H1 2023 RESULTS

Management's Discussion & Analysis

GROUP RESULTS

In the first half 2023, three of the Group's four business segments were able to grow their revenues at double-digit rates. Cybersecurity maintained the strong momentum of the previous year, growing at 15.0%, and continued to improve its revenue mix, with an increasing share of revenues generated by higher value-added products and services. Meanwhile, the IoT segment almost doubled its revenues, driven by the robust adoption of RecovR, its asset tracking product. Public Access posted a solid first half result, continuing its post-COVID-19 recovery, with a 14.5% growth of net revenues. On the other hand, the Digital TV business saw lower-than-expected sales, mainly in European markets. Revenues for Digital TV declined by 17.9% compared to the prior first half.

In the first half 2023, the Group's net revenues increased from USD 328.4 million to USD 335.3 million, representing a 2.1% growth. Other operating income decreased by USD 0.4 million to USD 4.6 million. Approximately half of the total other operating income is accounted for by research and development tax credits and other grants.

Margin after cost of material decreased from USD 245.0 million to USD 244.1 million. Relative to total revenues, margin after cost of material decreased from 73.5% to 71.8%, mainly reflecting a shift of the revenue mix from higher margin Digital TV to the other three segments.

Compared to the first half 2022, the Group's personnel expenses increased by USD 1.1 million. Over the first half of 2023, headcount decreased by 76 Full Time Equivalents (FTEs) to 3'157 at the end of June. The Group increased Cybersecurity and IoT headcount in this first half, in line with growing demand in these segments. On the other hand, it reduced Digital TV headcount by 50 FTEs and Public Access by 71 FTEs.

Other operating expenses increased by USD 2.0 million. This notably includes a provision of USD 1.8 million for bad debt in the Digital TV segment. During the first half, travel costs saw a reduction of USD 0.3 million, whereas expenses for sales and marketing increased by USD 0.4 million.

In this first half, the Group generated USD 3.5 million of operating loss before depreciation and amortization, compared to operating income of USD 0.5 million in the previous first half. At USD 15.1 million, depreciation, amortization and impairment was USD 1.8 million lower than in the first half 2022, as the Group has systematically reduced capital expenditures over recent reporting periods. Overall, the Group generated an operating loss of USD 18.6 million in the first half 2023.

At USD 5.0 million, interest expense was USD 0.4 million lower than in the prior first half. The Group posted USD 1.4 million of net finance expenses, primarily due to net foreign exchange losses. Income tax expenses for the period were at USD 2.8 million, resulting in a net loss of USD 28.5 million for the period, compared to a net loss of USD 18.6 million in the prior first half.

DIGITAL TV

Digital TV revenues decreased by 17.9% to USD 118.6 million. Over the past years, the Digital TV business has shifted from a hardware-based model, heavily reliant on sales of smart cards, to a more resilient software and service-oriented model. The shift to a software and service-oriented model is reflected in the sales figures for the Digital TV business, with smart card sales declining from USD 8.0 million in the first half 2022 to USD 4.4 million in this first half. Over the last few years, smart card sales declined materially; as a comparison, smart card sales generated USD 61.4 million in 2019. Hardware sales in the first half 2023 followed a similar pattern, generating USD 7.9 million revenues. This is less than half the amount generated from hardware sales in the prior first half, and in 2019, hardware sales generated USD 39.6 million. Revenue from professional services decreased by USD 7.7 million in the first half 2023 due to the completion of some major projects. Conversely, software, maintenance, and royalties showed greater resilience, experiencing a limited 7% decline compared to the previous first half. These changes demonstrate the transition of the Digital TV business from a hardware and smart-card focus to a software and maintenance-oriented model.

The Group's European Digital TV business posted 19.5% lower revenues compared to the first half 2022. Revenues from Vodafone have decreased, as the previous first half included substantial revenues from system integration services, which supported the integration of newly acquired networks. In addition, there was also a notable reduction in CAM (Conditional Access Module) sales both at Liberty Global and TiVu, mirroring the downward trajectory of hardware sales.

Digital TV revenues in the Americas decreased by 8.7%. The South American market had mixed results, with some clients such as Telefonica generating increased revenues in spite of the prevalent downward trend in the region. In North America, DISH continued to lose subscribers, leading to a decrease in revenues.

Sales in the Asia Pacific and Africa region experienced a decline of 28.4%. This decrease is attributed to the absence of significant hardware sales during this first half. Conversely, in the previous first half, Digital TV generated revenues from hardware sale deals with TBC, DMG, and Starhub.

Digital TV's margin after cost of material improved from 88.5% to 94.1%, reflecting a more favorable revenue mix, due to lower hardware sales, including of conditional access modules and set-top boxes. In this first half, this segment's operating expenses were USD 4.8 million lower than in the prior first half. This reduction primarily resulted from a decrease in headcount due to continued operational efficiency improvements. Digital TV's operating income before depreciation and amortization declined by USD 11.5 million to USD 14.7 million. As depreciation and amortization was USD 1.8 million lower, the segment's operating income decreased by USD 9.7 million to USD 8.8 million.

CYBERSECURITY

In the first half 2023, the Group's cybersecurity business posted USD 96.4 million of gross revenues, a 21.2% increase from the first half 2022. Net revenues were at USD 58.6 million, representing a 15.0% growth. The business benefitted from growth across both of its main regions. In Europe, net revenues grew by 30.1% to reach USD 24.4 million, while the Americas grew by 7.8% to USD 33.9 million. In addition, the Group generated USD 0.2 million of cybersecurity revenue in the Asia Pacific and Africa region.

Margin after cost of material increased to USD 38.9 million, representing 18.7% growth from the prior first half. In relative terms, margin after cost of material increased from 64.3% to 66.4%, as the business mix continues to shift from lower margin technology reselling to higher margin advisory and managed detection and response services.

Throughout the first half of the year, Kudelski Security sustained its growth trajectory within pivotal sectors such as critical infrastructure, manufacturing, and pharmaceutical. Additionally, a significant milestone was achieved through the establishment of a strategic partnership with Hunters.ai. This collaboration aims to enhance the company's Managed Detection and Response (MDR) services by incorporating additional capabilities for client data analysis, improving scalability, and freeing up valuable resources for higher value-added analytical tasks.

Booking growth remains robust, maintaining double-digit rates. The upswing in bookings is primarily propelled by high-value business lines, particularly MDR services, which contributed a substantial increase of 32%. Furthermore, during this first half, advisory services experienced solid booking growth of over 20%. Conversely, the reduced demand in the blockchain market led to decreased demand for blockchain-related services. Consequently, the Group made structural adjustments to align with this change. As the Group's cybersecurity business enters the second half, backlog stands strong, which is expected to support the continued solid growth of this business.

In this first half, segment headcount increased to support the further expansion of the business. With the rising demand for the Group's MDR services, the Group continues to expand its new cyber fusion center in Spain, staffed with an experienced team of threat detection specialists and cyber response consultants, which complements our other centers in Switzerland and the US.

As a result of improved management of operating expenses in the first half 2023, the cybersecurity segment reduced its operating loss before depreciation and amortization by USD 3.0 million to USD 6.7 million.

INTERNET OF THINGS (IoT)

In the first half 2023, the IoT segment almost doubled its sales, generating USD 14.1 million of revenues, compared to USD 7.2 million in the first half 2022. The driver of this growth was RecovR, a comprehensive asset tracking solution that combines lot management for car dealers and theft recovery for their customers. In the current first half, RecovR sales are over three times the sales of the previous first half and represent roughly 80% of the total revenues for IoT. During this period, IoT successfully entered into contracts covering 110 new rooftops and secured deals with progressively larger automotive dealerships and industry leaders in the automotive financial services market. This has led to a robust backlog for the second half of the year. With a strong emphasis on the thriving asset tracking market, IoT focused less on the Lab and Design business and the keySTREAM platform, resulting in slightly decreased revenues from these businesses in comparison to the first half of 2022.

IoT's margin after cost of material went from 80.6% in the first half 2022 to 59.6% in this first half, which is attributed to the shift in revenue distribution towards RecovR. The segment's margin after cost of material saw an increase of 44.5%, reaching USD 8.4 million. The impressive traction gained by the asset tracking business prompted a decision to increase investments in this segment. This includes the development of RecovR for Keys, a new product tailored for car dealerships that is scheduled for launch in the third quarter of this year. This strategic move led to a corresponding increase of USD 2.2 million in the IoT operating expenditure base. In the aggregate, the segment's EBITDA loss decreased marginally by USD 0.5 million in the first half 2023, settling at USD 9.0 million.

PUBLIC ACCESS

Public Access achieved robust performance in the first half 2023, notably highlighted by a 14.5% increase in net revenue. SKIDATA's dedicated emphasis on the digital sector is yielding positive outcomes. Examples include the success of SKIDATA Connect, the digital platform for visitor management, along with the Group's intelligent mobility solutions and the thriving digital subscription segment, all of which are propelling growth.

The expansion of the service-oriented Facility Operations business continues to be a significant catalyst for Public Access' growth. Moreover, this first half witnessed a considerable recovery in the Project Business, with double-digit growth rates in comparison to the preceding first half.

European sales maintained a strong momentum in the first half 2023, increasing by 12.7% to USD 89.9 million. France and Italy were the best performing European markets, with solid first half growth rates. France exhibited a robust performance in the first half, expanding by USD 3.2 million, driven by contributions from both the project and service businesses. Likewise, Italy experienced a USD 3.0 million growth, also attributed to strong demand for projects and services.

The Americas rebounded with a notable growth of 21.3% to reach USD 33.6 million. In the US, revenue from new projects more than doubled during this first half, serving as a pivotal driver of the robust revenue momentum experienced in this period.

The Asia/Pacific and African operations experienced growth of 12.0%, reaching USD 20.5 million. Alongside the resilient Australian market, smaller markets like the United Arab Emirates and the West Asian subregion made substantial contributions to the growth witnessed in the first half. SKIDATA's decision to withdraw from the Chinese market earlier this year had a negligible impact on the segment's profit and loss, as the Chinese entity generated minimal revenues and incurred a minor loss.

Ongoing disruptions within supply chains led to escalated costs of goods. Despite these higher expenditures, SKIDATA was able to pass through only a portion of the increase to customers. Consequently, margin after cost of material in this first half temporarily declined from 62.4% to 59.1%. This effect is expected to diminish over time, and margins are projected to rebound to levels seen in previous periods, coinciding with the implementation of supply chain optimization measures.

In the first half 2023, Public Access marginally increased operating expenses by USD 3.1 million compared to the preceding first half. Notably, SKIDATA headcount decreased by 71 FTEs during this period. SKIDATA's exit from the Chinese market resulted in a reduction of 42 FTEs compared to the end of December. Additionally, European headcount decreased by 23 FTEs, primarily in Austria, from December 2022, thus establishing a favorable cost structure for the second half of the year.

Overall, Public Access generated an operating income before depreciation and amortization of USD 4.1 million, compared to USD 0.5 million in last year's period.

BALANCE SHEET AND CASH FLOWS

In June 2023, the Group established a trade receivables securitization program for up to USD 50 million, in which selected subsidiaries of the Group based in Switzerland and the US are participating. The Group receives cash consideration from the sale of receivables to a special purpose entity. At the end of June, the Group had drawn USD 8.8 million net cash from this program. The total value of receivables sold under this program during this first half reached USD 67.8 million, of which USD 18.9 million have already been settled. The remaining balance of unsettled sold receivables was USD 39.9 million as of the end of June. Net of USD 0.3 million of interest income, purchase discount and currency translation adjustments, this balance is accounted for as a financial asset at fair value. This results in the USD 40.2 million increase of the "Financial Asset at Fair Value Through Profit and Loss" figure in the balance sheet.

Total non-current assets increased by USD 40.4 million to USD 593.0 million from December 31, 2022, mainly driven by the aforementioned increase in financial assets. The Group also continued to reduce its overall level of investments in tangible and intangible assets compared to previous years. Tangible fixed assets decreased by USD 1.0 million and intangible assets decreased by USD 13.6 million.

Compared to December 31, 2022, total current assets decreased by USD 38.9 million to USD 373.5 million. An increase of USD 6.0 million in total inventory mainly reflects the buildup of safety stock at SKIDATA to mitigate supply risks due to the volatility of semiconductor supply chains, as SKIDATA added USD 4.5 million of inventory, reaching a total of USD 54.2 million at the end of the period.

Trade receivables exhibited a decrease of USD 51.1 million, primarily due to the aforementioned receivables securitization program. Furthermore, SKIDATA's receivables have decreased by USD 19.6 million compared to the end of the prior year due to continued improvements in SKIDATA's collection processes.

At the end of the period, cash and cash equivalents amounted to USD 59.4 million, representing a USD 2.8 million decrease from December 31, 2022.

Total equity decreased by USD 35.8 million, mainly reflecting the USD 28.5 million net loss for the period and a USD 13.3 million negative currency translation adjustment. Total non-current liabilities increased by USD 12.1 million to USD 285.4 million, with long-term financial debt increasing by USD 3.3 million to USD 185.5 million, driven by currency translation effects.

Total current liabilities increased by USD 25.2 million to USD 355.3 million, with short-term financial debt decreasing by USD 2.5 million to USD 74.4 million. This reduction can be attributed to both debt repayments and currency translation effects.

During the first half 2023, the Group improved cash generation, moving from a negative free cash flow in the preceding first half to a positive cash flow. Cash generated from operating activities reached USD 14.5 million, primarily due to a reduction in working capital. Throughout this period, the Group continued its rigorous approach to managing capital expenditures. Cash flows for investing activities for the first half amounted to USD 3.3 million. Net cash-out for financing activities amounted to USD 14.1 million. This outflow includes a USD 5.6 million debt repayment and a USD 7.8 million in lease obligation payments.

OUTLOOK

Following the trend of preceding years, the Group anticipates that second half Digital TV revenues in 2023 will be higher compared to the first half, but slightly lower than revenues in the second half of 2022. Operating expenses for the second half are expected to align with those of the first half, thereby leading to a higher EBITDA for the second half when compared to the first half of the year. Overall, the Group expects a decrease in Digital TV EBITDA for the full year in comparison to 2022.

The Group expects double-digit percentage growth in revenues and profit after cost of material for the Cybersecurity segment. Conversely, operating expenses are forecasted to grow only slightly compared to the first half, resulting in a significant year-over-year reduction in the EBITDA loss.

Driven by the strong momentum of RecovR sales, the Group anticipates surpassing the previous objective of doubling IoT revenues for the full year 2023 in comparison to 2022. This is expected to result in a significant improvement in the segment’s EBITDA in the second half of 2023. The reduction of the EBITDA loss is projected to be achieved despite a less favorable segment margin after cost of materials, owing to the higher revenue share of products including hardware components, and the increased operating expenses required to sustain the highly promising momentum of this segment.

Consistent with previous years, Public Access revenues are expected to exhibit strong seasonality, with second-half revenues notably surpassing those of the first half. With a year-over-year growth rate for the second half of 2023 in the 10% range, Public Access sales are expected to maintain solid momentum for the full year. Margin after cost of material for the second half 2023 is projected to exhibit a slight recovery in comparison to the first half, while operating expenses are expected to experience marginal growth. Consequently, the Group foresees a significant improvement in segment EBITDA for the full year 2023 as compared to 2022.