NAGRA
KUDELSKI GROUP

H1 2022 RESULTS

Management's Discussion & Analysis

GROUP RESULTS

The development of the Group's four business lines followed different trajectories in the first half 2022. Cybersecurity maintained the strong momentum of the previous year, growing at 15.4% in constant currency, and continued to improve its business mix, with an increasing share of revenues generated by high value-added business lines. IoT, while still small in absolute terms, grew by a factor of 2.7, reflecting the successful expansion of its asset tracking business. Public Access recovered after two years of COVID-19 related revenue decline. In this first half, Public Access delivered a double-digit constant currency revenue growth. Digital TV suffered from unfavorable exchange rate developments and the base effect of a strong 2021. Revenues for Digital TV declined by 8.9% in constant currency and by 13.2% on an as-reported basis.

In the first half 2022, the Group's total revenues and other operating income decreased from USD 340.5 million to USD 333.4 million. Net revenues grew by 3.3% in constant currency but decreased by 2.2% to USD 328.4 million on an as-reported basis.

Other operating income increased by USD 0.2 million to USD 5.0 million due to, among other factors, a USD 2.0 million government grant to SKIDATA.

Margin after cost of material decreased from USD 248.6 million to USD 245.0 million. Relative to total revenues, margin after cost of material increased from 73.0% to 73.5%, mainly reflecting higher gross margins in the Digital TV and Cybersecurity segments.

Compared to the first half 2021, the Group's personnel expenses decreased by USD 0.5 million, due in particular to favorable exchange rate effects. Over the first half of the year, headcount increased by 59 Full Time Equivalents (FTEs) to 3'285 at the end of June. The Group mainly increased Cybersecurity and Public Access headcount in this first half, in line with growing demand in these segments. Total FTEs in Europe as of June 30, 2022 were 48 higher than at the end of the previous year, driving most of the headcount growth.

In the first half 2022, the Group increased other operating expenses by USD 11.4 million. In the prior first half, the Group released USD 4.3 million of bad debt provisions, whereas in this period an additional USD 0.4 million of provisions were booked. Travel and marketing expenses increased, as pandemic-related restrictions eased. In this first half, travel expenses grew by USD 3.4 million and marketing and sales expenses increased by USD 2.0 million.

In this first half, the Group generated USD 0.5 million of operating income before depreciation and amortization, compared to USD 15.0 million in the previous first half. At USD 16.9 million, depreciation, amortization and impairment was USD 4.3 million lower than in the first half 2021, as the Group has systematically reduced capital expenditures over recent reporting periods. Overall, the Group generated an operating loss of USD 16.4 million for the half year.

At USD 5.4 million, interest expense was USD 0.4 million higher than in the prior first half. The Group posted USD 5.9 million of net finance income, primarily due to net foreign exchange gains. Income tax expenses for the period were at USD 2.9 million, resulting in a net loss of USD 18.6 million for the period, compared to USD 3.1 million in the prior first half.

DIGITAL TV

Digital TV revenues decreased by 13.2% to USD 144.5 million, representing a constant currency decline of 8.9%. In addition to foreign exchange factors, the base effect of strong 2021 Digital TV revenues drove this year-on-year development.

The Group's European Digital TV business posted 14.2% lower revenues compared to the first half 2021. In constant currency, European revenues declined by 6.6%. Among the highlights, Digital TV continues to grow its business with Vodafone and to deploy next generation security solutions. In Italy, RAI selected Nagravision's multi-DRM solution. United Group, a multi-play telecom and media provider in southeastern Europe, selected Nagravision's NexGuard watermarking. On the other hand, sales of conditional access modules (CAM) declined compared to the prior first half, due to, among other factors, a supplier's inability to deliver. CAM supply issues affected, in particular, Digital TV's Italian business, with revenues from the Italian market declining by 60% compared to the prior first half.

At USD 45.0 million, the Americas business posted 12.8% lower revenues in this first half. South American markets remain weak, still suffering from the negative impact of the pandemic. In the US, revenues were more resilient, delivering a single digit revenue decline compared to the prior first half.

At USD 28.7 million, the Asia Pacific and Africa region posted a 11.4% revenue decline in the first half 2022. After a strong first half 2021 that was driven by hardware sales, revenues from Starhub materially declined in the first half 2022. Among the positive highlights, VTVCab selected Nagravision's TVkey Cloud to deploy its direct-to-TV service on Samsung TVs in Vietnam. In India, PT Linknet selected Nagravision to migrate its Hybrid OTT/IPTV solution to the OpenTV Video Platform.

Digital TV margin after cost of material improved from 87.0% to 88.5%, reflecting a more favorable revenue mix, due to lower hardware sales, including conditional access modules and set-top boxes. In the first half, this segment's operating expenses were USD 0.4 million lower than in the prior first half. While currency effects resulted in an overall cost reduction, marketing, business development and services costs increased compared to the prior first half. Digital TV's operating income before depreciation and amortization declined by USD 16.4 million to USD 26.2 million. As depreciation and amortization was USD 3.3 million lower, this segment's operating income decreased by USD 13.1 million to USD 18.6 million.

CYBERSECURITY

In the first half 2022, the Group's cybersecurity business posted USD 79.6 million of gross revenues, a 12.1% increase from the first half 2021. Net revenues were at USD 51.0 million, representing a growth in constant currency of 15.4%. On an as-reported basis, cybersecurity net revenues grew by 12.2%. The business benefitted from growth across both of its main regions. In Europe, net revenues grew by 38.7% in constant currency to reach USD 18.8 million, while the Americas grew by 2.7% to USD 31.5 million. In addition, the Group generated USD 0.7 million of cybersecurity revenue in the Asia Pacific and Africa region. The Group's cybersecurity business continues to earn industry recognition. In this first half 2022, it was recognized in Forrester's Now Tech: European Managed Security Service Providers, and in the Gartner Market guide for Managed Security Services.

Margin after cost of material increased to USD 32.8 million, representing 34.2% growth from the prior first half. In relative terms, margin after cost of material increased from 54.0% to 64.3%, as the business mix continues to shift from lower margin technology reselling to higher margin advisory services, managed security services and proprietary technology sales. The development of cybersecurity bookings underscores the positive momentum of this business. In the first half 2022, the cybersecurity segment generated over USD 100 million of total bookings, continuing to grow at double-digit rates compared to the first half 2021. Bookings in high value-added business lines, including managed detection and response services, advisory and proprietary technology sales, increased by 32% over this same period. During the first half of the year, the cybersecurity business won substantial new contracts in luxury goods manufacturing, healthcare and hospitals, as well as in the energy and critical infrastructure sectors.

In this first half, segment headcount increased to support the further expansion of the business. With the rising demand for the Group's managed detection and response services, the Group launched a new cyber fusion center in Spain, staffed with an experienced team of threat detection specialists and cyber response consultants, complementing existing centers in Switzerland and the US. In addition, the Group continues to expand its cybersecurity offering portfolio, with the launch of MDR ONE, a new all-in-one solution that provides cloud-native managed detection and response services based on the Group's proprietary technologies.

As a result of the Group's continued investments, in the first half 2022, the cybersecurity business posted a USD 9.8 million operating loss before depreciation and amortization, roughly in line with the USD 9.5 million loss booked in the first half 2021.

INTERNET OF THINGS (IoT)

RecovR, the asset tracking solution combining lot management and theft recovery, continues to increase its pace of deployments at car dealerships across the United States. RecovR enables car dealers to manage their lots efficiently, improve the sales process and create a new revenue stream, while offering consumers an advanced and reliable wireless theft recovery solution. In the first half 2022, the Group added 140 new rooftops, accelerating RecovR's market penetration. This strong momentum drove IoT's first half revenue growth. In the first half 2022, IoT generated USD 7.2 million of revenues, compared to USD 2.6 million in the first half 2021. KeySTREAM, the Group's end-to-end IoT security platform, gained further traction in the first half year, delivering double-digit growth compared to the prior first half. IoT Security Labs continued to acquire new customers, while commanding higher man day rates. As a result, IoT Security Labs revenues almost doubled compared to the prior first half.

Operating expenses only marginally increased in this first half, as the business previously undertook investments in the organizational structure required to successfully launch and scale its RecovR asset tracking deployments. As a result, IoT reduced its operating loss before depreciation and amortization by USD 2.1 million to USD 9.5 million.

PUBLIC ACCESS

Following two years in which COVID-19 affected Public Access results, investments in access control infrastructure for parking, ski and events started to recover in the first half 2022. The service business, which has historically been more resilient than the project business, also benefitted from higher post-pandemic demand. As a result, Public Access revenues in constant currency increased by 11.8% in the first half 2022, but a weaker Euro had a negative impact on reported USD-denominated revenues. At USD 125.7 million, reported first half 2022 revenues grew by 3.7% compared to the prior first half. European sales strongly recovered, increasing by 4.4% to USD 79.7 million, in spite of the negative impact of the Euro exchange rate. In constant currency, European revenues grew by 14.4% from the previous first half. Austria, France and Italy were the best performing markets, with solid first half growth rates. In Austria, the mountain business benefitted from a strong recovery, with sales of consumable products and revenues from recurring software licenses also driving growth. In France and Italy, both the car and the mountain markets contributed to growing revenues, with service, consumable products and recurring software also driving higher sales.

Revenues from new deployments in the US market continued to decline in the first half 2022, while the service business started to recover, growing compared to the previous first half. In the US market, revenues in the car segment declined, while the event and mountain segments grew compared to the prior first half. Overall, Public Access generated USD 27.7 million of revenues in the Americas, growing by 0.5% from the first half 2021. The Asia Pacific and Africa markets continue to recover, with revenues growing by 6.1% to USD 18.3 million. SKIDATA's Australian affiliate increased its revenue contribution by USD 0.9 million compared to the prior first half.

Margin after cost of material relative to revenues decreased from 63.4% to 62.4%, reflecting the recovery of the lower margin project business.

In the first half 2022, Public Access increased operating expenses by USD 1.6 million compared to the previous year. In the prior first half, SKIDATA benefitted from COVID-related savings. In addition, SKIDATA increased headcount by 17 FTEs in this first half, expanding European headcount in line with the higher volume of business in the region. In this first half, SKIDATA also increased marketing, travel, consultancy, and software expenses.

Overall, Public Access generated a positive operating income before depreciation and amortization of USD 0.5 million, compared to USD 0.7 million in last year's period. For this first half, Public Access posted an operating loss of USD 7.1 million.

BALANCE SHEET AND CASH FLOWS

Total non-current assets decreased by USD 41.5 million to USD 551.0 million from December 31, 2021. Foreign exchange effects decreased the USD value of assets denominated in foreign currencies. However, the Group also continued to reduce the overall level of investments in tangible and intangible assets compared to previous years. Tangible fixed assets decreased by USD 5.0 million and intangible assets decreased by USD 19.7 million. Financial assets at amortized costs decreased by USD 6.2 million, reflecting lower long-term trade accounts receivables due to collections and reclassification to short-term receivables.

Compared to December 31, 2021, total current assets decreased by USD 103.2 million to USD 529.7 million. The USD 14.3 million increase of inventory reflects the buildup of safety stock at SKIDATA and for the IoT business, to mitigate supply risks due to the volatility of semiconductor supply chains. SKIDATA added USD 6.1 million of inventory and IoT added USD 6.8 million. The Group decreased trade receivables by USD 20.6 million, as SKIDATA reduced outstanding receivables by USD 15.9 million.

At the end of the period, cash and cash equivalents amounted to USD 184.0 million, representing a USD 100.5 million decrease from December 31, 2021, as the Group repaid open credit lines and increased working capital in the first half 2022.

Total equity decreased by USD 41.5 million, mainly reflecting the USD 18.6 million net loss for the period and a USD 20.1 million negative currency translation adjustment. Total non-current liabilities decreased by USD 37.0 million to USD 273.3 million, with long-term financial debt declining by USD 15.4 million to USD 181.4 million, driven by currency translation effects and debt repayment. In this first half, the Group repurchased a nominal amount of CHF 12.1 million of its 2022 bond and CHF 1.8 million of its 2024 bond. On August 12, 2022, the Group fully repaid its 2022 bond.

The Group reduced employee benefit liabilities by USD 15.5 million to USD 9.2 million. Lower pension liabilities are mainly driven by CHF 47.2 million favorable impact from a change of the discount rate for future liabilities from 0.35% to 2.05%, partly offset by a CHF 25.4 million plan asset loss. This reduction of liabilities is booked as other comprehensive income and has no impact on the Group's profit and loss statements.

Total current liabilities decreased by USD 66.4 million to USD 452.2 million, with short-term financial debt decreasing by USD 27.9 million to USD 212.1 million, as the Group fully repaid its Kudelski SA credit lines. The Group reduced trade accounts payable by USD 22.0 million to USD 46.6 million.

During the first half 2022, the Group generated negative USD 38.7 million of cash flow from operating activities, compared to positive USD 30.5 million in the first half 2021. First half negative operating cash flows follow the strong cash flow generation of the prior two years. Working capital increases were a key driver of the negative operating cash flow, including USD 15.8 million of cash used to increase inventory and USD 16.6 million to reduce account payables. In the first half, the Group maintained a strong discipline in managing capital expenditures, using USD 1.2 million cash for investing activities.

Net cash-out for financing activities amounted to USD 48.3 million. The cash outflow includes USD 8.0 million of payments for lease obligations, the USD 10.8 million dividend paid to non-controlling shareholders, and the USD 6.0 million cash distribution paid to Kudelski SA shareholders. In the first half 2022, the Group repaid USD 28.0 million of debt. Foreign exchange effects also resulted in a decrease of USD 12.3 million in the balance of cash and cash equivalents.

OUTLOOK

Following the Digital TV segment's strong 2021 results, which materially exceeded management expectations, the Group expects Digital TV revenues to decline in 2022 at single-digit rates in constant currency. Second half revenues should be higher than the first half's, in line with the seasonality patterns of prior years. Full year operating expenses are expected to be roughly at the same level as in 2021. These developments reflect the base effect of the strong 2021 results and will translate to a year-on-year reduction of the segment's EBITDA.

In the Cybersecurity segment, the Group expects to maintain its 2021 momentum, with revenues growing at a double-digit rate. As the Cybersecurity business continues to drive the development of higher margin product lines, margin after cost of material should also grow at a double-digit rate. After the material build-up of operating expenses in 2021, the growth of operating expenses is expected to slow down in 2022, resulting in a material improvement of segment profitability.

The strong momentum of RecovR sales is expected to drive IoT's revenues in 2022, while the Group will continue to promote IoT Services and the keySTREAM platform as a driver of long-term growth. Consistent with 2021, the Group expects IoT revenues to at least double in 2022 compared to the prior year. 2022 gross margins will decline, as the revenue mix will increasingly shift to the asset tracking business line. With operating expenses only marginally increasing compared to 2021, revenue growth is expected to translate into a lower EBITDA loss in 2022.

In Public Access, the Group forecasts a partial recovery in 2022, with high-single digit revenue growth in constant currency and a limited increase of operating expenses. The Group expects to benefit from the continued streamlining of SKIDATA's operations and a tighter integration with other Group businesses and is targeting a material improvement of Public Access profitability for 2022.