First Half 2005 Earnings Release

# Profit from Growth: Operating Margin Increases to 9.4%

- **Revenue rises to USD 498 million, up 16%**
- **Gross margin increases by 1.5 percentage point, to 33.8%**
- **Operating margin grows from 6.7% to 9.4%**
- **Operating income improves by 62% to USD 47 million**
- **Net income up 71% at USD 33 million**
- **Net earnings attributable to equity holders of USD 79 cents per share**
- **Free cash flow generated during the period: USD 42 million.**

**Amsterdam, 8 September 2005** – Axalto (Euronext: NL0000400653 - AXL) reports today its results for the six-month period ended June 30, 2005. These interim 2005 consolidated condensed financial statements have been prepared in accordance with the IFRS accounting principles.

**Commenting on these results, Axalto Chief Executive Officer, Olivier Piou, said:** "Axalto's performance over the first six months of the year is just remarkable. In a very competitive environment our teams have recorded tremendous commercial gains in all lines of business. Axalto's worldwide presence was once again decisive, enabling us to take advantage of the rapidly changing geography of growth. The substantial increase in volume was further leveraged by continuous improvements in operational excellence. The market continues to be characterized by strong price pressures. Looking to the year-end we'll bear in mind that last year's comparative basis was particularly high and that the seasonal pattern, which traditionally favors the second-half, will be less marked. For the full year, we are determined to remain the most profitable player in our industry."

| **Axalto** *All amounts in USD million* | **First Half 2004** | **First Half 2005** | Variation | Variation at constant exchange rates |
|---|---|---|---|---|
| **Revenue** | **430.3** | **498.2** | + 16% | +12% |
| **Gross Profit** | **138.9** | **168.2** | + 21% | +20% |
| *Gross Margin (%)* | *32.3 %* | *33.8 %* | | |
| **Operating Income** | **29.0** | **47.1** | +62% | |
| *Operating Margin (%)* | *6.7 %* | *9.4 %* | | |
| **Income Before Taxes** | **28.5** | **47.3** | +66% | |
| *As a percentage of Revenue (%)* | *6.6%* | *9.5 %* | | |
| **Net Income** | **19.5** | **33.3** | +71% | |
| *Net margin (%)* | *4.5%* | *6.7 %* | | |
| **Net Income attributable to equity holders** | **19.0** | **31.9** | +68% | |
| Average number of shares outstanding | 40.1 million | 40.4 million | | |
| **Earnings Per Share attributable to equity holders (basic)** | **USD 47 cents** | **USD 79 cents** | +66% | |
| *Earnings Per Share attributable to equity holders (fully diluted)* | *USD 47 cents* | *USD 77 cents* | +62% | |

## An excellent performance: all indicators improve relative to the first-half of 2004

During the first-half of the year 2005, Axalto recorded strong growth in its level of activity and a sharp improvement in its profitability.
Over the period, the company posted a 16% increase in revenue to USD 498.2 million, a 62% progression in operating income to USD 47.1 million and a 71% rise in net income, which reached USD 33.3 million.
Based on an average number of shares in circulation of 40.4 million over the period, Axalto's basic earnings per share attributable to equity holders was USD 79 cents, a 66% improvement on the interim earnings of 2004.
This excellent performance contributed to strong cash generation from operating activities of USD 55.4 million during the period. Axalto's net cash position at the end of June 2005 improved to USD 220.3 million.

## Revenue grows 16%

Over the first-half, all of Axalto's businesses contributed to the company's top line growth. In particular, the Mobile Communication product line grew by 23%, to USD 295.5 million. During the period, this product line accounted for 59% of Axalto revenue, up 3 percentage points relative to the first-half of 2004.

In regional terms, the Europe Middle East Africa area posted solid growth of 14% compared with the first half of 2004, reaching USD 275 million.
The Americas recorded the fastest revenue increase, both in absolute terms, adding USD 40.2 million, and in percentage terms with a +52% jump in sales, to USD 118 million.
During the period, this region became the second largest contributor to Axalto's revenue, accounting for 24% of the global figure while Asia's share decreased almost symmetrically to 21% due to the contraction in the Chinese market for mobile communication products.

Axalto shipped close to 204 million microprocessor cards during the first six months of 2005, a 32% increase in volume when compared with 2004's first half. Volume growth was most marked in Mobile Communication: Axalto sold 157 million SIM cards to mobile network operators, a 48% increase on last year's comparable figure.

## Operating margin increases strongly, from 6.7% to 9.4%

During the period, Axalto's increase in operating profit was driven by

- the Group's strong first-half revenue
- the larger share of revenue derived from Mobile Communication and the favorable sales mix in this product line. High-end cards accounted for 34% of SIM card deliveries versus 22% for the same period of last year.
- pointed improvements in the gross margins of the Mobile Communication and the Public sector, access and other product lines as well as in the Point-of-Sales terminals segment. As a result Axalto's gross margin rose by 1.5 percentage point to 33.8% during the first-half, and gross profit increased 21% on the year-earlier period to USD 168.2 million,
- strict discipline in operating expenses which grew at a much slower pace than sales. Posting an increase of +9.8%, and +5.6% at constant rates, to USD 123 million, these expenses represented 24.7% of Axalto's first half revenue, down 1.4 percentage point compared with the same period of last year.

## Activity generates USD 42 million in free cash flow

Strong net income as well as continued tight control over both working capital requirements and capital expenditure contributed to the solid cash flow generation performance.

**About Axalto**

Axalto (AXAL.PA - Euronext: NL0000400653 - AXL) is the world's leading provider (Gartner 2005, Frost & Sullivan 2004) of microprocessor cards - the key to digital networks - and a major supplier of point-of-sale terminals. Its 4,500 employees, from over 60 nationalities, serve customers in more than 100 countries, with worldwide sales reaching over 3 billion smart cards to date. With a 25-year experience in smart card innovation, the company leads its industry in security technology and open systems.

Axalto creates new generations of products for use in a variety of applications in the telecommunications, finance, retail, transport, entertainment, healthcare, personal identification, information technology and public sector markets. Microprocessor cards provide convenience, security and privacy to public and private services operators, their customers and end users. For more information, please visit www.axalto.com

Unless stated otherwise, all comparisons in this document are shown on a current exchange rate basis.

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## Supplementary information

During this six-month period ended June 30, 2005, Axalto revenue came in at USD 498.2 million, a 16% growth compared with the same period last year, when recorded revenue was USD 430.3 million. At constant exchange rates, revenue grew 12%.

The Americas (NSA) region grew 52% compared with the same period last year and became the second largest contributing region to Axalto's revenue, accounting for close to a quarter (24%) of Axalto total revenue, at USD 118 million.
The Europe Middle East Africa (EMEA) area grew by 14%, and 8% at constant exchange rates, compared with first half of 2004, recording revenue of USD 275 million, corresponding to slightly more than half (55%) of Axalto's revenue for the period.
Asia inched down 5% to USD 105 million compared with the same period of 2004 and represented slightly more than a fifth (21%) of Axalto total revenue.

Gross profit came in at USD 168.2 million, an increase of 21% on the year-earlier period, where gross profit was USD 138.9 million.
At constant exchange rates, gross profit increased 20%.
Gross margin rose by 1.5 percentage point, from 32.3% to 33.8%.

Operating expenses, excluding other income net, rose by 9.8% to USD 123.1 million, and by 5.6% at constant exchange rates, compared with USD 112.1 million in the first half of 2004.
These represented 24.7% of revenue, down 1.4 percentage point compared to the first half of 2004's ratio of 26.1%.

As a consequence of higher revenue, improved gross margin and tight control over operating expenses, operating income, at USD 47.1 million, grew by 62% over the year-earlier period.
Operating margin increased by 270 basis points, from 6.7% to 9.4%.

Axalto generated net income attributable to the equity holders of the company of USD 31.9 million in the first half of 2005, a 68% improvement on 2004's comparable first-half figure of USD 19.0 million.

Axalto also generated USD 42.1 million of free cash flow during the period. Despite the strong growth recorded in the first half 2005, working capital requirements were maintained at the very low level achieved at end 2004.
Variations of assets and liabilities, including working capital, generated USD 3.5 million of cash flow during the period. Capital expenditure amounted to USD 13.3 million, 2.7% of revenue, versus USD 11 million in the same period last year.
Axalto available cash and short-term investment at the end of June 2005 amounted to USD 227.8 million, and its net cash position was USD 220.3 million at the same date, versus respectively USD 223.8 million and USD 185.0 million on December 31st, 2004.

# Product line Information

## Cards segment

| Million USD | Six months ended June 30, 2004 | 2005 | Variation % |
|---|---|---|---|
| **Revenue** | | | |
| Mobile Communication | 239.8 | 295.5 | +23.2% |
| Financial Cards | 97.4 | 99.1 | +1.7% |
| Public sector, Access and Other (1) | 43.3 | 43.4 | +0.2% |
| Prepaid Phone Cards | 21.4 | 21.6 | +1.1% |
| Total Cards | 401.9 | 459.6 | +14.4% |
| **Gross profit** | | | |
| Mobile Communication | 89.0 | 111.9 | +25.8% |
| Financial Cards | 24.0 | 24.3 | +1.3% |
| Public sector, Access and Other (1) | 17.2 | 20.7 | +20.9% |
| Prepaid Phone Cards | 2.5 | 1.5 | (39.9%) |
| Total Cards | 132.6 | 158.5 | +19.5% |
| ***Gross margin*** | ***33.0%*** | ***34.5%*** | |
| **Operating expenses (2)** | **101.9** | **113.9** | +11.8% |
| **Operating Income** | **30.7** | **44.5** | +44.9% |
| ***Operating margin*** | ***7.6%*** | ***9.7%*** | |

(1) Includes the revenue from the licensing of Intellectual Property.
(2) Including “Other income net”, in accordance with IFRS

Revenue in the Cards segment rose by 14% when compared with the first half of 2004, and by 11% at constant exchange rates.

Growth was strongest in absolute (+ USD 43.0 million) and relative terms (+58%) in the Americas (NSA) region, due to strong demand for SIM cards resulting from the growing GSM standard adoption by existing American mobile networks, a simultaneous increase in subscribers to these networks and a considerable product mix improvement.
The region accounted for USD 117.1 million in revenue or a quarter (25%) of the Cards’ segment revenue.
EMEA posted solid growth of 10% (and +5% at constant rates) and accounted for USD 243.1 million in revenue or 53% of the Cards’ segment revenue during the first half. The increase stemmed from strong sales performances of Mobile Communication products in Eastern Europe and Africa.
Asia’s Cards revenue decreased by 7% to USD 99.4 million over the first six months of 2005. The inflection was in large part due to the marked contraction in the Chinese mobile communications’ market which is currently in the process of being reorganized by the Chinese government.

Axalto’s microprocessor cards shipments rose by 32% in volume in the first half of 2005.
SIM cards deliveries to mobile operators grew by 48% to 157 million. Deliveries of microprocessor cards to financial institutions were essentially stable, at 36 million.
In the Public sector, access and other product line, shipments of microprocessor cards were down 11% on last year’s comparable figure, mainly due to lower deliveries in the Pay TV business.

Gross margin in the Cards segment increased by 1.5 percentage points to 34.5%. In dollar terms, gross profit rose by 19.5%, and by 19% at constant exchange rates to reach USD 158.5 million.

Operating expenses, excluding Other income net, rose at a much slower pace than revenue: +10.3%, and by 6% at constant exchange rates.
The increase in sales, marketing and technical support costs to support revenue growth was 4.6%.
General and administrative expenses grew, as anticipated, by 15.4%. The rise resulted from higher, forecasted administrative costs, related to Axalto's status as an independent and publicly-listed company, which fully impacted the first-half 2005, whereas the Group had been supported at lower cost by Schlumberger's shared financial and administrative structures during most of the first-half 2004, until its IPO on 18 May 2004.

Operating income came in at USD 44.5 million, a 44.9% increase on the level recorded in the first half of 2004. Resulting operating margin for the Cards segment was 9.7%, a 2.1 percentage points increase on last year's comparable figure.

**Mobile Communication**

| USD million | **First Half 2004** | **First Half 2005** | Variation<br>% | Variation at constant exchange rates<br>% |
|---|---|---|---|---|
| **Revenue** | **239.8** | **295.5** | +23% | +21% |
| **Gross profit** | **89.0** | **111.9** | +26% | +26% |
| ***Gross margin (%)*** | ***37.1%*** | ***37.9%*** | | |

Revenue in the Mobile Communication product line grew by more than 23% to $295.5 million in the first half of 2005.
This strong growth was mainly driven by a sharp rise in sales volumes.
SIM card volumes grew by 48% to 157.3 million units, with all three regions contributing to this growth.

Compared with the first half of 2004, the average SIM card selling price contracted by 16.6%, and 18.4% at constant exchange rates, reflecting continued competitive pressure.
Once again, this downtrend was entirely offset by volume growth while the improvement in the product mix, due to higher sales of high-end cards, accounted for the positive growth in revenue.

Growth in the Europe, Middle East and Africa region (EMEA) came to +23% in the first half, on the back of very strong sales in Eastern Europe and Africa.
Activity in Asia decreased by 11% compared with the first half of 2004 due primarily to the decline in revenue recorded in China.
The Americas (NSA) region posted impressive growth, with revenue up 94% compared with the first-half of the previous year. This remarkable success was driven by a strong increase in the volume of microprocessor cards delivered and by the considerable improvement in the region’s product mix, almost entirely comprised of high-end cards.

On a worldwide basis during the first-half, the share of high-end SIM cards in overall SIM card volumes shipped settled at 34%, a significant progress on last year’s comparable figure of 22%.

This greater proportion of high-end products in the sales mix, together with the sharp rise in volumes, was instrumental to the strong growth in the product line’s gross profit, which rose by 25.8% with respect to the first half of 2004.
Gross margin increased to 37.9% from 37.1% a year ago.
The Mobile Communication product line accounted for 67% of Axalto’s gross profit during the first half, versus 64% a year ago.

**Financial Cards**

| USD million | First Half 2004 | First Half 2005 | Variation<br>% | Variation at constant exchange rates<br>% |
|---|---|---|---|---|
| **Revenue** | **97.4** | **99.1** | +2% | (3%) |
| **Gross profit** | **24.0** | **24.3** | +1% | (1%) |
| ***Gross margin (%)*** | ***24.6%*** | ***24.5%*** | | |

Revenue in the Financial Cards product line came in at USD 99.1 million, an increase of 2% compared with the first half of 2004. At constant exchange rates, revenue decreased by 3%.

This stable half-year picture is the result of contrasting performances during each quarter. The slower pace of revenue growth during the first quarter of 2005 was due to a particularly strong first quarter 2004 comparative basis. However, Axalto posted solid expansion in this product line during the second quarter.

Overall microprocessor cards sales volumes were stable at 36 million units. Migration to EMV standards continues to spread throughout continental Europe, while Asia and the Americas are beginning to adopt them as well. EMEA remains the main market for this product line. Asia recorded an excellent performance, posting revenue growth of 64%.
Average sales price grew 6.2% at historical exchange rates over the period, and 1.6% at constant exchange rates, reflecting improvement in the geographical sales mix within the EMEA region.

Gross profit in the Financial Cards product line increased slightly at USD 24.3 million and gross margin was stable at 25%. The Financial Cards product line accounted for 14% of Axalto's gross profit during the first half, versus 17% a year ago.

**Public Sector, Access and Other**

| USD million | First Half 2004 | First Half 2005 | Variation<br>% | Variation at constant exchange rates<br>% |
|---|---|---|---|---|
| **Revenue** | **43.3** | **43.4** | +0.2% | (3%) |
| **Gross profit** | **17.2** | **20.7** | +21% | +20% |
| ***Gross margin (%)*** | ***39.6%*** | ***47.8%*** | | |

Revenue in this product line was stable at a high level, coming in at USD 43.4 million, up very slightly on the first half of 2004, and inched down 3% at constant exchange rates.

The public sector and transport product lines recorded healthy growth despite delays in many large national programs to deploy electronic passports and ID cards. Access applications revenue increased in Asia and NSA.
These gains almost entirely offset significantly lower sales in the pay TV business, which faced heavy price declines that prompted Axalto to not renew certain contracts during the second quarter and focus its offering on the higher margin products.

Gross profit in the Public Sector, Access and other product line rose by 21% to USD 20.7 million and accounted for a 12% share of Axalto's gross profit, a similar share as last year.
The 8 percentage points increase in gross margin, which settled at 48%, reflects a marked improvement in the product mix with high-end cards shipped to North America and Asia in both the Public sector and Access businesses.

**Prepaid Phonecards**

| USD million | **First Half 2004** | **First Half 2005** | Variation<br>% | Variation at constant exchange rates<br>% |
|---|---|---|---|---|
| **Revenue** | **21.4** | **21.6** | +1% | (2%) |
| **Gross profit** | **2.5** | **1.5** | (40%) | (30%) |
| ***Gross margin (%)*** | ***11.8%*** | ***7.0%*** | | |

Revenue in the Prepaid Phonecards product line came in at $21.6 million in the first half of 2005, a 1% increase, and a 2% decrease at constant exchange rates.

This increase in revenue was mainly due to large deliveries of cards over the period to a long-standing customer.

The Prepaid Phonecards product line accounted for 4% of Axalto's total revenue, versus 5% in the first half of 2004. This decrease illustrates the downward trend in sales that results from Axalto's strategic focus on microprocessor cards.

Gross profit decreased to USD 1.5 million. The product line's gross margin fell by almost 5 percentage points, as a result of the strong decrease in average selling prices.

## Point-of-Sale Terminals segment

| USD million | First Half 2004 | First Half 2005 | Variation % | Variation at constant exchange rates % |
|---|---|---|---|---|
| **Revenue** | **28.4** | **38.6** | +36% | +29% |
| **Gross profit** | **6.2** | **9.7** | +56% | +47% |
| ***Gross margin (%)*** | ***21.9%*** | ***25.2%*** | | |
| **Operating expenses (1)** | **7.9** | **7.2** | (9%) | |
| **Operating income** | **(1.7)** | **2.5** | NA | NA |
| **Operating margin** | **(5.9%)** | **+6.6%** | NA | NA |

(1) Including "Other income net", in accordance with IFRS

Revenue reported in the Point-of-Sale Terminals segment rose by 36% to USD 38.6 million.
However, activity in the first-half of 2004 had been impacted by revenue deferrals related to shipments made to large financial institutions.

In the first-half 2005, Axalto's now geographically repositioned POS activities leveraged the expanding EMV migration in EMEA and Asia, extending their customer base beyond the large European financial institutions that drove growth in 2004.
Gross profit which had also been impacted by the revenue deferrals described above, grew by 56% relative to the figure reported in first-half 2004. Gross margin rose by 3 percentage points to 25%, reflecting the success of Axalto's products and of its production outsourcing strategy.

POS operating expenses, excluding Other income net, increased slightly by 3% to USD 8.2 million from USD 8.0 million, and decreased by 2% at constant exchange rates.
This segment reported operating income of USD 2.5 million, a marked improvement on last year's loss of USD 1.7 million.

## Revenue by Region

| Area | Segment | First Half 2004 (USD m) | First Half 2005 (USD m) | Variation (%) | Variation at constant exchange rate (%) |
|---|---|---|---|---|---|
| **Asia** | Cards | 107.3 | 99.4 | (7%) | (7%) |
| | POS | 3.4 | 5.8 | 72% | 71% |
| | **Total** | **110.7** | **105.2** | **(5%)** | **(5%)** |
| **EMEA** | Cards | 220.4 | 243.1 | 10% | 5% |
| | POS | 21.4 | 31.9 | 49% | 40% |
| | **Total** | **241.8** | **275.0** | **14%** | **8%** |
| **NSA** | Cards | 74.2 | 117.1 | 58% | 58% |
| | POS | 3.7 | 0.9 | (76%) | (77%) |
| | **Total** | **77.9** | **118.0** | **52%** | **51%** |
| | **Total Cards** | **401.9** | **459.6** | **14%** | **11%** |
| | **Total POS** | **28.4** | **38.6** | **36%** | **29%** |
| **Total AXALTO** | | **430.3** | **498.2** | **16%** | **12%** |

## Consolidated balance sheet highlights at 30 June 2005

| USD million | From audited, consolidated balance sheet as at December 31, 2004 | From unaudited, consolidated balance sheet as at June 30, 2005 | Variation % |
|---|---|---|---|
| **Equity** | **709.3** | **674.7** | **(5%)** |
| **Cash and short-term investments** | **223.8** | **227.8** | **+2%** |
| **Net Cash** | **185.0** | **220.3** | **+19%** |

## Cash flow statement

Free cash flow generated by Axalto in the first half 2005 was USD 42.1 million. It stems from:

- strong generation of cash by operations, USD 55.4 million, produced by:
  - USD 33.3 million of net income
  - USD 18.7 million of depreciation and amortization add-backs
  - USD 3.5 million of change in working capital and other assets and liabilities, whose aggregate amount net of currency fluctuations remained essentially stable overall at the very low level achieved at the end of 2004, as a result of a continued, company-wide effort.
- and capital expenditure of USD 13.3 million for the period, mainly related to capacity increases for the Cards segment.

The free cash flow generated in the first half was mainly affected to the reimbursement of the short- and long-term debt, the total amount of which decreased to USD 7.6 million, from USD 38.8 million at 31 December, 2004.