

Financial report 2004

Axalto Holding N.V.

Amsterdam

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Consolidated balance sheet as at 31 December 2004 (in thousands of US \$)

Before appropriation of profit

	Note	2004	2003
Assets			
Intangible fixed assets other than goodwill	4	24 964	31 016
Goodwill	4	297 167	287 621
		322 131	318 637
Property, plant and equipment	5	108 899	105 410
Deferred tax assets	6	42 740	14 515
Other long-term assets	7	9 705	8 978
		52 445	23 493
Total non-current assets		483 475	447 540
Inventories	8	122 492	103 827
Trade receivables	9	202 160	190 466
Receivables from related parties	17	1 895	12 666
Deferred tax assets	6	11 288	6 835
Other current assets	10	54 565	34 894
		269 908	244 861
Cash and cash equivalents		223 820	50 154
Total current assets		616 220	398 842
Total assets		1 099 695	846 382
Equity and liabilities			
Issued capital		55 089	0
Share premium		553 001	0
Retained earnings		-1 475	
Accumulated other comprehensive income		42 002	0
Net income		42 789	0
Shareholder investment		0	541 213
	12	691 406	541 213
Minority interest	11	7 059	9 876
Total equity		698 465	551 089
Provision for pensions and other employment benefits	13	15 013	11 175
Provision for deferred tax liabilities	6	5 905	5 092
Other provisions	13	14 210	16 326
Total provisions		35 128	32 593
Interest bearing loans and borrowings	14	30 249	2 287
Other non-current debts	15	6 267	8 827
Total non-current debts		36 516	11 114
Bank overdrafts and short-term loans		8 592	21 615
Trade payables		126 644	94 812
Payables to related parties	17	146	10 263
Employee, other payables and accrued liabilities	16	173 656	113 860
Income tax payable		20 548	11 036
Total current liabilities		329 586	251 586
Total equity, provisions and liabilities		1 099 695	846 382

Consolidated income statement for the year ended 31 December 2004

in thousands of US \$

	Note	2004	2003
Revenue		960 427	767 662
Cost of revenue		(645 027)	(529 447)
Amortization of goodwill		(14 143)	
Gross profit		<u>301 257</u>	<u>238 215</u>
Research and engineering expenses		63 962	49 034
Sales and marketing expenses		109 842	91 935
General and administrative expenses		55 216	49 355
Total operating expenses		<u>229 020</u>	<u>190 324</u>
Operating profit	20	<u>72 237</u>	<u>47 891</u>
Other income, net	22	2 822	1 250
Foreign currency transaction loss, net		(5 715)	(9 939)
Interest income, (expense) net	21	291	(5 309)
Profit before tax		<u>69 635</u>	<u>33 893</u>
Income tax expense	23	(24 944)	(6 910)
Profit after tax		<u>44 691</u>	<u>26 983</u>
Share in results of participating interest		(1 214)	422
Group income		<u>43 477</u>	<u>27 405</u>
Minority interest		(688)	(2 396)
Net income		<u><u>42 789</u></u>	<u><u>25 009</u></u>
Basic earnings per share (in US dollars)	24	1.06	
Diluted earnings per share (in US dollars)	24	1.05	
Average number of shares outstanding (in thousands)	24	40 295	
Average number of shares outstanding assuming dilution	24	40 697	

Consolidated statement of cash flows for the year ended 31 December 2004

in thousands of US\$

	Note	2004	2003
Cash flows from operating activities		42 789	25 009
Net income			
Adjustments to reconcile net income to Net Cash provided by operating activities:			
Depreciation, amortization (other than goodwill)	20	44 914	37 321
Amortization goodwill		14 143	-
Deferred taxes		1 781	(1 011)
Non cash loss on disposal of fixed assets and write-offs		3 988	1 866
Share of losses of equity investees, net of dividends received		2 282	245
Changes in assets and liabilities:			
Trade receivables, net		(1 838)	32 509
Receivables from related parties		17 054	(7 065)
Inventories, net		(10 750)	12 077
Trade payables		22 215	3 001
Payables to related parties		(12 321)	(15 348)
Employee, other payables and accrued liabilities		45 421	699
Pensions and other provisions		698	(338)
Estimated liability for taxes on income		9 055	3 609
Other assets and liabilities, net		(13 563)	(7 528)
Net cash providing by operating activities		165 868	85 046
Cash flows from investing activities			
Capital expenditures (fixed assets)	5	(36 783)	(18 802)
Capital expenditures (intangible assets)	4	(2 547)	(1 146)
Proceeds from sale of fixed assets		407	3 909
Net cash used in investing activities		(38 923)	(16 039)
Cash flows from (used in) financing activities			
Net equity / invested equity		31 912	(44 494)
Bank overdrafts and short term loans		(15 380)	(3 367)
Long term debt		26 340	162
Net cash provided by (used in) financing activities		42 872	(47 699)
Net increase in cash and short-term investments		169 817	21 308
Translation effect on cash and short-term investments		3 849	777
Cash and short-term investments, beginning of period		50 154	28 069
Cash and short-term investments, end of period		223 820	50 154

Consolidated statement of changes in stockholders' equity							Accumulated other comprehensive income			
in thousands of US \$										
		Issued capital	Share premium	Retained earnings	Stockholders investment	Foreign currency translation adjustments	Market value cash flow hedges adjustment	Total	Net income	Total
December 31, 2003					541 213 ^{b)}					541 213
Net equity Axalto Holding B.V.as at December		22	12 500	-10 890						1 632
Capital increase due to change B.V. to N.V.		34	-34							0
Additional contribution from Schlumberger					51 191					51 191
Recapitalisation and issuance of common stock, net capital contribution by Schlumberger Ltd		50 000	532 989	9 415	-592 404					0
Capital increase reserved to employees		547	7 546							8 093
Net income									42 789	42 789
Foreign currency translation adjustment						40 490		40 490		40 490
Translation adjustment share capital		4 486				-4 486		-4 486		0
Market value cash flow hedges adjustment							5 998	5 998		5 998
		55 089	553 001	-1 475	0	36 004	5 998	42 002	42 789	691 406
^{b)} of which 31,104 relates to Axalto Holding and 510,199 to Schlumberger Authorised capital amounts to 150 million Euro ordinary shares with a nominal value of each share of 1€ At the end of 2004, 40,490,668 ordinary shares were issued with a nominal value of 1€ each										

Notes to the consolidated financial statements

1 Background and Basis of Presentation

1.1 Background

Axalto Holding N.V., formerly Schlumberger Systems B.V., was incorporated on December 10, 2002 and has its statutory seat in Amsterdam. Axalto Holding N.V. acted initially as an intermediate holding company.

In the fourth quarter of 2002, Schlumberger Limited (“Schlumberger”) announced its intention to divest various businesses, including certain of its Products Group. On March 19, 2004, Schlumberger and Axalto (the “Company”) entered into a Master Separation Agreement (“Separation Agreement”) under which Schlumberger agreed to transfer to Axalto the assets and liabilities associated with the businesses of Smart Cards (“Cards”) and Point of Sales Terminals (“POS”), which belonged to the Schlumberger Products Group, in connection with the listing of Axalto’s shares on the Euronext Paris. Cards includes microprocessor, magnetic stripe, memory and other cards and related services for mobile communications, financial cards, public sector and access applications including licensing of intellectual property rights, and prepaid phone cards. POS includes point of sales terminals, systems and related services.

Axalto was first listed on the Euronext Paris on May 18, 2004. Schlumberger sold 87.5% of the stock of Axalto Holding N.V. through the Initial Public Offering, and divested its remaining 12.5% stake on September 17, 2004.

1.2 Basis of Presentation

The accompanying financial statements of Axalto and its subsidiaries as at December 31, 2004, are expressed in US dollars and have been prepared in accordance with generally accepted accounting principles for financial information in The Netherlands. Unless otherwise indicated historical cost is used for the valuation of assets and liabilities and the determination of income. Assets and liabilities are recorded at face value unless otherwise disclosed hereafter. Unless otherwise indicated all amounts are in thousands of US dollars.

The prior year figures in the consolidated accounts show the combined financial statements of Axalto for 2003 which were derived from the consolidated financial statements of Schlumberger Limited. The combined financial statements which have been prepared in accordance with generally accepted accounting principles for financial information in the United States of America, include the historical assets, liabilities, revenues and expenses that were directly related to the Axalto business within Schlumberger during the period presented.

Certain amounts of Schlumberger’s corporate expenses, including the cost of services relating to legal, tax, accounting, employee benefits, internal audit, real estate management, insurance and information technology, as well as treasury and other corporate and infrastructure costs, although not directly attributable to Axalto’s operations, have been allocated to Axalto on the basis that Schlumberger and Axalto consider to be a reasonable reflection of the utilization of services provided or the benefit received by Axalto. These allocations have been based upon revenue, headcount or other methods depending on the nature of the costs that reflect assumptions management believes are reasonable. However, the financial information provided herein may not reflect the combined financial position,

operating results, changes in invested equity and cash flows of Axalto in the future or what they would have been had Axalto been a separate, stand alone company during the period presented.

During 2003, Axalto did not operate as a separate, stand-alone company. Axalto's results were included in the consolidated financial statements of Schlumberger on a divisional basis, and there were no separate meaningful historical equity accounts for Axalto. Changes in total invested equity represented Schlumberger's net investment in Axalto after giving effect to the net earnings of Axalto, dividends paid and net transfers (including cash) to and from Schlumberger. As the result of the contribution by Schlumberger to Axalto of the assets and liabilities related to the Cards and POS businesses, Schlumberger's net investment in Axalto converted to common stock and additional paid-in capital. 40,027,000 common stock of Axalto Holding N.V. were issued and subscribed by Schlumberger prior to the first listing with Euronext Paris on May 18, 2004.

1.3 Consolidation

The consolidated accounts comprise the financial information of Axalto Holding N.V. and of its group companies. Group companies are entities in which Axalto Holding N.V directly or indirectly, exercises a controlling interest, through the ability to exercise a majority of the voting rights or any other ability to exert control over financial and operating activities. This includes potential voting rights that may be exercised at the balance sheet date.

All intercompany transactions and balances within Axalto are eliminated.

Considering the fact that the parent company's income statement is included in the consolidated annual accounts, a summarized statement of operations is prepared following article 402, Book 2 of the Civil Code.

The consolidated annual accounts comprise the financials of Axalto Holding N.V. and the following group companies:

Country of incorporation	Company	Direct or indirect ownership	Percentage held by the company
Germany	Axalto GmbH	Direct	100%
Netherlands Antilles	Cards & Terminals N.V.	Direct	100%
Australia	Axalto Pty Ltd.	Direct	100%
Brazil	Axalto do Brazil Cartoes e Terminais Ltda	Direct	100%
Canada	Axalto Canada Ltd	Direct	100%
China	Axalto (Beijing) Smart Cards Technology Co Ltd.	Indirect	100%
China	Hunan Telecommunications Equipment Co Ltd.	Indirect	51%**
China	Shanghai Axalto IC Cards Technology Co Ltd	Indirect	51%
Spain	Axalto SP S.A.	Indirect	100%
United States	Axalto Inc.	Direct	100%
United States	Axalto CP8 Inc	Indirect	100%
France	CP 8 Technologies S.A.	Indirect	100%
France	Electronics Transactions Integration Services S.A.	Indirect	100%
France	Axalto S.A.	Direct	100%
France	Axalto International S.A.S.	Direct	100%
United Kingdom	Axalto Terminals Ltd	Indirect	100%
United Kingdom	Axalto UK Ltd	Direct	100%
United Kingdom	Axalto Cards Ltd	Indirect	100%
Hong Kong	CP 8 Hong Kong Ltd	Indirect	100%
Hong Kong	Axalto Technologies Asia Ltd	Indirect	100%
Hungary	Axalto Hungary Commercial and Services Ltd	Direct	100%
British Virgin Islands	Axalto Cards & Terminals Ltd	Indirect	100%
British Virgin Islands	Axalto Technology Ltd	Indirect	100%
India	Axalto Cards & Terminals India Ltd	Direct	100%
Indonesia	PT Axalto Indonesia	Indirect	100%
Italy	Axalto SPA	Direct	100%
Japan	Axalto KK	Direct	100%
Japan	SPOM Japan KK	Indirect	100%
Malaysia	Axalto International Ltd	Indirect	100%
Malaysia	Axalto (M) Sdn Bhd	Direct	100%
Mexico	Distribucion S.A. de CV	Direct	100%
Mexico	Axalto Cards Mexico S.A. de CV	Indirect	100%
Mexico	CP8 Mexico SA de CV	Indirect	100%
Panama	Axalto Eastern Holdings Inc	Indirect	100%
Netherlands	Axalto BV	Direct	100%
Philippines	Axalto Philippines Inc	Indirect	100%
Czech republic	Axalto SRO	Direct	100%
Singapore	Axalto Singapore Pte Ltd	Direct	100%
Sweden	Axalto AB	Indirect	100%
Thailand	Boonakarn Holdings (Thailand) Ltd	Indirect	100%
Thailand	Axalto Industries (Thailand) Ltd	Indirect	100%
Turkey	Axalto Cards & Terminals Ltd Sirketi	Direct	100%

** Axalto holds a 51% interest in H.S.T.E, a company located in China. A portion of H.S.T.E's business includes Schlumberger's public phones equipment business in China, which is not within the scope of Axalto's operations. As part of the reorganization, Schlumberger has agreed to assume all risks and rewards of the past and future operations of the public phone equipment business in H.S.T.E as specified in the separation agreement. As a result, it was not considered appropriate to include the results of operations of the public phones equipment business in the statement of operations of Axalto.

1.4 Notes to the cash flow statement

As no Dutch GAAP consolidated balance sheet was prepared as at December 31, 2002, the comparative cash flow statement for the year 2003 has been derived using the US GAAP combined balance sheet for that period.

In determining the cash flow provided by or used in the changes in assets and liabilities in our consolidated statements of cash flows, we deduct from the year-end balances of those assets and liabilities the amount corresponding to the variations in the functional currencies of group companies against the US dollar over the period.

1.5 Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, 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. On an ongoing basis, Axalto evaluates its estimates, including those related to doubtful accounts, valuation of inventories and investments, recoverability of goodwill and intangible assets, income tax provision and recoverability of deferred taxes, contingencies and litigations and actuarial assumptions for employee benefit plans. Axalto bases its estimates on historical experience and on various other assumptions that, in management's opinion, are reasonable under the circumstances. These results form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

2 Principles of determination of result

2.1 Revenue recognition

2.1.1 Products and services revenue

Axalto's products and services are generally sold based upon contracts or purchase orders with the customer that include fixed and determinable prices and that do not include right of return, other similar provisions or other significant post delivery obligations. Revenue is recognized for products upon delivery when title and risk pass, the price is fixed and determinable and collectibility is reasonably assured. Revenue for services is recognized over the period when services are rendered and collectibility is reasonably assured. Revenue for royalties is recognized when income is earned and collectibility is reasonably assured.

Certain revenues are recognized using the percentage of completion method as services are provided. These services include installation and integration services. Under the percentage of completion method, the extent of progress towards completion is measured based on actual costs incurred to total

estimated costs. Losses on contracts are recognized during the period in which the loss first becomes probable and can be reasonably estimated.

2.1.2 Multiple Element Arrangements

Revenue from contracts with multiple elements, such as those including services, is recognized as each element is earned based on the relative fair value of each element and when there are no undelivered elements that are essential to the functionality of the delivered elements.

2.1.3 Collectibility

As part of the revenue recognition process, Axalto determines whether trade and notes receivables are reasonably assured of collection based on various factors, including the ability to sell those receivables and whether there has been deterioration in the credit quality of customers that could result in the inability to sell those receivables. Axalto defers revenue and related costs when it is uncertain as to whether receivables will be collectable. Axalto defers revenue but recognizes related costs when it determines that the collection of receivables is unlikely.

2.1.4 Deferred and unbilled revenue

Deferred revenue includes amounts that have been billed per contractual terms but have not been recognized as income. Revenue in excess of amounts invoiced on long-term contracts is recorded as work in progress and included in inventory.

2.2 Concentration of credit risk

Axalto's financial instruments, which potentially subject Axalto to concentration of credit risk, consist primarily of accounts receivable. Axalto maintains an allowance for uncollectible accounts receivable based on expected collectibility. Axalto performs ongoing credit evaluations of its customers' financial condition.

2.3 Foreign Currency accounting

Axalto's functional currencies are primarily local currencies.

All assets and liabilities recorded in functional currencies other than U.S. dollars are translated at current exchange rates as of the balance sheet date. Goodwill of the foreign participations is regarded as an asset and is also translated at the rate of exchange prevailing at the balance sheet date. The resulting translation differences are taken to the foreign currency translation adjustment reserve within shareholder's equity.

The share capital of Axalto Holding N.V. is also translated at the current exchange rate as at December 31, 2004. The resulting adjustments are charged or credited directly to equity.

Revenue and expenses resulting from transactions, including interest income and expenses, are translated at the weighted-average exchange rates for the period. Realised and unrealised gains and losses are included in income in the period in which they occur. They reflect the cumulative impact of the change in values due to currency fluctuation between the booking and settlement dates of assets

and liabilities denominated in currencies other than the functional currency in each of the Axalto entities.

The combined financial statements of Axalto for the year ended 31 December 2003, did not include the gains or losses relating to the foreign currency exchange contracts entered into as a hedge against the risk attached to the future settlement of assets and liabilities denominated in a currency other than the functional currency. These contracts were entered into at Group level by Schlumberger and the corresponding gains (losses) were not allocated back to the Cards or POS business. Foreign currency transaction gains (losses) included in the results of operations were \$ (9.9) million in 2003.

For the year ended December 31, 2004, Axalto entered into foreign currency exchange contracts as a hedge against the risk attached to the future settlement of assets and liabilities denominated in a currency other than the functional currency. The consolidated income statement as at December 31, 2004 therefore includes a net transaction loss of \$(1.6) million after taking into account the result on these hedging instruments.

2.4 Research and engineering

All research and engineering costs are expensed as incurred, including costs related to patents or rights that may result from such expenditures, except for certain software development costs qualifying for capitalisation.

Axalto capitalised eligible software development costs upon achievement of technological feasibility subject to net realizable value considerations. Based on Axalto's development process, technological feasibility is generally established upon completion of a working model. Research and engineering standard costs prior to a determination of technological feasibility are expensed as incurred. Amortisation of capitalised software development costs begins when the products are available for general release over their estimated useful life, which usually varies between 3 and 6 years. Unamortized capitalised software development costs determined to be in excess of the net realisable value of the product are expensed immediately. In 2003 capitalised software development costs amounted to \$ 2.6 million of which 0.4 million was amortized at 31 December 2003. In 2004, costs incurred for software development costs were capitalised for \$ 1.6 million, bringing the total balance at year-end to \$ 4.2 million of which \$ 1.4 were amortized at December 31, 2004.

2.5 Personnel remuneration

Regular payments

Salaries, wages and social security costs are charged to the income statement when due, and in accordance with employment contracts and obligations.

Pensions

The group has a number of pension schemes in operation. The majority are defined contribution schemes whereby premiums are paid to insurance companies or pension funds on the basis of salary levels during the year. The group has no legal or actual obligations in case of a deficit within the insurance company or pension fund.

The ongoing cost of providing pensions for current and former employees through defined benefit schemes is charged to the income statement over the period during which the benefit is derived from the employees' services, based on the calculations carried out by independent qualified actuaries applying United States accounting standard FAS 87 "Employers' Accounting for pensions". If the provision recorded at year-end is below the Accumulated Benefit Obligation resulting from the actuarial valuation, an intangible asset is recognized for the difference and readjusted yearly (see Note 4) to ensure that the provision recorded at least equals the minimum liability.

Stock option plan and employee stock purchase plan

Axalto uses the intrinsic value method for stock based awards granted to employees. No compensation expense for its stock based awards to employees was recognized for the years 2003 and 2004.

Costs associated with the employee stock purchase plan (corresponding to the purchase price less the prevailing market price on the day of the grant) are reflected in the income statement under other income, net.

2.6 Taxes on income

Historically, the operating results of the Axalto activities have been included in tax returns filed by the Schlumberger companies that held the assets and liabilities related to these activities. In accordance with US GAAP applicable to the carved-out financial statements, the provision for income taxes reflected in our combined financial statements has been determined on a separate return basis which means that they were recorded as if each company comprising our business was not part of a tax group and could not benefit from tax benefits resulting from losses accruing in other Schlumberger companies or activities. These principles were applied to the year ended on 31 December 2003. In addition, we determined our tax assets and liabilities for the year ended on 31 December 2003 taking into consideration whether any of our subsidiaries and joint ventures belonged to a Schlumberger tax group in any relevant jurisdiction. To the extent that any of our tax assets and liabilities were held by companies that belonged to a Schlumberger tax group, such tax assets and liabilities were transferred at the end of the year to the Schlumberger company that constituted the head of such Schlumberger tax group in the relevant countries. As a result, these tax assets and liabilities have been eliminated from our combined balance sheet, and our total invested equity has been adjusted by the corresponding net amount.

The provision for income taxes presented in the consolidated financial statements for the year ended December 31, 2004 was computed in accordance with the tax rules and regulations of the taxing authorities where the income is earned. All tax assets and liabilities belonging to Axalto entities are shown in the consolidated balance sheet as at December 31, 2004.

3 Principles of valuation of assets and liabilities

3.1 Intangible fixed assets

3.1.1 Software

Software licences acquired are capitalized at acquisition cost and amortized over the estimated economic life.

3.1.2 Technology and patents

Most of the patents recorded in the balance sheet correspond to patents acquired. These patents were valued based on the report of an independent appraiser at the time of acquisition and are subject to periodic impairment tests. Technology and patents are amortized on a straight-line basis over the expected period to be beneficial but not exceeding 20 years.

3.1.3 Goodwill

Goodwill recorded in the financial statements represents the actual purchase price paid, less liabilities and assets assumed, for Schlumberger acquisitions that relate to the business of Axalto. It does not include any goodwill generated from other Schlumberger acquisitions. The majority of the net book value of goodwill relates to the acquisition in 2001 of the Cards division of the Bull Group, named Bull CP8 and is denominated in Euros.

The goodwill included in the transfer of assets and liabilities by Schlumberger to Axalto amounted to \$ 287.6 million. Goodwill is amortized on a straight-line basis over the expected period to be beneficial but not exceeding 20 years and is recorded in cost of revenue.

Axalto undertook an initial review of goodwill impairment and completed annual assessment in the fourth quarter of 2004 where no impairment charge was recognized.

3.2 Property, Plant and Equipment

Property, plant and equipment are stated at cost and depreciated using the straight-line method over the estimated useful lives of the assets as follows:

- Buildings : 20 – 30 years
- Leasehold improvements : 5 – 10 years
- Machinery and equipment : 3 – 10 years

Leasehold improvements are amortized on a straight-line basis over the shorter of their estimated useful lives or the lease term. When assets are retired or otherwise disposed of, the cost and

accumulated depreciation are removed from their separate accounts, and any gain or loss on such sale is reflected in operations. Maintenance and repair costs are expenses as incurred. Expenditures that substantially increase an asset's useful life are capitalised.

Any impairment as at the balance sheet date is recorded in the income statement.

3.3 Financial fixed assets

Investments in group companies and other participations where significant influence can be exercised are recorded at their net asset value. Significant influence is in any case deemed when the shareholder's interest exceeds 20%.

The net asset value is calculated using the valuation principles prevailing for the preparation of these annual accounts; for participations for which insufficient information is available for the adjustment to these principles, the accounting policies of the participation concerned are taken as a basis.

In cases where the participation's net asset value is negative, it is valued at nil. If in this situation Axalto Holding N.V. is wholly or partially liable for the debts of the participation, or if it has the firm intention to enable the participation to settle its debts, a provision is formed.

Participations where no significant influence can be exercised are valued at cost or lower fair value when the decrease in value is determined to be other than temporary in nature.

3.4 Impairment of Long-lived assets

On an annual basis, Axalto reviews the carrying value of its long-lived assets. In addition, whenever events or changes in circumstances indicate that the carrying value of an asset may no longer be appropriate, a review is performed. Axalto assesses recoverability of the carrying value of the asset by estimating the future net cash flows expected to result from the asset, including the proceeds from its eventual sale. If the sum of future undiscounted net cash flows is less than the carrying value of the asset, an impairment loss is recorded equal to the difference between the asset's carrying value and fair value.

3.5 Inventories

Inventories are stated at lower of cost of market. Axalto provides inventory allowances for excess and obsolete inventories.

3.6 Cash and Cash equivalents

Cash and cash equivalents are comprised of cash and short-term investments that do not have original maturities in excess of twelve months. The short-term investments are stated at cost plus accrued interest, which approximates market value. These investments are mainly comprised of bank deposits and marketable securities (cash investments) with major banks.

3.7 Fair Value of Financial Instruments

The fair value of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses is not materially different from their carrying value as reported at December 31, 2004 and 2003 because of their short maturities.

3.8 Minority interest

The minority interests as a component of group equity is valued at the amount of the net investment in the group companies concerned. If the group company concerned has a negative net equity value, this negative value and the other future losses are not allocated to the minority interests, unless the third party shareholders are committed to make up the deficiencies. As soon as the net equity value of the group company returns to positive, the results are recognised in the minority interests.

3.9 Provisions

3.9.1 General

Provisions are set up for legally enforceable and actual obligations existing at the balance sheet date, if it is probable that an outflow of resources is necessary and the size of the obligation may reliably be estimated.

When it is anticipated that obligations will be reimbursed by a third party, the reimbursement is recognised as an asset in the balance sheet.

Pension provisions are valued based on actuarial principles. The other provisions are recognised at face value.

3.9.2 Product Warranties

Axalto provides for future warranty obligations upon product delivery. The warranties are generally for 12 to 18 months from the date of sale depending on local legislation and contractual terms. Axalto's liability under these warranties is to provide a replacement product or issue a credit to the customer. Factors that affect Axalto's warranty liability provision include the number of units delivered, historical experience and Axalto's judgment regarding anticipated rates of warranty claims and cost per claim. Axalto assesses the adequacy of its recorded warranty liability provision at each period end and makes adjustments to the provision if necessary.

3.10 Deferred taxes

Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements. A valuation allowance is provided if it is more likely than not that some or all of the deferred tax asset will not be realized.

3.11 Currency Risk Management Contracts

Since June 30, 2003 Axalto began to hedge a portion of the impact on forecast cash flows of foreign currency movements through forward and options contracts.

Axalto formally documents all relationships between these hedging instruments and hedged items, as well as its risk management objectives and strategies for undertaking various hedge transactions.

Axalto characterizes the financial instruments as hedges of forecast transactions. When the forecast transactions being hedged are no longer expected to occur, Axalto recognizes the gain or loss on the designated hedging financial instruments in the combined income statement.

Forward and option contracts are recorded in the balance sheet at their fair market value as “other current assets”. Unrealised gains and losses on hedging contracts are recorded in the Stockholders’ Equity under Accumulated Other Comprehensive Income. Realised gains and losses from hedging instruments are recognized in the consolidated income statement consistently with the underlying transaction being hedged (see Note 25).

4 Intangible fixed assets

4.1 Intangible fixed assets other than goodwill							
	Software	Technology	Patents	Other	Prior service costs, pension liabilities	Total	
Balance as at 1 January 2004							
➤ Cost	6 602	33 068	158 905	2 454	978	202 007	
➤ Accumulated amortisation and impairment	-5 099	-27 899	-136 870	-1 123	-	-170 991	
➤ Book value	1 503	5 169	22 035	1 331	978	31 016	
Changes in book value							
➤ Exchange differences	90	224	1 657	-478	95	1 588	
➤ Investments	1 705					1 705	
➤ Divestments	-12			-55		-67	
➤ Amortisation	-1 289	-2 574	-2 983			-6 846	
➤ Impairment		-2 758				-2 758	
➤ Transfers between categories	-454	664	64	-274		0	
➤ Prior service costs (net) pension liabilities					326	326	
	40	-4 444	-1 262	-807	421	-6 052	
Balance as at 31 December 2004							
➤ Cost	8 993	37 704	172 959	1 569	1 399	222 624	
➤ Accumulated amortisation and impairment	-7 450	-36 979	-152 186	-1 045	-	-197 660	
➤ Book value	1 543	725	20 773	524	1 399	24 964	
Intangible fixed assets, other than goodwill, are amortized based on expected lives being:							
- Software :	3 to 5 years						
- Technology:	5 to 10 years						
- Patents :	5 to 10 years						
- Other :	1 to 15 years						
4.2 Goodwill							
Changes were as follows:							
Balance at the beginning of 2004	287 621						
Foreign currency translation adjustments	23 689						
Amortization 2004	-14 143						
Balance at end of 2004	297 167						

The impairment charge of \$2,758 on patents, is the result of the annual impairment test. We refer to Note 19.

5 Property, plant and equipment

The movements of property, plant and equipment can be shown as follows:				
		Land, buildings and improvements	Machinery and equipment	Total
Balance as at 1 January 2004				
➤ Cost price		72 229	206 354	278 583
➤ Accumulated depreciation and impairment		-28 605	-144 568	-173 173
➤ Book value		43 624	61 786	105 410
Changes in book value				
➤ Exchange differences		1 917	4 089	6 006
➤ Investments		2 483	34 300	36 783
➤ Divestments		-806	-3 184	-3 990
➤ Depreciation		-1 106	-34 204	-35 310
➤ Transfer between categories		-13 612	13 612	0
Balance		-11 124	14 613	3 489
Balance as at 31 December 2004				
➤ Purchase price		78 880	247 165	326 045
➤ Accumulated depreciation and impairment		-46 380	-170 766	-217 146
➤ Book value		32 500	76 399	108 899

Depreciation expense in 2004 includes a \$2.8 million write-down expense related to an industrial site located in an area subject to development restrictions likely to affect the realizable value of the asset.

The portion of fixed assets represented by the capitalisation of leases amounts to \$4.4 million (after the \$2.8 million write-down) for the year ended December 31, 2004 and to \$10.2 million for year ended December 31, 2003. It corresponds to the lease of one of Axalto's production facility as well as the assets in relation to a financing arrangement consisting of the sale of Point of Sales terminals operating lease contracts, on a recourse basis to a French financial institution.

6 Deferred tax position

At December 31, 2004 and 2003, net deferred tax assets were \$48,123 and \$ 16,258, respectively. The principal components of net deferred tax assets are as follows:

	<u>Year ended December 31,</u>	
	<u>2004</u>	<u>2003</u>
Deferred tax assets		
Net operating losses	36,348	14,034
CP8 Technologies Patents write down	29,335	30,842
Employee and retiree benefits	6,004	2,577
Warranty, reserves and accruals	3,312	2,961
Depreciation and amortization	2,450	4,651
Inventory reserve	541	1,396
Other	6,228	2,022
	<u>84,218</u>	<u>58,483</u>
Less: valuation allowance	(30,190)	(37,133)
Total deferred tax assets	<u>54,028</u>	<u>21,350</u>
Deferred tax liabilities		
Depreciation and amortization	(5,846)	(5,047)
Other	(59)	(45)
Total deferred tax liabilities	<u>(5,905)</u>	<u>(5,092)</u>
Net deferred tax assets	<u>48,123</u>	<u>16,258</u>

The deferred tax assets are presented in the balance sheet as follows:

	<u>Year ended December 31,</u>	
	<u>2004</u>	<u>2003</u>
Non-current deferred tax assets	42,740	14,515
Current deferred tax assets	11,288	6,835
Total deferred tax assets	<u>54,028</u>	<u>21,350</u>

A valuation allowance has been provided against a portion of Axalto's deferred tax assets, as it is more likely than not that such assets will not be realized.

As a result of the separation from Schlumberger, other deferred tax assets relating to losses carry-forward available to Axalto were recorded in 2004 for \$34.2 million on the basis of losses carry-forward existing as of December 31, 2003.

As of December 31, 2004, deferred tax assets relating to losses carry-forward available to Axalto, net of valuation allowances amount to \$33.4 million.

7 Other long term assets

The movements of the other long term assets can be shown as follows:				
		Interest in non consolidated companies	Other Investments	Total
Balance as at 1 January 2004		6 797	2 181	8 978
Changes in book value				
‣ Exchange differences		341	229	570
‣ Share in results participating interest		262		262
‣ Other movements		-627	522	-105
Balance as at 31 December 2004		6 773	2 932	9 705

The “Interest in non consolidated companies” is primarily composed of:

- A 31% interest in Axalto, Shanghai Post & Telecommunication Development Co. and Shanghai Feilo Co. Ltd. Axalto’s investment as of December 31, 2004 and 2003 was \$1.8 million and \$2 million respectively. Axalto’s equity income from this company was \$76 in 2004 and \$51 in 2003.
- A 38% interest in Trusted Logic S.A., a company incorporated in France,
- A 22.7% interest in Xiring S.A., a company also incorporated in France.

Axalto records income from these companies using the equity method of accounting.

8 Inventories

Inventory consists of the following:

	Year ended December 31,	
	2004	2003
Raw materials and spares	71,796	60,576
Work in progress	22,825	20,264
Finished goods	27,871	22,987
	<u>122,492</u>	<u>103,827</u>

The provision for obsolete and excess inventory aggregated \$18,661 as at December 31, 2004 and \$17,324 as at December 31, 2003.

9 Trade receivables

	Year ended December 31,	
	2004	2003
Face amounts	220,156	209,902
Allowance for doubtful accounts	<u>(17,996)</u>	<u>(19,436)</u>
Net amount	<u>202,160</u>	<u>190,466</u>

10 Other current assets

Other current assets consist of the following:

	Year ended December 31,	
	2004	2003
Prepaid expenses	5,496	2,743
VAT recoverable & tax receivable	13,260	8,490
Advances to suppliers and related	5,886	3,861
Unbilled customers	10,739	5,301
Fair market value of currency risk hedging contracts	7,105	2,456
Other	12,079	12,043
	<u>54,565</u>	<u>34,894</u>

The increase between 2004 and 2003 of the line Prepaid expenses is explained for \$1.8 million by the prepaid expenses incurred in relation with certain contracts of the POS activity which are amortized over the duration of each contract.

In 2004, the increase of the line “VAT recoverable” is explained by the increase of the suppliers accounts in relation with our increased activity.

11 Minority interest

Minority interest changed in 2004 as follows:

Balance as at January 1, 2004	9,876
Share in result 2004	688
Dividend declared	(3,957)
Other (relating to H.S.T.E.)	452
Balance as at December 31, 2004	<u>7,059</u>

Minority interest relates to the Chinese companies Shanghai Axalto IC Cards Technology Co Ltd. and Hunan Telecommunications Equipment Co Ltd.

12 Equity

We refer to the consolidated statement of changes in stockholders’ equity

The reconciliation between consolidated equity and equity according to the parent company accounts is as follows:

Stockholders’ equity according to the consolidated accounts	691,406
Difference in goodwill amortization (net of tax)	(761)
Difference between 2003 impairment and 2004 reversal	586
Stockholders’ equity according to the parent company accounts	<u>691,231</u> =====

The reconciliation between the consolidated result and the result according to the parent company accounts is as follows:

Net income according to the consolidated accounts	42,789
Difference in goodwill amortization (net of tax)	(761)
Net income according to the parent company accounts	<u>42,028</u> =====

Goodwill is amortized in the consolidated accounts based on the historical underlying values as included in the combined accounts. Goodwill in the parent company accounts is considered to be acquired in 2004 and amortized straight line over 20 years.

13 Provisions

13.1 Provision for pensions and other employment benefits

US Employee Benefit Plans

Since May 18, 2004, Axalto employees in the United States benefit from an individual savings plan commonly named « 401k » in the United States. According to this plan, the employer matches dollar for dollar the contribution of the employee up to a certain percentage of the eligible compensation. Funds are managed by Fidelity. As this plan qualifies as a defined contribution plan per SFAS 87, no liability in the balance sheet was recognized as at December 31, 2004.

In 2003 and until its first listing, Axalto employees were covered by several defined benefit pension plans in the name of Schlumberger Technology Corporation, a wholly owned subsidiary of Schlumberger. Schlumberger Technology Corporation also provides certain health care benefits to former employees who have retired under the US pension plans. Upon the separation from Schlumberger, Schlumberger retained the obligations and liabilities associated with US defined benefits plans.

As Schlumberger managed its US employee benefit plans on a global basis for all the employees of its various activities, separate company information was not readily available. Therefore, Axalto's share of the Schlumberger US plans' assets and liabilities is not included in the combined balance sheet for the year ended December 31, 2003. The combined income statement 2003 and the consolidated statement of operations for 2004 include, however, an allocation of the costs of the US employee benefit plans. These costs were allocated based on Axalto's US active employee population for each of the years presented. In relation to these US plans, Axalto recorded pension expense of \$477 and \$1,429 for the years ended December 31, 2004, and 2003 respectively.

Non US Employee Benefit Plans

Outside the US, Axalto has sponsored since its first listing several defined contribution plans that cover substantially all employees who are not covered by statutory plans.

In the United Kingdom, during 2004, the employees of Axalto remained under the defined benefit or defined contribution plans managed by Schlumberger at UK level. As at December 31, 2003, as separate company information was not readily available, the combined balance sheet did not reflect Axalto's share of the plans' assets and liabilities. Schlumberger will retain the obligations and liabilities related to the UK defined benefits plans at the date when employees of Axalto in the UK join the Axalto UK defined contribution plan currently being set up. For the UK plan, Axalto recorded for the defined benefits plans a pension expense of \$130 and \$163 for the years ended December 31, 2004 and 2003 respectively.

In Germany, the Company recorded a not significant pension expense for the year ended December 31, 2003. For the year ended December 31, 2004, the pension expense recorded in the income statement amounts to \$95 and the liability recorded in the balance sheet to \$397.

In France, in addition to state social security and other compulsory plans, Axalto provides the following benefits to its employees:

- Pursuant to applicable French law and labor agreements in force in the industry, a lump sum payment is made to employees upon retirement. The amount of the payment is based on the length of service of the employees and is conditional upon the employee still being employed by Axalto when retiring.
- Jubilees: after 20, 30 and 40 years of service, active employees receive a lump sum.

The characteristics of these benefits are summarized as follows:

- The expense relating to this plan was \$2,238 and \$1,320 for the years ended December 31, 2004 and 2003 respectively.
- The Projected Benefit Obligation (PBO) computed by third party actuaries amounts to \$16,085 for the year ended December 31, 2004 and \$13,506 for the year ended December 31, 2003. The assumptions used for the computation of the 2004 PBO are the following: inflation rate of 2%, discount rate of 4.75% in 2004 (versus 5% in 2003) and salary increases of 3% for exempts and 2.75% for non-exempts.
- The liability recorded in the balance sheet in relation with these benefits amounted to \$14.6 million and \$10.8 million for the years ended December 31, 2004 and 2003 respectively.
- The projected payments for the period 2005-2009 are expected to be \$1.1 million per year on average. The projected payments for the period 2010-2014 are expected to total \$1.4 million.

Changes in the provision are as follows:

Balance as at 1 January 2004	11,175
Service costs	1,143
Prior service costs	421
Interest costs	790
Amortization actuarial gains and losses	385
Exchange difference	1,099
Balance as at 31 December 2004	<u><u>15,013</u></u>

13.2 Other provisions

Movements in 2004 are as follows:

	Warranty liability	Environmental costs	Other	Total
Balance as at 1 January 2004	3,840	857	11,629	16,326
Movements, net during the year	1,141	-	(3,257)	(2,116)
Balance as at 31 December 2004	<u>4,981</u>	<u>857</u>	<u>8,372</u>	<u>14,210</u>
	=====	=====	=====	=====

The column "Other", totalling 8,372 as at 31 December 2004 primarily relates to expected losses on contracts, penalty on late deliveries and litigations.

14 Interest bearing loans and borrowings

In 2004, Axalto set up a syndicated loan with major commercial banks. This committed agreement, totaling \$150 million and available to European wholly owned subsidiaries of Axalto Holding N.V., includes 3 facilities of \$50m each:

- a 1-year multicurrency revolving facility;
- a 2-year multicurrency revolving facility and;
- a 3-year bond and guarantee

On December 31, 2004 \$28,888 was drawn under the 2-year facility, being the dollar equivalent of GBP 3 million at 5.26% and EUR 17 million at 2.55%.

Further is included under this caption the long-term portion of the finance lease for a production facility amounting to \$1,361.

For guarantees given for the syndicated loan we refer to note 36.5.

15 Other non-current liabilities

Other non-current liabilities consist of:

	2004	2003
Long term portion of capital lease on client sale	3,711	8,391
Subsidies	970	-
Accrual for remediation costs	708	-
Accrual for refurbishment costs	551	-
Other liabilities	327	436
	<u>6,267</u>	<u>8,827</u>

We also refer to Note 5 related to the capital lease.

16 Employee, other payables and accrued liabilities

Employee, other payables and accrued liabilities consist of the following:

	<u>2004</u>	<u>2003</u>
Payroll, vacation and employee benefits	70,405	51,502
Accrued expenses	50,700	36,644
Accrued VAT	11,112	6,836
Deferred revenue	33,812	16,419
Other	<u>7,627</u>	<u>2,459</u>
	<u>173,656</u>	<u>113,860</u>

The increase in “Payroll, vacation and employee benefits” is mainly due to increases in accruals related to management incentive plans (for \$7.1 million) and profit sharing plans in several countries where Axalto operates (for \$2.6 million), the consequence of the increased profitability of operations in 2004.

“Accrued expenses” include sales commissions to third parties, which have increased in relation with the growth of our activity.

The increase in “Deferred revenue” is explained for \$9,956 by the deferral of revenue related to certain contracts of the Point of Sales terminals activity and higher deferred revenue in the Cards segment accounts for the remainder.

17 Related party transactions

Although Schlumberger sold its remaining shareholding of 12.5% in Axalto on September 17, 2004, Schlumberger has to be considered as a related party for the transactions that occurred in 2004.

The remaining balances of the related party payables and receivables included in the 2003 combined balance sheet represent amounts arising from trade transactions entered into by Axalto with other Schlumberger entities and certain local recharges of support services, and have been repaid or collected.

The revenue, cost of revenue, receivables and payables related to transactions with Schlumberger entities are as follows:

	<u>Year ended December 31,</u>	
	<u>2004</u>	<u>2003</u>
Revenue	2,780	6,909
Cost of revenue	1,398	4,341

	<u>Year ended December 31,</u>	
	<u>2004</u>	<u>2003</u>
Accounts receivable	1,895	12,666
Accounts payable	146	10,263

18 Stock compensation plan

Axalto has established a Global Equity Incentive Plan (“GEIP”) for its employees, approved by the general meeting of shareholders held on March 18, 2004 and April 21, 2004. The GEIP authorizes the company to grant to employees over the duration of the plan (ending on April 21, 2014) the right to acquire a total of 7 million ordinary shares of Axalto Holding N.V. The Board of Axalto Holding N.V., in its meeting of April 2, 2004, approved the main terms and conditions of the 2004 option grant under the GEIP 2004.

As at December 31, 2003, Axalto did not operate a stock option plan specific to its stand alone business. Employees of Axalto were part of the Schlumberger Limited Group and certain employees participated in the stock option plan and employee stock purchase plan of Schlumberger. Following the successful completion of the Initial Public Offering of Axalto, Axalto employees are not longer allowed to participate in the Schlumberger employee stock purchase plan and their rights under the Schlumberger stock option plan were terminated in accordance with the provisions applicable to employees leaving the company.

Stock option plans

Per the 2004 GEIP, it was decided to authorize the grant of 3,300,000 options to buy ordinary shares with an exercise price equal to the initial price offered to investors, i.e. 14.80 Euros per share. 3,198,000 stock options were granted on May 18, 2004. The vesting schedule differs, depending of the country of employment of the optionee, and varies from a 25% vesting per year over 4 years to a cliff vesting at the end of the 4 year period. No options were exercisable at year-end.

For 2004, the following assumptions were used for the Axalto stock option grant: no dividend, expected volatility of 25%, risk-free rate of 2.9%, and expected option life of 4.11 years.

Employee stock purchase plan

In the period from May 4, 2004 to May 14, 2004, it was proposed to Axalto employees to subscribe to a capital increase reserved to them and so acquire Axalto shares at a price 15% below the initial public offering price, up to a limit of 20,000 euros per employee. 445,668 new ordinary shares of Axalto were created and acquired by the employees at 12.58 Euros per share.

In 2003, under the Schlumberger Discounted Stock Purchase Plan, Schlumberger was authorized to issue up to 22,012,245 shares of common stock to its employees. Under the terms of the Plan, employees can choose each year to have up to 10% of their annual earnings withheld to purchase Schlumberger common stock. The purchase price of the stock is 85% of the lower of its

beginning or end of the Plan period market price. Under the Plan, Schlumberger, sold 47,739 shares to Axalto employees in 2003. The compensation expense related to this plan has been computed for the fair value of the employees purchase rights, which was estimated using the Black-Scholes model with the following assumptions for 2003: dividend of \$ 0.75; expected life of one year, expected volatility of 28% and risk-free interest rates of 0.75% The weighted-average fair value of those purchase rights granted in 2003 was \$ 7.910.

19 Restructuring and Impairment Charges

Restructuring Charges

Restructuring charges are allocated to the cost item of the combined income statement based on the functions or positions that were made redundant and the nature of the assets being impaired or written down.

In 2003, \$1,135 of the remaining provision for restructuring charges recorded at December 31, 2002 was utilised. The remaining \$ 2,890 was credited to the corresponding expense line in the combined income statement. A continuous operating performance improvement plan was implemented in 2003, which caused Axalto to incur severance and termination expenses of \$2,077 and to record a pre-tax provision of \$ 1,505. This provision related to expected severance payments for 8 employees for Cards and 5 for POS to be made in early 2004. The total impact of the plan for the period was a net charge of \$ 692, of which \$ 617 was recorded in cost of revenue, \$ 705 in sales and marketing and \$ 387 in general and administrative expenses, partially offset by \$1,107 income in research and engineering expenses mainly due to the reversal of the provision recorded at December 31, 2002. In addition Axalto recorded, in connection with the disposal of its POS manufacturing operations, an inventory write-down of \$ 1,289 corresponding to the inventory not purchased by the buyer.

In 2004, Axalto used all of the existing provisions. As part of the continuous operating performance improvement plan, Axalto incurred severance and termination expenses of \$ 1,744 and recorded a pre-tax provision of \$ 1,797. This provision relates to expected severance payments for employees to be made in early 2005. The total impact of restructuring for the period is a net charge of \$3,541, of which \$720 was recorded in cost of revenue, \$ 494 in research and engineering expenses, \$1,822 in sales and marketing and \$ 505 in general and administrative expenses.

Impairment charges

In the fourth quarter of 2004, following the annual impairment test, to reflect management's best estimate of the fair value of the intangible assets, Axalto recorded in cost of revenue a total impairment charge of \$ 2,758 on the CP8 core and existing technologies, all in the financial cards sector. This core impairment was made necessary following the decrease of sales of products based on these CP8 core and existing technologies, which are being progressively replaced by more recent developments (see Note 4).

20 Operating profit

Operating profit includes the following costs

20.1 Salaries, wages and headcount

	<u>Year ended December 31</u>	
	<u>2004</u>	<u>2003</u>
Salaries and wages	177,611	150,014
Social security contributions including pension costs	71,392	61,769
Discount on capital increase reserved to Axalto employees	1,214	
Total	<u>250,217</u>	<u>211,783</u>

Number of employees

	<u>Year ended December 31</u>	
	<u>2004</u>	<u>2003</u>
Cards	4,666	4,297
Point of sales terminals	131	159
Head office	26	17
Total	<u>4,823</u>	<u>4,472</u>

As at December 31, 2004, there were less than 100 people employed by the Group in the Netherlands.

20.2 Depreciation and Amortisation

	<u>Year ended December 31</u>	
	<u>2004</u>	<u>2003</u>
Depreciation intangible fixed assets	35,310	31,915
Amortization intangible assets other than goodwill	6,846	5,406
Impairment charges	2,758	-
Total	<u>44,914</u>	<u>37,321</u>

21 Interest income (expenses) net

Detailed as follows:	<u>Year ended December 31</u>	
	<u>2004</u>	<u>2003</u>
Interest income	2,194	258
Interest expenses	<u>(1,903)</u>	<u>(5,567)</u>
Net amount	<u>291</u>	<u>(5,309)</u>

In 2003 Axalto was included in the Schlumberger structure and the financial results reflected the Schlumberger's financing policy.

22 Other income, net

	<u>Year ended December 31</u>	
	<u>2004</u>	<u>2003</u>
Consist of:		
Resolution litigation	3,238	-
Discount on capital increase reserved to Axalto employees	(1,213)	-
Miscellaneous	797	1,250
Total	<u>2,822</u>	<u>1,250</u>

23 Taxes on Income

Pre-tax income/(loss) subject to Netherlands and foreign income taxes for each of the two years ended December 31, 2004 and 2003 are as follows:

	<u>Year ended December 31</u>	
	<u>2004</u>	<u>2003</u>
Netherlands	(2,383)	-
Foreign	72,018	33,893
Total	<u>69,635</u>	<u>33,893</u>

The provision for income taxes for the years ended December 31, 2004 and 2003 consisted of the following benefit/(expense):

	<u>Year ended December 31,</u>	
	<u>2004</u>	<u>2003</u>
Current tax:		
Netherlands	(76)	-
Foreign	(19,362)	(8,787)
	<u>(19,438)</u>	<u>(8,787)</u>
Deferred tax:		
Netherlands	-	-
Foreign	(5,506)	1,877
	<u>(5,506)</u>	<u>1,877</u>
Total income tax benefit/(expense)	<u>(24,944)</u>	<u>(6,910)</u>

The reconciliation between the Netherlands income tax rate and the effective tax rate is presented below:

	Year ended December 31,			
	2004		2003	
	\$	%	\$	%
Netherlands income tax	(24,024)	34.5	(11,693)	34.5
Impact of foreign operations & permanent differences	(9,423)	13.53	4,135	(12.20)
Changes in valuation allowance	8,503	(12.21)	648	(1.91)
	<u>(24,944)</u>	<u>35.82</u>	<u>(6,910)</u>	<u>20.39</u>

24 Earnings per share

Year ended December 31, 2004			
	Net income	Average shares outstanding (in thousands)	Earning per share (in US\$)
Basic	42,789 -----	40,295 -----	1.06 ----
Dilutive effect of options	-----	402 -----	-----
Diluted	42,789	40,697	1.05

The company presents both basic and diluted earnings per share (EPS) amounts.

Basic EPS is calculated by dividing net income by the weighted average number of common shares outstanding during the period.

Diluted EPS is calculated according to the Treasury Stock method by dividing net income by the average number of common shares outstanding assuming dilution, the calculation of which assumes that all stock options which are in the money are exercised at the beginning of the period and the proceeds used by Axalto to purchase shares at the average market price for the period. For the purpose of determining the average number of common shares over 2004, all the capital increases of Axalto Holding NV (except that reserved to Axalto employees, effective on June 9, 2004, following the May, 18, 2004 Initial Public offering) were considered as having occurred on January 1, 2004.

No historical earnings per share are presented as the Axalto Group was only operating since 2004 as such.

25 Financial instruments

Axalto transacts business globally and is subject to the effects of the fluctuations in foreign exchange rates. Axalto's objective is to reduce earnings and cash from variations caused by foreign exchange rate fluctuations. Axalto enters into various options and forward contracts to protect the value of a certain percentage of its forecast, but not firmly committed, foreign currency costs for periods generally not exceeding eighteen months. The gains and losses on these contracts offset currency gains or losses on the related forecast transactions. These hedges mainly relate to Euro denominated costs.

Gains and losses on these contracts are initially recorded under Accumulated Other Comprehensive Income ("AOCI") in stockholder's equity, and reclassified to current earnings under cost of revenue when related cost of revenue (for sales to third parties) are recognised, offsetting changes in the value of the foreign currency costs.

At December 31, 2004, Axalto has pre-tax deferred realised and unrealised gains of \$ 7.8 million recorded under Accumulated Other Comprehensive Income ("AOCI"), which the company expects to recognize as a credit to the cost of revenue over the next 12 months. The impact of cash flow hedging activities on the 2004 operating income was a net gain of \$ 2.2 million, booked as a credit to Cost of revenue.

Fair value of Financial Instruments

At December 31, 2004, Axalto's financial instruments included cash, cash equivalents, investments, receivables, accounts payable, borrowings, and foreign exchange risk management contracts. At December 31, 2004, the fair values of cash and cash equivalents, receivables, accounts payable, accrued expenses, investments and borrowings approximated the carrying values because of the short-term nature of these instruments.

The estimated fair values of other financial instruments determined based on quoted market prices for the same or similar instruments, and the related carrying amounts are as follows:

	December 31, 2004	
	Carrying amount	Fair value
Currency risk management contracts		
• Foreign exchange forwards	222	222
• Foreign exchange options	6,883	6,883
	7,105	7,105
	=====	=====

Credit Concentration

As at 31 December 2004, three major commercial banks are the counterparty to Axalto's risk management contracts.

Axalto's trade receivables and investments do not represent a significant concentration of credit risk at December 31, 2004 due to the wide variety of customers and markets into which Axalto's products are sold, their distribution across many geographic areas, and the diversification of Axalto's portfolio among instruments and issuers.

26 Lease and Lease Commitments

Minimum rental lease commitments under non-cancelable operating leases, primarily real estate and office facilities in effect at December 31, 2004 are as follows:

• 2005	12,780
• 2006	8,944
• 2007	4,634
• 2008	1,789
• 2009	1,277
• 2010 and after	4,402

Operating lease rental expense aggregated \$ 13,274 in 2004 and \$ 9,736 in 2003.

27 Commitments and contingencies

Axalto holds a 51% interest in SAIT, a Chinese venture company. The financial statements of this company have been fully consolidated within Axalto. In 2003, Schlumberger and the venture partner amended its articles of association and agreed the following:

- Axalto guarantees the profit of SAIT will not be less than Chinese Renminbi 30 million (approximately \$3.6 million) for 2002 and Chinese Renminbi 25 million (approximately \$ 3 million) for each fiscal year thereafter until 2006 (inclusive).
- In exchange, Axalto is granted and shall exercise control of SAIT until December 31, 2006.

Commitments concerning pensions are described in Note 13.1, those concerning financial instruments in Note 25, and those concerning leasing commitments in Note 26.

Axalto is party to various legal proceedings and claims that arise in the ordinary course of business. As of December 31, 2004, there are no such matters pending that Axalto expects to be material in relation to its business, financial condition, results of operations or cash flows.

Pursuant to the terms of the Master Separation Agreement signed on March 19, 2004, Schlumberger and Axalto have agreed to carry out the complete transfer of the Schlumberger Group's Cards and POS businesses to Axalto or one of its subsidiaries.

These undertakings remain in effect so long as there are contracts, assets or liabilities falling within the scope of Axalto's business that have not been transferred at the time of the Separation. This also applies to contracts, assets or liabilities falling within the scope of Schlumberger's business that have not been transferred at that same time.

Until the date of transfer of the such contracts, assets or liabilities to Axalto or to Schlumberger, as the case may be, or in the event that they cannot be transferred or shall not be transferred as agreed by the parties, Schlumberger and Axalto have agreed to cooperate and execute the contracts or manage the assets and liabilities in the name of and for the account of the other party, pursuant to the instructions of such party, who will receive all profits and bear all losses (including all taxes normally due, other than those due as a result of a tax reassessment, and which are covered by tax indemnification provisions) resulting from these contracts, assets and liabilities.

The activities, assets and liabilities pertaining to Schlumberger activities falling under the provisions of the Separation Agreement are not disclosed in the accompanying financial statements of Axalto.

As of December 31, 2004, the balance of the assets and liabilities belonging to Schlumberger was a net asset of \$15.0 million.

28 Segment information

Axalto's operations are organized into two business segments: Cards and Point of Sales Terminals (POS). The Cards segment is organized into four product lines: Mobile Communication, Financial Cards, Public Sector, Access Applications and Other and Prepaid Phone Cards.

The two segments were organized in accordance with how Axalto's management reviews business performance and allocates resources. To manage the four Cards product lines, management relies on an internal financial management reporting system, which provides revenue and gross profit for each of the product lines.

The accounting policies for the reportable business segments and product lines are the same as those applied in the combined and consolidated financial statements. The following tables present Axalto's revenues, gross profit, operating expense and net interest expense items by segment, and a reconciliation of the totals reported for each of the two segments to the consolidated amounts:

	Year ended December 31	
	2004	2003
Revenue		
Cards		
Mobile Communication	548,799	443,987
Financial Cards	196,195	160,266
Public sector, Access and Other (1)	98,425	62,525
Prepaid Phone Cards	39,663	49,859
Total Cards	883,082	716,637
Point-of-Sales Terminals	77,345	51,025
Total Revenue	960,427	767,662

(1) Includes the revenue from the licensing of Intellectual Property

	Year ended December 31	
	2004	2003
Gross profit		
Cards		
Mobile Communication	214,354	160,818
Financial Cards	42,108	26,545
Public sector, Access and Other (1)	37,800	30,047
Prepaid Phone Cards	3,057	9,395
Amortization of goodwill	(14,143)	-
Total Cards	283,176	226,805
Point-of-Sales Terminals	18,081	11,410
Total gross profit	301,257	238,215

(1) Includes the gross profit from the licensing of Intellectual Property

Cost of revenue includes restructuring and impairment charges as follows:

		Year ended December 31	
		2004	2003
Cards			
Restructuring charges		(463)	(268)
Impairment charges		-	-
	Mobile Communication	(463)	(268)
Restructuring charges		(164)	(174)
Impairment charges		(2,758)	-
	Financial cards	(2,922)	(174)
Restructuring charges		(60)	(43)
Impairment charges		-	-
	Public sector, Access and Other	(60)	(43)
Restructuring charges		(47)	-
Impairment charges		-	-
	Prepaid Phone Cards	(47)	-
Total Cards		(3,492)	(485)
Point of Sales Terminals			
Restructuring charges (1)		14	(1,421)
Impairment charges		-	-
	Total Point-of-Sales Terminals	14	(1,421)
Total Axalto	Restructuring charges	(720)	(1,906)
	Impairment charges	(2,758)	-
		(3,478)	(1,906)

(1) Includes in 2003, a \$1,289 inventory write-down related to the disposal of the POS manufacturing plant completed that year.

The 2004 cost of revenue also includes a \$2.8 million write-down expense against the carrying value of an industrial site, as mentioned in Note 5.

		Year ended December 31	
		2004	2003
Operating expenses			
	Cards	212,650	171,778
	Point-of-Sales Terminals	16,370	18,546
Total operating expenses		229,020	190,324

For the years ended December 31, 2004 and 2003, restructuring expenses recorded in operating expenses amounted to \$2,821 and \$ 75, respectively.

	Year ended December 31	
	2004	2003
Interest expense, net		
Cards	1,045	(4,700)
Point-of-Sales Terminals	(754)	(609)
Total interest expense, net	<u>291</u>	<u>(5,309)</u>

	Year ended December 31	
	2004	2003
Equity in income of investees accounted for by the equity method		
Cards	(1,214)	422
Point-of-Sales Terminals	-	-
Total equity in income of investees accounted for by the equity method	<u>(1,214)</u>	<u>422</u>

	Year ended December 31	
	2004	2003
Income (loss) before taxes		
Cards	69,187	41,638
Point-of-Sales Terminals	448	(7,745)
Total income (loss) before taxes	<u>69,635</u>	<u>33,893</u>

Supplemental segment information

	Year ended December 31	
	2004	2003
Total assets		
Cards	1,057,755	809,875
Point-of-Sales Terminals	41,940	36,507
Total assets	<u>1,099,695</u>	<u>846,382</u>

	Year ended December 31	
	2004	2003
Total liabilities		
Cards	365,161	267,243
Point-of-Sales Terminals	36,069	28,050
Total assets	<u>401,23026</u>	<u>295,293</u>

	Year ended December 31	
	2004	2003
Depreciation and amortization expense (other than goodwill)		
Cards	42,947	36,516
Point-of-Sales Terminals	1,967	805
Total depreciation and amortization expense	44,914	37,321

Geographic Information

The table below shows revenue attributed to geographic areas, on the basis of the location of the customer:

	Year ended December 31	
	2004	2003
Revenue		
North and South America	187,238	145,326
Europe, Middle East and Africa	535,885	402,746
Asia Pacific	237,304	219,590
Total revenue	960,427	767,662

	Year ended December 31	
	2004	2003
Long lived assets		
North and South America	48,044	37,621
Europe, Middle East and Africa	422,431	398,582
Asia Pacific	13,000	11,337
Total long lived assets	483,475	447,540

Significant Customers (as a percentage of revenue)

During each of the years ended December 31, 2004 and 2003 no customer accounted for 10% or more of the total revenues.

Axalto Holding N.V.

Company-only Balance sheets (in thousands of US dollars)

before proposed appropriation of income

Assets	Notes	December 31, 2004		December 31, 2003*	
		USD	USD	USD	USD
Fixed assets					
Intangible fixed assets	30	273,241		4,351	
Tangible fixed assets	31	213		-	
Financial fixed assets					
Investments in subsidiaries		354,052		16,384	
Loans to subsidiaries		21,358		156	
Total financial fixed assets	32	375,410		16,540	
Total Fixed assets			648,864		20,891
Current assets					
Receivables due from subsidiaries		637		-	
Prepayments		13		-	
Cash at banks and in hand		58,755		21	
Total currents assets			59,405		21
Total assets			708,269		20,912

* restated for comparison purposes.

Axalto Holding N.V.

Company-only Balance sheets (Cont'd) (in thousands of US dollars)
before proposed appropriation of income

	Note	December 31, 2004		December 31, 2003*	
		USD	USD	USD	USD
Shareholders' equity and liabilities					
Shareholders' equity					
Issued and paid in share capital	33	55,089		22	
Share premium		553,001		12,500	
Legal reserves and statutory reserves		-		-	
Translation adjustment reserve		36,004		-	
Other comprehensive income		5,998		-	
Other reserves		(889)		(99)	
Result for the year		42,028		(10,791)	
Total shareholders' equity			691,231		1,632
Current liabilities					
Loan from shareholder	34	-		19,178	
Payables to subsidiaries		612		24	
Payable to related party	35	15,027		-	
Other taxes and social securities		145		-	
Other liabilities		265		78	
Accruals		989		-	
Total current liabilities			17,038		19,280
Total shareholders' equity and liabilities			708,269		20,912

* restated for comparison purposes.

Axalto Holding N.V.
Company-only Statement of Operations (in thousands of US dollars)

		<u>2004</u>	<u>2003</u>
	Note	USD	USD
Income after taxes		(1,271)	(790)
Amorization of goodwill	30	(14,381)	-
Change in fair value of investments		-	(10,001)
Income from subsidiaries	32	57,680	-
Net income		42,028	(10,791)

Axalto Holding N.V.

Notes to Company-only Financial Statements (in thousands of US dollars)

29 General

29.1 Changes in accounting policies

During 2004, Axalto Holding N.V. has developed to the status of a full fledged holding of an international group quoted on the Euronext Paris. Therefore, Axalto Holding N.V. is now fully international: significant dividend flows to be expected from its subsidiaries will be received in US dollars, also most of the loans that the Company would grant to its subsidiaries to support their expansion would be made in US dollars, thus the interest income streams will also be mostly in US dollars.

Because of these facts, the functional currency of Axalto Holding N.V. was changed from Euro to US dollar effective January 1, 2004. All the assets, liabilities and equity lines of the balance sheet as at December 31, 2003 were converted to US dollars using an exchange rate of USD 1 = EUR 0.80 to arrive to the January 1, 2004 opening balance sheet.

Until December 31, 2003 financial fixed assets were valued using the historical cost method, which was supported by the fact that the Company was then an intermediate holding. As, during 2004, the Company has become a top holding, it was decided, for better insight, starting January 1, 2004 that the financial fixed assets would be valued at their net assets plus goodwill, and amortized over a 20 year period, starting January 1, 2004. The effect of this change is reflected in the caption "Adjustment to conform to new presentation" of the shareholder's equity reconciliation. The 2003 financial statements were restated for a better comparability.

29.2 Consolidation

The financial statements of Axalto Holding N.V., the parent company, are included in the consolidated financial statements of the Axalto Group.

29.3 Principles of valuation and determination of result

The accounting principles used for the preparation of the company-only financial statements are identical to those used for the preparation of the consolidated financial statements of the group, presented in the notes to the consolidated financial statements unless otherwise disclosed.

30 Intangible fixed assets

	<u>Goodwill</u>
Historical cost	
January 1, 2004	4,351
Additions	283,271
	<u>287,622</u>
December 31, 2004	287,622
Accumulated amortization	
January 1, 2004	-
Charge for the year	(14,381)
	<u>(14,381)</u>
<u>December 31, 2004</u>	<u>(14,381)</u>
	<u>273,241</u>
Net book value at December 31, 2004	<u>273,241</u>

31 Tangible fixed assets

	<u>Other fixed assets</u>	<u>Total</u>
	USD	USD
January 1, 2004		
Book value	-	-
2004 movements		
Additions	227	227
Depreciation	(15)	(15)
	<u>213</u>	<u>213</u>
December 31, 2004		
Acquisition or production costs	227	227
Accumulated depreciation	(15)	(15)
	<u>213</u>	<u>213</u>
Book value	213	213
Depreciation rates	20%-33%	

Other fixed assets are stated at cost and depreciated using the straight-line method over the estimated useful lives of the assets. The assets comprise mainly office furniture and equipment carrying depreciation rates between 3 and 5 years.

32 Financial fixed assets

An overview of the movements in the financial fixed assets is presented below:

	Investments in subsidiaries	Amounts due from subsidiaries	Total
	USD	USD	USD
January 1, 2004			
Book value	16,384	156	16,540
2004 movements			
Acquisitions	2,137	0	2,137
Capital increase subsidiaries	3,000	0	3,000
Contributions by shareholder	267,331	0	267,331
Divestments	(5,080)	0	(5,080)
Exchange differences	40,490	425	40,915
Market value of cash flow hedges	5,998	0	5,998
Draws on loan facility	0	106,405	106,405
Repayments on loan	0	(85,628)	(85,628)
Result participations	57,680	0	57,680
Dividend from participations	(33,888)	0	(33,888)
December 31, 2004			
Book value	354,052	21,358	375,410

Loans to subsidiaries

As at December 31, 2004, the loans to subsidiaries are primarily composed of loans to finance the Indian and Mexican subsidiaries.

On April 2, 2004, the Company financed its Indian subsidiary with two interest bearing loans denominated in US dollars priced at arm's length conditions. The first loan, with a maximum draw capacity of USD 3 million has a 3-year maturity and was drawn for USD 2.5 million at year-end. The second loan, with a maximum draw capacity of USD 8 million matures in 42 months and was drawn for USD 7.3 million at year-end.

On May 1, 2004, the Company financed its Mexican subsidiary with an interest bearing loan denominated in US dollars priced at arm's length conditions. The loan, with a maximum draw capacity of USD 17 million has a one-year maturity and was drawn for USD 11.5 million at year-end.

33 Shareholders' equity

	Issued and paid-in share capital	Share premium	Translation adjustment reserve	Other reserves	Other compreh ensive income	Result current year	Total
December 31, 2003	22	12,500		(99)		(10,791)	1,632
Appropriation of results				(10,791)		10,791	0
Change B.V. to N.V.	34	(34)					0
Cash capital increase Schlumberger B.V.		56,306					56,306
Capital increase reserved to employees	547	7,546					8,093
Capital increase to remunerate contributions	50,000	476,683					526,683
Translation adjustment share capital	4,486		(4,486)				0
Translation adjustment on subsidiaries			40,490				40,490
Market value cash flow hedges adjustment					5,998		5,998
Adjustments to conform to new presentation				10,001			10,001
Result current year						42,028	42,028
December 31, 2004	55,089	553,001	36,004	(889)	5,998	42,028	691,231

Share capital

The authorised share capital of the Company as at December 31, 2004, amounts to EUR 150 million and consists of 150 million ordinary shares with a nominal value of EUR 1 each.

Issued and paid-in share capital amounts to EUR 40,490,668 and consists of 40,490,668 ordinary shares with a nominal value of EUR 1. At year-end exchange rate of USD 1 = EUR 0,735 the translation difference of USD 4,486 was recorded in the “translation adjustment reserve”.

On February 6, 2004, the general meeting of shareholders of Axalto Holding B.V. resolved to convert the Company into a public company with limited liability and to amend the articles of association, which resolution includes an increase of the authorised share capital of the company. The Company issued 27,000 shares in the share capital of the Company with a par value of Euro 1 to the subscriber, Schlumberger B.V. against an issue price of 100% all of which were charged against the share premium reserve of the Company with an amount of EUR 27,000 equivalent to USD 33,750.

On February 17, 2004, the Company formalised this decision through a notarial deed of conversion and amendment of the articles of Association in which Axalto Holding B.V changed its name into Axalto Holding N.V. with a change of the statutory seat from The Hague to Amsterdam.

On February 25, 2004, the Company issued 40 million fully paid up shares with a nominal value of EUR 1 representing a nominal value of USD 50 million to the shareholder.

On April 21, 2004, the shareholder approved an Employee Stock Purchase Plan that lead to the issue of 445,668 fully paid up shares with a nominal value of EUR 1. The shares were issued at IPO price of Euro 14.80 with a discount of 15% i.e. Euro 12.58 per share. The discount of USD 1.2 million was treated as a compensation charge in the statement of operations of Axalto Holding N.V.

Share premium

Share premium of USD 553,001 represents additional contributions by the shareholder. On May 4, 2004, the shareholder Schlumberger B.V. contributed prior to the IPO, pursuant to the Master Separation Agreement, USD 56.3 million share premium in cash.

About two third of the share premium can be considered as fiscally paid-in capital.

Stock options were granted under the stock option plan of Axalto on May 17, 2004 and carry a different vesting pattern, depending on the country of employment of the optionee (see Note 18). Certain of these options will therefore vest on May 18, 2005. To date, the stock repurchase plan is being finalized.

34 Loan from shareholder

As at December 31, 2003, the current liabilities account of USD 19,178 was composed of a loan from Schlumberger B.V. maturing on December 27, 2004. This loan together with accumulated interest amounts was repaid on May 4, 2004, prior to IPO.

35 Payable to related party

The account "Payable to Related Party" corresponds to the payable due to Schlumberger, per the terms of the Master Separation Agreement, as described in further details in Note 27 to the consolidated accounts, "Commitments and Contingencies".

36 Supplementary information

36.1 Employees

The average number of staff employed by the Company during 2004 was 0.3 (2003: 0).

36.2 Remuneration of the Board

(amounts in Euro)

		Membership	Additional Remuneration	Committees	Total	Prorated amount effectively charged
John de Wit	Chairman	45,000	32,500	5,000	82,500	75,779
Olivier Piou	Chief Executive Officer	35,000	-	-	35,000	26,202
Maarten Scholten	Director	35,000	-	5,000	40,000	35,410
Robert Singer	Director	-	-	-	-	-
Michel Soublin	Director	35,000	-	5,000	40,000	31,475
Willem Stolwijk	Director	35,000	-	5,000	40,000	29,611
Arthur Van der Poel	Director	35,000	-	5,000	40,000	31,352
Total		220,000	32,500	25,000	277,500	229,829

The CEO benefits from a labor contract with the French group company AXALTO International S.A.S. and received a gross salary for the year 2004 of € 465,000 and an incentive of € 549,790. Furthermore an exceptional bonus was attributed to the CEO of € 73,305 for the successful I.P.O.

Mr Robert Singer resigned in December 2004 and renounced to his attributed remuneration.

36.3 Stock options Board Members

	Date of attribution	Number	Exercise price (€)	Date of exercise
Olivier Piou	May 2004	600,000	14.80	9 years and 6 months after the attribution

Stock options have been attributed under the Global Equity Incentive Plan (see note 18).

36.4 Axalto Holding shares held by the Board Members

Olivier Piou holds 70,000 shares of the Company.
Maarten Scholten holds 1,500 shares of the Company.
Michel Soublin holds 1,500 shares of the Company.

36.5 Guarantees granted by the Company

During 2004, Axalto Holding N.V. has issued guarantees to secure several banking facilities against the risk of default of payment of its borrowing subsidiaries. These guarantees are continuing securities and will be valid until final payment in full of all amounts owed. The aggregate amount recoverable from Axalto Holding N.V. shall not exceed USD 205.5 million. This includes the USD 150 million syndicated facility referred to in Note 14 to the Consolidated Financial Statements.

Amsterdam, April 19, 2005

Board of Directors,

J.G.M.N. de Wit

M.R. Scholten

M. Soublin

O.B.M. Piou

W.J.B.M. Stolwijk

A.P.M. van der Poel

Other information

37 Profit appropriation according to the Articles of Association

Stipulations relating to the distribution of profits and dividends by the Company to its shareholders are provided in articles 32 to 35 of the Articles of Association.

Following adoption of the annual Company and consolidated financial statements by the General Meeting of Shareholders, the Company may distribute profits, provided that the financial statements show that this is permissible. The Company may only pay dividends insofar as its equity exceeds the sum of the issued share capital and the mandatory statutory reserves.

The Board of Directors determines, with due observance of the Company's policy on additions to reserves and on distribution of profits, and taking into account the legal provisions relating to mandatory statutory reserves, what portion of the profit shall be retained by way of reserve. The portion of the profits that shall not be reserved shall be at the free disposal of the General Meeting of Shareholders. The General Meeting of Shareholders may also resolve, upon the recommendation of the Board of Directors, to make distributions charged to the share premium reserve or charged to the other reserves shown in the annual accounts which are not prescribed by the law.

The Board of Directors determines the terms of distributions to shareholders. Subject to having obtained, in accordance with the Articles of Association, the authorization of the General Meeting of Shareholders to issue shares, the Board of Directors may decide to pay dividends in shares or grant shareholders the option to choose distribution in cash or in shares. The Board will propose to the forthcoming annual general meeting of the Company to appropriate the profits to the retained earnings. If no such approval is given, this power is passed on to the General Meeting of Shareholders, on the recommendation of the Board of Directors.

Before the annual financial statements are adopted by the General Meeting of Shareholders, the Board of Directors may, at its own discretion and subject to the provisions of Section 105, subsection 4 of Book 2 of the Dutch Civil Code and with due observance of the Company's policy on additions to reserves and on distribution of profits, resolve to distribute one or more interim dividends to shareholders.

38 Proposed appropriation of profit

The Board will propose to the forthcoming annual general meeting of the Company to appropriate the profits to the retained earnings.

39 Reconciliation between US GAAP accounts and Dutch GAAP accounts

The primary consolidated financial statements of the Axalto Group are prepared under United States Generally Accepted Accounting Principles (US GAAP). The reconciliation between equity as at December 31, 2004 and the results for the year 2004 according to the US GAAP accounts and the accounts prepared under Generally Accepted Accounting Principles in The Netherlands (Dutch GAAP) is shown hereafter.

Stockholders' equity according to the Dutch GAAP accounts	691,406
Amortization of goodwill (net of taxes)	13,621
	<hr/>
Stockholders' equity according to the US GAAP accounts	705,027
	=====
Net income according to the Dutch GAAP accounts	42,789
Amortization of goodwill (net of taxes)	13,621
Comprehensive income adjustment marketable securities	1,476
Discount on capital increase reserved to AXALTO employees	1,213
	<hr/>
Net income according to the US GAAP accounts	59,099
	=====

Note

Under US GAAP, goodwill is no longer amortized but tested for impairment on an annual basis. Under Dutch GAAP, goodwill is amortized.

Unrealised loss on marketable securities is under US GAAP included in other comprehensive income. Under Dutch GAAP this loss is recorded in the income statement.

The discount on capital increase reserved to AXALTO employees is recorded in the income statement under Dutch GAAP. Under US GAAP the total net amount of the capital increase is recorded in stockholders' equity.

40 Post closing events

On March 11, 2005, Axalto signed a memorandum of understanding with its Chinese partner in H.S.T.E. (a company located in China, see Note 6) by which the partner has committed to sell to Axalto its interest of 49% in the company. This operation should not have a significant impact on the financial situation of Axalto.

To management's knowledge, there is no other significant event that occurred since December 31, 2004 which would materially impact the financial statements, as presented in this document.

41 Auditor's report

To the General Shareholders Meeting of Axalto Holding N.V.

Introduction

In accordance with your instructions we have audited the financial statements of Axalto Holding N.V, Amsterdam, for the year 2004 (as set out on page 3 to 49). These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Scope

We conducted our audit in accordance with auditing standards generally accepted in the Netherlands. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the company as at December 31, 2004 and of the result for the year then ended in accordance with accounting principles generally accepted in the Netherlands and comply with the financial reporting requirements included in Part 9 of Book 2 of the Netherlands Civil Code.

PricewaterhouseCoopers Accountants N.V.

April 19, 2005

ERRATUM FINANCIAL REPORT 2004

Axalto Holding N.V. wishes to draw shareholders' attention to an inconsistency in the Financial Report for the year ended 31 December 2004.

Whilst the inconsistency does not relate to a material issue, Axalto Holding N.V. considers it prudent to release a corrected version of the relevant section and this section is set out below:

Financial Report 2004

36.4 Axalto Holding shares held by the Board Members

On page 49 of the Financial Report 2004, under the above heading we disclose that Mr. Maarten Scholten holds 1,500 Axalto shares. Instead it should read that Mr. Maarten Scholten holds 2,000 Axalto shares.

On behalf of Axalto Holding N.V.
Amsterdam, the Netherlands, 29 August 2005