


Kudelski Group

Annual report 2007

NAGRA
KUDELSKI GROUP

Highlights

2007

Strong top line growth in all markets and particularly in Asia

New contract wins for Nagravision in Digital TV, Mobile TV and IPTV, and multiple successes in collaboration with OpenTV

Global reach with 84 million active cards/ devices for Nagravision conditional access families in 2007 and 100 million cumulative device licences delivered by OpenTV

Strongest ever progress and results for Nagra Public Access in 2007

Nagravision expects major migration to service model during 2008

Operational efficiency improvement and cost reduction initiatives launched to improve profitability

Key figures

In CHF'000	2007	2006*	2005	2004
Total revenues, gain on sale of subsidiary and other operating income	942 535	756 182	697 173	606 131
OIBDA [1]	137 166	188 162	160 833	125 950
EBIT [2]	87 655	150 207	121 142	92 221
Net income	**67 448**	138 530	86 772	93 500

[1] OIBDA: operating income before interest, taxes, depreciation and amortization.
[2] EBIT: operating income.
* 2006 revenues included the CHF 59 million gain on the sale of a subsidiary company.

Key figures

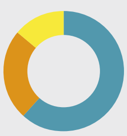
2007 Kudelski Group results show a robust top line development with total revenues and other operating income reaching CHF 942.5 million, corresponding to an annual growth over the previous year of 33.3% or 15% excluding OpenTV, a historic record for the Group. The Group's consolidated EBIT, even though down, is nevertheless among the four best performances in the history of the company.

Revenue breakdown by sector and by region

In CHF'000	Europe/Middle East	Americas	Asia/Pacific, Africa	2007
Digital TV	321 996	139 898	111 516	573 410
Public Access	186 420	18 378	19 505	224 303
Middleware/advertising	56 918	33 861	37 321	128 100
Total	565 334	192 137	168 342	**925 813**

Revenues by sector

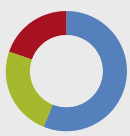
Digital TV
Public Access
Middleware/advertising



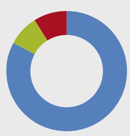
Revenues by region

Europe/Middle East
Americas
Asia/Pacific, Africa

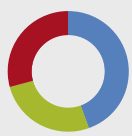
Digital TV



Public Access



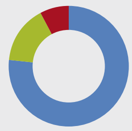
Middleware/advertising



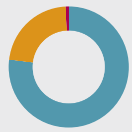
Revenues excluding gain on the sale of subsidiary and other operating income.

Employee breakdown

By region	Total headcount	%
Europe/Middle East	1 979	77.0%
Americas	399	15.5%
Asia/Pacific, Africa	194	7.5%
Total	2 572	100.0%



By activity	Total headcount	%
Digital TV*	1 982	77.1%
Public Access	571	22.2%
Audio	19	0.7%
Total	2 572	100.0%



* Including 513 employees Middleware/advertising.

Principal brands and companies of the Kudelski Group

Digital Television

NAGRAVISION
nagrastar – A KUDELSKI • ECHOSTAR JOINT-VENTURE
lysis
MEDIAGUARD
NAGRA+
LIVEWIRE
NAGRA FRANCE
SMARDTV
QUATIVE Kudelski Group
opentv*
nagraID – SWISS COMPETENCE IN IDENTIFICATION
Nagrard
Abilis SYSTEMS

Public Access

SKIDATA KUDELSKI GROUP
polyright

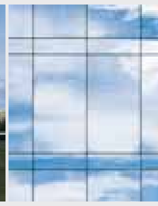
Audio

NAGRA

* On the reporting level, OpenTV is classified under Middleware/advertising.







Contents

Kudelski Group: a market driver and shaper

Digital Television is the Kudelski Group's core business. The company is a world leader in this sector, with security and access control solutions providing a very high level of protection throughout the content distribution chain, from creation to consumption. The Group's innovations are continuously contributing to the evolution of the digital television ecosystem, enabling operators to complete their services and market them more efficiently.

Public Access is the Group's second main activity sector, also demonstrating the company's know-how in the field of security. Solutions developed for this sector target operators of sports and leisure facilities, buildings, institutions and sites that require managing and controlling the access of people and vehicles.

Audio is the founding activity of the Kudelski Group which, more than half a century ago, gave birth to the Nagra brand, legendary for its professional recording equipment. This sector also includes a range of high-end Hi-Fi devices designed for music lovers in search of perfection.

Message to shareholders

The year 2007 marks an important milestone in the evolution of the Group. Several major strategic objectives have been successfully reached, durably modifying the Group's positioning and therefore the balance of forces in the digital television ecosystem.

In 2007, the Kudelski Group achieved total revenues, including the gain on the sale of a subsidiary and other operating income, of CHF 942.5 million, an operating income (EBIT) of CHF 87.7 million and a net income of CHF 67.4 million. The annual revenue growth reached 33.3%, or 15% excluding OpenTV, a record for the Group. EBIT, even though down, is nevertheless among the four best performances in the history of the company.

The year 2007 marks an important milestone in the evolution of the Group. Several major strategic objectives have been successfully reached, durably modifying the Group's positioning and therefore the balance of forces in the digital television ecosystem. However, some initiatives taken in order to reach these goals as part of the Group's medium and long-term development strategy, had an impact on short-term profitability.

Strategy for sustainable value creation

In the past, the Kudelski Group provided access control solutions by collaborating with partners to offer turnkey solutions. Today, following a profound change in the digital television industry, operators require increasingly complex integrated solutions, enabling them to maintain a competitive advantage against the new rivalry of the telcos. For this reason, the Kudelski Group has invested substantially in new technologies ranging from IPTV to video on demand and from conditional access to content management.

Along with organic growth through acquiring new customers and expanding services into new areas of activity, the Kudelski Group made a decisive step in the area of middleware and interactivity by acquiring control in early 2007 of OpenTV, a San Francisco-based company.

Collaboration with partners in the area of middleware and interactivity has long proved to be the best solution both to preserve the Group's independence and from a strictly economic point of view. The Group awaited the strategically opportune moment to make this acquisition when, following a consolidation, the market evolved towards a situation of duopoly. By taking control of one of the two major players, we became the world leader in this sector.

However, being number one in the conditional access, middleware and interactivity markets is not the ultimate objective. A major effort must be made to ensure that the solutions are fully integrated with each other, so as to provide a comprehensive solution meeting the expectations of operators, and to reduce time-to-market and deployment costs.

The increasing number of contracts won simultaneously by Nagravision and OpenTV confirm what appears to be a fundamental market trend, namely the fact that operators want to reduce the number of suppliers in order to improve their ability to meet the challenges of the future.

Innovation – key to the Group's longevity

The ability of the Group to perpetually reinvent itself has enabled it to successfully accompany the technological revolutions and changing consumer habits. From a manufacturer of professional portable tape recorders, it has become a provider of integrated digital TV solutions, with revenues multiplied by 50. Although investments in developing new technologies are costly, they are also the key to over 56 years of longevity.

The digital TV's new business areas reflect the importance of innovation to the Kudelski Group. In 2007, the new solutions achieved sales of CHF 118.4 million, an increase of almost 120% compared to the previous year. The new product lines, although still not profitable, offer excellent prospects for profitability which should materialize when the market has reached critical mass and adequate volumes. The very positive response of consumers to the initial commercial launch of some of these solutions further confirms this perspective.

Among the new solutions should be especially noted Nagra Mobile which, in no more than two years, set the standard for television on mobile devices. The Kudelski Group is a pioneer and market leader in the mobile pay television DVB-H world with deployments approaching 1.2 million units. Additionally, it has strongly invested in the development of solutions based on the US MediaFLO and Chinese STiMi standards.

In terms of fundamental security technology, the year 2007 was marked by the roll-out of two new families of security solutions for digital television. These are very important steps for the long-term protection of content distributed by our operator customers and for the development of the Group's product portfolio. These new technologies offer optimum security levels to considerably reduce the risk of simultaneous security attacks over geographically distant networks. Their development required a major investment due to the large number and the diversity of Nagravision customers.

André Kudelski

Public Access - second major pillar of the Group

The other pillar of the Group, Public Access, achieved a record year in 2007, reaping the harvest of several years of investment in R&D and in the prospection of new markets. The Nagra Public Access entity not only published excellent figures both in terms of growth and profitability, but continued to consolidate its position in numerous new markets.

Outlook and targets

The major efforts made during 2007 will continue in 2008. To achieve the objective that the Group has set, namely to become a provider of turnkey solutions, substantial investments must be made upstream in order to build pre-integrated systems that are easy and cost-effective to install, particularly for emerging markets and medium-size operators.

In addition, the Group aims at becoming the reference in the fields of intuitive user interfaces and advanced advertising, in symbiosis with conditional access. The combination of these three areas into a single solution will enable the Kudelski Group to offer an added value unique in this industry.

The consumer will benefit from a simple and intuitive access to various programming content, whether live, recorded or on demand. It is a disruptive approach to space-time which, with Nagra Mobile technology, sketches the outline of the television of the future: the program you want, whenever and wherever you want it.

In parallel with these changes, the Kudelski Group has the opportunity of converting about 30 million active cards from sales mode to service mode in 2008. This objective, which has been announced for several years, will become reality in 2008. Even if it leads to a significant shortfall in the immediate future due to revenues being carried forward, this migration is a real opportunity to add value to the new conditional access technologies in the coming years.

Maintaining confidence

Despite these developments and future objectives, taking care of our shareholders is important to us. We are fully aware that the past year has been a difficult one for our share price and that our financial outlook for 2008 is not very promising. However, we count on our shareholders to support the strategy chosen by the Group to focus on the mid and the long term, and to continue placing their trust in the company. We are convinced that the investments we make today will be key to positioning the Group very strongly in its sector and ensuring its future prosperity. We expect to improve our external communication in order to better explain the fundamentals of our strategy.

For the fiscal year 2007, the Board of Directors proposes to the General Meeting of Kudelski SA the payment of an unchanged ordinary dividend of CHF 30 cents per bearer share, in continuity with previous years.

We wish to thank warmly our shareholders, customers, partners and employees for having enabled the Kudelski Group to grow in recent years, and for the trust that they have placed in us.

André Kudelski

Financial review

The Group's financial results show a robust top line development, confirming the positive revenue trend of the last five years, with a compounded annual growth rate at 25%.

2007 results show a robust top line development. The Group confirms the positive revenue trend of the last five years. Growth momentum continues to be strong with total revenues and other operating income reaching CHF 942.5 million, including CHF 128.6 million from the first time consolidation of OpenTV. Over the last five years, the compounded annual growth rate was at 25%.

Profitability is short of original expectations mainly due to continuous substantial investments in R&D and in new business areas, as well as customer shifts to the service model and lower-than-expected results of OpenTV. The Group consolidated EBIT in 2007 is at CHF 87.7 million, down by 3.8% compared to the 2006 EBIT adjusted for the gain on sale of Ticketcorner. The adjusted Group EBIT margin declines from 13% in 2006 to 9.5% in 2007, due to a 3 percentage point contraction of the Digital TV margin to 15.3%. Public Access EBIT on the other hand confirms the improvement trend and crosses the 10% threshold coming in at 11.5%. The consolidation of OpenTV has a dilutive effect on 2007 EBIT contributing a loss of CHF 7.6 million.

2007 Group profitability and improvement initiatives

The Group "Margin after cost of material sold" (a pro forma non-IFRS item) for the year is at CHF 678.5 million. As a percentage of revenues, adjusting for both other operating income and gain and loss on sale of subsidiaries, the margin after cost of material is up 3 percentage points to 72%. However, a further 2007 adjustment reversing the OpenTV margin contribution shows a 5% decline, reflecting in particular a material improvement potential in the Digital TV supply chain management.

The consolidation of OpenTV adds CHF 77.7 million personnel expenses, while the further CHF 43.1 million increase of personnel expenses is mainly due to a growing headcount in new business areas and in the core conditional access business R&D and service areas. Other operating expenses increases by CHF 66.5 million due to the consolidation of OpenTV and a further increase of outsourced engineering and development activities in core Digital TV.

End of 2007, the Digital TV division launched a profitability improvement program targeting the division's cost base. The program includes a review of the business portfolio, the business priorities and the investment schedules.

Secondly, it aims at adjusting the company's technology and platform roadmap to accelerate the deployment of highly secure, segmented new generation security solutions and to complete the offering. In this respect, the Digital TV division is redesigning key components of its solutions architecture to reduce the cost of deploying and operating the solutions.

Thirdly, the company is reviewing its location mix to better exploit global opportunities and cost structures. In addition, it is implementing cost reduction measures in areas such as procurement, with the goal of reducing smart card chipset costs.

Finally, the Group will stop the headcount increases in the established businesses.

Digital TV sales up, particularly in new business areas

Digital TV net revenues increase by 14.5% to CHF 573.4 million, while the operating margin declines to CHF 88.0 million, due to a negative gross margin development and a continued expansion of operating expenses.

European sales increase by 12.5%, with a well-balanced distribution. Among the highlights, digital terrestrial operators as well as Eastern European satellite operators experienced a particularly strong growth, with sales doubling compared to the previous year.

In the Americas, revenues are relatively stable, with the strong growth of South American sales compensating for the volume decline in North America and the USD weakness. In 2007, South American operators generated more than half the total American revenue base.

Sales in Asia/Pacific and Africa increase by 56.5% to CHF 111.5 million, with a material increase of smart card sales in the Indian, South Korean and particularly the Chinese markets.

Digital TV's new business areas exceed the CHF 100 million revenue target, reaching CHF 118.4 million for the full year. Conditional Access Modules are gaining traction beyond the traditional footprint, and are starting to secure a significant presence in new promising markets, such as Italy. In the advanced smart card business, the Group is extending its presence in financial services and in the government segments. Further, it is continuously expanding in the PVR/push VOD/EPG space, with, in particular, the NagraGuide solution.

In 2007, the Group further consolidated its leadership in the mobile TV market with several new wins, including the recent wins at T-Mobile in the Czech Republic, Dominanta in Russia and Telefonica in Latin America.

It also extended its IPTV customer footprint beyond the French market, winning T-Com Innovations GmbH in Germany and Etisalat in the Middle East, and more than doubled its revenue base in the digital terrestrial market.

New business areas, however, had a negative impact on Digital TV operating profits, reducing division EBIT by a high single digit million number. In particular, the mobile chipset business required material expenditures in 2007 without yet generating any revenue and will continue to generate losses in 2008; mobile TV still represents an investment, with volumes today still too low to put at break-even, mainly because of the delayed availability of frequencies for mobile TV operators. IPTV is also still in an early phase in terms of deployed units.

Public Access beats targets

In 2007, Public Access revenues are 15.8% higher than in the previous year, while EBIT is up by 46.3% at CHF 25.8 million, reaching historical high marks.

Over the last four years, Public Access operating profitability substantially improved, from a negative 2% in 2004 to a positive 11% last year, translating into an absolute EBIT improvement of CHF 29.4 million.

Public Access sales are growing across all regions, with Europe up by 14.5%, in a market where SkiData already has a very strong positioning in particular in the ski market, the Americas growing by 14.6% to CHF 18.4 million and the Asia-Pacific and Africa region up 30.4% to CHF 19.5 million.

Within three years, extra-European Public Access share of sales has increased from 8.2% to 16.9%.

Balance sheet and cash flow

The consolidation of OpenTV adds CHF 132.9 million of goodwill and further CHF 21 million intangible assets as well as CHF 8 million tangible fixed assets.

Working capital at the end of the year materially increases compared to 2006 due to the consolidation of OpenTV but also a high working capital in the Digital TV division. Inventory increases by CHF 34 million with Days Inventory Outstanding up 106 days, mainly due to two customer projects delayed into 2008. Day Sales Outstanding are down from 119 to 101 days, yet are still subject to improvement in spite of the seasonality effects in the Public Access business leading to high year end receivables. Other current assets increase to CHF 78 million, including a.o. CHF 16.1 million related to the OpenTV acquisition and cashed in from Liberty Media in January 2008.

Cash flow from operating activities in 2007 is at CHF 64.4 million, as a result of a strong CHF 146.7 million cash flow before working capital and high additional working capital needs (incl. cash taxes) of CHF 82.3 million.

Following a CHF 19.1 million first half cash flow from operating activities, the second half's was at CHF 45.3 million. Cash from investing activities mainly reflects the acquisition of OpenTV, but also high investments for security technologies and for technical equipment and machinery mainly related to the deployment of cards and equipments in service model.

Outlook

Over the last months, the Group has been actively promoting the migration of large Digital TV customers to the service model to better align with customers' incentives and to reduce the volatility of the Group's revenue base. In 2008, the majority of the Group's active devices are expected to be in the service model, due to the envisaged shift of close to 30 million smart cards to this model.

With a resilient, secure solution, this model is expected to generate materially higher revenues per card, thus providing a favorable return on the company's ongoing investments in new security solutions.

The migration, however, will negatively impact the 2008 profit and loss account as the full revenues generated by the cards to be delivered this year will not be recognized.

In the Public Access division, the Group reached its growth and profitability targets. The division expects a continuing growth in 2008.

The corrective measures implemented over the last few months at OpenTV have delivered initial tangible results in the fourth quarter of 2007. In 2008, the Group expects further progress along the same lines, with the organizational changes, the ongoing operational improvement program and in particular the synergies with the Digital TV division translating into a material profitability improvement.