 January 2010 (the “**Decree**”), pursuant to which the audit engagement for public-interest entities may have a nine-year term for the Independent Auditors and a seven-year term for the statutory auditors and cannot be renewed or re-granted unless at least four financial years have elapsed since the last engagement ended.

Thus, a new Independent Auditors must be appointed in accordance with the provisions of the Decree and Regulation (EU) No. 537/2014 in regard to the statutory audit of public-interest entities (the “**Regulation**”).

In that regard, (i) Article 13 of the Decree provides that the shareholders at a Shareholders’ Meeting shall make that appointment based on a justified proposal from the Board of Statutory Auditors, whereas (ii) Article 16 of the Regulation provides that the Internal Control and Audit Committee (the “**ICAC**”) – whose role, in the Italian legal system, under the Decree, is performed by the Board of Statutory Auditors for companies, like Tesmec, that have adopted the traditional system of management and control – shall submit a justified recommendation to the administrative body of the audited entity, which must contain at least two possible candidates for the appointment and which expresses a duly justified preference for one of them.

The shareholders at the Company’s Shareholders’ Meeting called to approve Tesmec’s financial statements as of 31 December 2018 will thus be asked to take action, based on the Board of Statutory Auditors’ justified proposal, in regard to granting the statutory audit engagement to the new Independent Auditors and determining its remuneration and any criteria for adjusting that remuneration during the period of the engagement.

In light of the foregoing, the Board of Statutory Auditors, acting as an ICAC, prepared the following recommendation (the “**Recommendation**”) for the Board of Directors in accordance with Italian and EU laws.

### **The legal framework**

The legal framework in regard to the statutory audit was significantly changed by two separate laws:

- Directive 2006/43/EC, as amended by Directive 2014/56/EU on statutory audits of annual accounts and consolidated accounts, which was transposed by Italian Legislative Decree No. 39 of 27 January 2010, as most recently amended by Italian Legislative Decree No. 135 of 17 July 2016; and
- Regulation (EU) No. 537/2014, on specific requirements regarding the statutory audit of public-interest entities, applicable since 17 June 2016.

The issuance of the Decree completed the process of reforming the statutory audit, which took place at the EU level in response to the financial crisis during the years 2008–2009.

The Decree lays down general rules regarding the statutory audit and certain specific rules for the statutory audit of public-interest entities.

The Regulation covers certain specific points in the laws relating to the legal audit of public-interest entities, which Tesmec is as an Italian company issuing securities admitted for trading on a regulated market.

The purpose of the new law is to further harmonise the rules originally introduced by Directive 2006/43/EC at the European Union level to ensure greater transparency and predictability of the obligations applicable to persons and entities that perform the statutory audit of the accounts and increase their independence and objectivity in performing their tasks, and to increase the public's trust in the financial statements and consolidated financial statements of the aforementioned entities.

As a tool for enhancing the quality of the audit, the Regulation strengthened the role of the ICAC in selecting the new company to perform the statutory audit of the accounts.

The ICAC was given the responsibility of submitting a justified recommendation to the administrative body (namely, the Board of Directors in companies that use the traditional governance system) to allow shareholders to make an adequately considered decision.

Specifically, Article 16 of the Regulation provides that:

- a) the ICAC shall submit a recommendation to the administrative body to grant the statutory audit engagement;
- b) the recommendation must be justified and contain at least two possible choices for the audit engagement, with a duly justified preference expressly indicated for one of them;
- c) the proposal to shareholders must include the recommendation and preference;

d) the Board of Statutory Auditors, as the ICAC, is responsible for the selection procedure.

Article 13 of the Decree references the provisions of Article 16 of the Regulation and provides that the shareholders, upon the supervisory body's justified proposal, shall grant the statutory audit engagement to the Independent Auditors and shall determine its remuneration for the entire term of the engagement and any criteria for adjusting that remuneration during the engagement.

### **The selection procedure**

With a view to the granting of the engagement to perform the statutory audit of the accounts, starting in September 2018 Tesmec began the procedure for selecting the new Independent Auditors which would be engaged for the financial years 2019–2027.

The Board of Statutory Auditors, acting as the “Internal Control and Audit Committee,” prepared the following Recommendation for the Board of Directors in accordance with the requirements of current European Union law.

The Company's functions are given “implementing” tasks, while the Board of Statutory Auditors is assigned the roles of responsibility, evaluating the entire process and ensuring the procedure is lawful.

The recommendation was prepared following a special selection process initiated by the Company and for which the Board of Statutory Auditors is responsible under Article 16, paragraph 3 of the Regulation. During the selection procedure, the Board of Statutory Auditors was supported by a commission that examined the candidates (the “**Commission**”) made up of the following individuals:

- the Chairperson of the Board of Statutory Auditors;
- the Deputy Chairperson of the Board of Directors;
- an Independent Director; and
- the CFO and Responsible Officer.

The Consolidated Financial Statements Manager acted as secretary of the Commission.

In preparation for commencing the selection process, the Company, together with the Board of Statutory Auditors, set clear and objective selection criteria to ensure the procedure was transparent and the work it performed and the decisions it made were traceable.

Technical, qualitative and quantitative aspects were considered in setting the selection criteria.

In order to obtain a better understanding of the information provided by the Independent Auditors, an “Analysis Grid” checklist was developed to identify the aspects to be clarified during the discussions with the companies participating in the tender proceeding and any additional documentation to be requested.

In regard to the Independent Auditors selection criteria, in order to better understand the hours and services offered, the scope, hours and mix proposed in the proposals were summarised in tabular form to permit the results to be compared with the information for the current auditor.

Main contents of the proposal:

The selection procedure covered the performance of the following services:

- under Article 14 of the Decree, the engagement to perform the statutory audit of Tesmec's financial statements and the Tesmec Group's consolidated financial statements for the years 2019–2027;
- the engagement to perform a limited audit of the interim condensed financial statements as of 30 June for the years 2019 to 2027;
- the report relating to the “Non–Financial Statement” under Italian Legislative Decree 254/2016;
- examining the adequacy of the system of internal controls associated with the preparation of the financial information to be used to prepare Tesmec's financial statements and the Tesmec Group's consolidated financial statements;
- reviews associated with signing Tesmec's and its audited Italian subsidiaries' tax returns;
- expressing an opinion as to the consistency of the Report on Operations and, specifically, that the report on corporate governance and ownership structures is consistent with the financial statements; and
- certification that the accounting records are being properly maintained and that the Company's operations are being recorded properly in Tesmec's accounting entries.

The Request for Proposals

The Company, together with the Board of Statutory Auditors, conducted an assessment for the purpose of identifying the Independent Auditors to be admitted to the procedure. It then sent a letter containing a request for proposals (the “**Request for Proposals**”), including annexes, to the selected firms regarding providing services for the statutory audit of the accounts required by the Company.

The Request for Proposals and related annexes were prepared in such a way that the Independent Auditors could understand the Company's business and the type of statutory audit of the accounts to be performed, so that those firms would have the information necessary to prepare their respective proposals. They contained transparent and non-discriminatory selection criteria for evaluating the proposals received, and stated that no clauses referred to in Article 16, paragraph 6 of the Regulation were applicable.

On 24 September 2018, the following Independent Auditors were requested to indicate their interest in participating in the selection: [Deloitte & Touche S.p.A. (“**Deloitte**”), KPMG S.p.A. (“**KPMG**”) and PriceWaterhouseCoopers S.p.A. (“**PWC**”)]. They were deemed suitable for participating in the selection process because, given the international scope of the Tesmec Group’s business, they are members of leading international networks and have high standards for professionalism and the quality of services they offer.

*Analysis and evaluation of the proposals*

After the letters were sent, the Commission met with representatives of the firms invited to submit proposals to provide all necessary documents and information useful for preparing their proposals.

The Independent Auditors that submitted proposals certified that they satisfied the independence requirements or declared their commitment to removing any grounds for incompatibility in accordance with the requirements of Italian and European Union law.

As required, on 24 October 2018 the Company received proposals from Deloitte and PWC (the “**Proposing Firms**”).

The Independent Auditors KPMG S.p.A. declined the invitation and did not submit a proposal.

After analysing the proposals received, the Commission decided it would be appropriate to clarify the relevant scope and consolidation perimeter for the audit work with the participants and asked for missing details to be provided for purposes of comparing the proposals.

Therefore, in a letter dated 3 December 2018, the Proposing Firms were asked to submit a better financial proposal (a “**Resubmission**”) containing the additional information requested with the resulting adjustment of and improvement to the financial proposal.

As requested, the Company received the Resubmission proposals on 17 December 2018.

After a careful analysis of the proposals received, the Commission decided to schedule meetings, which were held in January 2019, where the Proposing Firms presented their proposals and the work teams involved in detail.

Following the Company’s request that they provide additional details that were highlighted during the discussions, the Proposing Firms were asked to submit their final proposals, which were sent on 8 February 2019.

Based on the documents received and the valuation criteria set forth below, the Board of Statutory Auditors evaluated the proposals in detail by analysing the distinctive and qualifying aspects of each proposal for each evaluation criterion.

Each entry of the qualitative portion of the proposals submitted by the Independent Auditors was analysed and given a specific score on a scale from 1 to 100.

To evaluate the overall financial proposal (the quantitative portion), a score was assigned by giving a value of 50 to the average of the prices, and positive (meaning favourable to Tesmec) or negative variances from that average were added or subtracted. In order to also take into account the “quality” of the financial proposal, such as the composition of the mix of hours performed by the various members of the audit team, it was possible to further adjust the value so obtained by a maximum amount of 5. Thereafter, that amount was weighted.

Among the qualitative elements, the following aspects were considered:

*(i) Knowledge of the Group (administrative section) (1-100)*

Information useful for evaluating and verifying the prerequisites necessary to perform the engagement and determining whether any situations of incompatibility exist in regard to receiving that engagement, such as:

- existing and prospective consulting/professional service engagements already in place with any companies in the Group;
- the presence of any grounds for incompatibility that would impair the auditor’s future independence; and
- previous knowledge of the Company granting the engagement and of its Group gained in previous audit engagements.

*(ii) Characteristics of the Independent Auditors and its network (general section) (1-100)*

Information about the general characteristics of the Proposing Firm’s organisation, such as:

- the diffusion of its network (regional, national and international);
- its business model and system of corporate governance;
- main audit engagements for companies operating in a similar industry performed within the last 10 years;
- its quality control system;
- the presence of representatives of the Independent Auditors in institutional bodies and associations in Italy and abroad; and
- Quality & Risk management (independence).

*(iii) The methodological approach chosen (technical section) (1-100)*

Information about the audit process useful for evaluating the level of technical expertise, automation and strategy on which it is based, such as:

- the audit strategy/plan and the method for preparing the plan, specifically in regard to areas deemed critical in the Group’s consolidated financial statements and any tools used to support the audit process;

- methods of communicating with corporate and control functions (methods of interaction used by the appropriate professionals about the most significant topics and frequency and type of meetings with the Board of Statutory Auditors);
- the plan for managing the transition/passage of work product with the outgoing auditor;
- the process of analysing and identifying audit risk and determining audit plans; and
- internal governance and monitoring processes in relation to maintaining the requirements of independence and objectivity in accordance with applicable law.

*(iv) The composition of the audit team (professional section) (1-100)*

Information about the team that would be assigned to the engagement, directly or useful for evaluating its level of professionalism, seniority, relationships and availability, such as:

- the composition of the team that will be actually involved in the audit work;
- experience in the industry and with similar listed companies of the partners and managers and of the specialists that may be used; and
- the degree of knowledge of the Company by the partners and managers who will be involved in the audit work.

Among the quantitative elements, the following aspects were considered:

Information about the professional standard and use of resources and means, such as:

- the total cost of the audit; and
- the expected number of hours, including in relation to the different areas of work.

The Board of Statutory Auditors participated in the entire selection process and devoted several meetings during the period from September 2018 to February 2019 to that process, interacting with the firms and sometimes with their legal counsel.

### **Results of the selection**

The analyses that were performed on the proposals and the additional information received indicated that:

- a) In regard to knowledge of the Group, both firms demonstrated that they fully understand the Group's business and its specific characteristics. The Proposing Firms demonstrated full formal and substantive compliance with the independence requirements.
- b) In regard to the characteristics of the Independent Auditors and its network, both firms have gained significant experience in auditing listed Italian firms operating in the same industry that are comparable in terms of size, organisational structure and operating complexity to the Tesmec Group.

- c) In regard to the proposed methodological approach, adequacy of the audit plan and timing of the main work, both firms have an adequate profile; the firms have developed systems and processes that are appropriate for identifying and analysing audit risks and tailoring specific approaches and audit and review plans.
- d) In regard to the composition of the team that would be assigned to the engagement, all the proposed work groups consist of individuals with qualified expertise and well-established experience in the industry. Within that area of evaluation, particular focus was placed on evaluating the responsible partner and the teams dedicated to specific areas (International Accounting Standards, Tax Area, Laws and Regulations, Information Technology).
- e) From the quantitative standpoint, the total cost set forth in the proposals received from the firms were better than that for the outgoing Independent Auditors and was in line with the Company's expectations, although there were some differences in terms of estimated total hours and hourly rates applied.

### **Final considerations**

The Board of Statutory Auditors believes that it can submit Deloitte and PWC to the shareholders as candidates to assume the engagement to certify the 2019–2027 financial statements.

The Board of Statutory Auditors, in view of the foregoing and, specifically, having considered the results of the procedure for evaluating the qualitative and quantitative aspects described above, unanimously prefers the proposal submitted by **Deloitte** because:

- Deloitte's proposal is better from the standpoint of the greater contribution from Partners/Managers as a percentage of total expected hours. In particular, the role of the Lead Client Service Partner ("LCSP"), who would be the sole point of contact for all of the main decisions at the Italian and international level relating to the Tesmec Group's audit engagement, and the presence in the parent company's central team of an international managerial professional responsible for coordinating the audit of the subsidiaries, particularly the French subsidiaries, which is fundamental for coordinating and performing the engagement, was viewed positively.
- Deloitte viewed its process of learning about Tesmec's operations as part of its professional investment and will bear the cost of 25% of the estimated hours once it is fully on-boarded during the first two financial years.  
Deloitte intends to use highly qualified staff to manage the transition from the previous auditor and has proposed an "immediate on-boarding" process that can be launched immediately after notification of the results of the selection procedure.
- Considering that another auditor, Funaro & CO [*sic*: Co.], is expected to be appointed to audit the United States subsidiary Tesmec USA Inc., the knowledge gained during

previous and positive direct collaborative experiences between Deloitte's LCSP and the Responsible Partner at Funaro & CO [*sic: Co.*] should make it more efficient to conduct and coordinate the engagement.

- Deloitte's proposal is financially more competitive than PWC's proposal.

### **The Board of Statutory Auditors' Recommendation**

The Board of Statutory Auditors:

- based on the procedure conducted, the proposals received, the evaluations performed and the outcomes of the same,
- considering that Article 16, paragraph 2 of the Regulation requires that the Board of Statutory Auditors' justified recommendation contain at least two possible choices for the audit engagement so that a selection can be made, and
- considering that the cited Article 16, paragraph 2 of the Regulation requires the Board of Statutory Auditors to express a duly justified preference for one of them,

### ***RECOMMENDS***

that the Board of Directors of Tesmec S.p.A. propose to the shareholders at the Shareholders' Meeting called for 16 April 2019 to appoint one of the following firms to perform the statutory audit for the years 2019–2027: Deloitte or PWC.

The financial terms proposed by those Independent Auditors, with a summary of their proposals, are set forth in Annex 1; between the two,

### ***IT EXPRESSES ITS PREFERENCE***

for **Deloitte & Touche S.p.A.** as the firm with the best qualitative and quantitative assessment as a result of the selection procedure performed, and thus was considered most suitable to perform the engagement, because it conforms to the identified needs of the Company and the Group and demonstrated the expertise with which that engagement would be performed over the entire period, by dedicating resources, time and professionalism commensurate with the importance of the engagement.

**Statement pursuant to Article 16, section 2 of Regulation (EU) No. 537/2014 on the specific requirements relating to the statutory audit of the accounts of public-interest entities**

The Board of Statutory Auditors, acting as the Internal Control and Audit Committee, states that pursuant to Article 16, paragraph 2 of Regulation (EU) No. 537/2014 on specific requirements relating to the statutory audit of the accounts of public-interest entities, that this Recommendation was not influenced by third parties and none of the clauses referenced in section 6 of Article 16 of the Regulation applied.

Grassobbio, 28 February 2019

The Board of Statutory Auditors

Simone Cavalli

Stefano Chirico

Alessandra De Beni

## ANNEX 1

## SUMMARY OF THE PROPOSALS SUBMITTED BY THE INDEPENDENT AUDITORS DELOITTE &amp; TOUCHE S.p.A.

## Statutory audit of Tesmec S.p.A. 2019-2027 (\*)

	<u>Hours (**)</u>	<u>Fees (***)</u>
<b>Tesmec S.p.A.</b>	<b>2,000</b>	<b>129,000</b>
Statutory audit of the financial statements		
Statutory audit of the Group's consolidated financial statements		
Reviews associated with signing tax returns	1,206	79,070
Limited audit of the Group's interim condensed consolidated financial statements	450	28,900
Review of the consolidated non-financial statement	120	10,000
Examination of the adequacy of the systems of internal controls	100	6,600
Expressing a conformity and consistency opinion on the Report on Operations and Report on Corporate Governance and Ownership Structures	44	2,880
Periodic review that the accounting records are being properly maintained	80	5,280
Improved proposal discount		(3,730)
<b>Italian subsidiaries</b>	<b>512</b>	<b>30,500</b>
<b>Foreign subsidiaries</b>	<b>1,477</b>	<b>124,435</b>
<b>Total Group</b>	<b>3,989</b>	<b>283,935</b>

(\*) does not include audit-related services

(\*\*) For the first two years, Deloitte will not charge for 25% of the total hours once it is fully on-boarded as "professional investment" deemed essential during its "learning" phase about the Company's operations.

Mix for Italy: Partners 9%; Managers 22%; Seniors 32%; Staff 37%.

Worldwide mix: Partners 8%; Managers 19%; Seniors 33%; Staff 39%.

(\*\*\*) Fees include meals, lodging, travel, secretarial and administrative expenses.

Any expenses in addition to fees beyond those indicated above that are strictly necessary to perform the aforesaid engagement shall be discussed in advance, documented and in no event shall exceed 2% of fees. The supervisory contribution and VAT are in addition to those expenses.

The fees indicated above relate to the current situation and, thus, are subject to change. In that regard, the fee adjustment clause to which Tesmec is subject based on increased volume of audit work to be performed by us will be triggered only if revenues increase by more than 30% from one financial year to the next, subject to extraordinary transactions that significantly change the Company's business. Similarly, the fee adjustment clause will reduce the fees payable by Tesmec if significant changes to the structure of the Tesmec Group occur that reduce the volume of audit work.

The fees indicated above shall be adjusted based on the percentage change in the ISTAT [*Istituto nazionale di statistica* (Italian National Statistics Institute)] cost of living index (base month February 2019) and shall take effect with the audit of the 2020 financial statements.

## ANNEX 2

## SUMMARY OF THE PROPOSALS SUBMITTED BY THE INDEPENDENT AUDITORS PWC S.p.A.

## Statutory audit of Tesmec S.p.A. 2019-2027 (\*)

	<u>Hours (**)</u>	<u>Fees (***)</u>
<b>Tesmec S.p.A.</b>	<b>2,707</b>	<b>151,500</b>
Statutory audit of the financial statements		
Statutory audit of the Group's consolidated financial statements		
Reviews associated with signing tax returns	1,754	97,000
Limited audit of the Group's interim condensed consolidated financial statements	423	26,500
Review of the consolidated non-financial statement	250	18,000
Examination of the adequacy of the systems of internal controls	150	8,000
Expressing a conformity and consistency opinion on the Report on Operations and Report on Corporate Governance and Ownership Structures	30	2,000
Periodic review that the accounting records are being properly maintained	100	5,000
Improved proposal discount		(5,000)
<b>Italian subsidiaries</b>	<b>455</b>	<b>24,000</b>
<b>Foreign subsidiaries</b>	<b>1,327</b>	<b>123,200</b>
<b>Total Group</b>	<b>4,489</b>	<b>298,700</b>

(\*) does not include audit-related services

(\*\*) Worldwide mix: Partners 8%; Managers 18%; Seniors 42%; Staff 32%.

Fees include meals, lodging, travel, secretarial and administrative expenses.

Any expenses in addition to fees beyond those indicated above that are strictly necessary to perform the aforesaid engagement shall be discussed in advance with you, documented and in no event shall exceed 2% of fees. The supervisory contribution and VAT are in addition to those expenses.

(\*\*\*) The fees indicated above relate to the current situation and, thus, are subject to change. In that regard, the fee adjustment clause to which Tesmec is subject based on increased volume of audit work to be performed by us will be triggered only if revenues increase by more than 30% from one financial year to the next, subject to extraordinary transactions that significantly change the Company's business. Similarly, the fee adjustment clause will reduce the fees payable by Tesmec if significant changes to the structure of the Tesmec Group occur that reduce the volume of audit work.

The fees indicated above shall be adjusted based on the percentage change in the ISTAT cost of living index (base month February 2019) and shall take effect with the audit of the 2020 financial statements.