

2019 RESULTS

Management Discussion & Analysis

KUDELSKI GROUP SEGMENTS

The Digital TV segment provides secure, open, integrated platforms and applications for broadcast, broadband and mobile networks, enabling compelling and personalized viewing experiences. Such platforms allow digital TV operators and content providers to offer a wide range of high value-added video services.

The Cybersecurity segment provides end-to-end cybersecurity solutions to a wide variety of customers across multiple sectors. The portfolio is based on four pillars: advisory services, technology, managed security services and proprietary R&D. The Cybersecurity segment leverages the Group's historical strengths in R&D to fuel a highly differentiated product and service offering across each of the four pillars.

With the IoT segment, Kudelski offers a resilient and easy-to-integrate and operate security solution. The Group's IoT offering includes the Kudelski IoT Security Platform, a pre-integrated, end-to-end solution providing device and data protection, and Kudelski IoT Security Services, such as advanced lab services and managed security services.

In the Public Access segment, SKIDATA, the Group's subsidiary, designs and delivers integrated solutions to provide seamless, user-friendly access for people and vehicles to sites and installations such as car parks, ski-lifts, stadiums, arenas, amusement parks and exhibition halls.

GROUP RESULTS

In 2019, total revenues and other operating income decreased from USD 919.7 million to USD 827.3 million. Net revenues for the Group decreased by 10.8% to USD 810.2 million, an 8.4% decrease in constant currency, mainly driven by the Digital TV segment, which posted a USD 61.3 million decline reflecting the evolution of the emerging markets, and the Public Access segment, which generated USD 29.2 million less revenues than in 2018. Cybersecurity segment net revenues were USD 8.3 million lower compared to the previous year. IoT generated marginal revenues as the segment's primary focus continues to be the development of a secure IoT platform solution for the market.

Other operating income increased by USD 5.6 million to USD 17.1 million, mainly reflecting R&D grants at SKIDATA, the sale of working capital items and the provision of services related to a past M&A transaction, as well as the attainment of an additional earn-out.

Margin after cost of material decreased from USD 648.9 million to USD 572.0 million. Relative to total revenues, margin after cost of material decreased from 70.6% to 69.1%, due to the shift of revenue mix from higher margin Digital TV to lower margin Public Access and Cybersecurity

businesses. Relative margins continue to increase in the Cybersecurity segment, reflecting a concerted effort to focus on higher value-added services.

Compared to 2018, the Group reduced personnel expenses by USD 40.5 million. A significant reduction of Digital TV headcount drove this reduction of personnel expenses. Total Group headcount decreased by 224 to 3'520 employees at the end of 2019. Headcount in the relatively high cost locations of Western Europe decreased by 134 units. In Asia, Group headcount decreased by 93 units, as employees previously engaged in SmarDTV-related activities were transferred to the buyer of the SmarDTV assets. Total SKIDATA headcount increased by 8 to 1'527 employees as of the end of 2019.

Compared to 2018, the Group reduced other operating expenses by USD 41.2 million. As of January 1, 2019, the Group adopted IFRS 16, without restating the comparable 2018 numbers. With the adoption of this new standard, USD 16.2 million of operating leases previously recognized as other operating expenses are booked as depreciation in the 2019 income statement. This is the main driver of the USD 16.3 million reduction of building and infrastructure costs. In addition, the Group reduced legal and consultancy costs by USD 4.7 million, reflecting, in particular, a further reduction of legal expenses related to IP licensing activities. Administrative expenses are USD 4.4 million lower than in the previous year, reflecting cost reductions from operational efficiency measures.

The USD 81.7 million net reduction of Group operating expenses in 2019 includes USD 56.8 million of cost savings achieved with the ongoing restructuring program, net of the cost of additional investments in the Group's key growth areas.

The 2019 restructuring program enabled a further substantial reduction of recurring Digital TV expenses. Key measures of this program included the integration of the Security and User Experience R&D organizations into a consolidated unit, the streamlining of the product portfolio with an increased focus on profitable products that address new growth markets, a custom development approach to product areas lacking critical mass, the full integration of Conax and NAGRA operations and a further rationalization of the Group's global presence with the closure of smaller locations and further specialization of existing sites.

The total reduction of Group recurring operating expenses in constant currencies between 2018 and 2019 amounts to USD 56.8 million. The year-on-year development of Group operating expenses benefitted from a favorable currency effect. 2018 operating expenses, at average 2019 currency rates, were USD 15.7 million lower compared to 2018 reported expenses. In 2019, the Group incurred USD 23.4 million of restructuring and run-down costs for the restructuring of its Digital TV activities, compared to USD 40.2 million in 2018. In 2019, the Group also booked USD 17.5 million of one-off costs in the Public Access segment, in conjunction with the rationalization of SKIDATA operations and for the impairment of inventory and receivables. USD 9.8 million of these one-off costs were booked as cost of material and USD 7.7 million were booked as operational expenses.

The Group's operating income before depreciation and amortization net of one-off restructuring costs was USD 81.4 million, a USD 5.5 million increase over the previous year. Reported operating income before depreciation and amortization was USD 40.6 million, representing an improvement of USD 4.8 million from 2018. At USD 55.9 million, depreciation, amortization and impairment were USD 12.8 million higher than in 2018, mainly due to the introduction of IFRS 16. Overall, the Group generated an operating loss of USD 15.3 million, compared to a loss of USD 7.3 million in the prior year.

At USD 10.2 million, interest expense was USD 0.2 million lower than in the prior year. The Group's primary interest-bearing liabilities include the CHF 200 million bond with a 1.875% interest rate maturing in August 2022, the CHF 150 million bond with a 1.5% interest rate maturing in September 2024 and USD 64.6 million of bank debt at SKIDATA. The Group posted USD 1.7 million of net finance expenses. Income tax expense was USD 13.3 million, including, in particular, a one-off effect from the transfer of entrepreneurship from Conax to Nagravision. The Group booked a USD 38.6 million net loss for 2019, compared to a loss of USD 20.0 million in the previous year.

DIGITAL TV

In Digital TV, a significant reduction of the segment's cost base offset the decline in revenues, resulting in a higher EBITDA ex restructuring cost compared to the prior year.

Reported Digital TV revenues decreased by 13.8% to USD 382.2 million, representing a constant currency decline of 12.1%. In 2019, the digital TV market has continued to contract, mainly in emerging markets, as a number of established pay TV operators report lower subscriber numbers. In addition, the Group did not book any material IP licensing revenues in 2019.

The Group's European Digital TV business posted 6.0% lower revenues, largely due to the negative development of the EUR-USD exchange rate. At constant currency rates, European revenues declined by 2.2%. In terms of sales activity, most European markets were resilient in 2019, with the Group benefitting from the extension of partnerships with large customers. Emerging product lines, such as watermarking and the Group's cloud-based security platform, gained traction, as large operators such as Vodafone, Discovery, Altice and Canal selected these Group products.

At USD 143.7 million, the Americas business posted 18.1% lower revenues in 2019. In Latin America, sales to Telefonica were materially lower than in the previous year, as Telefonica stopped most of its new deployments in satellite TV subscriber acquisition activities across South America. A further factor for this revenue decline relates to the IP licensing business, which did not generate any material revenue in 2019. The erosion of satellite subscribers in North America, on the other hand, slowed down in the second half 2019, resulting in a lower revenue decline compared to the previous year.

The Asia Pacific and Africa region posted 20.1% lower revenues in 2019. Sales in India declined compared to the previous year as the pay TV market suffered from overcapacity and increased competitive pressure. Revenues in the Australian market also declined compared to the prior year, due, in particular, to a soft first half.

Digital TV margin after cost of material remains high at 88.5%.

Net of restructuring costs, Digital TV generated USD 114.4 million of operating income before depreciation and amortization, representing a USD 2.5 million improvement from the previous year. This segment's profitability benefits from the reduction of operating expenses driven by improved productivity results from the transformation and the Group's restructuring program. In 2019, the Group reduced Digital TV operating costs by USD 59.3 million net of restructuring costs. Reported Digital TV operating income before depreciation and amortization was USD 91.0 million, compared to USD 71.7 million in 2018, while reported operating income was USD 59.8 million, an increase of USD 15.6 million over the previous year.

CYBERSECURITY

In 2019, Cybersecurity revenues were lower than in the previous year, while margin after cost of material increased, 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 Group's managed security service portfolio continues to expand; in 2019, it added native integration of market leading cloud service providers, including Amazon Web Services (AWS), Google Cloud Platform and Azure. The Group's offering has been recognized in Gartner's Market Guide for the third consecutive year and was named one of the top 10 key players in Europe for managed security services. In 2019, the Group's Managed Security Services grew by 34% from the previous year. The Group's Cybersecurity unit also established a set of partnerships with technical and process specialists from around the world in the blockchain domain, boosting the capabilities and offerings of its Blockchain Security Center.

Kudelski's cybersecurity business generated USD 137.1 million of gross revenues in 2019, a 9.2% decrease from 2018. 2019 Cybersecurity net revenues were at USD 86 million. The European region posted strong growth, increasing net revenues to USD 16.5 million, a 30.2% year-on-year improvement. The European region achieved high profiles wins in Germany and France, where it previously had little exposure. The Americas were most affected by the shift of business mix, with net revenues declining by 15.4% to USD 69.0 million.

Margin after cost of material increased to USD 39.5 million. In relative terms, margin after cost of material increased from 41.5% in 2018 to 45.9%.

The Cybersecurity segment generated a USD 22.1 million operating loss before depreciation and amortization, compared to USD 21.3 million in the previous year.

INTERNET OF THINGS (IoT)

In 2019, the Group continued to extend the reach of its IoT security platform, with initial launches also integrated its IoT security platform and secure element with Deutsche Telekom's nuSIM chipset and cellular module partners and made the IoT Security Platform's Secure Client available on STMicroelectronics' STM32 family of microcontrollers. The Group's IoT unit has secured an initial portfolio of customers that is starting to generate early revenues and is building a funnel of prospects.

In 2019, IoT generated revenues of USD 2.8 million, mainly from the IoT Center of Excellence, and an operating loss before depreciation and amortization of USD 21.2 million, reflecting the early development stage of this business.

PUBLIC ACCESS

The Public Access segment delivered a weak performance in 2019 with a year-on-year revenue decline and an operating loss. Reported Public Access revenues decreased by 7.9% in 2019. In constant currency, revenues decreased by 4.3%. In the last two years, SKIDATA failed to adjust structures and processes to assimilate the growth of the previous years, suffering from a fragmented organizational structure, lacking coordination between central functions and local entities, and from inefficient processes across the organization.

In the Americas, SKIDATA generated revenues of USD 92.1 million, representing a decrease of 16.5% compared to the previous year. A systematic review of SKIDATA's US entities uncovered several operational issues and a need for operational clean up. An inadequate supply chain setup and poor working capital management led to material inefficiencies in local operations. The integration of subsidiaries acquired in prior years continued to affect local processes. Operational delays pushed the delivery of several projects into 2020.

Revenues for Asia/Pacific and Africa declined by 24.0% to USD 56.9 million. The Australian market delivered a weak 2019, following several years of sustained growth. Further drivers of this revenue decline were Russia and Western Asian markets, where we experienced weaker demand for SKIDATA's products.

The Group initiated a turnaround plan for SKIDATA in July 2019. Initial structural measures have already been implemented and a comprehensive restructuring program is defined. Effective July 2019, the Group appointed David Luken as the new CEO of SKIDATA, with the objective of improving both cash flow generation and profitability. In conjunction with his hiring, the Group launched a program to fundamentally transform SKIDATA's operations, drive operational excellence and enhance customer service and support.

At the same time, the Group completed an in-depth review of SKIDATA's operations, defining a blueprint for operating improvements aimed at building an optimized operating model. A first wave of measures was completed with a focus on SKIDATA US, including, in particular, the merger of formerly independent entities, the introduction of Group ERP and supply chain tools, a clean-up of the project portfolio, and the integration and streamlining of critical functions. To accelerate the implementation of its restructuring plan, the Group also replaced the General Manager of SKIDATA US.

On the positive side, Public Access' European sales increased by 3.8% to USD 190.2 million, representing an 8.8% growth in constant currency. The main markets driving growth were Switzerland and Germany.

Margin after cost of material relative to revenues decreased from 57.7% to 56.6%. Public Access' 2019 cost of material includes a USD 9.8 million one-off charge related to impairments booked in the context of the ongoing restructuring program. In addition, Public Access' 2019 operational expenses include USD 7.7 million of one-off costs related to the rationalization of SKIDATA operations, the consolidation of regional entities and the impairment of receivables and contract assets.

Public Access operating income before depreciation and amortization net of these one-off costs was USD 25.4 million. Reported operating income before depreciation and amortization was USD 8.0 million, representing a USD 13.1 million decline compared to 2018. Public Access reported an operating loss of USD 10.1 million in 2019.

BALANCE SHEET AND CASH FLOWS

Total non-current assets decreased by USD 0.9 million to USD 695.8 million. Investments in technical equipment and machinery in the Digital TV segment were lower compared to the previous year. As a result, tangible fixed assets decreased by USD 1.4 million. The USD 24.3 million decrease in intangible fixed assets is mainly due the lower investment level and the depreciation of assets capitalized with the acquisition of Conax. Lower intangible assets were mainly driven by a USD 8.9

million year-on-year decrease of customer lists, trademarks and brands, USD 7.4 million decrease of software, and USD 6.1 million decrease of technology.

With the adoption of the IFRS 16 standard, leases are recorded on the balance sheet. As of the end of December 2019, newly recorded right-of-use assets amount to USD 41.5 million. The related liabilities consist of USD 28.5 million of long-term lease obligations and USD 15.5 million of short-term lease obligations. Financial fixed assets at amortized cost decreased by USD 12.9 million, as we cashed in IP licenses accrued during previous periods.

Compared to December 31, 2018, total current assets decreased by USD 40.5 million to USD 486.4 million. The USD 5.6 million increase of inventories is mainly due to USD 5.4 million of higher stock at SKIDATA. The Group decreased trade receivables by USD 42.7 million, including, in particular, a USD 19.8 million reduction of outstanding SKIDATA receivables.

Contract assets consist of amounts due from clients for projects recognized on a percentage of completion basis. Out of the total USD 58.0 million of total contract assets, USD 55.2 million relate to SKIDATA. Other financial assets at amortized costs increased by USD 7.4 million to USD 48.4 million. Short-term government grants receivables and receivables from IP licenses due in the next 12 months drove this increase.

At the end of 2019, cash and cash equivalents amounted to USD 74.6 million.

Total equity decreased by USD 39.7 million, mainly reflecting the negative net income for the period, positive other comprehensive income, negative USD 9.3 million currency translation adjustment, and the USD 5.5 million cash distribution to Kudelski shareholders.

Total non-current liabilities increased by USD 2.3 million to USD 486.7 million. Long-term financial debt decreased by USD 5.2 million to USD 393.0 million. Employee benefits liabilities were USD 15.2 million lower than at the end of the previous year. Changes in financial assumptions, including, in particular, a reduction of the discount rate used for the calculation of defined benefit obligations from 1% to 0.2% led to an increase of such liabilities by USD 27.9 million. On the other hand, a USD 21.3 million return on plan assets and USD 20.6 million improvement due to favorable effects from demographic factors resulted in an overall decrease of pension liabilities. Total current liabilities decreased by USD 6.9 million to USD 303.6 million. Short-term financial debt increased by USD 9.6 million to USD 73.7 million.

In 2019, the Group generated USD 34.2 million cash flow from operating activities, compared with a negative USD 4.7 million in 2018. Cash generation significantly improved in the second half, as first half operating cash flow was USD -2.0 million, while operating cash flow in the second half was USD 36.2 million. The main driver of the year-on-year improvement is the reduction of trade accounts receivable, generating USD 58.8 million in 2019.

The Group used USD 14.9 million cash for investing activities, including USD 3.3 million to purchase intangible fixed assets and USD 13.7 million for tangible fixed assets. The Group reduced cash used for investing activities by USD 2.9 million compared to 2018.

Net cash-out for financing activities amounted to USD 30.4 million, compared to net cash-in of USD 39.4 million in 2018. The cash outflow includes the USD 5.5 million cash distribution paid to Kudelski SA shareholders. USD 17.0 million of the reduction of lease liabilities previously booked as operating cash flow are booked as outflow from financing activities.

OUTLOOK

For 2020, the Group expects the revenue erosion in the Digital TV segment to taper off, as the subscriber base erosion at established pay TV operators is slowing down and the Group will continue to benefit from multiyear contracts with large pay TV customers and is successfully introducing new solutions gaining added revenues with existing clients. Following the reduction of operating expenses in the past two years, the Group expects the Digital TV cost base to remain substantially stable in 2020.

With Cybersecurity, the Group will continue to drive the development of higher value product lines and expects continued growth of margin after cost of material. Cybersecurity is expected to continue adding new clients, expanding geographical coverage and increasing profitability by leveraging strategic offerings and high-value products and services. For 2020, the Cybersecurity segment top line is expected to revert to growth, resulting in a lower operational loss compared to 2019.

Following three years of substantial investments, a secure IoT platform is now available for commercial deployment. In 2020, the Group targets a level of revenue contribution from the IoT business that is at least double the level achieved in 2019. At the same time, operating expenses will remain in the same range as in prior years.

In the Public Access segment, SKIDATA is implementing rationalization measures that are expected to result in a material reduction of operating expenses. The organization is shifting to a regional operating model with the consolidation of local, subscale functions into regionalized units (e.g., warehouse consolidation and integration of corporate functions) and the closure of subscale offices. Further measures include the reengineering of selected core processes, the automation of manual processes, the reduction of overhead positions, and the rationalization of low-yield activities. SKIDATA will streamline its R&D portfolio with the discontinuation of non-core developments and by improving the alignment of its project portfolio with business needs. SKIDATA is expected to benefit from the tighter integration of relevant functions in the Kudelski Group. In particular, the Group will drive operating synergies in core operating and support functions. These measures are expected to restore an EBITDA margin level in line with prior years.