Kudelski Group

Financial statements 2006

NAGRA KUDELSKI GROUP

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Consolidated income statements for the years ended December 31, 2006 and 2005

In CHF'000	Notes	2006	2005
Revenues	5	694 340	687 102
Other operating income	6	2 759	10 036
Gain on sale of subsidiary	36	59 083	35
		756 182	**697 173**
Cost of material		-213 975	-227 893
Employee benefits expense		-215 311	-199 525
Other operating expenses	7	-138 734	-108 922
Operating income before interest, taxes, depreciation, amortization and impairment		**188 162**	**160 833**
Depreciation, amortization and impairment	8	-37 955	-39 691
Operating income (EBIT)		**150 207**	**121 142**
Interest expense	9	-11 772	-20 690
Other finance income/(expense), net	10	8 630	-10 401
Share of results of associates	16	3 231	2 663
Income before tax		**150 296**	**92 714**
Income tax expense	11	-11 766	-5 942
Net income for the year		**138 530**	**86 772**
Attributable to:			
– equity holders of the company		136 044	78 853
– minority interest		2 486	7 919
		138 530	**86 772**

In CHF	Notes	2006	2005
Earnings per bearer share			
– basic	13	2.6226	1.5265
– diluted	13	2.5716	1.5206
Earnings per registered share (not listed)			
– basic	13	0.2623	0.1527
– diluted	13	0.2572	0.1521

The accompanying notes form an integral part of the consolidated financial statements.

Consolidated balance sheets at December 31, 2006 and 2005

Assets

In CHF'000	Notes	**31.12.2006**	31.12.2005
Non-current assets			
Tangible fixed assets	14	149 457	135 292
Intangible assets	15	28 405	16 041
Investments in associates	16	9 441	7 559
Deferred income taxes	17	32 217	27 255
Financial assets and other non-current assets	18	37 951	23 974
Total non-current assets		**257 471**	**210 121**
Current assets			
Inventories	19	59 778	51 424
Trade accounts receivable	20	227 039	172 608
Other current assets	21	29 571	48 456
Financial assets at fair value through profit or loss	22	26 147	9 822
Cash and cash equivalents	23	444 007	434 685
Total current assets		**786 542**	**716 995**
Total assets		**1 044 013**	**927 116**

The accompanying notes form an integral part of the consolidated financial statements.

Equity and liabilities

In CHF'000

	Notes	31.12.2006	31.12.2005
Capital and reserves			
Share capital	24	519 352	516 829
Reserves		-30 630	-153 364
Treasury shares	25	-380	-380
Equity attributable to equity holders of the parent		**488 342**	**363 085**
Minority interest		26 926	27 408
Total equity		**515 268**	**390 493**
Non-current liabilities			
Long-term financial debt	26	318 516	314 458
Deferred income tax liabilities	17	2 952	2 899
Employee benefits liabilities	29	17 612	14 080
Provisions for other liabilities and charges	30	7 390	4 865
Other long-term liabilities	31	866	4 287
Total non-current liabilities		**347 336**	**340 589**
Current liabilities			
Short-term financial debt	32	11 310	18 534
Trade accounts payable	33	68 705	83 100
Other current liabilities	34	68 389	66 916
Current income taxes		15 870	8 393
Advances received from clients		9 382	15 261
Provisions for other liabilities and charges	30	7 753	2 070
Derivative financial instruments	35	–	1 760
Total current liabilities		**181 409**	**196 034**
Total liabilities		**528 745**	**536 623**
Total equity and liabilities		**1 044 013**	**927 116**

The accompanying notes form an integral part of the consolidated financial statements.

Consolidated cash flow statements for the years ended December 31, 2006 and 2005

In CHF'000	31.12.2006	31.12.2005
Net income for the year attributable to equity holders of the company	**136 044**	**78 853**
Adjustments for:		
Current and deferred income tax	11 766	5 942
Interest expense and other finance income/(expense), net	-11 257	14 299
Allocation of the equity conversion component, transaction costs and reconstitution of redemption value of convertible bonds	5 262	7 897
Net loss on tender and cleanup of the 2002 convertible bond	–	6 512
Depreciation, amortization and impairment	37 955	39 691
Change in fair value of financial assets at fair value through profit or loss	4 863	162
Net income associated companies	-3 231	-2 663
Dividends received from associated companies	1 879	502
Minority interest in net income	2 486	7 919
Non-cash employee benefits expenses	7 932	5 857
Net gain on sale of subsidiary	-59 083	-35
Other non cash income/expenses	-424	430
	134 192	**165 366**
Change in inventories	-7 179	25 697
Change in trade accounts receivable	-56 693	-1 080
Change in trade accounts payable	13 503	8 693
Change in other net current working capital headings	23 163	-3 668
Interest paid	-6 347	-4 398
Interest received	11 282	5 479
Income tax paid	-14 742	-6 814
Cash flow from operating activities	**97 179**	**189 275**

In CHF'000	Notes	**31.12.2006**	31.12.2005
Purchases of intangible fixed assets		-21 968	-4 822
Purchases of tangible fixed assets		-47 348	-44 169
Proceeds from sales of tangible and intangible fixed assets		1 602	1 227
Investment in financial fixed assets		-4 392	-4 383
Divestment of financial fixed assets and loan reimbursement		2 567	–
Investment in financial assets at fair value through profit or loss		-19 290	–
Disposal of subsidiaries, cash inflow/outflow	36	36 301	3 275
Acquisition of subsidiaries, cash outflow	37	-11 114	–
Cash flow used in investing activities		**-63 642**	**-48 872**
Change in bank overdrafts, long term loans and other non-current liabilities		-8 035	-9 206
Proceeds from employee share purchase program		113	264
Tender and cleanup of the 2002 convertible bond		–	-225 169
Proceeds from issuance of convertible bond, net of issuance costs		–	343 663
Cash received from exercise of stock options		1 556	–
Dividends paid to minority interest		-1 250	-5 490
Dividends paid to shareholders		-15 540	-10 321
Cash flow used in/from financing activities		**-23 156**	**93 741**
Effect of foreign exchange rate changes on cash and cash equivalents		-1 059	2 823
Net increase/(decrease) in cash and cash equivalents		**9 322**	**236 967**
Cash and cash equivalents at the beginning of the year		434 685	197 718
Cash and cash equivalents at the end of the year		444 007	434 685
Net increase/(decrease) in cash and cash equivalents		**9 322**	**236 967**

The accompanying notes form an integral part of the consolidated financial statements.

Consolidated statement of changes in equity

In CHF'000	Notes	Share capital	Share premium	Retained earnings	Fair value and other reserves	Currency translation adjustment	Treasury shares	Minority interest	**Total equity**
January 1, 2005		**515 596**	**50 972**	**-309 866**	**–**	**992**	**-380**	**22 545**	**279 859**
Currency translation adjustment						-442		2 595	2 153
Net profit				78 853				7 919	86 772
Total recognized income and expense for the year				**78 853**		**-442**		**10 514**	**88 925**
Minority interest disposed of	36							-161	-161
Employee share purchase program	41	105	249	7					361
Employee stock option plan	41			659					659
Shares issued for employees	41	1 128	2 063						3 191
Equity component convertible bond	27				33 470				33 470
Dividends paid to shareholders	40			-10 321					-10 321
Dividends paid to minority interests								-5 490	-5 490
December 31, 2005		**516 829**	**53 284**	**-240 668**	**33 470**	**550**	**-380**	**27 408**	**390 493**
Currency translation adjustment						-1 495		-1 718	-3 213
Net profit				136 044				2 486	138 530
Total recognized income and expense for the year				**136 044**		**-1 495**		**768**	**135 317**
Employee share purchase program	41	47	101	6					154
Employee stock option plan	41			470					470
Exercise of stock options by employees	41	778	778						1 556
Shares issued for employees	41	1 698	2 370						4 068
Dividends paid to shareholders	40			-15 540					-15 540
Dividends paid to minority interests								-1 250	-1 250
December 31, 2006		**519 352**	**56 533**	**-119 688**	**33 470**	**-945**	**-380**	**26 926**	**515 268**

The accompanying notes form an integral part of the consolidated financial statements.

Notes to the consolidated financial statements 2006

1. Summary of significant accounting policies

(A) Basis of preparation

The consolidated financial statements of the Kudelski Group ("Group" or "company") are prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and its predecessor organization, the International Accounting Standards Committee (IASC).

The policies set out below are consistently applied to all the years presented. These consolidated financial statements were prepared under the historical cost convention, except for items to be recorded at fair value.

The preparation of the consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. See note 2 for areas involving a higher degree of judgment and significant estimates.

The annual closing date of the individual financial statements of all Group companies is December 31.

(B) Group accounting

(a) Subsidiaries
Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies, generally implying an ownership of more than one half of the voting rights, unless they are held on a temporary basis. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries also comprise companies in which the Group does not own, directly or indirectly, more than one half of the voting rights but exercises significant power to govern their financial and operating policies and bears an overproportional responsibility for the main risks.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date on which control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets of the subsidiary acquired is recorded as goodwill.

Inter-company transactions, balances and unrealized gains on transactions between Group companies are eliminated. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

(b) Joint ventures
The Group's interests in jointly controlled entities are accounted for by proportionate consolidation.

The Group combines its share of the joint ventures' individual income and expenses, assets and liabilities and cash flows on a line-by-line basis with similar items in the Group's financial statements.

The Group recognizes the portion of gains or losses on the sale of assets by the Group to the joint venture that is attributable to the other venturers. The Group does not recognize its share of profits or losses from the joint venture that result from the Group's purchase of assets from the joint venture until it resells the assets to an independent party. However, a loss on the transaction is recognized immediately if the loss provides evidence of a reduction in the net realizable value of current assets, or an impairment loss. Accounting policies of joint ventures have been changed where necessary to ensure consistency with the policies adopted by the Group.

(c) Associates
Associates are entities over which the Group has significant influence but which is neither a subsidiary nor a joint-venture to the Group. Significant influence is the power to participate in the financial and operating policy decisions of the associate but not to control those policies. It is presumed to exist when the Group holds at least 20% of the associate's voting power.

Investments in associates are accounted for using the equity method of accounting and are initially recognized at cost.

Unrealized gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

(C) Foreign currencies

The consolidated financial statements of the Group are expressed in Swiss francs (CHF), which is the company's presentation currency.

The local currency is generally used as the reporting currency throughout the world. In the respective entity financial statements, monetary assets and liabilities denominated in foreign currencies are translated at the rate prevailing at the balance sheet date. Transactions are recorded using the approximate exchange rate at the time of the transaction. All resulting foreign exchange transaction gains and losses are recognized in the subsidiary's income statement.

Income, expense and cash flows of the consolidated companies have been translated into Swiss francs using average exchange rates. The balance sheets are translated using the year-end exchange rates. Translation differences arising from movements in the exchange rates used to translate equity, long-term internal financing deemed as net investment in a foreign operation and net income are allocated to reserves.

(D) Revenue recognition

Revenue includes the fair value from the sale of goods and services, net of value-added tax, rebates, discounts and sales commissions and after eliminating sales within the Group.

(a) Sale of goods
Sale of goods is recognized when delivery to the customer has occurred, the significant risks and rewards have been transferred to the buyer and collection of the related receivables is reasonably assured. Sale of goods may include delivery of complete systems comprising hardware, software, specific developments, an initial batch of smart cards, licenses and other services.

(b) Services rendered
Revenue for services rendered includes various types of services such as system integration, specific developments and customization, maintenance, training as well as revenues from complete security solutions generating recurring service revenues.

Complete security solutions may comprise hardware, software, specific developments, licenses, smart cards, maintenance and other services according to the specific arrangements contracted with the client. Assets made available to clients under such contracts are initially recognized in the balance sheet at cost under fixed assets as they remain the Group property. Revenue is recognized when contractually earned and is usually dependent on the client's number of subscribers or number of smart cards made available. Cost in connection with the depreciation of the assets made available to clients is recognized over the shorter of the duration of the contract and the useful lives of those assets. It is shown under depreciation in the income statement. It is also subject to periodic impairment reviews. Other costs (such as maintenance, services and security efforts) relating to those contracts are recognized when incurred. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognized immediately.

Revenue from system integration, specific developments and customization is recognized under the percentage of completion method. The stage of completion is measured by reference to the contract costs incurred and the effective hours worked up to the balance sheet date as a percentage of total estimated costs and total estimated hours worked for each contract.

For certain customers, the Group commits to provide replacement smart cards at low or no cost to the customer against the payment of a recurring security fee. Such revenues are recognized when earned, while estimated related cost in order to cover the risk is charged to the cost of material and disclosed under provision in the balance sheet.

Revenue from maintenance and training is recognized when earned (maintenance revenue is allocated over the contractual period).

(c) Royalties and licenses
Royalty income is recognized when earned. If the relevant license agreement contains certain performance obligations, the revenue is considered earned when the obligation has been performed. Revenue on licenses with a fix term is recognized upon the life of the contract on a straight line basis.

For software license arrangements that do not require significant modifications or customizations of the underlying software, the Group recognizes new software license revenue when: (1) The company enters into a legally binding arrangement with a customer for the license of software; (2) it delivers the products; (3) customer payment is deemed fixed or determinable and free of significant contingencies or uncertainties; and (4) collection is probable.

(d) Interest income
Interest income is recognized as earned unless collectibility is in doubt.

(E) Derivative financial instruments

Derivative financial instruments, including foreign exchange forward contracts, options and interest rate swaps, are initially recognized in the balance sheet at cost and are subsequently re-measured at their fair value. The method of recognizing the resulting gain or loss is dependent on whether the derivative is designated to hedge a specific risk and qualifies for hedge accounting.

The Group designates certain derivatives which qualify as hedges for accounting purposes as either a hedge of the fair value of recognized assets or liabilities or an unrecognized firm commitment (fair value hedge) or as a hedge of a forecasted transaction (cash flow hedge). The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives designated as hedges to specific assets, liabilities or cash flows. The Group also documents its assessment, both at the hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair value of hedged items.

(a) Derivatives that do not qualify for hedge accounting
Certain derivatives transactions, while providing effective economic hedging under the Group's risk management policy, do not qualify for hedge accounting under the specific rules of IAS 39. Changes in the fair value of any derivative instruments that do not qualify for hedge accounting under IAS 39 are recognized immediately in the income statement as part of other finance income/(expense), net.

(b) Fair value hedge
Changes in the fair value of derivatives that are designated and qualify as fair value hedges and that are highly effective are recorded in the income statement, along with any changes in the fair value of the hedged asset or liability that is attributable to the hedged risk.

(c) Cash flow hedge
Changes in the fair value of derivatives that are designated and qualify as cash flow hedges and that are highly effective are recognized in equity. Where the forecasted transaction results in the recognition of an asset or of a liability, the gains and losses previously included in equity are included in the initial measurement of the asset or liability. Otherwise, amounts recorded in equity are transferred to the income statement and classified as revenue or expense in the same period in which the forecasted transaction affects the income statement.

The instruments that may be used include forward foreign exchange contracts, currency swaps as well as zero cost option strategies with terms generally not exceeding six months. The derivative financial instruments are entered into with high credit quality financial institutions, consistently with specific approval, limit and monitoring procedures.

(F) Taxes

Taxes reported in the consolidated income statements include current and deferred taxes on profit, as well as non reimbursable withholding taxes and tax adjustments relating to prior years. Income tax is recognized in the income statement, except to the extent that it relates to items directly taken to equity, in which case it is recognized in equity. Taxes on income are accrued in the same periods as the revenues and expenses to which they relate.

Deferred taxation is the tax attributable to the temporary differences that appear when taxation authorities recognize and measure assets and liabilities with rules that differ from those of the consolidated accounts. Deferred taxes are calculated using the comprehensive liability method at the substantially enacted rates of tax expected to prevail when the temporary differences reverse. Any changes of the tax rates are recognized in the income statement unless related to items directly recognized in equity.

Deferred tax liabilities are recognized on all taxable temporary differences excluding non deductible goodwill. Deferred tax assets are recognized on all deductible temporary differences provided that it is probable that future taxable income will be available.

Deferred income tax liability have not been recognized for withholding tax and other taxes that would be payable on the unremitted earnings of certain subsidiaries. Such amounts are either permanently reinvested or do not generate any taxation due to the application of tax relief.

(G) Tangible fixed assets

(a) General
All property, plant and equipment is shown at cost, less subsequent depreciation and impairment, except for land, which is shown at cost less impairment. Cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repair and maintenance expenditures are charged to the income statement during the financial period in which they are incurred. Financing costs associated with the construction of tangible fixed assets are not capitalized.

Building acquisitions or constructions and building improvements are allocated to components which are depreciated over their useful life. Such useful life may be between 4 to 50 years.

Depreciation is calculated on a straight-line basis over the useful life, according to the following schedule:

Technical equipment and machinery

	Useful life in years
Machinery and measurement instruments	4 – 7
Digital material and equipment	4 – 5
Computers and information networks	4
Fixed assets made available to clients	2 –10

Other equipment

	Useful life in years
Office furniture and equipment	5 – 7
Vehicles	4 – 5

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is impaired immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. Gains and losses on disposal or retirement of tangible fixed assets are determined by comparing the proceeds received with the carrying amounts and are included in the consolidated income statements.

(b) Leased tangible fixed assets
Assets acquired under long-term finance leases are capitalized and depreciated in accordance with the Group's policy on property, plant and equipment. The financial commitments resulting therefrom are reported as other current and long-term liabilities. Rentals payable under operating leases are charged to the income statement as incurred.

(c) Fixed assets made available to clients
The Group makes equipment as well as smart cards available to clients within the scope of complete security solutions. The assets given to these clients remain the property of the Group and are initially recognized at cost and disclosed in the balance sheet under technical equipment and machinery. These assets are depreciated over the shorter of the duration of the contract and the economic life of the individual components and the related expense is disclosed under depreciation.

(H) Intangible assets

(a) Goodwill
Arising after January 1, 2004

Goodwill represents the excess of the acquisition cost over the fair value of the Group's share of net identifiable assets acquired at the date of acquisition. It is denominated in the local currency of the related acquisition. Goodwill is allocated to cash-generating units for the purpose of impairment testing. Goodwill on acquisition of subsidiaries and joint-ventures is included in intangible assets. Goodwill on acquisition of associates is included in investments in associates. All goodwill is considered to have an indefinite life and is at least annually tested for impairment and carried at cost less accumulated impairment losses.

Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Arising before January 1, 2004

Goodwill resulting from business combinations occurred before January 1, 2004 has been written off directly to equity following the Group's previous accounting policies and has not been reinstated. It is not transferred to the income statement when impaired or disposed of.

(b) Internal research and development
Internal research and development expenses are fully charged to the income statement. The Group considers that economic uncertainties inherent in the development of new products preclude it from capitalizing development costs, except for those developments related to the deployment of complete security solutions provided to certain customers and paid for by those customers in a rental agreement. In such cases, these specific developments are capitalized under the fixed assets made available to clients and amortized using the straight-line method over their estimated useful life of 4 to 5 years.

(c) External research and development
Expenditures for research and development, application software and technology contracts with external parties are charged to the income statement as incurred if they do not qualify for capitalization.

(d) Computer software
Acquired computer software licenses are capitalized on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortized using the straight-line method over their estimated useful lives (3 to 4 years). Costs associated with developing or maintaining computer software programs are recognized as an expense as incurred.

(e) Other intangibles in connection with business combinations
Under IFRS 3, in process research and development, core development technologies, customer lists and trademarks are valued as part of the process of allocating the purchase price in a new business combination. The respective values are recorded separately from goodwill and are allocated to cash-generating units and must be assessed for impairment.

Acquired intangibles are amortized on a straight-line basis over the following periods with the expense recorded in the income statement:

Core development technologies	Over the useful life, 5 years
Customer lists	Over the useful life, 10 years

(I) Financial assets

The Group classifies its investments in the following categories: financial assets at fair value through profit or loss, loans and receivables. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition and re-evaluates this designation at every reporting date.

(a) Financial assets at fair value through profit or loss
This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorized as held for trading unless they are designated as hedges. Assets in this category are classified as current assets if they are either held for trading or are expected to be realized within 12 months of the balance sheet date.

(b) Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as long-term assets. Loans and receivables are included in trade and other receivables in the balance sheet.

Purchases and sales of investments are recognized on settlement date. Investments are initially recognized at fair value plus transaction costs for all financial assets carried at fair value through profit or loss. Investments are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership.

Financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are carried at amortized cost using the effective interest method. Realized and unrealized gains and losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are included in the income statement in the period in which they arise.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, and option pricing models refined to reflect the issuer's specific circumstances.

(J) Inventories

Inventories are stated at the lower of cost and net realizable value. Cost is determined using the weighted average cost method.

The cost of work in progress and manufactured finished goods comprises direct production costs and an appropriate proportion of production overheads and factory depreciation.

Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

Furthermore, inventories which are no longer part of production and sales plans are directly written off from the gross value of inventories.

(K) Trade accounts receivable

Trade accounts receivables are carried at invoiced amounts, less adjustments for doubtful receivables. A provision for impairment is made for doubtful receivables based on a review of all material outstanding amounts at the reporting date.

(L) Cash and cash equivalents

Cash and cash equivalents include cash in hand and highly liquid investments with original maturities of three month or less. This position is readily convertible to known amounts of cash. Bank overdrafts are shown within short-term financial debt in current liabilities on the balance sheet.

(M) Marketable securities

Marketable securities consist of equity and debt securities which are traded in liquid markets. The Group has classified all its marketable securities as financial assets at fair value through profit or loss. All purchases and sales of marketable securities are recognized on the trade date, which is the date on which the Group commits to purchase or sell the asset.

(N) Convertible bonds

Convertible bonds are initially recognized at fair value, net of transaction costs incurred. They are subsequently stated at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the income statement over the period of the borrowings using the effective interest method.

The fair value of the liability component of convertible bonds is determined using a market interest rate for an equivalent straight bond at inception. This amount is recorded as a liability on an amortized cost basis until extinguished on conversion or maturity of the bond. The remainder of the proceeds is allocated to the conversion option. Issuance costs are allocated on a proportional basis to the liability component and are expensed over the convertible bond life.

(a) Convertible bond with cash settlement alternative
If the convertible bonds issued entitle the issuer to deliver cash upon exercise of the conversion option (cash settlement alternative), the conversion option is recorded as a liability and is subsequently measured at fair value using the Black & Scholes option pricing model. Changes in fair values of the conversion option are recognized in the income statement as other finance income/(expense), net.

(b) Convertible bond without cash settlement alternative
If the convertible bonds issued do not entitle the issuer to deliver cash upon exercise of the conversion option, the equity component is measured at inception and is allocated to the reserves.

(O) Provisions

Provisions are recognized when the Group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognized for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognized even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

(P) Contingent consideration

The purchase consideration for selected Group acquisitions may include contingent components, which depend on the future financial performance of the company acquired (earn out clause). It is based on the management's best estimate of the final consideration payable and is subject to a yearly review.

Where a portion of the contingent consideration for an acquisition is deferred to a date more than one year after the end of the current financial year, that portion is discounted to its present value and disclosed within other long term liabilities.

(Q) Employee benefits

(a) Pension obligations
The Group operates a number of defined benefits and defined contribution plans, the assets of which are generally held in separate trustee-administered funds. The pension plans are generally funded by payments from employees and by the relevant Group companies, taking into consideration the recommendations of independent qualified actuaries. For defined benefit plans, the Group companies provide for benefits payable to their employees on retirement by charging current service costs to income.

The liability in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date minus the fair value of plan assets, together with adjustments for actuarial gains/losses and past service costs. Defined benefit obligation is in all material cases calculated annually by independent actuaries using the projected unit credit method, which reflects services rendered by employees to the date of valuation, incorporates assumptions concerning employees' projected salaries and uses interest rates of highly liquid corporate bonds which have terms to maturity approximating the terms of the related liability. Actuarial gains and losses arising from experience adjustments, amendments to the pension plan and changes in actuarial assumptions in excess of the greater of 10% of the value of plan assets or 10% of the defined benefit obligation are charged or credited to income over the average working life of the related employees.

The Group's contributions to the defined contribution plans are charged to the income statement in the year to which they relate.

(b) Other long-term employee benefits
Other long-term employee benefits represent amounts due to employees under deferred compensation arrangements mandated by certain jurisdictions in which the Group conducts its operations. Benefits cost is recognized on an accrual basis in the personnel expenses.

(c) Employee Share Purchase Program (ESPP)
The Group put in place an employee share purchase program which allows certain employees to buy a specific number of shares at preferred conditions and with a blocking period of 3 years. The difference between the fair value of these shares and the employees' payments for the shares is expensed in the income statement at subscription date. The fair value of the shares transferred is determined based on the market price of the shares adjusted to account for the estimated value effect of the blocking period.

(d) Employee Stock Option Plan (ESOP)
The Group put in place an equity settled stock option plan for the members of the Board of Directors, the management and certain expert employees within the Group. The plan includes options with vesting periods of 3, 4 and 5 years and which may be exercised during a period of one year from the end of the vesting period.

Options are measured at fair value at the grant date using the Black & Scholes model adjusted to account for the estimated value impact of the exercise period. The determined fair value is then expensed in the income statement over the vesting period. An adjustment for future forfeited options is included in the calculation.

(e) Profit sharing and bonus plan
The Group recognizes a liability and an expense for bonuses and profit sharing where contractually obliged or where there is a past practice that has created a constructive obligation. In addition, the Board of Directors may grant free shares to certain employees. These shares may be subject to a blocking period of up to 5 years and are expensed in the income statement at their fair value at grant date taking into account the estimated value reduction due to the blocking period.

(f) Other employee benefits
Salaries, wages, social contributions and other benefits are recognized on an accrual basis in the employee benefits expense in the year in which the employees render the associated services.

(R) Treasury shares

Treasury shares are deducted from equity at acquisition cost. Gains or losses on the sale or cancellation of treasury share are recognized in the retained earnings.

(S) Dividends

Dividends are recorded in the Group's financial statements in the period in which they are approved by the Group's shareholders.

(T) New and amended accounting standards and IFRIC interpretations

IAS 19 (Amendment), Employee Benefits is mandatory for the Group's accounting period beginning on or after 1 January 2006. As the Group did not intend to change the accounting policy adopted for recognition of actuarial gains and losses and does not participate in any multi-employers plans, the adoption of this amendment only impacts the format and extent of the disclosure.

Following IFRICs are mandatory but were not relevant to the Group's operations:

- IFRIC 4, Determining whether an Arrangement contains a Lease (effective from January 1, 2006)
- IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds (effective from January 1, 2006)
- IFRIC 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment (effective from December 1, 2005)

Certain new standards, amendments and interpretations to existing standards have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2007 or later periods but which the Group has not early adopted:

- IFRS 7, Financial Instruments: Disclosures, and a complementary amendment to IAS 1, Presentation of Financial Statements – Capital Disclosures (effective from 1 January 2007). IFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. The amendment to IAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. The Group is currently assessing the impact of IFRS 7 and the amendment to IAS 1 and will apply IFRS 7 and the amendment to IAS 1 from annual periods beginning January 1, 2007.

- IFRS 8, Operating segments (effective from 1 January 2009). IFRS 8 replaces IAS 14 Segment Reporting. IFRS 8 requires entities to define operating segments and segment performance in the financial statements based on information used by the chief operating decision-maker. This new requirements will have an impact on the segments presented, the items reported and their respective measurement.

  Following IFRICs are not relevant or are expected to have no impact on the Group's accounts:

  - IFRIC 7, Applying the Restatement Approach under IAS 29, Financial reporting in Hyperinflationary Economies (effective from periods beginning on or after 1 March 2006)

  - IFRIC 8, Scope of IFRS 2 (effective from periods beginning on or after 1 May 2006)

  - IFRIC 9, Reassessment of embedded derivatives (effective from periods beginning on or after 1 June 2006)

  - IFRIC 10, Interim Financial Reporting and Impairment (effective for annual periods beginning on or after 1 November 2006)

  - IFRIC 11, Group and Treasury Share Transactions (effective from periods beginning on or after 1 March 2007)

  - IFRIC 12, Service Concessions Arrangements (effective from periods beginning on or after 1 January 2008)

2. Critical accounting estimates and judgments

The Kudelski Group's principal accounting policies are set out in note 1 of the Group's consolidated financial statements and conform to International Financial Reporting Standards (IFRS). Significant judgments and estimates are used in the preparation of the consolidated financial statements which, to the extent that actual outcomes and results may differ from these assumptions and estimates, could affect the accounting in the areas described in this section.

Complete security solutions generating recurring service revenues
As defined in note 1 D, the Group provides complete security solutions generating recurring service revenues by making assets available to clients, whereby depreciation is recognized over the shorter of the duration of the contract and the useful life of such assets. Depending on the contract terms with each client, the Group may replace the assets made available to the client for security or economic reasons. Early replacement due to technical obsolescence would affect the profitability of the Group by resulting in an impairment of the assets made available to the client.

Litigation and product liability provisions
A number of Group subsidiaries can be subject to litigation and product liability claims arising out of the normal conduct of their businesses. As a result, claims could be made against them that might not be covered by existing provisions or by external insurance coverage. Management believes that the outcomes of such actions, if any, would not be material to the Group's financial condition but could be material to future results of operations in a given period.

Provision for smart card replacement
Within the framework of certain contracts, the Group commits to provide replacement smart cards at special conditions to the customer during a certain time frame against the payment of a recurring security fee. The estimated cost to cover the risk of replacement is charged to the income statement proportionally to the remaining estimated life of each individual security device. The actual life time of the technology may significantly differ from estimates and, as a result, the recorded provision may differ significantly from the accrued costs.

Deferred tax assets
The Group is subject to income tax in numerous jurisdictions. Significant judgment is required in determining the portion of tax losses carried forward which can be offset against future taxable profit (note 17). In order to assess whether there is any future benefit, forecasts are made of the future taxable profits by legal entity. Actual outcomes could vary significantly from forecasts of future profits and could therefore modify significantly the deferred tax asset and the income taxes captions.

Retirement benefit plans

The Kudelski Group sponsors pension and other retirement plans in various forms covering employees who meet eligibility requirements. Several statistical and other factors that attempt to anticipate future events are used in calculating the expense and liability related to the plans. These factors include assumptions about the discount rate, expected return on plan assets and rate of future compensation increases, as determined by Group management within certain guidelines. In addition, the Group's actuarial consultants use statistical information such as withdrawal and mortality rates for their estimates. The actuarial assumptions used (note 29) may differ materially from actual results due to changing market and economic conditions, higher or lower withdrawal rates or longer or shorter life spans of participants. The Group has recorded in compliance with IFRS 1 the initial differences as of January 1, 2004 between assumed and actual income and expense as a liability in its balance sheet and uses the corridor approach in order to recognize its unrecorded gains and losses.

3. Business combinations

Digital Television

On May 22, 2006 the Kudelski Group closed an asset deal to acquire the assets of DTVS (Digital Television Solutions), a division of secure access solutions provider SCM Microsystems for a total consideration of USD 11 million. SmarDTV SA, Cheseaux, a newly created Swiss company owns the intellectual property and the contracts while Research and Development activities are located in La Ciotat, France.

Furthermore, the Group bought 50% of Mediacrypt AG for a consideration of kCHF 800 increasing its share to 100% as of June 30, 2006 and merged it with Nagravision SA.

Contribution and Pro forma data including acquisitions for all of 2006

The acquired businesses contributed net income of kCHF -1 831 to the Group for the period from acquisition date to December 31, 2006. Had the acquisitions been consummated on January 1, 2006, then pro forma 2006 twelve months consolidated revenues and net income would have been approximately kCHF 707 404 and kCHF 137 093 respectively.

4. Substantial divestment

On February 17, 2006, the Group closed a sale agreement with a consortium of investors to dispose of the Ticketcorner company. The Group retains a 28% stake of the Ticketcorner business. The net consideration for the equity sold was CHF 71.1 million consisting of a cash payment of CHF 53.6 million and a loan of CHF 17.5 million. Furthermore, the acquirer has reimbursed the CHF 10 million loan and committed to an earn-out payment of up to CHF 15.5 million. The net profit realized in connection with this divestment amounts to CHF 59.1 million and is disclosed under Gain on sale of subsidiaries.

5. Segment information

Primary segments

A business segment is a group of assets and operations engaged in providing products and services subject to risks and returns that are different from those of other business segments.

Operating divisions

The Group is divided operationally on a worldwide basis into two divisions, Digital Television and Public Access. These divisions, which are also based on internal management structures, can be described as follows:

– The Digital TV division provides open conditional access solutions allowing digital TV and content providers to operate a wide range of high value-added pay TV services on a secure platform.

Primary segment information

In CHF'000	**Operating division Digital Television 2006**	Operating division Digital Television 2005	**Operating division Public Access 2006**	Operating division Public Access 2005
Revenues				
External sales	500 593	492 162	193 747	194 940
Inter-segment sales	6 691	4 162	873	1 684
Total revenues	**507 284**	**496 324**	**194 620**	**196 624**
Income statement				
Operating income (EBIT)	**92 357**	**125 432**	**76 705**	**9 971**
Interest expense and other				
Finance income/(expense), net				
Share of result of associates	144		3 087	2 663
Income before tax				
Income tax expense				
Net income for the year				
Balance sheet				
Assets				
Segment assets	584 850	435 133	170 844	176 230
Investments in associates	351		9 090	7 559
	585 201	**435 133**	**179 934**	**183 789**
Liabilities				
Segment liabilities	**131 640**	**108 495**	**77 556**	**113 367**
Other information				
Capital expenditure	58 425	40 211	10 891	8 780
Depreciation and amortization	-33 807	-31 897	-4 108	-7 759
Impairment losses				

Expenses, assets and liabilities relating to Corporate include the costs, assets and liabilities of Group headquarters and the items of expenses, assets and liabilities which are not directly attributable to specific divisions.

– The Public Access division provides access control systems and ticketing services for ski lifts, car parks, stadiums, concert halls and important events as well as multifunctional cards for universities and corporations.

Corporate
Income and expenses relating to Corporate include the costs of Group Headquarters and the items of income and expense which are not directly attributable to specific divisions.

Corporate 2006	Corporate 2005	**Eliminations 2006**	Eliminations 2005	**Total 2006**	Total 2005
				694 340	687 102
		-7 564	-5 846	–	–
		-7 564	**-5 846**	**694 340**	**687 102**
-18 855	**-14 261**			**150 207**	**121 142**
				-3 142	-31 091
				3 231	2 663
				150 296	**92 714**
				-11 766	-5 942
				138 530	**86 772**
278 878	308 194			1 034 572	919 557
				9 441	7 559
278 878	**308 194**			**1 044 013**	**927 116**
319 549	**314 761**			**528 745**	**536 623**
				69 316	48 991
-40	-35			-37 955	-39 691
				–	–

Secondary segments

A geographical segment provides products or services within a particular economic environment that is subject to risks and returns that are different from those segments operating in other economic environments.

Sales

In CHF'000	**Digital Television 2006**	Digital Television 2005	**Public Access 2006**	Public Access 2005	**Total 2006**	Total 2005
Europe	286 134	244 247	162 749	171 232	448 883	415 479
Americas	143 183	184 431	16 042	13 925	159 225	198 356
Asia, Oceania and Africa	71 276	63 484	14 956	9 783	86 232	73 267
	500 593	**492 162**	**193 747**	**194 940**	**694 340**	**687 102**

Sales are allocated based on where the client is located.

Other geographical information

In CHF'000	Europe	Others	**Total**
Total assets as of December 31			
– 2006	928 055	115 958	**1 044 013**
– 2005	861 346	65 770	**927 116**
Capital expenditures for			
– 2006	68 001	1 315	**69 316**
– 2005	47 950	1 041	**48 991**

Assets and capital expenditures are allocated based on location of the entity owning the assets.

Revenue categories

In CHF'000	**2006**	2005
Sale of goods	481 891	493 031
Services rendered	158 987	147 995
Royalties and licenses	53 462	46 076
	694 340	**687 102**

6. Other operating income

In CHF'000	2006	2005
Income received for costs incurred in maintaining system security	–	7 750
Loss on fixed assets sales proceeds	-126	-226
Others	2 885	2 512
	2 759	**10 036**

Others include among others government grants for research and development and professional training. They are recognized when earned.

7. Other operating expenses

In CHF'000	2006	2005
Development and engineering expenses	27 325	24 383
Travel, entertainment and lodging expenses	23 767	18 780
Legal, experts and consultancy expenses	30 531	17 189
Administration expenses	15 656	14 279
Building and infrastructure expenses	16 617	13 835
Marketing and sales expenses	11 201	9 091
Taxes other than income tax	3 567	3 739
Insurance, vehicles and others	10 070	7 626
	138 734	**108 922**

Notes to the consolidated financial statements 2006

8. Depreciation, amortization and impairment

In CHF'000	Notes	2006	2005
Land and buildings	14	2 681	2 093
Equipment and machines	14	31 257	33 252
Total depreciation and impairment of tangible fixed assets		**33 938**	**35 345**
Patents, software and other	15	4 017	4 346
Total amortization and impairment on intangible fixed assets		**4 017**	**4 346**
Depreciation, amortization and impairment		**37 955**	**39 691**

9. Interest expense

In CHF'000	Notes	2006	2005
Interest expense			
– convertible bond 2002-2009	28	–	10 449
– convertible bond 2005-2012	27	10 950	2 576
– other and bank charges		822	1 152
Loss on the repurchase of the convertible bond 2002-2009		–	6 513
		11 772	**20 690**

10. Other finance income / (expense), net

In CHF'000	Notes	2006	2005
Interest income		13 936	7 300
Change in fair value of the convertible bond 2002-2009 conversion option		–	2 064
Net gains/(losses) on foreign exchange related derivative financial instruments not qualifying for hedge accounting		1 916	-6 663
Net foreign exchange transaction gains/(losses)	12	-182	-13 156
Fair value adjustment of financial asset at fair value through profit or loss		-6 623	–
Others		-417	54
		8 630	**-10 401**

11. Income tax expense

In CHF'000	Notes	2006	2005
Current income tax		-15 536	-10 337
Deferred income tax	17	4 872	4 852
Other taxes		-1 102	-457
		-11 766	**-5 942**

Other taxes include non reimbursable withholding taxes.

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to profits of the consolidated companies as follows:

In CHF'000	2006	2005
Profit before taxes	**150 296**	**92 714**
Tax calculated at domestic tax rates applicable to profits in the respective countries	-22 077	-21 746
Income not subject to income tax	8 891	7 672
Utilization of previously unrecognized tax losses	3 109	6 932
Write off deferred taxes	-1 217	-1 766
Expenses not deductible for tax purposes	-395	-385
Prior year income taxes	-521	–
Non-reimbursable withholding tax	-1 102	-457
Other	1 546	3 808
Tax expense	**-11 766**	**-5 942**

Profit before tax includes the full profit before tax of a joint venture company whose taxes are paid by its shareholder since it is a tax transparent company. As a result 100% of the profit before taxes of this company is included although the Group only recognizes 50% of the taxes on this profit due to the special tax arrangements. The tax impact which is included in other amounts to kCHF 1 138 (2005: 3 735).
The weighted average applicable tax rate was 14.69% (2005: 23.45%). The decrease in tax rate is mainly attributable to two elements:
a) material gains on a sale of subsidiary in a low income tax company in 2006 and
b) change in the profitability mix of the subsidiaries (different countries, different tax regimes).

12. Net foreign exchange result

The exchange differences accounted for in the income statement are as follows:

In CHF'000	**2006**	2005
Sales	-4 390	6 742
Cost of material	145	-1 380
Other finance income/(expense) net	-182	-13 156
Total exchange differences	**-4 427**	**-7 794**

13. Earnings per share (EPS)

Basic earnings per share

Basic earnings per share are calculated by dividing the net income attributable to shareholders by the weighted average number of shares outstanding during the year. The number of outstanding shares is calculated by deducting the average number of shares purchased and held as treasury shares from the total of all issued shares.

In CHF'000	**2006**	2005
Net income attributable to bearer shareholders	123 902	71 785
Net income attributable to registered shareholders	12 142	7 068
Total net income	**136 044**	**78 853**
Weighted average number of bearer shares outstanding	47 244 699	47 025 780
Weighted average number of registered shares outstanding	46 300 000	46 300 000

In CHF	**2006**	2005
Basic earnings per share		
Bearer shares	2.6226	1.5265
Registered shares	0.2623	0.1527

Diluted earnings per share

The diluted earnings per share calculation takes into account all potential dilutions to the earnings per share arising from the convertible bonds and options on Kudelski SA shares.

In CHF'000	**2006**	2005
Net income attributed to equity holders of the company	136 044	78 853
Elimination of interest expense on convertible debt*	10 950	–
Tax impact on above adjustments	–	–
Net income used to determine earnings per share	**146 994**	**78 853**
Of which:		
– attributable to bearer shareholders	135 088	71 813
– attributable to registered shareholders	11 906	7 040
	146 994	**78 853**
Weighted average number of bearer shares outstanding	47 244 699	47 025 780
Effect of dilutive potential bearer share:		
– employee stock option plan (ESOP)	120 877	201 041
– convertible bond*	5 165 290	–
Weighted average number of bearer shares for the purpose of diluted earnings per share	**52 530 866**	**47 226 821**
Weighted average number of registered shares for the purpose of diluted earnings per share	46 300 000	46 300 000

In CHF	**2006**	2005
Diluted earnings per share		
Bearer shares	2.5716	1.5206
Registered shares	0.2572	0.1521

* Shares equivalent of 0 (2005: 3 341 254) relating to the convertible bonds were excluded from the calculation of diluted earnings per share as they were anti-dilutive.

Notes to the consolidated financial statements 2006

14. Tangible fixed assets

Tangible fixed assets comprise the following:

In CHF'000	31.12.2006	31.12.2005
Land and buildings	78 725	59 524
Equipment and machines	70 732	75 768
	149 457	**135 292**

Land and buildings

In CHF'000	Land	Buildings	Building improvements	Construction in progress	Total
Gross values at cost					
As of January 1, 2005	**11 107**	**29 563**	**8 681**	**8 385**	**57 736**
Additions	81	4 814	272	18 326	23 493
Disposals and retirements	–	–	-666	–	-666
Change in scope of consolidation	–	–	–	–	–
Currency translation adjustment	–	-11	45	–	34
Reclassification and other	–	–	7	-114	-107
As of January 1, 2006	**11 188**	**34 366**	**8 339**	**26 597**	**80 490**
Additions	3 973	6 727	1 077	7 980	19 757
Disposals and retirements	–	–	-16	–	-16
Change in scope of consolidation	385	2 127	–	–	2 512
Currency translation adjustment	30	548	-9	–	569
Reclassification and others	–	31 537	–	-31 537	–
As of December 31, 2006	**15 576**	**75 305**	**9 391**	**3 040**	**103 312**

In CHF'000	Land	Buildings	Building improvements	Construction in progress	**Total**
Accumulated depreciation and impairment					
As of January 1, 2005	**–**	**-11 759**	**-7 443**	**–**	**-19 202**
Systematic depreciation	–	-1 605	-488	–	-2 093
Recovery of depreciation on disposals and retirements	–	–	350	–	350
Currency translation adjustment and others	–	3	-24	–	-21
As of January 1, 2006	**–**	**-13 361**	**-7 605**	**–**	**-20 966**
Systematic depreciation	–	-2 309	-372	–	-2 681
Recovery of depreciation on disposals and retirements	–	-264	-10	–	-274
Change in scope of consolidation	–	-330	–	–	-330
Currency translation adjustment	–	-343	7	–	-336
As of December 31, 2006	**–**	**-16 607**	**-7 980**	**–**	**-24 587**
Net book values as of December 31, 2005	**11 188**	**21 005**	**734**	**26 597**	**59 524**
Net book values as of December 31, 2006	**15 576**	**58 698**	**1 411**	**3 040**	**78 725**
Useful life in years		10-50	4-8		

Leased land and buildings included in the table above amount to:

In CHF'000	**31.12.2006**	31.12.2005
Leased land and buildings	–	8 737
Accumulated depreciation	–	-6 885
Net book value	**–**	**1 852**

Leased land and buildings were purchased during 2006.

In CHF'000	**31.12.2006**	31.12.2005
Fire insurance value of buildings	91 622	53 252
Corporate buildings on land whose owner has granted a permanent and specific right of use	4 667	4 027

Equipment and machines

In CHF'000	Technical equipment and machinery	Other equipment	**Total**
Gross values at cost			
As of January 1, 2005	**141 520**	**9 096**	**150 615**
Additions	19 212	1 441	20 653
Disposals and retirements	-4 277	-225	-4 502
Change in scope of consolidation	-52	–	-52
Currency translation adjustment	634	222	856
Reclassification and others	-725	864	139
As of January 1, 2006	**156 312**	**11 397**	**167 709**
Additions	25 178	2 413	27 591
Disposals and retirements	-19 350	-272	-19 622
Change in scope of consolidation	-5 558	-1 527	-7 085
Currency translation adjustment	1 443	-62	1 381
Reclassification and others	-394	-9	-403
As of December 31, 2006	**157 631**	**11 940**	**169 571**
Accumulated depreciation and impairment			
As of January 1, 2005	**-56 099**	**-5 381**	**-61 480**
Systematic depreciation	-31 517	-1 735	-33 252
Impairment	–	–	–
Recovery of depreciation on disposals and retirements	3 179	201	3 380
Change in scope of consolidation	2	–	2
Currency translation adjustment	-443	-139	-582
Reclassification and others	375	-384	-9
As of January 1, 2006	**-84 503**	**-7 438**	**-91 941**
Systematic depreciation	-29 575	-1 682	-31 257
Impairment	–	–	–
Recovery of depreciation on disposals and retirements	19 063	226	19 289
Change in scope of consolidation	4 312	1 245	5 557
Currency translation adjustment	-927	43	-884
Reclassification and others	397	–	397
As of December 31, 2006	**-91 233**	**-7 606**	**-98 839**
Net book values as of December 31, 2005	**71 809**	**3 959**	**75 768**
Net book values as of December 31, 2006	**66 398**	**4 334**	**70 732**
Useful life in years	2-10	4-7	

The technical equipment and machinery comprise assets made available to clients and generating recurring service revenue.

Fire insurance value

In CHF'000	**31.12.2006**	31.12.2005
Equipment	56 946	58 530

15. Intangible assets

In CHF'000	Know-how	Goodwill	Other intangibles	Total
Gross values at cost				
As of January 1, 2005	**5 000**	**–**	**30 867**	**35 867**
Additions	–	–	4 812	4 812
Disposals and retirements	–	–	-190	-190
Change in scope of consolidation	–	–	-302	-302
Currency translation adjustment	–	–	10	10
Reclassification and others	–	–	–	–
As of January 1, 2006	**5 000**	**–**	**35 198**	**40 198**
Additions	–	–	21 968	21 968
Disposals and retirements	–	–	-990	-990
Change in scope of consolidation	–	1 808	-14 909	-13 101
Currency translation adjustment	–	21	320	341
Reclassification and others	–	–	-7	-7
As of December 31, 2006	**5 000**	**1 829**	**41 580**	**48 409**
Accumulated depreciation and impairment				
As of January 1, 2005	**-5 000**	**–**	**-15 002**	**-20 002**
Systematic amortization	–	–	-4 347	-4 347
Impairment	–	–	–	–
Recovery of amortization on disposal and retirements	–	–	175	175
Change in scope of consolidation	–	–	14	14
Currency translation adjustment	–	–	-7	-7
Reclassification and others	–	–	9	9
As of January 1, 2006	**-5 000**	**–**	**-19 156**	**-24 156**
Systematic amortization	–	–	-4 017	-4 017
Recovery of amortization on disposal and retirements	–	–	11	11
Change in scope of consolidation	–	–	8 313	8 313
Currency translation adjustment	–	–	-165	-165
Reclassification and others	–	–	10	10
As of December 31, 2006	**-5 000**	**–**	**-15 004**	**-20 004**
Net book values as of December 31, 2005	**–**	**–**	**16 041**	**16 041**
Net book values as of December 31, 2006	**–**	**1 829**	**26 576**	**28 405**
Useful life in years		Infinite	4-10	

Other intangibles include patents, software, technology and customer lists.

16. Investments in associates

In CHF'000	**2006**	2005
At January 1	**7 559**	**5 399**
Acquisition of an associate	207	–
Share of profit/(loss)	3 231	2 663
Dividends received	-1 879	-503
Exchange differences	323	–
At December 31	**9 441**	**7 559**

The Group’s interests in its principal associates, all of which are unlisted, were as follows:

Name of associate	Principal activity	**Interest held 2006**	Interest held 2005
Digital Elektronik GmbH, Austria	Manufacture of Electronics products	25%	25%
APT-SkiData Ltd, United Kingdom	Sales of Physical Access products	26%	26%
SkiData Parking Systems, Japan	Sales of Physical Access products	26%	26%
TESC Test Solution Center GmbH, Germany	Services for Digital Television	25%	–
Ticketcorner Holding AG	Event distribution and ticketing	28%	*100%

* Fully consolidated in 2005.

Summarized financial information of the Group’s associates

In CHF'000	**31.12.2006**	31.12.2005
Total assets	193 986	52 802
Total liabilities	162 077	22 725
Net assets	31 908	30 078
Group’s share of associates’ net assets	9 441	7 559

In CHF'000	**2006**	2005
Revenue	149 867	76 781
Result of the period	8 849	10 545
Group’s share of associates’ result for the period	3 231	2 663

The Group’s share in the consolidated net assets of its associate Ticketcorner Holding AG, as adjusted for the unrealized portion of its revalued assets and liabilities, is negative. As the Group has no legal or constructive obligation on behalf of the associate, it has not recognized its share of the negative equity. It will resume recognizing its share of subsequent profits once these equal the share of losses not recognized.

17. Deferred income taxes

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority. The offset amounts are as follows:

In CHF'000	31.12.2006	31.12.2005
Deferred tax asset	32 217	27 255
Deferred tax liabilities	-2 952	-2 899
	29 265	**24 356**

The movement on the deferred income tax account is as follows:

In CHF'000	Notes	2006	2005
At January 1		**24 356**	**19 234**
Exchange differences		37	270
Income statement (expense)/income	11	4 872	4 852
At December 31		**29 265**	**24 356**

The movement in deferred tax assets and liabilities during the year, without taking into consideration the offsetting of balances within the same tax jurisdiction, is as follows:

In CHF'000	01.01.2006	Charged to income statement	Exchange differences	31.12.2006
Deferred tax assets associated with				
– intangibles	8 372	7 159	–	15 531
– employee benefits	2 777	607	19	3 403
– tax losses	9 818	-92	33	9 759
– provisions	4 086	-3 851	60	295
– inter-company profit elimination	3 215	250	41	3 506
– others	299	220	–	519
Total deferred tax asset (gross)	**28 567**	**4 293**	**153**	**33 013**
Deferred tax liabilities associated with				
– affiliates and allowances for Group companies	-3 354	-62	-110	-3 526
– provisions and accelerated tax depreciation	-857	842	-2	-17
– others	–	-201	-4	-205
Total deferred tax liability (gross)	**-4 211**	**579**	**-116**	**-3 748**
Net deferred tax asset/(liability)	**24 356**	**4 872**	**37**	**29 265**

Notes to the consolidated financial statements 2006

And for the past year:

In CHF'000	01.01.2005	Charged to income statement	Exchange differences	**31.12.2005**
Deferred tax assets associated with				
– intangibles	7 407	965	–	8 372
– employee benefits	2 391	386	–	2 777
– tax losses	6 990	2 828	–	9 818
– provisions	715	3 371	–	4 086
– inter-company profit elimination	4 232	-1 289	272	3 215
– others	963	-664	–	299
Total deferred tax asset (gross)	**22 698**	**5 597**	**272**	**28 567**
Deferred tax liabilities associated with				
– affiliates and allowances for Group companies	-2 386	-968	–	-3 354
– provisions and accelerated tax depreciation	-1 046	191	-2	-857
– others	-32	32	–	–
Total deferred tax liability (gross)	**-3 464**	**-745**	**-2**	**-4 211**
Net deferred tax asset / (liability)	**19 234**	**4 852**	**270**	**24 356**

At the balance sheet date, the Group has unused tax losses and temporary differences of CHF 271.1 million (2005: 248.0 million) available for offset against future profits. A deferred tax asset has been recognized in respect of CHF 143.5 million (2005: CHF 113.0 million) of such losses. No deferred tax asset has been recognized in respect of the remaining CHF 127.6 million (2005: CHF 135.0 million) due to the unpredictability of future profits streams. The amount of unused tax losses carry forward which has not been capitalized as deferred tax assets, with their expiry dates, is as follows:

In CHF million	**2006**	2005
One year	1.8	0.9
Two years	1.6	1.8
Three years	33.7	1.6
Four years	25.1	45.0
Five years	1.6	30.5
More than five years	63.8	55.2
Total	**127.6**	**135.0**

Tax losses are capitalized if it is probable that future taxable profits will arise to utilize the losses.

18. Financial assets and other non current assets

In CHF'000	31.12.2006	31.12.2005
Financial assets at fair value through profit or loss	2 631	10 044
Loans – third parties	14 981	11 590
Loans – associated company	17 550	–
Others	2 789	2 340
	37 951	**23 974**

Financial assets at fair value through profit or loss consist of investments for which the fair value is determined using either the market value or the future discounted cash flow method. The CHF 17.55 million loan to Ticketcorner bears a 7% interest rate. The effective interest rate on third party loans was 5.13% (2005: 6%). Others mainly consist of guarantee deposits.

19. Inventories

In CHF'000	31.12.2006	31.12.2005
Raw materials	11 059	10 074
Work in progress	6 317	7 086
Finished goods	42 402	34 264
	59 778	**51 424**

Write-downs of inventories recognized as an expense amount to kCHF 1 198 (2005: kCHF 888).
Changes in inventories of finished goods and work in progress included in cost of material are kCHF 6 758 (2005: kCHF -27 755).

20. Trade accounts receivable

In CHF'000	31.12.2006	31.12.2005
Trade accounts receivable	229 615	178 306
Trade accounts receivable related parties	11 148	6 252
Provision for impairment	-13 724	-11 950
	227 039	**172 608**

Provisions recognized for the impairment of trade receivables amount to kCHF -4 210 (2005: kCHF -2 302).

Notes to the consolidated financial statements 2006

21. Other current assets

In CHF'000	**31.12.2006**	31.12.2005
Loans – short term portion	3 065	1 733
Other receivables	20 322	22 664
Prepaid expenses	5 071	13 129
Accrued income	1 113	10 930
	29 571	**48 456**

22. Financial assets at fair value through profit or loss

In CHF'000	**31.12.2006**	31.12.2005
Financial assets held for trading:		
– marketable securities	26 147	9 822
	26 147	**9 822**

23. Cash and cash equivalents

In CHF'000	**31.12.2006**	31.12.2005
Cash at bank and in hand	115 480	68 784
Short term deposits	328 527	365 901
	444 007	**434 685**

The effective interest rate on short-term bank deposit was 2.5% (2005: 2.3%); these deposits have an average maturity of 30 days.

24. Share capital

Issued and fully paid share capital

In CHF'000	31.12.2006	31.12.2005
47 305 240 / 47 052 914 bearer shares, at CHF 10 each	473 052	470 529
46 300 000 registered shares at CHF 1 each	46 300	46 300
	519 352	**516 829**

The Registered Shares are not listed nor traded on any stock exchange. The Bearer Shares have been listed on the main market of the SWX since 2 August 1999 (ticker: KUD, security number: 1 226 836; ISIN CH0012268360) and are included in the SMIM (Swiss Market Index Mid-Cap).

Authorized share capital

In CHF'000	31.12.2006	31.12.2005
3 768 164 / 3 768 164 bearer shares, at CHF 10 each	37 682	37 682
3 200 000 registered shares at CHF 1 each	3 200	3 200
Authorized share capital as of December 31	**40 882**	**40 882**

The Board of Directors is authorized to increase the share capital in one or more stages until May 2, 2008, for the purpose of financing the full or partial acquisition of other companies.

Conditional share capital

In CHF'000	2006	2005
Conditional share capital as of January 1	**114 609**	**68 342**
Increase of conditional share capital	–	47 500
Employee share purchase plan	-47	-105
Exercise of options	-778	–
Shares allotted to employees	-1 699	-1 128
Conditional share capital as of December 31	**112 085**	**114 609**
Of which may be utilized as of December 31 for:		
– convertible bonds:		
10 000 000 bearer shares, at CHF 10 each	100 000	100 000
– options or share subscriptions to employees:		
1 208 516/1 460 842 bearer shares, at CHF 10 each	12 085	14 609
	112 085	**114 609**

The shareholders of Kudelski SA met in an Extraordinary General Meeting on September 30, 2005 and approved an increase of the conditional share capital of up to a total amount of CHF 100 000 000, through the issue of 10 000 000 bearer shares of a nominal value of CHF 10, to be issued as and when rights are exercised to convert the bonds of Kudelski SA and its subsidiaries. Furthermore the ordinary 2005 General Assembly approved an increase of the conditional share capital for options exercises or share subscriptions to employees up to a maximal amount of CHF 15 841 760 consisting of 1 584 176 bearer shares of a nominal value of CHF 10.

25. Treasury shares

	Number of bearer shares	Book value in CHF'000
As of December 31, 2005 and December 31, 2006	**20 155**	**380**

No transaction occurred during the last two financial years.

26. Long term financial debt

In CHF'000	Notes	31.12.2006	31.12.2005
Bank loans		1 828	1 172
Financial lease obligations		–	1 860
CHF 350 million 1.625% unsubordinated convertible bond 2005/2012	27	316 688	311 426
		318 516	**314 458**

The fixed interest rate paid in 2006 and 2005 for bank loans is 2%. The fair value of the CHF 350 million unsubordinated convertible bond 2005/2012 is kCHF 302 433 (2005: kCHF 303 894).

27. Convertible bond 2005/2012

On October 5, 2005, Kudelski Financial Services Holding SCA issued a CHF 350 000 000 unsubordinated convertible bond due 2012, convertible into bearer shares of Kudelski SA. This bond has a denomination of CHF 5 000 nominal amount with an initial conversion price of CHF 67.76 per bearer shares of Kudelski SA with a nominal value of CHF 10. Bondholders may request conversion at any time from January 1, 2006 until September 12, 2012. The bond is callable at par value after October 5, 2010, subject to a 110% provisional call hurdle. If not converted prior to the date of maturity, the bonds will be redeemed at par value. Interest expense on the liability component of the bond is calculated on the effective yield basis using an effective rate of 3.2%.

The convertible bond is recognized in the consolidated balance sheets as of December 31, as follows:

In CHF'000	**2006**	2005
Face value of convertible bond issued on October 5, 2005	**350 000**	350 000
Transactions costs	-5 719	-5 719
Equity conversion component	-34 087	-34 087
Liability component on initial recognition on October 5, 2005	**310 194**	**310 194**
Cumulative Interest expense as of January 1	2 576	–
Interest expense for the year	10 950	2 576
Interest paid	-5 688	–
Interest accrued (short term portion)	-1 343	-1 343
Liability component as of December 31	**316 688**	**311 426**

Transaction costs amounted to kCHF 6 337 of which kCHF 618 were allocated to the equity component of the convertible bond.

The above interest expense includes the following:

In CHF'000	**2006**	2005
Base interest (1.625%)	5 688	1 343
Allocation of the equity conversion component	4 445	1 040
Effective interest expense (effective yield rate of 3.2%)	**10 133**	**2 383**
Allocation of transaction costs	817	193
Interest expense	**10 950**	**2 576**

28. Convertible bond 2002/2009

On January 31, 2002, Kudelski Financial Services Holding SCA issued a convertible bond with an aggregate principal amount of USD 325 000 000. This convertible bond was issued in denominations of USD 1 000 at par value, with interest at 2.25% payable semi-annually and final redemption in January 2009 at 105.79, representing a yield to maturity of 3%. The conversion price was set at CHF 100. The issuer could redeem all of the bonds at any time after January 31, 2005 and before January 31, 2007. On September 6, 2005 the issuer and Kudelski SA announced that they would tender for cash the remaining USD 157 928 000 convertible bond. As a result, holders of a total of USD 149 297 000 have tendered at a price of USD 1 020 per USD 1 000 principal amount. On November 9, 2005, the issuer called for the redemption of the remaining portion of the convertible bond with a redemption date of December 12, 2005 at a price of USD 1 030.41 per USD 1 000 principal amount. As of December 12, 2005 the bond was delisted and fully repaid.

The convertible bond is recognized in the consolidated balance sheets as of December 31, as follows:

	2006 CHF'000	2005 USD'000	2005 CHF'000
Face value of convertible bond as of January 1	–	**172 928**	**197 138**
Carrying value as of January 1, of:			
– conversion option	–	-9 754	-11 119
– reconstitution of the redemption value	–	4 046	4 611
– transaction costs	–	-1 524	-1 738
Liability component as of January 1	–	**165 696**	**188 892**
Interest expense	–	7 688	9 708
Interest paid	–	-2 996	-3 784
Transaction cost allocated	–	586	740
Cash reimbursement	–	-176 061	-225 170
Gain on repurchase	–	-2 023	-2 573
Impairment of conversion option and transaction costs	–	7 110	9 085
Exchange rate (gain)/loss	–	–	23 102
Liability component as of December 31	–	–	–

Transaction and issuing costs of kUSD 7 832 have been deducted from the carrying value of the liability and equity components upon initial recognition. The above figures assumed an early redemption on January 31, 2007; therefore the initial transaction and issuing costs were allocated over the period up to this date on a straight line basis.

The above interest expense includes the following:

	2006 CHF'000	2005 USD'000	2005 CHF'000
Interest expense	–	2 996	3 784
Reconstitution of the redemption value	–	1 111	1 402
Amortization of the conversion option	–	3 581	4 522
	–	**7 688**	**9 708**

Interest expense on the bond is calculated using the effective interest method by applying the effective interest rate of 5.895% to the liability component. As the convertible bond entitles the issuer to deliver cash upon exercise of the conversion option (cash settlement alternative), the conversion option is treated as a derivative financial instrument (note 35).

29. Employee benefits liabilities

In addition to the social security plans mandated by the law, the Group sponsors an independent pension plan in Switzerland. All employees in Switzerland are covered by this plan, which is a defined benefit plan according to IAS 19. Retirement benefits are based on contributions, computed as a percentage of salary, adjusted for the age of the employee and shared approximately 46%/54% by employee and employer. In addition to retirement benefits, the plan provides death and long-term disability benefits to its employees. Liabilities and plan assets are revised every year by an independent actuary. In certain locations abroad, the Group is subject to termination and jubilee benefits treated as defined benefit plans according to IAS 19.

Plan assets have been estimated at market fair value. Liabilities have been calculated according to the "Projected Unit Credit" method.

The following table sets forth the status of the pension plans and the amount that is recognized in the balance sheet:

In CHF'000	**31.12.2006**	31.12.2005	31.12.2004	01.01.2004
Fair value of plan assets	69 994	55 886	45 667	38 434
Defined benefit obligation	-99 328	-81 006	-66 937	-49 385
Funded status	**-29 334**	**-25 120**	**-21 270**	**-10 951**
Unrecognized gains/(losses)	-11 721	-11 040	-9 104	–
Prepaid/(accrued) pension cost	**-17 613**	**-14 080**	**-12 166**	**-10 951**

The liability that is recognized in the balance sheet at December 31, 2006 amounts to kCHF 17 613 (kCHF 14 080 at December 31, 2005).

According to IAS 19, the following amount is recorded as net pension cost in the income statement of the financial year 2006 (resp. 2005):

In CHF'000	**2006**	2005
Service cost	-10 225	-8 677
Interest cost	-2 304	-2 134
Expected return on plan assets	2 794	2 283
Employees contributions	3 027	2 897
Amortization of gains/(losses)	-140	101
Net pension (cost)/income	**-6 848**	**-5 530**
Exchange rate difference	**-181**	**–**
Employer contributions	**3 569**	**3 616**

The net pension cost for the financial year 2006 amounts to kCHF 6 848 (kCHF 5 530 for the financial year 2005).

The main assumptions used for the calculation of the pension cost and the defined benefit obligation for the years 2006 and 2005 are as follows:

Switzerland

	31.12.2006	31.12.2005
Discount rate	2.75%	2.75%
Rate of future increase in compensations	2.00%	2.00%
Rate of future increase in current pensions	1.00%	1.00%
Expected long-term rate of return on plan assets	5.00%	5.00%

Abroad

	31.12.2006	31.12.2005
Discount rate	4.84%	4.51%
Rate of future increase in compensations	3.30%	3.32%

The changes in Defined benefit obligation, Fair value of plan assets and Unrecognized Gains/(losses) during the year 2006 and 2005 are as follows:

A. Change in Defined benefit obligation

In CHF'000	**2006**	2005
Defined benefit obligation as of January 1	**-81 006**	**-66 937**
Service cost	-10 225	-8 677
Interest cost	-2 304	-2 134
Benefits paid/(received)	-2 722	496
Actuarial (gains)/losses	-2 817	-3 754
Acquisition	-73	–
Exchange rate difference	-181	–
Defined benefit obligation as of December 31	**-99 328**	**-81 006**

B. Change in Fair value of plan assets

In CHF'000

	2006	2005
Fair value of plan assets as of January 1	**55 886**	**45 667**
Expected return on plan assets	2 794	2 283
Employees' contributions	3 027	2 897
Employer's contribution	3 569	3 616
Benefits (paid)/received	2 722	-496
Plan assets gains/(losses)	1 996	1 919
Exchange rate difference	–	–
Fair value of plan assets as of December 31	**69 994**	**55 886**

C. Change in Unrecognized Gains / (losses)

In CHF'000

	2006	2005
Unrecognized Gains / (losses) as of January 1	**-11 040**	**-9 104**
Amortization	140	-101
Actuarial gains/(losses)	-2 817	-3 754
Plan assets gains/(losses)	1 996	1 919
Unrecognized Gains / (losses) as of December 31	**-11 721**	**-11 040**

The actual return on plan assets amounts to kCHF 4 790 for the year 2006 (kCHF 4 202 for the year 2005). The estimated employer's contribution to the pension plans for the financial year 2007 amounts to kCHF 4 389.

The categories of plan assets and their corresponding expected return at December 31, 2006 are as follows:

	Proportion in % 31.12.2006	Expected return 31.12.2006	Proportion in % 31.12.2005	Expected return 31.12.2005
Cash	11.9%	1.5%	7.7%	1.5%
Swiss bonds	34.9%	2.5%	39.4%	2.5%
Foreign bonds	7.0%	3.9%	5.9%	3.9%
Swiss shares	22.8%	8.3%	18.6%	8.3%
Foreign shares	15.6%	8.9%	19.7%	8.9%
Real estates	7.8%	4.4%	8.7%	4.4%
Total	**100.0%**	**5.0%**	**100.0%**	**5.0%**

Notes to the consolidated financial statements 2006

30. Provisions for other liabilities and charges

In CHF'000	Legal fee and litigations	Provision for warranty	**Total 2006**	Total 2005
As of January 1	**5 072**	**1 863**	**6 935**	**20 994**
Additional provisions	44	8 847	8 891	412
Unused amounts reversed	-209	-481	-690	–
Used during the year	–	-246	-246	-14 471
Change in scope of consolidation	–	-11	-11	–
Exchange differences	129	135	264	–
As of December 31	**5 036**	**10 107**	**15 143**	**6 935**
Thereof:				
– short-term	–	7 753	7 753	2 070
– long-term	5 036	2 354	7 390	4 865
	5 036	**10 107**	**15 143**	**6 935**

Legal fee and litigations

A number of Group companies are the subject of litigation arising out of the normal conduct of their business, as a result of which claims could be made against them. Such claims, in whole or in part, might not be covered by insurance. The provisions for legal fee and lawsuit are valued according to the best management estimate principle.

Provision for warranty

Provision for warranty includes kCHF 2 354 to cover the risk of smart card replacement for certain customers paying a recurring security fee.

31. Other long-term liabilities

In CHF'000	31.12.2006	31.12.2005
Contingent consideration (earn out) – long-term portion	–	3 168
Loans granted by third parties	866	866
Loans granted by related parties	–	253
	866	**4 287**

The loans granted by third parties have a nil interest rate.

32. Short term financial debt

In CHF'000	Notes	31.12.2006	31.12.2005
Short term bank borrowings		9 954	16 103
Short term financial lease obligations		13	1 088
Other short term financial liabilities	27	1 343	1 343
		11 310	**18 534**

The average effective interest rate paid in 2006 for short term bank borrowings is 4.44% (2005: 2.49%).
The effective lease interest rate for 2006 and 2005 was between 2.8% and 3.7% depending of the lease term.

33. Trade accounts payable

In CHF'000	31.12.2006	31.12.2005
Trade accounts payable – third parties	57 616	75 652
Trade accounts payable – related parties	11 089	7 448
	68 705	**83 100**

34.Other current liabilities

In CHF'000	31.12.2006	31.12.2005
Accrued expenses	45 708	46 467
Deferred income	6 120	7 686
Payable to pension fund	947	995
Other payables	15 614	11 768
	68 389	**66 916**

35. Derivative financial instruments

In CHF'000	Assets 31.12.2006	Liabilities 31.12.2006	Assets 31.12.2005	Liabilities 31.12.2005
Zero cost options on currencies	–	–	–	1 760
Total current portion	**–**	**–**	**–**	**1 760**
Total	**–**	**–**	**–**	**1 760**

Convertible bond – conversion option

The conversion option related to the 2002 convertible bond is treated as a derivative financial instrument (see note 28). The initial measurement has been deducted from the liability component of the convertible bond. Subsequent measurement is the fair value of the financial instrument and differences resulting thereto are recognized in other finance income/(expense), net (note 10). Fair value is determined using the Black & Scholes option model.

Zero cost options on currencies

Short-term derivatives on currencies are entered into to cover exposure in foreign currencies. In 2005 and 2006, they did not meet the criteria for hedge accounting.
The notional amounts of the outstanding zero cost options on currencies as of December 31, 2006 are kCHF 0 and kCHF 37 250 as of December 31, 2005.

36. Cash flows arising from divestments of subsidiaries

The following is a summary of the cash flow impact of the divestments of subsidiaries:

In CHF'000	**Disposal 2006**	Disposal 2005
Financial fixed assets	612	–
Intangible fixed assets	13 093	288
Tangible fixed assets	1 627	50
Net working capital	-19 644	-37
Short term financial debt	-568	–
Long term debt	-10 272	–
Cash and cash equivalent	16 945	25
Fair value of net asset disposed of	**1 793**	**326**
Minority interest disposed of	–	-161
Gain on disposal of subsidiaries	59 083	35
Disposal expenses	10 194	–
Contingent consideration adjustment (“earn out”)	–	–
Total sale proceeds	**71 070**	**200**
Disposal consideration not paid as of December 31 (loan granted)	-17 550	–
Consideration received from prior year disposed of subsidiaries	–	3 100
Reimbursement of an inter-company loan	9 920	–
Cost related to the disposal	-10 194	–
Cash and cash equivalent disposed of	-16 945	-25
Net cash inflow/(outflow) on disposals	**36 301**	**3 275**

37. Cash flows for acquisition of subsidiaries

In CHF'000	Acquisitions 2006
Tangible fixed assets	2 337
Intangible assets (excluding goodwill)	6 459
Net working capital	2 682
Short term financial liability	253
Cash and cash equivalents	846
Fair value of net assets acquired	**12 577**
Goodwill	1 808
Acquisition costs	45
Total consideration	**14 430**
To deduct:	
Contingent consideration	-2 470
Cash and cash equivalents	-846
Net cash outflow for acquisitions	**11 114**

The goodwill is fully attributable to the purchase of the assets of DTVS a division of SCM Microsystems (note 3) and is attributable to the capacity of the employees to develop new products, to the entity's position in its market and synergies expected to arise from the acquisition.

38. Principal shareholders

	Voting rights 31.12.2006	Voting rights 31.12.2005	**Share-holdings 31.12.2006**	Share-holdings 31.12.2005
Kudelski Family	**57%**	57%	**22%**	22%

According to information available to the Board of Directors at December 31, 2006, there were no other shareholders with more than 5% of the voting rights.

39. Research and development

The following amounts were recognized as expenses and charged to the income statement:

In CHF'000	2006	2005
Research and development	**195 285**	**165 563**

40. Dividend

The dividend paid in 2006 was kCHF 15 540 (2005: kCHF 10 321) which corresponds to a dividend of CHF 0.30 (2005: CHF 0.20) per bearer share and CHF 0.03 (2005: CHF 0.02) per registered share.

For the current year, the Board of Directors proposes a dividend of CHF 0.30 per bearer share and CHF 0.03 per registered share, Moreover, the Board of Directors proposes an extraordinary dividend of CHF 0.30 per bearer share and CHF 0.03 per registered share. The ordinary and extraordinary dividends to be paid are kCHF 15 581 and kCHF 15 581 respectively and may fluctuate upon exercise of option and conversion rights. Those ordinary and extraordinary dividends are subject to the approval of shareholders at the Annual General Meeting and have not been included as a liability in these financial statements.

41. Employee share participation plans

Employee stock option plan

In April 2003 the Kudelski Group set up a stock option plan for the members of the Board of Directors, the management and certain expert employees. The Board of Directors and executive management determined the modalities and the conditions governing the grant of options. The following options were granted:

Year of grant	Number of options	Vesting	Maturity	Ratio	Exercise price
2003	125 000	01.04.2006	01.04.2007	1:1	20
2003	125 000	01.04.2007	01.04.2008	1:1	20
2003	125 000	01.04.2008	01.04.2009	1:1	20
2005	1 000	01.04.2007	01.04.2008	1:1	20
2005	1 000	01.04.2008	01.04.2009	1:1	20

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The following table summarizes the change in options held:

Changes in options held

	Options 2006	Strike price CHF 2006	Options 2005	Strike price CHF 2005
In circulation on January 1	**357 140**	**20**	**358 303**	**20**
– of which exercisable	–		–	
New rights issued	–	–	2 000	20
Rights exercised	-77 781	20	–	–
Rights forfeited	-5 114	20	-3 163	20
In circulation on December 31	**274 245**	**20**	**357 140**	**20**
– of which exercisable	40 199		–	

The expense charged against the income statement for the financial year 2006 amounts to kCHF 470 (2005: kCHF 659). The expense assumes a departure rate based on the fact that some beneficiaries will not be able to exercise.

Employee share purchase program (ESPP)

As of financial year 2004, the Group set up a plan to allow employees of certain Group companies to buy shares, giving them preferential conditions to buy Kudelski SA bearer shares. All such shares purchased and the additional shares and options obtained through this plan are subject to a three-year blocking period.

	Shares 2006	Options 2006	Shares 2005	Options 2005
Shares underwritten by employees	4 085	–	9 135	–
Bonus shares and options from ESPP	593	224	1 407	420
Total employee share program	**4 678**	**224**	**10 542**	**420**

In CHF'000	2006	2006	2005	2005
Amount paid by employees	113	–	264	–
Booked corporate charges (excluding social charges)	35	6	89	7
	148	**6**	**353**	**7**

Shares issued for employees

In 2006, 169 867 bearer shares of Kudelski SA (2005: 112 792) were given to employees for no consideration, of which 105 000 include a five year blocking period (2005: 85 000) and 15 058 include a three year blocking period (2005: 0). The total expense recognized in the income statement amounts to kCHF 4 068 (2005: kCHF 3 193).

42. Related parties

(a) Trading transactions

Transaction between the Group and its subsidiaries, which are related parties of the Group have been eliminated on consolidation and are not disclosed in this note.

During the year, Group entities entered into the following significant trading transactions with related parties that are not member of the Group, associates or joint ventures:

In CHF'000	**Sales of goods and services 2006**	Sales of goods and services 2005	**Purchase of goods and services 2006**	Purchase of goods and services 2005	**Amounts owed to related parties 31.12.06**	Amounts owed to related parties 31.12.05	**Amounts owed by related parties 31.12.06**	Amounts owed by related parties 31.12.05
Digital-Elektonik GmbH	1 364	316	40 227	31 012	9 824	7 204	–	71
APT-Skidata Ltd	14 301	8 562	–	–	–	–	5 142	3 599
Skidata Parking System	9 541	5 712	–	–	–	–	2 639	2 576
Ticketcorner Group	74	–	–	–	–	–	18 631	–
Total associated companies	**25 280**	**14 590**	**40 227**	**31 012**	**9 824**	**7 204**	**26 412**	**6 246**
Mediacrypt SA	1	35	251	817	–	277	–	5
Total joint ventures	**1**	**35**	**251**	**817**	**–**	**277**	**–**	**5**

Digital Elektronik is the main supplier of access control material for Skidata. APT Skidata and Skidata Parking Ltd are sales representatives companies for Skidata Group. The amounts owed by Ticketcorner Group comprise a CHF 17.55 million loan and accrued interest thereon.

(b) Key management compensation

In CHF'000	**2006**	2005
Salaries and other short-term employee benefits	9 097	7 951
Share-based payments	4 053	3 485
	13 150	**11 436**

Management compensation includes share and cash-based payments granted for the year but not yet executed at the closing date.

43. Commitments and contingencies

Operating lease commitments

The future aggregate minimum lease payments under operating leases are as follows:

In CHF'000	2006	2005
Within one year	1 572	1 163
In the second to fifth year inclusive	2 753	1 288
	4 325	**2 451**

44. Financial risk management

(a) Market risk

The Group is exposed to market risk, primarily related to foreign exchange, interest rates and the market value of investments assets and equity securities. Management actively monitors these exposures. The objective is to minimize, where deemed to be appropriate, fluctuations in earning flows associated with changes in foreign exchange, interest rates and the market value of investments in financial assets and securities. To manage the volatility relating to these exposures and to enhance the yield on investments in financial assets, the group uses derivative financial instruments. The Group does not use financial derivatives for trading or speculative reasons, or for purposes unrelated to normal business activities. Any loss in value on a financial derivative would normally be offset by an increase in the value of the underlying transaction.

The Group does not enter into any financial transactions containing a risk that cannot be quantified at the time the transaction is concluded; i.e. it does not sell assets short. The Group only sells existing assets or hedges transactions and future transactions (in the case of anticipatory hedges) it knows it will have in the future based on past experience. In the case of liquid funds, it writes options on assets it has, or on positions it wants to acquire, and for which it has the required liquidity. The Group therefore expects that any loss in value for these instruments would be generally offset by increases in the value of the hedged transactions.

(b) Foreign exchange risk

The Group conducts business in a variety of countries using a variety of foreign currencies. However, the Group prepares its consolidated financial statement in Swiss francs. It is therefore exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the US Dollar and the Euro. Foreign exchange risk arises from future commercial transactions, recognized assets and liabilities and net investments in foreign operations. In order to manage the foreign exchange risk arising from future commercial transactions and certain assets and liabilities, the Group uses forward contracts and foreign currency zero cost option contracts to hedge certain anticipated foreign currency revenues.

Until November 2005, the Group had a USD denominated convertible bond liability. This foreign currency liability was not fully offset by a corresponding USD asset amount as it was used as a natural hedge for long-term USD cash flows.

Net investments in Kudelski affiliates with a functional currency other than the Swiss Franc are of long-term nature: the Group does not hedge such foreign currency translation exposures.

(c) Interest rates

The Group manages its exposure to interest rate risk through a mix of fixed rate debt and variable rate debt in its total debt portfolio. To manage this mix, the Group may enter into interest rate swap agreements, in which it exchanges periodic payments based on a notional amount with agreed upon fixed and variable interest rates.

However, at the end of 2006, the Group had no such swap agreement.

(d) Counterparty risk

Counterparty risk includes issuer risk on debt securities, settlement risk on derivative and money market transactions, and credit risk on cash and fixed term deposits. Issuer risk is limited by buying debt securities, which are at least A rated.

Settlement and credit risk is reduced by entering into transactions with counterparties that are usually at least A rated banks or financial institutions. Exposure to these risks and compliance with the risk parameters approved by the Board of Directors is closely monitored.

The Group does not expect any losses due to non-performance by these counterparties. The diverse portfolio of investments limits the exposure to any single counterparty or sector.

(e) Equity prices

The Group is not exposed to equity price risks.

(f) Commodities

The group has very limited exposures to price risk related to anticipated purchases of certain commodities used as raw materials in its business. A change in commodity prices may alter the gross margin, but due to the limited exposure to any single raw material, a price change is unlikely to have a material unforeseen impact on the Group's earnings.

45. Additional information

In CHF'000	**31.12.2006**	31.12.2005
Guarantee in favor of third parties	68 922	13 209
Current assets pledged to secure own commitments	4 770	964

46. Principal currency translation rates

	Year end rates used for the consolidated balance sheets 2006	Year end rates used for the consolidated balance sheets 2005	**Average rates used for the consolidated income and cash flow statements 2006**	Average rates used for the consolidated income and cash flow statements 2005
1 USD	1.22	1.31	1.25	1.25
1 GBP	2.39	2.26	2.31	2.26
1 EUR	1.61	1.55	1.57	1.55
100 MYR	34.50	34.70	34.15	32.90
100 SEK	17.80	16.50	17.00	16.20
1 SGD	0.795	0.79	0.79	0.75

47. Events subsequent to the balance sheet date

These consolidated financial statements have been approved for issue by the Board of Directors on February 15, 2007.

On January 17, 2007 the Group completed the acquisition of a controlling interest in OpenTV Corp for a cash consideration of USD 132.2 million corresponding to an economic interest of 26.53% and a voting interest of 74.51%. OpenTV will be fully consolidated in the Group financial statements from the closing date. As OpenTV Corp financial statements at closing date are not yet available, the determination of the Purchase Price Allocation (PPA) is impracticable at the date of the financial statements.

On January 18, 2007 the Group disposed of 50% of interest in polyright SA, Sion for a cash consideration amounting to CHF 1 million. polyright SA will be consolidated as a joint venture from the closing date.

48. Principal operating companies

Company	Place of incorporation		Activity		**% held 2006**	% held 2005
Digital Television						
Nagravision SA	CH	Cheseaux	Solutions for Digital TV and audio products	■	100	100
NagraCard SA	CH	Cheseaux	Secure smart cards	■	100	100
NagraID SA	CH	Chaux-de-Fonds	Smart card production	■	100	100
Nagra France Sàrl	FR	Paris	Solutions for Digital TV and audio products	■	100	100
Nagra USA, Inc.	US	Nashville	Sales and support	■	100	100
Nagravision Asia Pte Ltd	SG	Singapore	Services	■	100	100
Quative Ltd	UK	London	IPTV solutions	■	100	100
SmarDTV SA	CH	Cheseaux	Chipsets for iDTV and conditional access modules	■	100	–
NagraStar LLC	US	Englewood	Smart cards and digital TV support	■	50	50
Nagra Plus	CH	Cheseaux	Analog Pay-TV solutions	■	50	50
Nagra Thomson Licensing SA	FR	Paris	Intellectual property management	◧	50	50
Public Access						
Nagra Public Access AG	CH	Zug	Holding in public access	■	100	100
SkiData Group	AT	Gartenau	People and car access systems	■	100	100
Ticketcorner Group	CH	Rümlang	Event distribution and ticketing	□	28	100
polyright SA	CH	Sion	Multifunction chipcard system	■	100	100
Corporate						
Kudelski SA	CH	Cheseaux	Holding, parent company of the Group	■	100	100
Kudelski Financial Services SCA	LU	Luxemburg	Finance, convertible bearing company	■	100	100

■ Full consolidation method applied.
◧ Joint-venture accounting applied.
□ Ticketcorner Group was consolidated using the full consolidation method in 2005 and the equity method since the closing date of the partial exit transaction.

Report of the Group Auditors to the general meeting of Kudelski SA Cheseaux-sur-Lausanne

As Auditors of the Group, we have audited the consolidated financial statements (balance sheet, income statement, statement of cash flows, statement of changes in equity and notes) included on pages 3 to 52 of Kudelski SA for the year ended December 31, 2006.

These consolidated financial statements are the responsibility of the board of directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with Swiss Auditing Standards and with the International Standards on Auditing, which require that an audit be planned and performed to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the consolidated financial statements. We have also assessed the accounting principles used, significant estimates made and the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements give a true and fair view of the financial position, the results of operations and the cash flows in accordance with the International Financial Reporting Standards (IFRS) and comply with Swiss law.

We recommend that the consolidated financial statements submitted to you be approved.

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers SA

F. Roth
Auditor in charge

S. Jaquet

Lausanne, February 15, 2007

Balance sheets at December 31, 2006 and 2005

Assets

In CHF'000	Notes	**31.12.2006**	31.12.2005
Fixed assets			
Intangible fixed assets	3.1	–	40
Financial fixed assets			
Investments	3.2	314 138	311 342
Loans to Group companies		266 271	294 492
Total fixed assets		**580 409**	**605 874**
Current assets			
Accounts receivable from Group companies		134 546	74 963
Other accounts receivable and accruals	3.3	2 396	1 280
Treasury shares	3.5	380	380
Marketable securities		7 320	9 822
Cash and cash equivalents	3.4	119 343	135 827
Total current assets		**263 985**	**222 272**
Total assets		**844 394**	**828 146**

Shareholders' equity and liabilities

In CHF'000	Notes	31.12.2006	31.12.2005
Shareholders' equity			
Share capital		519 352	516 829
General reserve		68 249	62 659
Reserve for treasury shares		380	380
Retained earnings		169 568	152 267
Net income		72 320	35 182
Total shareholders' equity	3.5	**829 869**	**767 317**
Long-term liabilities			
Provisions	3.6	–	1 856
Loans from Group companies		–	505
Total long-term liabilities		**–**	**2 361**
Current liabilities			
Short-term loans from Group companies		13 702	57 414
Other liabilities		543	649
Accruals		280	405
Total current liabilities		**14 525**	**58 468**
Total liabilities		**14 525**	**60 829**
Total shareholders' equity and liabilities		**844 394**	**828 146**

Income statements and proposal for appropriation of available earnings for the year 2006

Income statements for the years ended December 31, 2006 and 2005

In CHF'000	Notes	2006	2005
Financial income	4.1	84 255	68 341
Gain on sale of investment	4.2	300	–
Release of provision	3.6	1 856	–
Administrative and other expenses	4.3	-5 729	-5 930
Financial expenses and exchange result	4.4	-1 350	-566
Impairment of financial fixed assets	4.5	-6 967	-26 582
Depreciation and amortization		-40	-36
Income before tax		**72 325**	**35 227**
Income tax		**-5**	**-45**
Net income		**72 320**	**35 182**

Proposal for appropriation of available earnings for the year 2006

In CHF'000	2006
Balance brought forward from previous year	169 568
Net income	72 320
Total available earnings	**241 888**
Proposal of the Board of Directors:	
Ordinary dividend:	
– CHF 0.30 on 47 305 240* bearer shares	14 192
– CHF 0.03 on 46 300 000 registered shares	1 389
Extraordinary dividend:	
– CHF 0.30 on 47 305 240* bearer shares	14 192
– CHF 0.03 on 46 300 000 registered shares	1 389
General reserve allocation	4 251
Balance to be carried forward	206 475
Total available earnings	**241 888**

* This figure represents the number of bearer shares which are dividend bearing as of December 31, 2006. It may fluctuate due to the exercise of option and conversion rights between December 31, 2006 and the ordinary General meeting date.

Notes to the financial statements 2006

1. General Comments

Kudelski SA is the ultimate holding company of the Kudelski Group, which comprises subsidiaries and associated companies. The financial statements are presented in accordance with the requirements of the Swiss Code of Obligations. They are also prepared under the historical cost convention and on the accrual basis.

2. Accounting Policies

Financial fixed assets
Investments and loans to Group companies are accounted for at acquisition cost less adjustment for impairment of value.

Cash and cash equivalents
Cash and cash equivalents include cash at bank and short-term deposits. Cash at bank consists of all funds in current accounts available within 48 hours. Short-term deposits generally include bank deposits and fixed term investments whose maturities are of three months or less from the transaction date.

Exchange rate differences
Transactions in foreign currencies are accounted for in Swiss francs (CHF) at the exchange rate prevailing at the date of the transaction. Assets and liabilities in foreign currencies are accounted for at year-end rates.
Any resulting exchange differences are included in the respective income statement caption depending upon the nature of the underlying transactions; the aggregate unrealized exchange difference is calculated by reference to original transaction date exchange rates and includes hedging transactions. Where this gives rise to a net loss it is charged to the income statement, whilst a net gain is deferred.

Notes to the financial statements 2006

3. Notes to the balance sheet

3.1 Intangible fixed assets

This item includes brands registered by the Group as well as the capitalization of software licenses.

3.2 Investments

Company	Location		Activity	Share capital		**% held 2006**	% held 2005
Nagravision SA	CH	Cheseaux	Solutions for Digital TV and audio products	kCHF	12 000	100	100
NagraCard SA	CH	Cheseaux	Secure smart cards	kCHF	100	100	100
Lysis SA	CH	Cheseaux	No activity	kCHF	100	100	100
Nagravision Iberica SL	ES	Madrid	Sales and support Digital TV	kEUR	3	100	100
Nagra France Sàrl	FR	Paris	Solutions for Digital TV and audio products	kEUR	32 833	100	100
Nagra Kudelski (GB) Ltd	GB	St. Albans	Sales and support	kGBP	1	100	100
Nagravision GmbH	DE	Hildesheim	Services	kEUR	25	100	100
Nagra USA, Inc.	US	Nashville	Sales and support	kUSD	10	100	100
Nagra Public Access AG	CH	Zug	Holding in public access	kCHF	15 000	100	100
Nagra Plus	CH	Cheseaux	Analog Pay-TV solutions	kCHF	2 000	50	50
NagraID SA	CH	Chaux-de-Fonds	Smart card production	kCHF	4 000	100	100
MediaCrypt AG	CH	Zurich	Fundamental scrambling technology	kCHF	1 000	M	50
Nagra Trading SA	CH	Cheseaux	Trading of set-top-boxes	kCHF	100	100	0
SmarDTV SA	CH	Cheseaux	Chipsets for iDTV and conditional access modules	kCHF	1 000	100	0
Kudelski Financial Services Holding SCA	LU	Luxembourg	Finance	kCHF	37 050	100	100
Kudelski Luxembourg Sàrl	LU	Luxembourg	Finance	kEUR	13	100	100
Leman Consulting SA	CH	Nyon	Intellectual property consulting	kCHF	100	100	100
Nagravision Asia Pte Ltd	SG	Singapore	Services	kSGD	100	100	100
Kudelski Malaysia SDN. BHD.	MA	Kuala Lumpur	Services	kMYR	–	100	100
Abilis Systems Sàrl	CH	Plan-les-Ouates	Research & development for mobile phones	kCHF	20	70	70
Nagravision Shanghaï Technology	CN	Shanghaï	Software integration for Digital TV	kCNY	1 619	100	100
Quative Ltd	UK	London	IPTV Solutions	kGBP	1 000	100	100
TESC Test Solution Center GmbH	DE	Munich	Services	kEUR	25	25	–
Nagravision Italy Srl	IT	Milan	Services	kEUR	10	100	–
Nagra Travel Sàrl	CH	Cheseaux	Travel agency	kCHF	50	100	100
Acetel Co Ltd	SK	Séoul	Digital broadcasting solution provider	kKRW	1 460	15	15
Thema SAS	FR	Paris	Worldwide brokerage for existing audio-visual thematic channels	kEUR	46	10	10

M: merged company.

3.3 Other receivables

In CHF'000	31.12.2006	31.12.2005
Other accounts receivable	615	873
Prepaid expenses and accrued income	1 337	60
Withholding tax	444	347
	2 396	**1 280**

3.4 Cash and cash equivalents

In CHF'000	31.12.2006	31.12.2005
Cash at bank and in hand	2 411	1 157
Short-term deposits	116 932	134 670
	119 343	**135 827**

3.5 Change in shareholders' equity

In CHF'000	Share capital	General reserve	Reserve for treasury shares	Available earnings	**Total shareholders' equity**
As of December 31, 2004	**515 596**	**60 312**	**380**	**162 622**	**738 910**
General reserve allocation		36		-36	–
Dividend				-10 319	-10 319
Share capital increase	1 233	2 311			3 544
Net income				35 182	35 182
As of December 31, 2005	**516 829**	**62 659**	**380**	**187 449**	**767 317**
General reserve allocation		2 341		-2 341	–
Dividend				-15 540	-15 540
Share capital increase	2 523	3 249			5 772
Net income				72 320	72 320
As of December 31, 2006	**519 352**	**68 249**	**380**	**241 888**	**829 869**

Notes to the financial statements 2006

Treasury shares

	Number of bearer shares	Book value in CHF'000
As of December 31, 2005 and December 31, 2006	**20 155**	**380**

No transaction occurred during the last two financial years. Treasury shares are capitalized at the cost of acquisition or the stock market price, whichever is lower. In compliance with Article 659 a para 2 of the Swiss Code of Obligations, the company allocated a total corresponding to the acquisition value of treasury shares to a separate reserve.

Composition of share capital

In CHF'000	**31.12.2006**	31.12.2005
47 305 240 / 47 052 914 bearer shares, at CHF 10 each	473 052	470 529
46 300 000 registered shares at CHF 1 each	46 300	46 300
	519 352	**516 829**

The Registered Shares are not listed nor traded on any stock exchange. The Bearer Shares have been listed on the main market of the SWX since 2 August 1999 (ticker: KUD, security number: 1 226 836; ISIN CH0012268360). They are included in the SMIM (Swiss Market Index Mid-Cap).

Conditional share capital (article 6 of Articles of incorporation)

In CHF'000	**2006**	2005
Conditional share capital as of January 1	114 609	68 342
Increase of conditional share capital	–	47 500
Employee share purchase plan	-47	-105
Exercise of options	-778	–
Shares allotted to employees	-1 699	-1 128
Conditional share capital at December 31	**112 085**	**114 609**
Of which may be utilized as of December 31 for:		
– convertible bonds		
10 000 000 bearer shares, at CHF 10 each	100 000	100 000
– options or share subscriptions to employees		
1 208 516 / 1 460 842 bearer shares, at CHF 10 each	12 085	14 609
	112 085	**114 609**

The shareholders of Kudelski SA met in an Extraordinary General Meeting on September 30, 2005 and approved an increase of the conditional share capital of up to a total amount of CHF 100 million, through the issue of 10 000 000 bearer shares of a nominal value of CHF 10, to be issued as and when rights are exercised to convert the bonds of Kudelski SA and its subsidiaries.
Furthermore the ordinary 2005 General Assembly approved an increase of the conditional share capital for options exercises or share subscriptions to employees up to a maximal amount of CHF 15 841 760 consisting of 1 584 176 bearer shares of a nominal value of CHF 10.

Authorized share capital (Article 7 of Articles of Incorporation)

In CHF'000	**31.12.2006**	31.12.2005
3 768 164 / 3 768 164 bearer shares, at CHF 10 each	37 682	37 682
3 200 000 registered shares at CHF 1 each	3 200	3 200
Authorized share capital as of December 31	**40 882**	**40 882**

The Board of Directors is authorized to increase the share capital in one or more stages until May 2, 2008, for the purpose of acquiring companies or parts of companies.

Major shareholders

In CHF'000	**Voting rights 31.12.2006**	Voting rights 31.12.2005	**Shareholdings 31.12.2006**	Shareholdings 31.12.2005
Kudelski Family	**57%**	**57%**	**22%**	**22%**

3.6 Provision

The provision on sale of an investment is a tax-free reserve arising from a gain realized from the transfer of Nagrastar LLC to Nagra USA Inc. as on January 1, 1999. It can be dissolved with no tax impact on December 31, 2006 in accordance with article 207a LIFD. It has been released against income statement in 2006 for an amount of kCHF 1 856.

4. Notes to the income statement

4.1 Financial income

In CHF'000	**2006**	2005
Dividends received from Group subsidiaries	69 950	36 500
Interest income third parties	2 654	1 971
Interest on loans to Group subsidiaries	11 651	9 854
Net currency exchange gains	–	19 959
Other income	–	57
	84 255	**68 341**

4.2 Gain on sale of investment

Following the purchase of the remaining 50% of Mediacrypt, Kudelski SA sold the 100% of the company to another Group company and merged it. This transaction resulted in a gain of kCHF 300.

Notes to the financial statements 2006

4.3 Administrative and other expenses

In CHF'000	2006	2005
Administrative expenses	-4 314	-4 912
Taxes other than income tax	-1 415	-1 018
	-5 729	**-5 930**

4.4 Financial expenses and exchange results

In CHF'000	2006	2005
Net currency exchange losses	-1 076	–
Interest on loans from Group subsidiaries	-255	-550
Interest expenses	-19	-16
	-1 350	**-566**

4.5 Impairment of financial fixed assets

In CHF'000	2006	2005
Reversal of/(allocation to) provisions on Group investments and loans	-6 967	-27 367
Reversal of provision on third party loan	–	775
Value adjustment on marketable securities and others	–	10
	-6 967	**-26 582**

5. Commitments and contingencies

In CHF'000	31.12.2006	31.12.2005
Guarantee commitments		
Guarantees for the repayment of the capital and interest of the convertible bond	350 000	350 000
Commitment in favor of third parties	48 800	21
Deposits and guarantees in favor of third parties	1 600	1 600
Guarantees for a subsidiary commitment	866	866
	401 266	**352 487**
Other commitments		
Penalty risk for non-completion of contracts	p.m.	p.m.
Subordinated loans in favor of Group companies	p.m.	p.m.
Support letters and guarantees signed in favor of Group companies	p.m.	p.m.

Report of the Statutory Auditors to the general meeting of Kudelski SA Cheseaux-sur-Lausanne

As Statutory Auditors, we have audited the accounting records and the financial statements (balance sheet, income statement and notes) included on pages 54 to 62 of Kudelski SA for the year ended 31.12.2006.

These financial statements are the responsibility of the board of directors. Our responsibility is to express an opinion on these financial statements based on our audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with Swiss Auditing Standards, which require that an audit be planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the financial statements. We have also assessed the accounting principles used, significant estimates made and the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accounting records and financial statements and the proposed appropriation of available earnings comply with Swiss law and the company's articles of incorporation.

We recommend that the financial statements submitted to you be approved.

PricewaterhouseCoopers SA

F. Roth
Auditor in charge

S. Jaquet

Lausanne, February 15, 2007

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