2017 RESULTS

Management Discussion & Analysis

In 2017, the traditional pay TV market continued to slow down, negatively impacting the Group's revenues and contribution margins from its core digital TV products. The Group initiated a restructuring program in the second half of the year to better align its core digital TV cost base with market demand. In the context of this program, the integrated Digital TV (iDTV) structure is undergoing a major transformation that involves, in particular, the full integration of Nagravision and Conax operations and the streamlining of digital TV operations in Switzerland, France and Norway. The Group is also consolidating its operations into locations with a critical mass and proximity to key target markets. As part of this process, the Group is downsizing several locations and closing smaller sites. In 2017, the Group completed several IP licensing transactions and settled its major ongoing litigation. As a result, the Group expects a material reduction in legal costs for 2018. Finally, the Group is increasing its Public Access segment's focus on profitability and cash generation, seeking to better leverage SKIDATA's market leadership.

In connection with the ongoing efforts to streamline its core digital TV operations, the Group is seeking to establish strategic partnerships with best-of-breed set-top box and conditional access module suppliers, which comprise the Group's SmarDTV subsidiary. Such partnerships are likely to encompass a transfer of relevant assets and resources to the selected partners. As such assets and resources, and the related businesses, represent the bulk of SmarDTV's profit and loss and balance sheet, SmarDTV has been reported as a discontinued operation in the current period and in the comparative previous period and the assets and liabilities of the entity have been reclassified as held for sale at the end of the reporting period.

Group activities are increasingly expanding beyond traditional pay TV, in particular into cybersecurity and security for Internet of Things (IoT). The Group continues to invest in the expansion of these fields of activity, significantly raising expenditures in both domains. Furthermore, the Group continues to develop its cloud-based portfolio. In May 2017, the Group acquired DVNor, a Norwegian entity providing media asset management services, including transcoding, storage, distribution and post-production services for USD 4.3 million.

As over 56% of its revenues are denominated in USD and 47% of Group revenues are generated in the Americas, the Group changed its reporting currency from CHF to USD as of January 1, 2017. Accordingly, prior year's numbers have been restated in USD for comparison purposes.

In 2017, the Group increased its consolidated revenues and other operating income from continuing operations by 7.1% to USD 1'068.7 million. SmarDTV's revenues are not included in the reported revenue line as they are classified as discontinued operations. Operating income excluding restructuring costs decreased from USD 113.5 million to USD 48.1 million in 2017. After USD 22.5 million restructuring costs, 2017 operating income was USD 25.6 million.

iDTV segment revenues increased by 4.2% in 2017, reaching USD 688.4 million.

Intellectual property (IP) licensing agreements materially contributed to the 2017 segment revenues. In 2017, the Group completed licensing agreements and/or settled litigation with AT&T, Turner, Scripps Networks Interactive, Advance Magazine Publishers, Twitter, Arris, Comcast and Roku.

Kudelski Security, the Group's cybersecurity business, more than doubled its revenue contribution in 2017, reflecting the full consolidation of M&S Technologies as of January 2017 and the strong performance of its European operations. M&S Technologies is a Dallas-based cyber and network security provider that extends the Group's cybersecurity presence into the South-Central region of the United States.

The Group's cybersecurity operations benefit from strong organic growth and an expanding portfolio of offerings. For example, in 2017, the Group launched a new cybersecurity CxO Performance Solution to improve planning, management and reporting to Cyber Executives as well as White Noise, a platform for secure mobile phone communications. In 2017, the Group materially increased its investment in the development of a comprehensive IoT security platform and also initiated its first customer engagements in this area targeting several vertical markets. Together with the Group's continued investment in the development of a proprietary technology portfolio for enterprise security, the Group's overall investment level has resulted in widening losses for the cybersecurity and IoT business line.

Public Access maintained its strong top line momentum, with revenues growing at two-digit rates to reach USD 361.3 million, representing 11.7% growth. Public Access completed two small acquisitions in 2017. In July, it acquired Advanced Parking Solutions for USD 1.4 million, strengthening its distribution in Ireland. In November 2017, it completed an asset transaction for USD 3.0 million resulting in the takeover of Tecnopass, which strengthens Public Access' distribution and service capabilities in the Chilean market.

GROUP REVENUES AND PROFITABILITY

Total revenues and other operating income from continuing operations for 2017 grew by USD 70.5 million to reach USD 1'068.7 million. Revenues grew by USD 65.3 million to USD 1'049.7 million, while other operating income grew by USD 5.2 million.

Margin after cost of material decreased by USD 5.2 million to USD 706.6 million. Relative to total revenues, margin after cost of material decreased from 71.3% to 66.1%. The main driver of this margin reduction relates to a shift of revenue mix from relatively higher margin core digital TV revenues to relatively lower margin cybersecurity revenues. While cybersecurity currently generates lower margins, the Group expects this business to increase its margins as the share of proprietary technologies increases in the cybersecurity business' revenue mix.

Personnel expenses increased by USD 58.8 million to USD 462.9 million. USD 22.8 million of this increase are due to a 2016 accounting effect related to Swiss pension fund accounting. The remaining USD 36.0 million increase of personnel costs was primarily driven by the addition of substantial headcount to the Group's cybersecurity operations, including headcount from newly acquired M&S Technologies, and by hiring activity at SKIDATA required to support business expansion. In 2017, the Group also fully consolidated the NexGuard watermarking business acquired in July 2016 as well as the business of DVNor, the Norwegian-based provider of media asset management services acquired in May 2017. Total Group headcount at year end was 3'962 compared to 3'801 at the end of 2016. Group US headcount increased by 112 to 782 employees, mainly driven by the expansion of Kudelski Security and SKIDATA's North American operations and the establishment of the Group's second headquarters in Phoenix, Arizona. In addition, the Group continues to grow in India, adding an additional 110 employees in 2017 to reach a total headcount of 513.

Compared to 2016, the Group increased other operating expenses by USD 25.8 million to USD 179.6 million. Main drivers of this increase were USD 12.8 million in higher legal expenses at Nagravision driven by the Group's IP licensing activities, as well as higher operating costs at SKIDATA and the restructuring provision booked in respect of Nagravision.

In 2017, the Group booked USD 22.5 million of restructuring costs as operating expenses, compared to USD 3.0 million in 2016. Between 2016 and 2017, total recurring operating expenses increased from USD 577.7 million (including USD 22.8 million of pension cost adjustments and a net of USD 3.0 million of restructuring costs) to USD 620.0 (net of USD 22.5 million restructuring costs). Cybersecurity and IoT security platform investments were the major driver of this increase, adding USD 29.0 million in related costs year-on-year. The expansion of SKIDATA's operations resulted in an operating cost increase of USD 21.4 million, while Nagravision booked an additional USD 12.8 million of legal costs related to IP litigation. The ongoing restructuring program already resulted in a USD 23.3 million cost reduction in 2017, mainly though efficiency improvements in the core digital TV domain. Further USD 50 to 70 million operating cost reductions are expected to be realized in 2018.

The Group's operating income before depreciation and amortization net of restructuring costs was USD 86.7 million in 2017, a USD 70.1 million decrease over the previous year. At USD 38.6 million, depreciation, amortization and impairment were USD 4.7 million lower than in 2016, due to lower impairment charges compared to the previous year. Overall, the Group generated operating income of USD 25.6 million in 2017. Operating income net of restructuring costs for the year was at USD 48.1 million, compared to USD 113.5 million in 2016.

At USD 8.5 million, 2017 interest expense was USD 1.4 million lower than in the prior year. The Group's primary interest-bearing liabilities include the CHF 200 million bond issued in 2015 with a 1.875% interest rate and the CHF 150 million bond issued in 2016 with a 1.5% interest rate. The Group posted USD 2.8 million of net finance expenses in 2017, including in particular a USD 3.3 million negative foreign exchange effect. This represents a decrease of USD 8.0 million over 2016.

The Group booked USD 12.6 million of income tax expenses in 2017. Tax rate reductions, including in particular the cantonal tax rate in Vaud (Switzerland), generated a USD 20.9 million charge to Group income tax expenses, reducing deferred income tax assets by the corresponding amount. This impact was partly offset by a USD 10.0 million positive effect from the capitalization of previously unrecognized tax assets on tax losses carried forward in the United States. The integration of SKIDATA's US operations with the Group's US tax group is expected to enable the Group to offset the taxable income of SKIDATA's US operations against existing tax losses carried forward.

The Group generated USD 2.7 million of net income from continuing operations in 2017, a decrease of USD 85.8 million from the previous year. Net loss from discontinued operations decreased from USD 20.1 million in 2016 to USD 9.4 million in 2017. In addition to the losses from SmarDTV's operations, 2016 results included the impairment of the contingent consideration related to the NagraID Security sale transaction completed in 2014. Including discontinued operations, the Group booked a USD 6.7 million net loss in 2017.

INTEGRATED DIGITAL TV

Reported iDTV revenues increased by 4.2% to USD 688.4 million, representing a constant currency growth of 3.8%.

The Group's European iDTV business declined by 7.5% in 2017 to USD 186.1 million. Larger Western European markets continue to be affected by a declining traditional pay TV subscriber base. In Italy, for example, the main digital terrestrial pay TV operator has been focused on improving profitability, while reducing its emphasis on subscriber growth.

The Group's Americas business posted a 22.7% growth in spite of lower volumes from DISH Network. The consolidation of newly acquired M&S Technologies and strong organic growth are driving revenues from the Group's cybersecurity operations. Brazil also contributed to regional growth, as revenues from Brazilian customers recovered compared to a weak 2016.

The Asia/Pacific and Africa region posted 17.4% lower revenues in 2017, which was primarily due to the base effect of a strong 2016. In 2016, regional revenues benefitted from a large project with

Starhub in Singapore and strong momentum in India. While Starhub continues to represent a positive highlight for the Group, the bulk of revenues from this large project was earned in the previous year. In India, sales by Conax normalized in 2017 following the exceptional volumes generated in 2016. Africa remains highly volatile, with a 2017 revenue contribution that is significantly lower than in the previous year.

Overall, operating income excluding restructuring costs for the iDTV segment was USD 44.2 million compared to USD 115.1 million in 2016, mainly reflecting lower core digital TV profitability and higher investments in the growing cybersecurity and IoT security businesses. Conax's contribution was materially lower compared to the previous year. The Group is currently in the process of fully integrating Nagravision and Conax operations, eliminating duplicate functions and extracting cost synergies.

In spite of the decline in traditional pay-tv volumes, the Group continues to gain traction in emerging video distribution markets. For example, the Group entered into an agreement with IBCAP to fight illegal content streaming through the deployment of its advanced monitoring and detection technologies. In Germany, the Group has entered into a cooperation with the Deutsche Fussball Liga to fight illegal content distribution of football matches.

In 2017, IP licensing continued to progress. The Group completed licensing agreements and/or settled litigation with AT&T, Turner, Scripps Networks Interactive, Advance Magazine Publishers, Twitter, Arris, Comcast and Roku.

While still loss making, the Group's cybersecurity business continues to gain traction. Completed in January 2017, the acquisition of M&S Technologies added a strong foothold in the South-Central region of the United States. Total consideration for this transaction was USD 10.4 million. Kudelski Security added a record number of 105 new customers in the United States and 74 new customers in Europe. With the newly launched Internet of Things Center of Excellence, the Group continues to drive innovation leveraging its track record with end-to-end secure architectures and device security and through partnerships with market leaders. While these initiatives drive top line growth, they also resulted in a widening loss compared to the previous year.

PUBLIC ACCESS

SKIDATA maintained its strong momentum from 2016, posting 10.1% constant currency growth in 2017 to achieve revenues of USD 361.3 million.

At USD 178.9 million, revenues generated in Europe were 2.9% higher compared to the previous year. Among the markets that performed well, Spain, France and Italy were the main contributors of SKIDATA's regional growth.

In the Americas, SKIDATA generated revenues of USD 121.5 million, representing 19.7% growth. The United States market alone generated over USD 100 million revenues for SKIDATA in 2017, with over 300 employees located in 14 offices. Over the past three years, SKIDATA has increased its revenues in the Americas more than threefold. Highlights from 2017 include several new wins in the events segment, such as Disneyland in Los Angeles.

Revenues for Asia/Pacific and Africa grew by 26.3%, reaching USD 60.9 million. SKIDATA continues to extend its footprint in this region; for example, in the first half 2017, SKIDATA completed its first installation in the Philippines. In early 2018, SKIDATA announced the acquisition of a controlling stake of Cytel, the Chinese leader of premium parking access control solutions. With this acquisition, SKIDATA gains a strong foothold in the Chinese parking market.

Public Access' operating income improved by USD 3.9 million in 2017, reaching USD 21.3 million. The profitability improvement was driven by top line expansion and was achieved in spite of continued investment to further expand its business, including, for example, the opening of new offices in Ireland and in US states such as Virginia and Georgia.

BALANCE SHEET AND CASH FLOW

The fair value of SmarDTV's balance sheet items are reported as "Assets classified as held for sale" and "Liabilities classified as held for sale". Such assets represent USD 62.7 million and the liabilities represent USD 32.5 million.

Total non-current assets increased by USD 33.0 million to USD 705.3 million at the end of 2017, with tangible fixed assets decreasing by USD 9.1 million and intangible fixed assets increasing by USD 23.4 million. The acquisition of M&S Technologies, DVNor and SKIDATA Ireland, as well as currency translation effects, added USD 21.2 million to goodwill. Financial fixed assets increased by USD 23.7 million, mainly due to a USD 25.3 million increase in the long-term portion of trade accounts receivable driven by, among others, discounted revenues related to the licensing of the Group's intellectual property portfolio.

Total current assets decreased by USD 47.8 million to USD 525.2 million in 2017. A USD 5.8 million higher inventory is mainly due to a USD 9.5 million increase at SKIDATA. The Group increased trade receivables by USD 61.1 million, as newly acquired M&S Technologies added USD 11.5 million and other cybersecurity activities added an additional USD 7.7 million. SKIDATA was the main driver of the increase with an additional USD 38.4 million of trade receivables in 2017. At the end of 2017, cash and cash equivalents amounted to USD 71.9 million.

Total equity increased by USD 6.7 million, mainly reflecting a positive USD 36.5 million of other comprehensive income and the USD 19.3 million distribution to shareholders in March 2017.

Total non-current liabilities decreased by USD 15.9 million to USD 428.9 million. Long-term financial debt includes the CHF 200 million 1.875% bond maturing in August 2022 and the CHF 150 million 1.5% bond maturing in September 2024. As both these bonds are denominated in CHF, long-term financial debt increased by USD 13.9 million primarily due to foreign exchange translation effects. Other long-term liabilities decreased by USD 14.0 million due to a USD 8.5 million reduction of long-term advances from customers and a USD 6.5 million reduction of long-term loan granted by a seller in connection with a business combination.

Total current liabilities increased by USD 24.5 million to USD 333.4 million. Short-term financial debt increased by USD 35.4 million, reflecting higher short-term borrowings by SKIDATA.

In 2017, the Group used USD 54.2 million of cash flows for operating activities, mainly reflecting a total of USD 118.0 million of negative working capital adjustments. This variation includes, in particular, a USD 75.1 million increase of trade accounts receivable. SKIDATA's higher working capital and amounts due to the Group in connection with the licensing of its intellectual property portfolio are the main driver of this working capital increase. The Group used USD 59.3 million of cash for investing activities. The net cash consideration for the acquisition of M&S Technologies, DVNor and a SKIDATA distributor in Ireland amounted to USD 13.5 million. In 2017, the Group invested USD 20.1 million for purchases of tangible assets, including USD 9.0 million at SKIDATA and USD 17.3 million for purchases of intangible assets, including for the deployment of a new ERP system for the Group.

Cash in from financing activities amounted to USD 1.7 million, including in particular USD 19.3 million repaid as a distribution to Kudelski SA's shareholders in March 2017.

OUTLOOK

The slowdown of the traditional pay TV business is expected to continue into 2018, reflecting the continued major transformation of the digital TV landscape. While new opportunities are emerging, in particular for end-to-end security solutions in the Internet video space, revenues from these new areas are not yet expected to fully replace the decline of traditional pay TV revenues. As a result, the Group expects declining revenues and margins in its legacy digital TV business and is implementing measures to adapt its cost base accordingly. These measures include efficiency improvements in core digital TV and corporate functions, the full integration of Nagravision and Conax operations, the rationalization of the iDTV global presence with the closure of smaller locations and the downsizing of underutilized sites.

The Group's cybersecurity business is expected to maintain its top line momentum in 2018, delivering sustained organic growth both in the United States and Europe. However, as the Group continues to invest in this emerging business, cybersecurity is expected to continue to generate materially negative contribution margins in 2018.

In the Public Access segment, SKIDATA is expected to continue extending its market leadership and delivering growth. In 2018, the Group also expects SKIDATA to achieve higher profitability and cash generation.