2023 RESULTS

Management's Discussion & Analysis

GROUP RESULTS

2023 presents a mixed picture with three of the Group's four business segments growing at solid rates and improving their profitability, while Digital TV revenues and profits declined from the previous year. Cybersecurity sustained its strong momentum, achieving a growth rate of 9.2% while continuing to improve its revenue mix, notably driven by the growth of managed security services. In parallel, the IoT segment witnessed a remarkable threefold increase in revenues, propelled by the widespread adoption of RecovR, its asset tracking product. Public Access showcased a strong performance, continuing its post-COVID-19 recovery with a 16.5% growth in net revenues. Conversely, the Digital TV business experienced a 14.3% decline in revenues compared to the prior year.

In 2023, the Group's total revenues and other operating income increased from USD 715.9 million to USD 761.5 million, representing a 6.4% growth. Net revenues increased by 4.9% in constant currency and by 6.4% to USD 750.8 million on an as-reported basis. Other operating income rose by USD 0.6 million to USD 10.6 million in 2023, driven by the booking of a contingent consideration of USD 1.0 million from the sale of patents, along with USD 1.1 million in payment processing royalties at SKIDATA.

Margin after cost of material increased from USD 515.4 million to USD 532.2 million. Relative to total revenues, margin after cost of material decreased from 72.0% to 69.9%, mainly reflecting a shift of the revenue mix from higher margin Digital TV to the other three segments.

Compared to 2022, the Group's personnel expenses saw an increase of USD 11.9 million, primarily attributed to adverse exchange rate effects, which accounted for USD 8.0 million of the total rise. In 2023, headcount decreased by 81 Full-Time Equivalents (FTEs) to 3,152. The Group increased headcount in Cybersecurity and IoT to align with the growing demand in these segments. Conversely, it reduced headcount in Digital TV and Public Access. Geographically, the distribution of headcount remained largely unchanged from the previous year end. Europe experienced a marginal decrease of 2 FTEs, with minor reductions in Austria and an expansion of operations in Spain. In Asia, headcount decreased due to SKIDATA's exit from the Chinese market, resulting in a total reduction of 43 FTEs in China.

Other operating expenses increased by USD 9.4 million. This notably includes a USD 5.1 million change in provisions and a USD 1.5 million increase in computer, software, and telecom expenses. The increase in computer, software, and telecom expenses can be primarily attributed to heightened usage of cloud software infrastructure.

The Group generated an operating income before depreciation and amortization of USD 28.7 million in 2023, which represents a USD 4.5 million decrease from the USD 33.2 million in the previous year. Depreciation, amortization, and impairment for the period amounted to USD 30.7 million, which was USD 1.6 million lower than in 2022, as the Group has reduced capital expenditures systematically in recent reporting periods. Overall, the Group generated an operating loss of USD 2.0 million in 2023.

Interest expense was USD 0.5 million higher than in the prior year, totaling USD 10.5 million. The Group posted USD 8.8 million of net finance expenses, primarily due to net foreign exchange losses as well as financial costs related to the Group's securitization program. Income tax expenses for the period were at USD 4.2 million, resulting in a net loss of USD 24.5 million in 2023.

DIGITAL TV

Digital TV revenues decreased by 14.3% to USD 257.8 million. Over the past years, the Digital TV business has shifted from a hardware-based model, heavily reliant on sales of smart cards and other hardware, to a more resilient software and service-oriented model.

The transition to a software and service-oriented model is reflected in the sales performance of the Digital TV business. Smart card and hardware sales saw a continued decline, decreasing from USD 51.7 million in 2022 to USD 32.5 million. Revenue generated from professional services also decreased by USD 8.8 million in 2023 due to the completion of some major projects. Additionally, in 2022, the Group recorded a one-off patent licensing transaction amounting to USD 5.5 million. Conversely, software, maintenance, and royalties demonstrated greater resilience, experiencing only a limited single-digit percentage decline compared to the previous year. These shifts underscore the ongoing transition of the Digital TV business from a hardware and smart-card-centric focus to a more software and maintenance-oriented model. In 2023, Digital TV generated initial revenues from its sports streaming platform. The introduction of Eurovision Sport, a novel global sports streaming service launched in collaboration with the European Broadcasting Union, and other sports-related services are poised to enhance revenues from this platform.

The Group's European Digital TV business posted 11.4% lower revenues compared to 2022. The majority of this decline occurred in the first half of the year, with revenues decreasing by 19.5%. However, the European business stabilized in the second half, with a more moderate decline of 1.9%. Throughout the full year, Vodafone revenues decreased compared to the prior year, which had included significant revenues from system integration to support the incorporation of newly acquired networks. Additionally, sales of Conditional Access Modules (CAM) at Liberty Global and TiVu were significantly lower, reflecting the downward trend in hardware sales. Altice also faced challenges, experiencing a substantial decline in its subscriber base, which impacted the Group's royalty revenues.

Digital TV revenues in the Americas decreased by 12.9%. In the South American market, there was a marginal decrease in revenue, although specific accounts such as Telefonica experienced higher year-on-year revenues. In North America, DISH continued to lose subscribers, leading to a decrease in the Group's revenues.

Sales in the Asia Pacific and Africa region experienced a decline of 22.2%. This decrease is attributable to the absence of significant hardware sales in 2023. Conversely, in the previous year, Digital TV generated revenues from hardware sale deals with TBC, DMG, and Starhub.

Digital TV's margin after cost of material improved from 87.4% to 90.3%, reflecting a more favorable revenue mix, due to lower hardware sales, including of conditional access modules and set-top boxes. Operating expenses for the segment were USD 5.7 million lower in 2023 compared to the previous year. This reduction primarily resulted from a decrease in headcount due to continued operational efficiency improvements. Digital TV's operating income before depreciation and amortization declined by USD 24.4 million to USD 40.7 million. As depreciation and amortization was USD 2.4 million lower, the segment's operating income decreased by USD 22.0 million to USD 29.5 million.

CYBERSECURITY

In 2023, the Group's cybersecurity business posted USD 185.9 million of gross revenues, an 8.5% increase from 2022. Net revenues were at USD 119.3 million, representing a 9.2% growth.

The European region exhibited robust growth, with net revenues rising to USD 55.0 million, representing an impressive year-on-year increase of 27.1%, following a growth of 34.7% in 2022. The business continues to extend its presence outside the Swiss market, gaining further traction in Germany, France, and the UK. This strategic move lays the foundation for sustained growth in the coming years. On the other hand, revenues from the US experienced a slight 1.5% year-on-year decline, though the quality of revenues continues to improve. This improvement is reflected in the region's higher year-on-year margin after cost of material.

Overall, managed security service revenues surged by 28%, reaching USD 52.9 million in 2023. This robust growth trajectory is anticipated to continue into 2024 and beyond, buoyed by the upward trend in bookings, which reached USD 58.3 million in 2023. The recently launched next-generation Managed Detection and Response (MDR) service, MDR ONE Resolute, is anticipated to bolster this growth trajectory. MDR ONE Resolute offers enhanced value for organizations aiming to mitigate risk, strengthen resilience, and manage costs effectively. Powered by a new XDR platform, MDR ONE Resolute integrates cutting-edge security technologies with AI and other proprietary tools. This comprehensive approach aids organizations in minimizing the repercussions of breaches on both reputation and financial performance.

Segment margin after cost of material persistently improve, rising from 64.6% to 68.9%, reflecting robust growth in higher-margin business lines, particularly the MDR business. In absolute terms, margin after cost of material increased by 16.4% to reach USD 82.2 million.

Cybersecurity showcased improved expense management compared to previous years, with costs only increasing by USD 7.8 million from 2022. Consequently, the segment EBITDA loss was reduced by USD 3.8 million to USD 9.8 million. In the second half of the year, Cybersecurity generated a low EBITDA loss of USD 3.1 million.

INTERNET OF THINGS (IoT)

In 2023, the IoT segment demonstrated exceptional performance, with sales tripling from USD 15.7 million in 2022 to USD 47.4 million. The driver of this growth was RecovR, a comprehensive asset tracking solution that combines lot management for car dealers and theft recovery for their customers. RecovR accelerated its impressive growth trajectory, gaining substantial traction with deployments at numerous US dealerships, resulting in revenues nearly quintupling compared to the previous year. Additionally, as part of the expansion efforts, IoT successfully acquired new rooftops and established partnerships with progressively larger car dealerships, including the largest retailer of used vehicles in the US. Moreover, the newly launched RecovR for Keys was deployed at five rooftops in 2023.

With a strong emphasis on the thriving asset tracking market, IoT focused less on the Lab and Design business and the keySTREAM platform, leading to slightly lower revenues compared to 2022.

IoT's margin after cost of material went from 69.4% in 2022 to 49.8% in 2023, primarily due to the shift in revenue distribution towards RecovR, which included larger deals at lower relative margins. The segment's margin after cost of material more than doubled from USD 10.9 million in 2022 to USD 23.7 million in 2023. The impressive traction gained by the asset tracking business prompted a decision to increase investments in this segment. This strategic move led to a corresponding increase of USD 6.7 million in the IoT operating expenditure base. In the aggregate, the segment's EBITDA loss materially decreased by USD 6.0 million in 2023, settling at USD 12.9 million. In the second half of the year, IoT generated a low EBITDA loss of USD 3.9 million.

PUBLIC ACCESS

Public Access achieved robust performance in 2023, notably highlighted by a 16.5% increase in net revenue. SKIDATA's dedicated emphasis on the digital sector is yielding positive outcomes. Examples include the success of SKIDATA Connect, the digital platform for visitor management, along with the intelligent mobility solutions and the thriving digital subscription segment, all of which are propelling growth.

The expansion of the service-oriented Facility Operations business continues to be a significant catalyst for Public Access' growth. Moreover, 2023 witnessed a considerable recovery in the Project Business, with growth rates in excess of 20% from the previous year.

SKIDATA's European sales maintained a strong momentum in 2023, increasing by 13.0% to USD 196.4 million. Italy and Germany were the best performing European markets, with solid year-on-year growth rates. Italy exhibited a robust performance, expanding by USD 4.4 million, driven by contributions from both the project and service businesses. Likewise, Germany experienced a USD 3.0 million growth, also attributed to sustained demand for projects and services. Sales in Austria were also strong, increasing by USD 3.4 million in 2023.

The Americas rebounded with a notable growth of 29.7% to reach USD 81.5 million. In the US, revenue from new projects more than doubled in 2023, serving as a pivotal driver of the robust revenue momentum experienced throughout the year.

SKIDATA's Asia/Pacific and African operations experienced growth of 11.2%, reaching USD 48.5 million. Smaller markets such as the United Arab Emirates, Japan, and the West Asian subregion significantly contributed to this growth. Despite SKIDATA's exit from China, the impact on the profit and loss statement was negligible, as the Chinese entity generated less than USD 2 million in revenues and incurred a small loss in 2022.

Ongoing disruptions within supply chains led to escalated costs of goods, and SKIDATA was able to pass through only a portion of the increase to customers. Consequently, margin after cost of material declined from 61.1% to 59.3%. This effect is expected to diminish over time, and margins are projected to rebound to levels consistent with previous years, as supply chains normalize and SKIDATA is able to implement additional optimization measures.

In 2023, Public Access increased operating expenses by USD 10.8 million compared to the preceding year, mainly reflecting exchange rate variations and changes in provisions. SKIDATA headcount decreased by 60 FTEs in 2023. SKIDATA's exit from the Chinese market resulted in a reduction of 42 FTEs compared to the end of December 2022. Additionally, SKIDATA decreased its European headcount by 17 FTEs, primarily in Austria, from December 2022. Overall, these efforts establish a favorable cost structure for 2024 and beyond.

Overall, Public Access generated an operating income before depreciation and amortization of USD 27.2 million, compared to USD 15.4 million in 2022.

BALANCE SHEET AND CASH FLOWS

In June 2023, the Group established a trade receivables securitization program for up to USD 50 million, in which selected subsidiaries of the Group based in Switzerland and the US are participating. The Group receives cash consideration from the sale of receivables to a special purpose entity. At the end of December, the Group had drawn USD 33.8 million net cash from this program.

Total non-current assets increased by USD 39.0 million to USD 591.6 million from December 31, 2022, mainly driven by the aforementioned increase in financial assets. USD 46.7 million of financial assets at fair value primarily comprise the balance of unsettled receivables transferred to the securitization program. The Group also continued to reduce its overall level of investments in tangible and intangible assets compared to previous years. Tangible fixed assets decreased by USD 1.4 million and intangible assets decreased by USD 10.6 million.

Compared to December 31, 2022, total current assets decreased by USD 82.4 million to USD 330.0 million. An increase of USD 6.9 million in total inventory mainly reflects the buildup of safety stock at SKIDATA to mitigate supply risks due to the volatility of semiconductor supply chains. SKIDATA added USD 7.8 million of inventory, reaching a total of USD 57.5 million at the end of the year.

Trade account receivables exhibited a decrease of USD 49.2 million, primarily due to the aforementioned receivables securitization program. SKIDATA's receivables remained largely stable compared to the end of 2022. On the other hand, SKIDATA continued to improve its invoicing cycles, driving a reduction of USD 10.6 million in contract assets.

At the end of 2023, cash and cash equivalents amounted to USD 56.4 million, representing a USD 5.8 million decrease from December 31, 2022.

Total equity decreased by USD 64.6 million, mainly reflecting the USD 24.5 million net loss for the period, a USD 19.7 million negative currency translation adjustment, and an additional effect of USD 15.5 million in other comprehensive income, mainly attributed to pension accounting.

The Group reclassified the outstanding CHF 145.9 million bond to short-term liabilities. As a result, total non-current liabilities decreased by USD 156.1 million to USD 117.2 million, with long-term financial debt decreasing by USD 171.7 million to USD 10.5 million. Total current liabilities increased by USD 177.3 million to USD 507.4 million, with short-term financial debt increasing by USD 154.2 million to USD 231.0 million. A partial repayment of bank debt drove the overall reduction of financial debt. Furthermore, the Group increased employee benefit liabilities by USD 18.0 million, bringing the total to USD 22.7 million. This adjustment is due to a reduction in the discount rate of future liabilities from 2.3% to 1.5%.

In 2023, the Group improved cash generation, transitioning from a negative free cash flow in the previous year to a positive cash flow. Cash generated from operating activities reached USD 63.9 million, primarily attributed to a reduction in working capital. Notably, the operating cash flow for 2023 includes USD 33.8 million drawn from the receivables securitization program as of December 31, 2023. The favorable cash contribution from changes in other net working capital items includes, among other things, an USD 8.4 million reduction of other receivables and a similar reduction in accrued income. Throughout 2023, the Group remained committed to stringent capital expenditure management, with cash flows for investing activities totaling USD 7.0 million. Cash outflow for financing activities amounted to USD 62.5 million. This outflow includes a USD 46.8 million debt repayment, USD 4.5 million dividends distributed to non-controlling shareholders, and USD 15.7 million in lease obligation payments.

OUTLOOK

The Group has a bond maturing in September 2024 with an outstanding amount of CHF 145.9 million as of December 31, 2023. Following a detailed strategic review, the Board of Directors has initiated a process which aims at finding a potential acquirer for to its Public Access division (SKIDATA). While there can be no guarantee that any offers received for SKIDATA will include terms and conditions that are acceptable to the Board of Directors, initial assessments conducted by management indicate that a divestiture of SKIDATA would yield adequate proceeds to fulfill the Group’s financial obligations by the scheduled maturity. The Board of Directors of Kudelski Group has engaged Goldman Sachs International as financial advisor in relation to the divestment process for SKIDATA. The Group aims to finalize the potential sale of SKIDATA ahead of the bond's maturity date. The Group is also exploring various alternative financing options in case there should be any delay in receiving the proceeds from a potential sale. Kudelski Group will make further announcements only if and when appropriate.

For the Digital TV segment, the Group forecasts a single digit decline in revenue for 2024, accompanied by reduced operating costs. Cost reduction initiatives, including headcount reductions implemented in the first two months of 2024, are expected to drive a decrease in year-on-year operating expenses. Overall, the Group expects a moderately lower segment EBITDA compared to 2023.

In the Cybersecurity segment, the Group targets double-digit growth rates in both segment revenues and margins after cost of material for the year. With moderate growth in operating expenses anticipated, the Group aims to halve the EBITDA loss compared to 2023.

For the IoT business, the Group anticipates maintaining the long-term trajectory of doubling year-on-year revenues. However, given that 2023 was an exceptionally strong year, the Group expects a lower year-on-year revenue growth rate in 2024 due to this base effect. Margins after the cost of material are forecasted to recover to a level exceeding 50%, as a large sale transaction impacted margins in 2023. Operating expenses are projected to rise at a rate similar to 2023. Overall, the Group is expecting a substantial further reduction in the segment's EBITDA loss for 2024.

The Group expects the Public Access segment to sustain its strong growth trajectory in 2024. Additionally, it anticipates margins after cost of material to return to historical levels, as supply chains have normalized, leading to decreased material costs. As a result, a further significant improvement in segment EBITDA is expected in 2024. However, given the anticipated sale of SKIDATA before year-end, the Group expects to consolidate only a portion of SKIDATA's annual results.