# KUDELSKI GROUP

## Interim Report

## January/June 2002

## Message to the Shareholders

Dear Madam,
Dear Sir,

Over the last ten years, the Kudelski Group has been regularly confronted with major challenges in the pay television sector. However, it has multiplied its revenues by a factor of more than twenty during this time frame. The continuous changes in the market environment have not prevented it from implementing a long-term strategy and facing up to changes year after year without significant hitches.

Nevertheless, on Thursday 29 August 2002 the Kudelski Group published the first profit warning in its history. This announcement disconcerted investors and the financial markets, although some observers had expected it. The surprise came from the scale of the revision, which exceeded even the most pessimistic scenarios. It is legitimate to wonder at the reasons for this abrupt turnaround, as even at the beginning of July the Group was anticipating closing a record 2002 financial year despite a difficult first semester in a volatile environment.

Traditionally, the Kudelski Group realizes up to 50% of its turnover in the fourth quarter. With the growing importance of the physical access control activities, this seasonality has not weakened, contrary to initial expectations. In the specific context of 2002, we expected the seasonal effect to be extreme given the significant weakness - which we judged to be temporary - on the digital television market during the first half of 2002.

The revision of forecasts for 2002 was the result of the conjunction of several factors which had a decisive impact on provisional revenues for the period from September to December 2002. Each year, between the end of July and September, we record orders for the end of the year. Historically, these orders were very substantial, yet this year they will be very low.

In addition, we experienced several other difficulties ranging from delays in the negotiation of new contracts through difficulties in the supply of a specific component to postponements of delivery dates by clients. Alongside this sudden fall in expected revenues, costs rose sharply during the first part of 2002 due to the many strategic challenges that await the Kudelski Group from the second half of 2002, including the expected merger of EchoStar and DirecTV.

While such incidents in the life of a company are difficult moments, both in external relations and internally, they present opportunities for improving the organization of a company. Carried away in a trend of uninterrupted growth for almost ten years, we see these difficult times as offering a real opportunity to review the structures of our Group in a fundamental and open-minded way in order to be better equipped to deal with the new market conditions.

While today we perceive only the bad news, it is only in the months and years to come that it will be possible to measure the continuous ability of the Kudelski Group to adapt to a changing environment. We are determined to succeed.

André Kudelski

## Key figures – 1st half-year 2002

| In kCHF | January/June 2002 | January/June 2001 | in % |
|---|---|---|---|
| Total Income | 165’736 | 158'560 | 4.53% |
| Gross margin | 104’143 | 90'562 | 15.00% |
| Gross margin in % of sales | 65.60% | 58.24% | |
| EBITDA | 205 | 26'868 | -99.24% |
| EBITDA in % of sales | 0.13% | 17.28% | |
| Operating income (EBIT) | -14’160 | 19'595 | -172.26% |
| Operating margin in % of sales | -8.92% | 12.60% | |
| Net result | -17’895 | 21'843 | -181.93% |

| | 30.06.2002 | 31.12.2001 | in % |
|---|---|---|---|
| Shareholders’ equity including minority interest | 559’976 | 580’851 | -3.59% |
| Gross cash | 835’222 | 415’857 | 100.84% |
| | | | |
| Basic earnings per shares | -0.35 | 1.42 | |
| Fully diluted earnings per share | -0.19 | 1.42 | |
| | | | |
| Market capitalization | 2'433'531 | 4’526’415 | |

## Activity in the first half of 2002

### Introduction

During the first half of 2002 the Kudelski Group reached revenues of CHF 165.7 million which represents an increase of 4.5% vs. the first half of 2001. While the business in the US and in Asia was still encouraging, the first six months of 2002 were marked by a sharp fall in the sales of the Group in the digital television sector in Europe. The expansion of business in Asia and in America was insufficient to compensate for the difficulties encountered on what was, historically, Nagravision's primary market. The widening in 2001 of the scope of consolidation allowed a slight income growth during the first half of 2002.

The evolution of the Group's business during the first semester of 2002 did not exclude the possibility of a strong acceleration in sales in the second half of the year. Given that the Kudelski Group was expecting an excellent second semester, it was important to prepare for that by making the necessary investments.

Today, though we realize that the anticipated revenues will not arrive in 2002, all of these investments remain valid as they are essential to address the future needs of our operator clients.

### Results to 30 June 2002

In the physical access control sector, the evolution was in line with expectations. This activity is marked by a significant seasonable variation which also prejudices the first half of the current financial year.

On a financial level, the first half was penalized by several combined factors:

- the weakness of the American Dollar, the growth in the proportion of revenues expressed in this currency and a policy of partial currency exchange in the television sector which negatively impacted both the revenues and the profitability of this sector;
- intensified efforts required for the deployment of a new equipment at EchoStar;
- the integration of Lysis still not meeting expectations;
- the weakness of the Euro against the Swiss Franc had a negative impact on revenues of the physical access control sector;
- revenues from deposits much lower than anticipated (for operations both in Dollars and in Swiss Francs) principally due to a strong decline in the short term interest rates had a significant impact on financial results.

Aside from these unfavourable elements, the Kudelski Group endeavoured to systematically reduce total outstanding receivables and was able to bring down a certain number of operational expenses within a constant scope of consolidation (operating and administrative expenses, cost of sales) during the first six months. These efforts will be intensified in the course of the second half.

## Activity in the first half of 2002

### Television sector

The first six months of 2002 were marked by a sharp reduction in revenues from digital television operators in Europe in general and in the UK and Spain in particular. This evolution had been anticipated, though it proved to be more unfavourable than expected, particularly with regard to revenues generated by system upgrades.

While sales in America were in line with expectations, they grew very sharply in Asia, where Nagravision installed several new systems and won new clients, particularly in China, Taiwan, Japan and Indonesia.

Furthermore, a more refined credit management system that takes into account the specific financial situation of each operator client led the Group to forego some sales opportunities which were judged to be too risky. A similar approach resulted in improvements in the quality of revenues, namely an increase in the relative gross margin.

### Physical access control sector

During the first semester, the results of the physical access control sector were in line with forecasts, although a certain slowdown was felt on several European markets. Activities in the parking sector developed well and several major sites were installed. Globally, a rigorous cost control policy allowed this sector – which is subject to strong seasonality - to maintain its profitability.

### Structure of the Group

Since the third quarter of 2001, Kudelski's management has worked on the integration of the various acquisitions within the Group. Lysis was integrated with Nagravision during the second half of 2001, however without producing the expected effects yet. In addition, SkiData took over the entirety of the physical access control activities in the first semester of 2002, with first results that look promising.

In 2001, the Kudelski Group decided to implement a new reporting system which has now been operational since the end of June 2002. In the next few months, an upgrade of this system will allow the automatic integration of the various management processes of the digital TV activities. Additionally, Nagravision's activity is being reorganized; this should be finalized by early 2003.

### Convertible bond issue

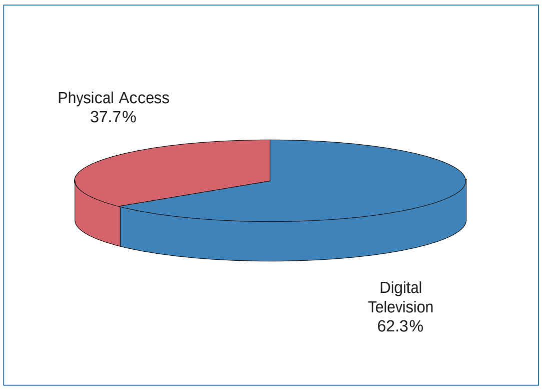
At the end of January 2002, the Kudelski Group issued a convertible bond of USD 325 million with the aim of investing in the company EchoStar in view of the expected merger between EchoStar and Hughes (DirecTV). As at 30 June 2002, the Kudelski Group had not yet made any firm commitment as to the use of the funds raised.

### Outlook

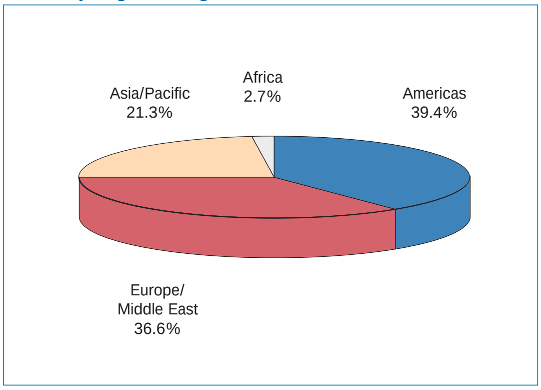
Contrary to initial expectations, the 2002 financial year will record a lower performance than the previous year. At the end of August 2002, the sharp deterioration in the short-term order book in the digital TV sector will have a disproportionately negative effect on the year 2002. In reaction to the new situation, the management of the Kudelski Group is taking all the steps needed in order to mitigate the negative consequences while at the same time safeguarding the growth opportunities of the Group in the medium and long term. It is totally determined to overcome this challenge.

## Sales breakdown

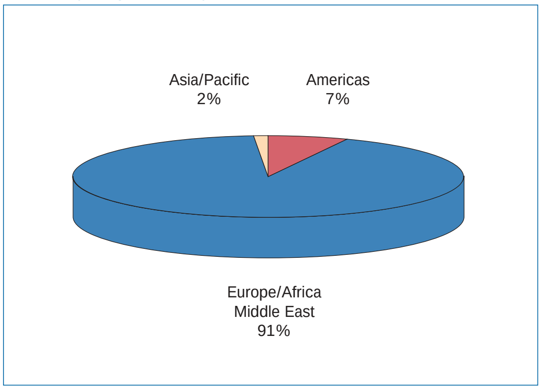
### Sales by activity




### Sales by region - Digital television



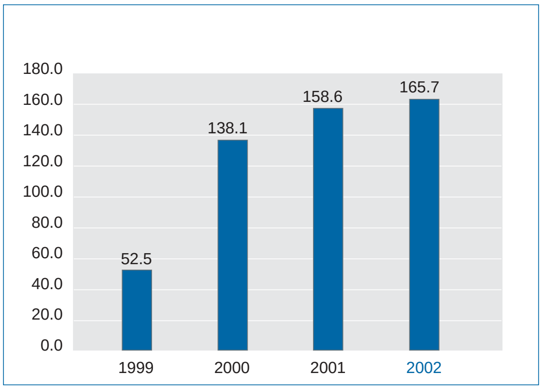

### Sales by region - Physical access



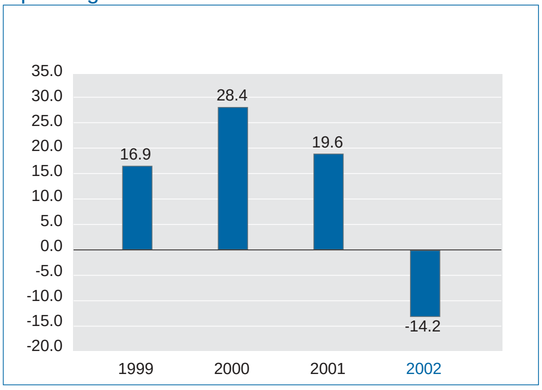
## 4 year comparison January/June

In mCHF

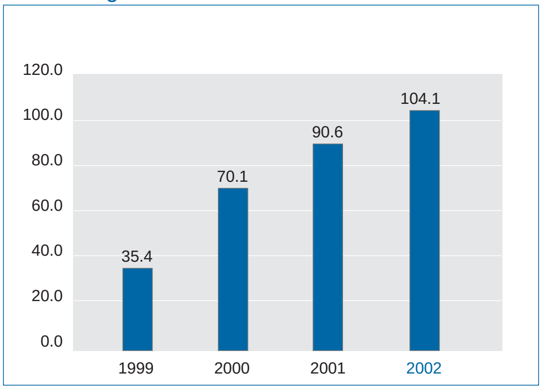
### Total Income



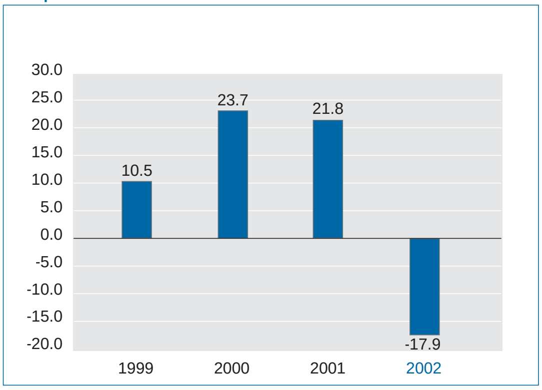

### Operating income



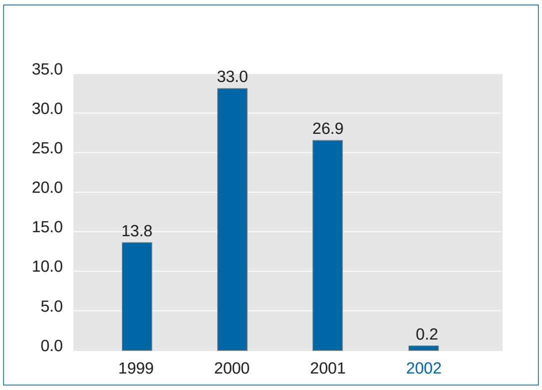

### Gross margin




### Net profit




### EBITDA



## Consolidated balance sheet

In kCHF

| Assets | 30.06.2002 | 31.12.2001 | in % |
|---|---|---|---|
| | unaudited | audited | |
| Fixed assets | | | |
| Intangible assets | 27'935 | 24'757 | |
| Long-term investments | 11'578 | 11'704 | |
| Loans | 18'563 | 34'266 | |
| Land and buildings | 35'315 | 35'622 | |
| Fixtures and fittings | 28'272 | 24'278 | |
| Total fixed assets | 121'663 | 130'627 | -6.86% |
| Current assets | | | |
| Inventories | 62'609 | 54'129 | |
| Work in progress | 0 | 412 | |
| Trade accounts receivable | 235'250 | 292'279 | |
| Other receivables | 28'359 | 28'469 | |
| Cash and cash equivalents | 835'222 | 415'857 | |
| Total current assets | 1'161'440 | 791'146 | 46.80% |
| Total Assets | 1'283'103 | 921'773 | 39.20% |

| Shareholders's equity and liabilities | 30.06.2002 | 31.12.2001 | in % |
|---|---|---|---|
| | unaudited | audited | |
| Shareholders' equity | | | |
| Share capital | 512'941 | 512'941 | |
| Share premium and reserves | 28'652 | 47'989 | |
| Total shareholders' equity, Group's interest | 541'593 | 560'930 | -3.45% |
| Minority interests | 18'383 | 19'921 | |
| Total shareholders' equity | 559'976 | 580'851 | -3.59% |
| Long-term liabilities | | | |
| Provisions | 39'621 | 41'276 | |
| Convertible bond | 472'884 | 0 | |
| Other long-term loans | 4'575 | 3'800 | |
| Total long-term liabilites | 517'080 | 45'076 | 1047.13% |
| Current liabilities | | | |
| Bank overdrafts | 36'552 | 51'743 | |
| Trade accounts payable | 80'276 | 111'445 | |
| Advances received from clients | 5'003 | 13'600 | |
| Other payables | 13'975 | 33'692 | |
| Short-term provisions | 25'732 | 31'645 | |
| Accrued liabilities | 44'509 | 53'721 | |
| Total current liabilities | 206'047 | 295'846 | -30.35% |
| Total Shareholders's equity and liabilities | 1'283'103 | 921'773 | 39.20% |

## Consolidated income statements (unaudited)

| In kCHF | January/June 2002 | January/June 2001 | in % |
|---|---|---|---|
| Sales | 137'087 | 104'469 | |
| Sales on long-term contacts | 21'668 | 51'017 | |
| Capitalization of new product development costs | 6'981 | 3'074 | |
| Total income | 165'736 | 158'560 | 4.53% |
| | | | |
| Cost of goods and components sold | -61'593 | -67'998 | |
| Gross margin | 104'143 | 90'562 | 15.00% |
| Salaries and wages | -63'378 | -29'965 | |
| Operating expenses | -16'651 | -15'161 | |
| Sales and administration costs | -23'909 | -18'568 | |
| EBITDA, Operating income before interest, taxes, depreciation and amortization | 205 | 26'868 | -99.24% |
| Change in provisions | -4'401 | -762 | |
| Depreciation and amortization | -9'964 | -6'511 | |
| EBIT, Operating income | -14'160 | 19'595 | -172.26% |
| Financial income | 11'653 | 10'160 | |
| Financial expenses | -15'566 | -3'155 | |
| Net result before tax and minority interests | -18'073 | 26'600 | -167.94% |
| | | | |
| Income tax | -98 | -3'090 | |
| Net result of the Group | -18'171 | 23'510 | -177.29% |
| | | | |
| Minority interests | 276 | -1'667 | |
| Net result | -17'895 | 21'843 | -181.93% |
| | | | |
| As a percentage of income | | | |
| EBIT, Operating income | -9% | 12% | |
| Net result | -11% | 14% | |

## Consolidated statements of cash flows (unaudited)

| In kCHF | January/June 2002 | January/June 2001 |
|---|---|---|
| Net income, Group's interest | -17'895 | 21'843 |
| Interest income | -6'954 | -10'167 |
| Interest expense | 7'512 | 3'155 |
| Income tax | 98 | 3'090 |
| Depreciation and amortization | 9'964 | 6'511 |
| Issuance cost and bond discount amortization | 2'609 | 0 |
| Change in long-term provisions | -706 | 2'115 |
| Change in deferred tax liability | 31 | 0 |
| Minority interest in net income | -276 | 1'667 |
| Cash flow | -5'617 | 28'214 |
| Change in inventories | -8'480 | -5'812 |
| Change in work in progress | 412 | -771 |
| Change in trade accounts receivable | 57'029 | -21'610 |
| Change in other assets | 1'599 | 4'829 |
| Change in trade accounts payable | -31'169 | -3'386 |
| Change in other liabilities | -36'548 | -9'454 |
| Change in short-term provisions | -5'080 | -7'910 |
| Operating cash flow | -27'854 | -15'900 |
| Interest paid | -2'509 | -438 |
| Interest received | 5'465 | 10'320 |
| Tax paid | -8'688 | -5'131 |
| Net cash used in operating activities | -33'586 | -11'149 |
| Investment of intangible assets | -6'792 | -3'423 |
| Investment of tangible assets | -10'037 | -8'166 |
| Investments in financial assets | 126 | -8'815 |
| Repayment of loans | 15'703 | 0 |
| Acquisition of subsidiaries, net of cash acquired | 0 | -23'585 |
| Net cash used in investing activities | -1'000 | -43'989 |
| Increase in share capital | 0 | 4'980 |
| Change in long-term loans and banks | -14'416 | -325 |
| Convertible bond, net of issuance costs | 472'884 | 0 |
| Payment from minority shareholders | 0 | 250 |
| Dividends paid to minority interests | 0 | -1'000 |
| Net cash from financing activities | 458'468 | 3'905 |
| Effect of exchange rate changes on cash and cash equivalents | -4'517 | 1'930 |
| Movement in cash and cash equivalents | 419'365 | -49'303 |
| Cash and cash equivalents at January 1 | 415'857 | 554'395 |
| Cash and cash equivalents at June 30 | 835'222 | 505'092 |
| Movement in cash and cash equivalents | 419'365 | -49'303 |

## Change in Shareholders' equity (unaudited)

| In kCHF | Share capital | Share premium | Other reserves | Goodwill | Consolidated shareholders' equity, Group's interest | Minority interest | Total shareholders' equity |
|---|---|---|---|---|---|---|---|
| At January 1, 2001 | 499'310 | 49'798 | 145'984 | -21'119 | 673'973 | 19'183 | 693'156 |
| Shares issued for employees | 617 | | | | 617 | | 617 |
| Change in scope of consolidation | 13'014 | | | -196'426 | -183'412 | 1'842 | -181'570 |
| Dividends paid to minority interests | | | | | 0 | -1'000 | -1'000 |
| Currency translation adjustment | | | -548 | | -548 | 388 | -160 |
| Write down on long-term investments | | | -1'786 | | -1'786 | | -1'786 |
| Net income | | | 72'086 | | 72'086 | -492 | 71'594 |
| At December 31, 2001 | 512'941 | 49'798 | 215'736 | -217'545 | 560'930 | 19'921 | 580'851 |
| Currency translation adjustments | | | -1'442 | | -1'442 | -1'262 | -2'704 |
| Net loss | | | -17'895 | | -17'895 | -276 | -18'171 |
| At June 30, 2002 | 512'941 | 49'798 | 196'399 | -217'545 | 541'593 | 18'383 | 559'976 |

# Notes to the consolidated financial statements at June 30, 2002 (unaudited)

## General comments and principles of consolidation

The unaudited interim consolidated financial statements are prepared in accordance with Swiss GAAP FER and give a true and fair view of the financial position and results of the Group. The accounting conventions and accounting policies are the same as those applied in the end 2001 Consolidated accounts.

## Modification of the scope of consolidation

During the 1st semester 2002, the scope of consolidation of the Kudelski Group has not been changed. For information, in 2001 the scope of consolidation was modified by the inclusion of the following entities:

- e-prica AG, Lyss, Switzerland, 50% (January)
- Livewire Communications Inc., Gainesville, USA,100% (April)
- Lysis International SA, Lausanne, Switzerland, 100% (April)
- Leman Consulting SA, Nyon, Switzerland, 100 % (May)
- TicketCorner AG, Rümlang, Switzerland 100% (May)
- SkiData Group, Gartenau, Austria, 100% (September)
- Nagra ID SA and Thermoplex F. Droz SA, La Chaux-de-Fonds, Switzerland 100% (October)

## Bonds

| Face value | Interest rates | | Year of issue / | June 30, 2002 |
|---|---|---|---|---|
| kUSD | Nominal | To maturity | Maturity | in kCHF |
| 325’000 | 2.25 % | 3 % | 2002 / 2009 | 472’884 |

At the end of January 2002, Kudelski Financial Services Holding S.C.A (the issuer), a 100 % subsidiary of Kudelski SA, issued an unsubordinated convertible bond of kUSD 325’000. The initial conversion price is CHF 127.50 per bearer share of Kudelski SA. Kudelski SA guarantees this issuance unconditionally and irrevocably.

The bonds have a denomination of USD 1'000 each, the issue price was 100%; the interest rate is 2.25% per annum, calculated on the nominal amount of the bonds and payable semi-annually in arrears on January 31, and July 31, in each year commencing on July 31, 2002. The yield to maturity is 3% per annum on a semi-annual basis.

At the January 31, 2009 maturity date, the issuer will redeem the bonds at 105.79% of their nominal amount. The issuer may at any time after January 31, 2005 until January 31, 2007 redeem all of the bonds.

The convertible bond is quoted at the Luxembourg stock exchange, the ISIN value is XS0140968842.

## Notes to the consolidated financial statements at June 30, 2002 (unaudited)

### Principal exchange rates

| CHF for | 1 USD | 1 EUR | 1 GBP |
|---|---|---|---|
| Average January / June 2002 | 1.64 | 1.47 | 2.37 |
| Average January / June 2001 | 1.70 | 1.53 | 2.45 |
| Rates for end of June 2002 | 1.48 | 1.47 | 2.27 |
| Rates for end of December 2001 | 1.68 | 1.48 | 2.42 |
| Rates for end of June 2001 | 1.80 | 1.52 | 2.53 |

### Legal and arbitration proceedings

The Group is subject to three lawsuits – alleged infringement of patents – before the American and German Courts. Provisions have been made for these legal proceedings. No notable evolution has to be noticed by today, as from December 31, 2001.

## Agenda 2003

| | |
|---|---|
| Release of 2002 financial results | 26th March, 2003 |
| Annual general meeting | 23rd May, 2003 |

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