2020 RESULTS

Management Discussion & Analysis

IMPACT OF COVID-19

The COVID-19 pandemic affected demand for the Group's offerings. After a first half with materially reduced levels of activity in the Public Access and Digital TV markets, the resilience of the Group's businesses was better-than-expected in the second half of the year. Recovery of demand combined with the favorable impact of proactive cost control measures resulted in strong second half profitability and cash flows.

In the first half, some Digital TV operators lowered paywalls to compete with an increase in streaming activities. Revenues in the first half were also negatively impacted by the closure of retail markets, particularly in Italy. In the second half, Digital TV was more resilient than anticipated, benefitting from a robust recurring business and in spite of the negative impact of COVID-19 on the project side of the business. While key markets in Asia-Pacific and Latin America remained closed and under lockdown restrictions in the second half, resulting in continued pressure on revenues in these regions, the recurring Digital TV business in Europe overperformed compared to expectations with a strong momentum in the last quarter. Furthermore, growth areas such the Group's analytics business benefitted from new customer wins.

The onset of COVID-19 also brought disruption to the Group's Cybersecurity business, affecting the Group's ability to engage with clients, slowing sales activities and delaying delivery of services traditionally delivered in person. This had a negative impact on first half revenues in the US, which declined by 23.5% from the first half 2019. The second half 2020 saw a recovery of demand in the US, translating to a 13.9% revenue growth compared to the first half 2020. COVID-19 had virtually no impact on the pace of growth and expansion of the Cybersecurity business in Europe. The Group's 2020 European cybersecurity business grew by 57.4% from the previous year. The development of bookings points to the change of business momentum between the first and the second half: first half global Cybersecurity bookings declined by 10.4% compared to the second half 2019, while second half 2020 bookings strongly recovered, growing by 27.5% compared to the first half 2020.

Of our business units, Public Access was the most significantly affected by COVID-19, as large customers, including in particular airports, shopping centers and stadiums, postponed new deployments and asset refreshment projects. First half sales were severely affected, resulting in a 23.6% revenue decline. Service volume dropped to nearly 25% of normal volume in April and May due to shutdowns, reflecting reduced usage of the parking infrastructure. By the end of June, service volumes within Europe were recovering to approximately 90% of the prior year volumes with other regions averaging about 75%. This partial recovery led to a more resilient than expected second half. Compared to the second half 2019, Public Access second half 2020 revenues experienced a limited 4.5% decline. Overall, the negative effect of lockdowns on the usage of parking infrastructure and on the level of activities in the ski domain continue to affect SKIDATA's top line.

COVID-19 MEASURES

The Group has implemented measures aimed at mitigating the impact of COVID-19 in the following areas: structural COVID-driven business adjustments, cost savings, cash flow optimization, and financing measures.

The Group swiftly adapted its structure and operations to the changed COVID-19 environment. In the second half, it integrated the learning from the first COVID-19 wave, ensuring full business continuity in spite of extended lockdowns. In addition, it adjusted its marketing and sales approach, in particular, increasingly leveraging digital channels.

With the onset of the pandemic, the Group implemented a set of measures aimed at temporarily reducing its cost base in order to align with the reduced levels of demand in the Public Access and Digital TV segments. Partial unemployment measures in several countries enabled the Group to reduce personnel costs. At the same time, the Group implemented structural measures to adapt its cost base to the reduced level of demand. At year end, the Group reduced overall headcount by 262 FTEs, mainly in Public Access, compared to the end of 2019. The Group also reduced travel costs by USD 16.5 million, a 52.5% decrease compared to 2019.

The Group took a very selective approach to capital expenditures, resulting in a reduction of cash flows used in investing activities from USD 14.9 million in 2019 to USD 8.9 million in 2020. As a further lever of cash generation, the Group managed to materially reduce working capital. Through working capital improvements, the Group released USD 92.4 million of cash in 2020, in particular with the implementation of measures aimed at accelerating the collection of outstanding invoices.

In 2020, the Group obtained COVID-related loans at favorable terms for a total amount of USD 29.9 million. Together with strong cash flow generation, these loans secured Group liquidity for 2021 and beyond.

GROUP RESULTS

In 2020, total revenues and other operating income decreased from USD 827.3 million to USD 741.5 million. Net revenues for the Group decreased by 10.0% to USD 729.5 million, a 10.6% decrease in constant currency, reflecting a decline of Digital TV and Public Access sales. After a weak first half, with net revenues declining by USD 78.4 million compared to the previous first half, Group sales strongly recovered in the second half. Second half 2020 total Group revenues marginally declined by USD 5.3 million from the second half 2019, with cybersecurity and IoT activities growing and Digital TV materially stable. Compared to the first half 2020, second half 2020 total Group revenues increased by USD 101.3 million, driven by higher sales in all segments.

Other operating income decreased by USD 5.0 million to USD 12.1 million, due to a decrease of USD 3.3 million in government grants and the base effect from the one-time contribution in 2019 from the provision of services related to a past M&A transaction and attainment of an additional earn-out.

Margin after cost of material decreased from USD 572.0 million to USD 529.9 million. Relative to total revenues, margin after cost of material increased from 69.1% to 71.5%, as the Group achieved gross margin improvements across all segments.

Compared to 2019, the Group reduced personnel expenses by USD 39.5 million in 2020. Streamlining of Public Access' operations enabled the reduction of 168 FTEs, through the implementation of measures planned in the 2019 restructuring program. In addition, temporary headcount reduction measures in Public Access and Digital TV were a further driver enabling lower personnel expenses. At the end of the year, Group headcount was at 3'258 FTEs, representing a reduction of 262 FTEs compared to the end of 2019. Restructuring of SKIDATA US was the main driver of the 133 FTE reduction in the Americas. In Europe, the Group reduced headcount by 62 FTEs. The main locations driving this decrease were Austria and France. In Asia, the Group reduced FTEs by 67.

Compared to 2019, the Group cut USD 26.5 million of other operating expenses. COVID-related measures resulted in a USD 16.5 million reduction of travel expenses, USD 3.7 million savings in development and engineering, and USD 3.5 million reduction of building and infrastructure costs.

2020 operating expenses include one-off items related to the accounting treatment of the Swiss pension fund and expenses related to the ongoing SKIDATA restructuring. Newly adopted LPP 2020 assumptions include a revised demographic basis, resulting in a lower conversion rate for the Swiss pension fund. The lower conversion rate produced a positive USD 10.0 million effect on personnel costs. This positive effect mainly benefits the Digital TV segment. On the negative side, SKIDATA booked USD 5.2 million cost of material from the impairment of obsolete inventory. Further, SKIDATA booked a USD 2.5 million bad debt provision and USD 0.2 million negative revenue adjustment. Overall, these one-off effects result in a positive USD 2.1 million impact on Group's operating expenses.

The Group generated USD 64.3 million of operating income before depreciation and amortization, a USD 23.7 million improvement from the previous year. This improvement reflects a strong second half, in which the Group generated USD 59.4 million, an increase of USD 54.5 million compared to the first half. Compared to the second half 2019, second half EBITDA improved by USD 34.3 million. At USD 48.3 million, depreciation, amortization and impairment were USD 7.6 million lower than in 2019, as some assets were fully depreciated in prior reporting periods. Overall, the Group generated an operating income of USD 16.1 million, compared to a loss of USD 15.3 million in 2019.

At USD 10.4 million, interest expense was USD 0.2 million higher than in the prior year. The Group posted USD 14.8 million of net finance expense, due to net foreign exchange losses. The revaluation of intercompany positions and foreign exchange effects from USD-denominated working capital items booked in entities with a Swiss Franc functional currency result in these foreign exchange differences. These exchange differences have no impact on Group's cash flow. Income tax expense was USD 10.7 million, including, in particular, a one-off effect from the impairment of tax assets related to SKIDATA affiliates. The Group booked a USD 18.0 million net loss for 2020, compared to a loss of USD 38.6 million in the previous year.

DIGITAL TV

Digital TV delivered a strong 2020, increasing EBITDA by USD 5.9 million to USD 96.9 million. In relative terms, EBITDA margin increased from 23.8% in 2019 to 28.1% in 2020.

2020 net revenues decreased by 9.6% to USD 345.4 million, representing a constant currency decline of 9.9%. Following a slow first half, second half segment revenues were in line with the second half 2019 and increased by USD 36.0 million from the first half 2020. Recurring revenues, particularly in advanced pay TV markets, enabled Digital TV resilience.

Digital TV also benefited from positive momentum in new product areas, including Insight, NexGuard watermarking, TVKey, OpenTV Platform and system integration services. Insight leverages big data and artificial intelligence to predict viewers' behaviors and suggests to operators smart actions to improve content and limit churn. In 2020, Altice and Canal+ adopted Insight, benefitting from its proven track record of profitability improvement. NexGuard protects high-value content in the early stages of the content supply chain (pre-release, digital cinema) and for operators. In addition to mitigating the economic impact of piracy on open Internet devices, NexGuard and the operational security services bundled with this platform provide forensic support for the identification of piracy sources and users, with a proven legal success track record in several jurisdictions. Liberty Global and RAI adopted NexGuard in 2020. TVKey seamlessly integrates the functions of traditional set-top boxes in TV sets, thus eliminating the need for additional devices. The Group is the sole partner of Samsung for the deployment of these devices. OpenTV Platform provides an end-to-end video platform supporting the seamless delivery of video content across broadcast and broadband channels. The platform is also available as a ready-to-deploy video solution for sports and was deployed by La Liga and the International Hockey Federation in 2020. Finally, the Group increasingly provides system integration services to operators such as Vodafone, though custom development projects supporting content providers and TV operators across the value chain. Aggregate 2020 revenues from these growth areas grew by 48% from the previous year to reach USD 40 million.

The Group's European Digital TV business posted 4.5% lower revenues compared to 2019. Most large European customers were resilient in spite of the COVID-19-related market turbulences. Notwithstanding such COVID-related impacts, the Group continues to grow its partnerships with large operators. For example, Vodafone continues to expand its footprint to additional European countries, relying on the Group's SSP (Security Services Platform) technology to integrate newly acquired operators in the Vodafone TV ecosystem.

At USD 124.5 million, the Americas business posted 13.3% lower revenues in 2020. COVID-19 negatively impacted Latin American markets, with large operators such as America Movil and Telefonica, in particular, putting on hold projects and substantially reducing smart card orders. The US Digital TV business, on the other hand, posted year-on-year growth, driven in particular by the further development of the Group's partnership with Altice. In 2020, Altice USA and Nagra have continued to extend their partnership on antipiracy. In addition, Altice continues to adopt Insight, the Group's business analytics platform to address subscriber churn and monitor and optimize quality of service and customer experience and deployed Nagra Protect, enabling a new generation of high-definition digital TV adapters.

The Asia Pacific and Africa region posted 13.4% lower revenues in 2020, as the COVID-19 crisis strongly affected this region's activity levels. In particular, full year revenues from Starhub, Essel and Foxtel declined by over USD 11 million in the aggregate. Following a weak first half, second half sales recovered and increased by 50.6% in the second half.

Digital TV margin after cost of material further improved from 88.5% to 88.7%. The USD 37.8 million reduction of operating expenses achieved in 2020 enabled the Group to sustain the segment's performance in spite of the negative impact of COVID-19 on Digital TV revenues, as the Group identified the changing market conditions early on and was fast in reacting to put in place appropriate cost control measures resulting in reduction of operating expenses. Compared to 2019 when the Group posted USD 23.4 million of restructuring costs, no such costs were booked in 2020, contributing to the material year-on-year improvement of the segment's cost base. In 2020, Digital TV generated USD 96.9 million of operating income before depreciation and amortization, representing a USD 5.9 million improvement from the previous year and USD 72.1 million of operating income, representing a USD 12.3 million improvement from 2019.

CYBERSECURITY

In 2020, Kudelski's cybersecurity business posted USD 139.9 million of gross revenues, a 2.0% increase from 2019. 2020 net revenues were at USD 85.3 million, representing a 0.8% decline from 2019. The Group's cybersecurity business continues to shift from lower margin technology reselling to the higher margin advisory, managed security services and proprietary technology business lines. In addition, revenue recognition policies are also impacting the segment's net revenue development. As the market is increasingly moving from on-premises to SaaS (software as a service) deployments, the segment recognizes lower revenues, as the reselling of on-premises equipment is typically booked on a gross basis, while the as-a-service business is generally booked on a net basis.

Margin after cost of material increased to USD 48.4 million, representing 22.6% growth from the previous year. In relative terms, margin after cost of material increased from 45.9% to 56.7%. The evolution of margin after cost of material provides the most relevant measure of the segment's performance, as this measure accurately reflects the development of the value-added component of the Group's cybersecurity business over time.

In 2020, the Group continued to expand its cloud-first cybersecurity portfolio supporting digital transformation initiatives of global enterprises using private and public cloud services. For example, in June 2020, it launched its dedicated Microsoft security services, enabling clients to effectively consume and configure Microsoft security capabilities and add additional monitoring to their Microsoft 365 and Azure environments.

The European region posted strong growth, increasing net revenues to USD 26.7 million, a 57.4% year-on-year improvement. In the Americas, revenues declined by 15.1% to USD 58.6 million. Following a first half of the year in which the US business was affected by a reduction of discretionary hardware sales due to the pandemic, in the second half, US revenues grew by 13.9% compared to the first half.

In 2020, the US cybersecurity business incurred expenses related to organizational changes. In addition, the Group continued to expand its European cybersecurity operations beyond the Swiss market strengthening its presence in France and Germany. As a result, the segment's operating expenses increased by USD 4.4 million compared to the previous year. The Cybersecurity segment posted a USD 17.5 million operating loss before depreciation and amortization, an improvement of USD 4.6 million from the previous year. At USD 6.0 million, second half operating loss before depreciation and amortization improved by USD 5.5 million compared to the first half.

INTERNET OF THINGS (IoT)

In 2020, the Group significantly revamped its IoT operations to better take into account the early maturity stage of this market. Specifically, to complement the existing IoT Services (lab and design) and IoT Systems (centered around the keySTREAM platform) business lines, the Group added an IoT Solution business, which leverages existing Group assets to provide a fully deployable end-to-end asset tracking solution. RecovR, the new IoT Solution, is currently in a pilot phase with select customers and will be commercially deployed starting in the first half 2021. With this development, the Group addresses the requirement to provide a full end-to-end solution in addition to its customizable IoT security platform.

The Group launched a standalone IoT secure element, the Pico SE 800, allowing IoT device manufacturers to easily embed keySTREAM into their devices. Kudelski IoT partnered with ST to embed keySTREAM into ST Microelectronics' ST4SIM eSIM solutions and continued its partnership and integration into u-blox products and services. It also announced support for the GSMA's IoT SAFE initiative, which establishes guidelines for the use of mobile SIM cards to provide IoT security. In 2020, the Group won its first customer for its passive keyless access based on keySTREAM. The customizable passive keyless access platform provides drivers with access to vehicles using an authorized mobile phone or other digital key options. In the IoT Services domain, Kudelski IoT Labs became an Amazon authorized test lab for Alexa voice Services (AVS) for built-in devices.

2020 results reflect the initial benefits of this strategic refocusing. Full year revenues increased by USD 0.9 million to USD 3.7 million. Second half revenues more than doubled compared to the first half, still mainly driven by the IoT Services business. Refocusing IoT operations to high potential domains led to a reduction of operating expenses compared to the previous year. Overall, these developments translate to a USD 4.7 million reduction of the operating loss before depreciation and amortization compared to the prior year.

PUBLIC ACCESS

COVID-19 significantly affected 2020 Public Access results, with revenues decreasing by 13.0% year-on-year to USD 295.1 million. The first half was mostly affected, with revenues declining by 23.6%, while the second half partially recovered, posting a 4.5% decline compared to the second half 2019.

At USD 175.8 million, European sales decreased by 7.6%. COVID-19 effects impacted most European markets, with the main revenue losses affecting France (USD 4.8 million decline), Germany (USD 4.1 million), and Italy (USD 2.5 million). COVID-19 also negatively impacted demand in the Americas, where SKIDATA is in the process of restructuring its US operations. COVID-19 mainly affected first half results. For the full year, American revenues declined by USD 8.9 million, with USD 16.2 million lower revenues in the first half and USD 7.3 million higher revenues in the second half. In the US market, revenues declined by USD 10.3 million in the first half and increased by USD 6.6 million in the second half. Public Access generated USD 36.0 million revenues in Asia/Pacific and Africa, a decline of 36.6% over the prior year. The Australian market delivered a weak 2020, with a USD 8.2 million revenue decline from the previous year.

Margin after cost of material relative to revenues increased from 56.5% to 58.1%. Public Access reduced 2020 operating expenses by USD 28.9 million compared to the previous year. In addition to temporary COVID-related actions, structural headcount reduction measures enabled these cost savings. Overall, Public Access generated an operating income before depreciation and amortization of USD 16.5 million, representing USD 8.5 million improvement compared to the prior year. For the full year, Public Access posted an operating loss of USD 1.2 million.

BALANCE SHEET AND CASH FLOWS

Total non-current assets decreased by USD 25.4 million to USD 670.4 million. The overall level of investments in tangible and intangible assets was lower compared to previous years. On the other hand, foreign exchange effects increased the USD value of assets denominated in foreign currencies. Tangible fixed assets increased by USD 0.9 million and intangible assets decreased by USD 8.0 million. Financial assets at amortized costs decreased by USD 13.6 million, reflecting a lower long-term portion of trade accounts receivables due to collection and reclassification to short-term of such receivables.

Compared to December 31, 2019, total current assets increased by USD 47.5 million to USD 533.9 million. The USD 6.3 million decrease of inventory is mainly due to a reduction of stock levels both at SKIDATA and within Digital TV. SKIDATA launched a supply chain restructuring program that is expected to drive a substantial reduction of its inventory balance. The Group decreased trade receivables by USD 29.9 million, as SKIDATA reduced outstanding receivables by USD 10.0 million. The main Digital TV entities reduced outstanding receivables by USD 16.2 million, benefitting from targeted measures aimed at preserving cash in the context of the COVID-19 pandemic. The Group reduced contract assets by USD 13.4 million to USD 44.6 million, as SKIDATA improved its invoicing cycles. Other current assets increased by USD 12.9 million to USD 38.5 million, driven by cybersecurity subscription software transactions delivered and accrued in 2020 but not yet invoiced.

At the end of 2020, cash and cash equivalents amounted to USD 152.6 million, representing USD 78.0 increase from December 31, 2019.

Total equity decreased by USD 34.4 million, mainly reflecting the USD 18.0 million net loss for the period, USD 10.2 million dividend paid to non-controlling interests and USD 5.7 million dividend paid to Kudelski SA shareholders.

Total non-current liabilities increased by USD 44.1 million to USD 530.8 million, with long-term financial debt growing by USD 46.2 million to USD 439.2 million, mainly driven by currency translation effects. Total current liabilities increased by USD 13.7 million to USD 317.3 million, with short-term financial debt decreasing by USD 25.5 million to USD 48.2 million, driven by a lower utilization of Kudelski SA and SKIDATA credit lines. Overall, 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, CHF 20 million of COVID-relief loans received by Nagravision and USD 50.5 million of bank debt at SKIDATA.

At the end of 2020, contract liabilities increased by USD 24.4 million, mainly reflecting a prepayment received from a Digital TV customer for services to be delivered and recognized as revenue in 2021. Other current liabilities increased by USD 16.6 million, to include VAT due on customer prepayments and accruals for amounts due to suppliers for cybersecurity products delivered in 2020 but not yet invoiced.

In 2020, the Group generated USD 132.6 million of cash flow from operating activities, representing a USD 98.4 million improvement from the previous year. Working capital improvements drove 2020 cash generation, contributing USD 92.4 million. In particular, the Group generated USD 64.8 million of cash flow from the reduction of accounts receivable and contract assets. The Group generated USD 41.9 million of operating cash flow in the first half and USD 90.7 million in the second half.

The Group used USD 8.9 million cash for investing activities, including USD 4.0 million to purchase intangible fixed assets and USD 6.7 million for tangible fixed assets. The Group reduced cash used for investing activities by USD 6.0 million compared to 2019.

Net cash-out for financing activities amounted to USD 52.3 million, compared to USD 30.4 million in 2019. The cash outflow includes USD 16.7 million payments of lease obligations, USD 10.2 million of dividends paid to non-controlling interests and the USD 5.7 million cash distribution paid to Kudelski SA shareholders. Net debt reimbursement for 2020 amounts to USD 19.9 million.

OUTLOOK

In the Digital TV segment, the Group expects the positive momentum of the second half 2020 to continue into 2021, with stable year-on-year revenues. The European Digital TV business is expected to continue to maintain its strong resilience, while both the Latin American and Asian regions are expected to recover, following a challenging 2020. As the 2020 Digital TV segment cost base benefitted from the one-off positive effect from the IAS 19 plan amendment, the Group anticipates higher 2021 Digital TV operating expenses compared to 2020.

In the Cybersecurity segment, the Group expects growing 2021 revenues. As the Cybersecurity business continues to drive the development of higher margin product lines, margin after cost of material should continue to grow at a double-digit rate. Such positive momentum is expected to result in a material improvement of segment operating income before depreciation and amortization.

The launch of RecovR in Spring 2021 is expected to drive this year's IoT revenue growth, while the Group continues to promote IoT Services and the keySTREAM platform. The Group expects 2021 IoT revenues to at least double compared to 2020.

The Public Access business will continue to face uncertainties related to the COVID-19 impact on airports, shopping centers, stadiums and ski resorts, for at least the first half of the year. Segment plans for 2021 take these uncertainties into account. In 2021, the Group will continue to streamline SKIDATA's operations, seeking a tighter integration with other Group segments and corporate functions and among the SKIDATA local and central entities. In spite of the market uncertainties, the Group targets a material 2021 improvement of Public Access profitability.