

# Gemplus 2<sup>nd</sup> Quarter 2004 Results Presentation

**Presenters:** Alex Mandl  
Frans Spaargaren  
Jacques Seneca

**President & CEO**  
**Executive Vice-President CFO**  
**Executive Vice-President**  
**R&D, ID & Security Services**

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# Agenda

- ▶ • **Overview**
- Q2 2004 Financials
- Business Highlights
- R&D Strategy
- FY 2004 Outlook

# Q2 2004: Overview

- **A further quarter of solid growth**
  - Revenue up 22.1 % year-on-year
  - Sustained development across all business segments
  - Leadership position confirmed
- **Confirmation of margin recovery**
  - Operating profit: € 8.5 m, before restructuring and goodwill amortization
- **Highlight on R & D strategy**

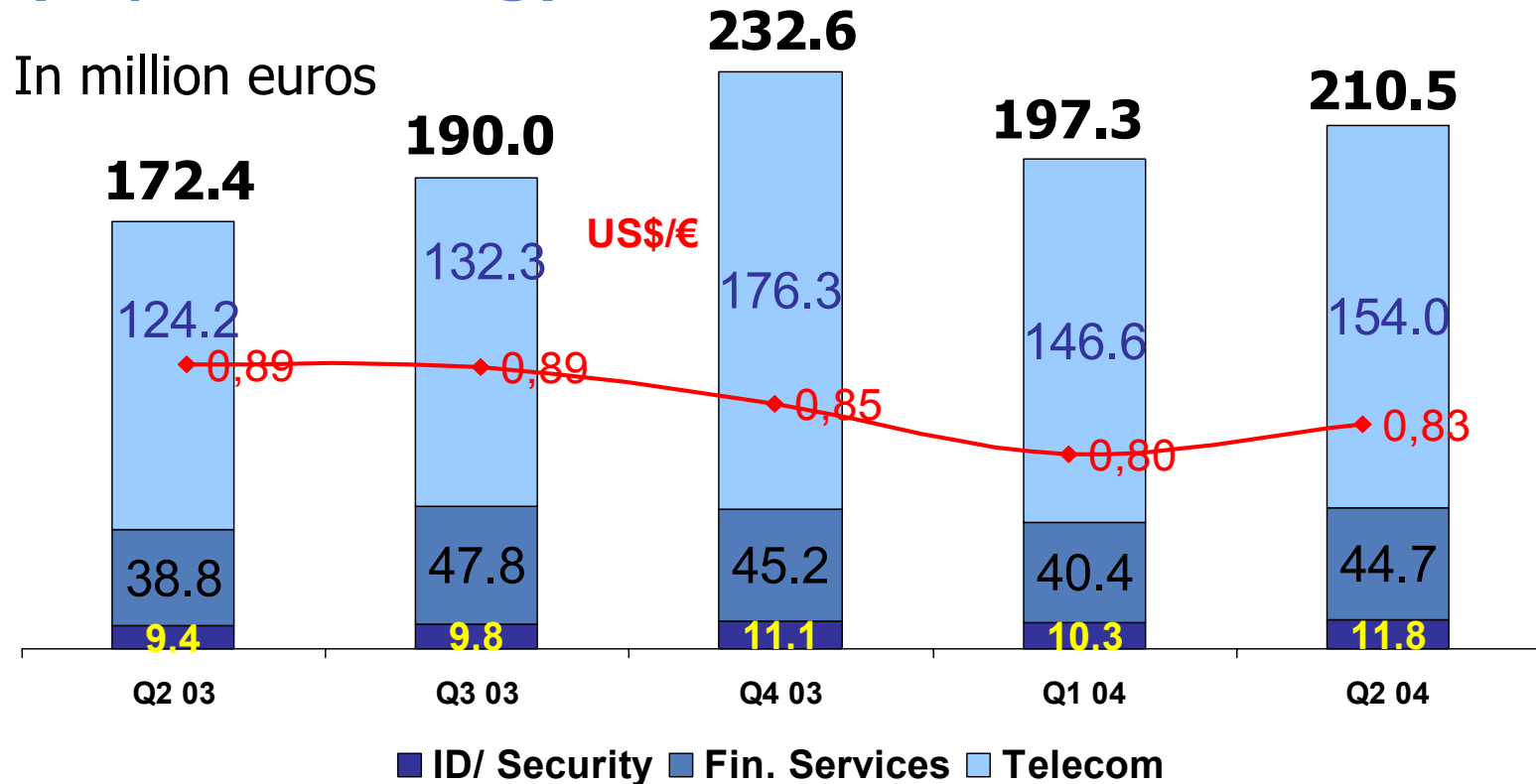
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# 2<sup>nd</sup> quarter 2004 highlights

- **Group revenue up 22.1 %** year-on-year to **€ 210.5 m**, reflecting:
  - Very strong sales growth for Wireless, up 42.0 % year-on-year
  - Sustained growth in EMV Program
  - In Identity & Security, successful implementation of the strategy focused on subsystem
- **Highest gross margin in 3 years : 32.3%** (up 1.3 ppt QoQ)
- Operating expenses up **5.4 %** quarter-on-quarter
- Operating profit: **€ 8.5 m** before restructuring and goodwill amortization
- Net income: **€ 1.1 m**
- **Stable cash, at € 383.1 m**

# Revenue by business segment (1 year rolling)

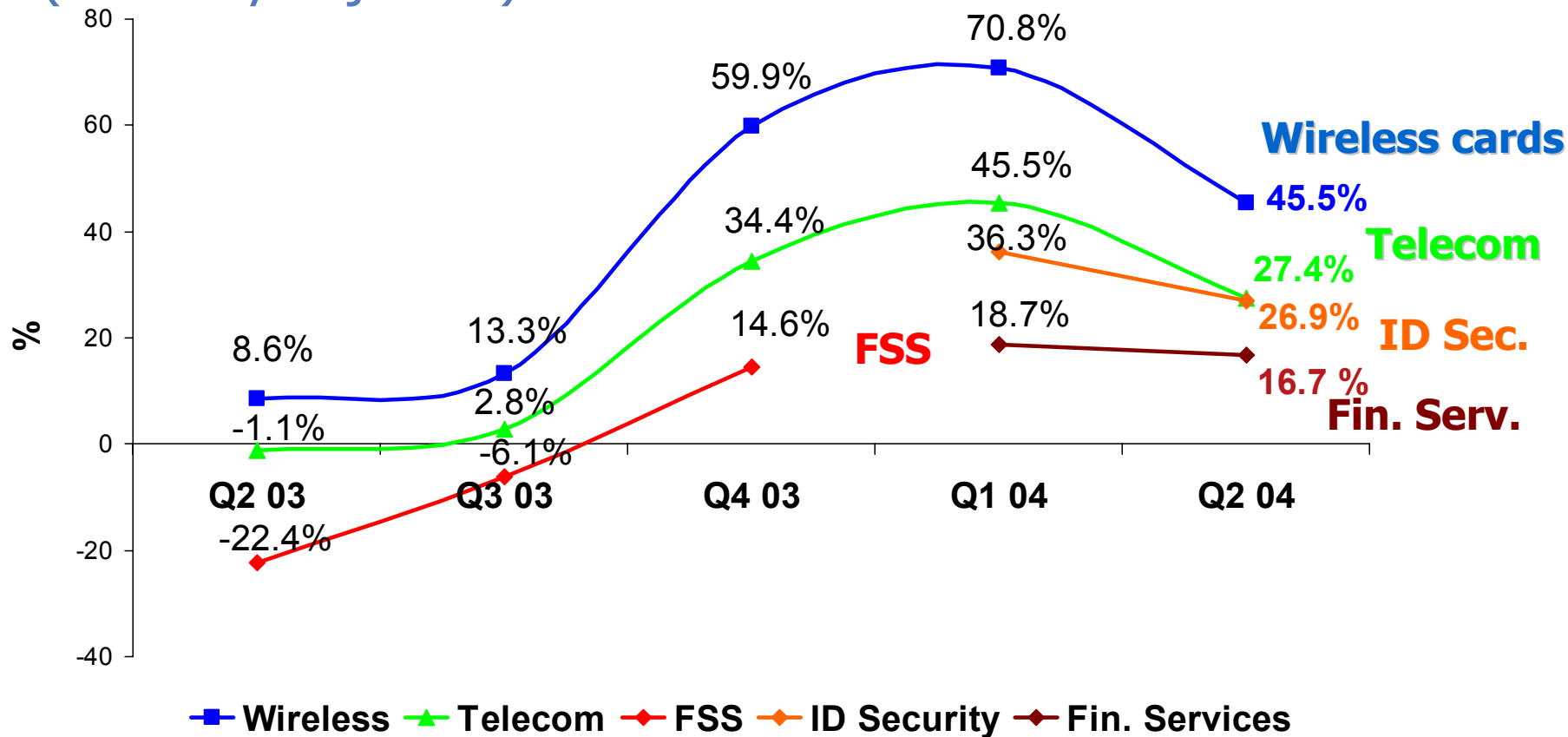


- **Year-on-year change\*** : Group revenue up 25.0 %
  - Telecom up 27.4 %, of which **Wireless up 45.5 %**
  - Financial Services up 16.7 %
  - Identity & Security up 26.9 %
- **Quarter-on-quarter change\*** : Group revenue up 4.3 %
  - Telecom up 2.6 %
  - Financial Services up 8.6 %
  - Identity & Security up 12.1 %

\* After adjusting for currency fluctuations, discontinued operations and acquisitions

# Year-on-year revenue growth rate

(currency adjusted)

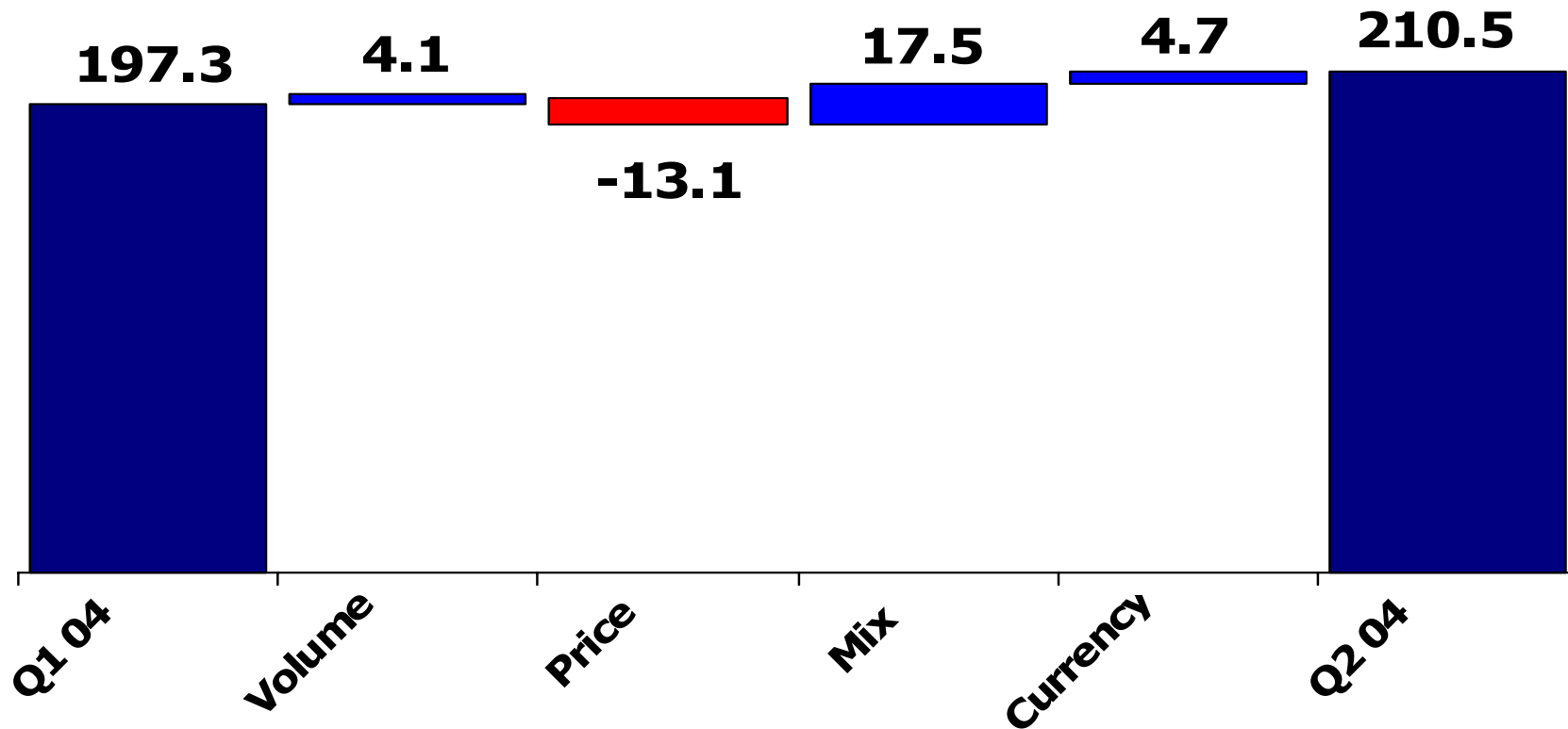


- Favorable development in all business segments
- Telecom revenue driven by very strong growth in Wireless

\* After adjusting for currency fluctuations, discontinued operations and acquisitions

# Q2 2004 vs. Q1 2004 revenue

In million euros

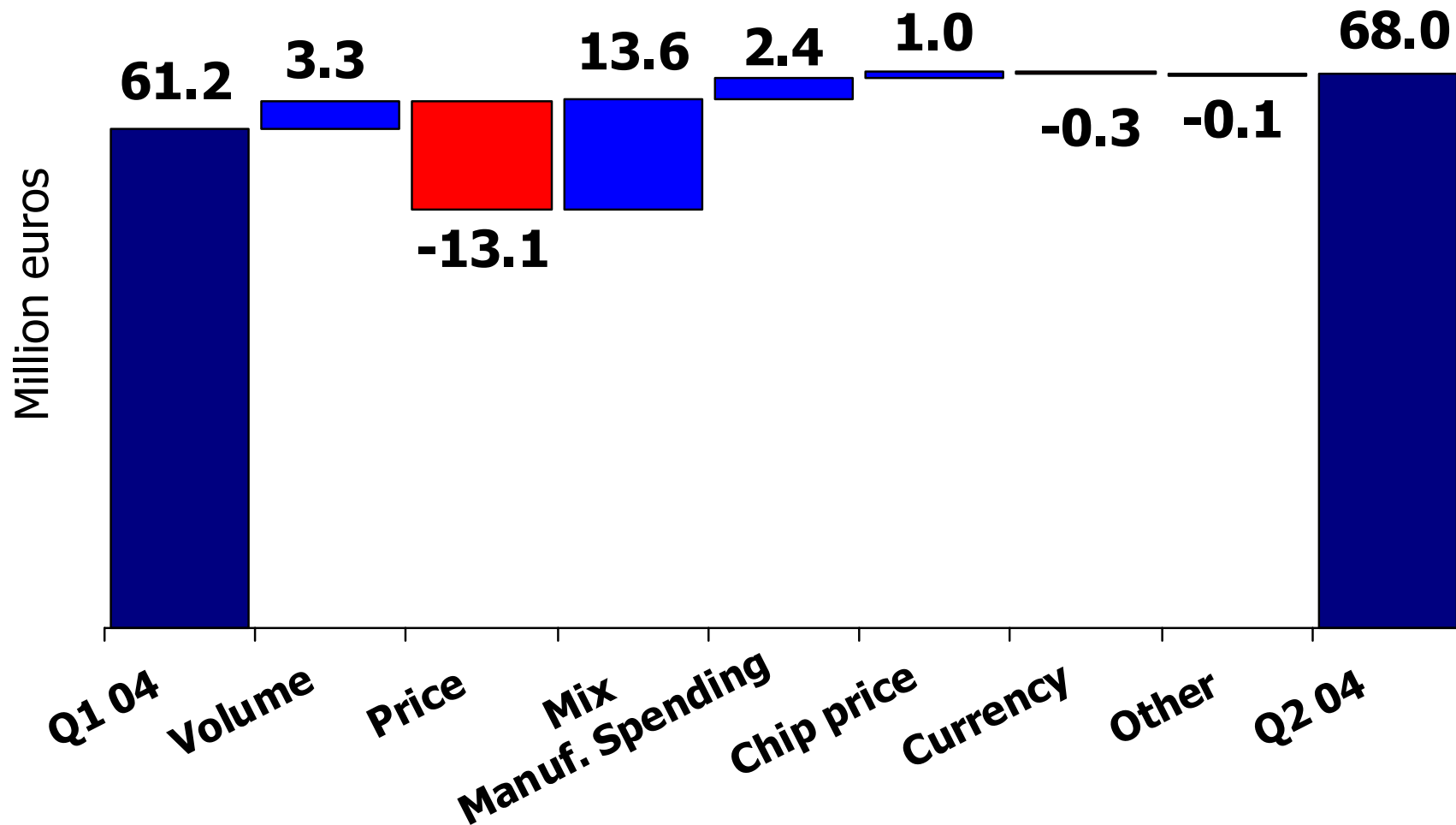


- Product mix improvement more than offsets continuous pricing pressure
- Volume improvement mainly related to Geldkarte, and Telecom software & services sales

# Q2 2004 vs. Q1 2004 gross profit

Margin **31.0 %**

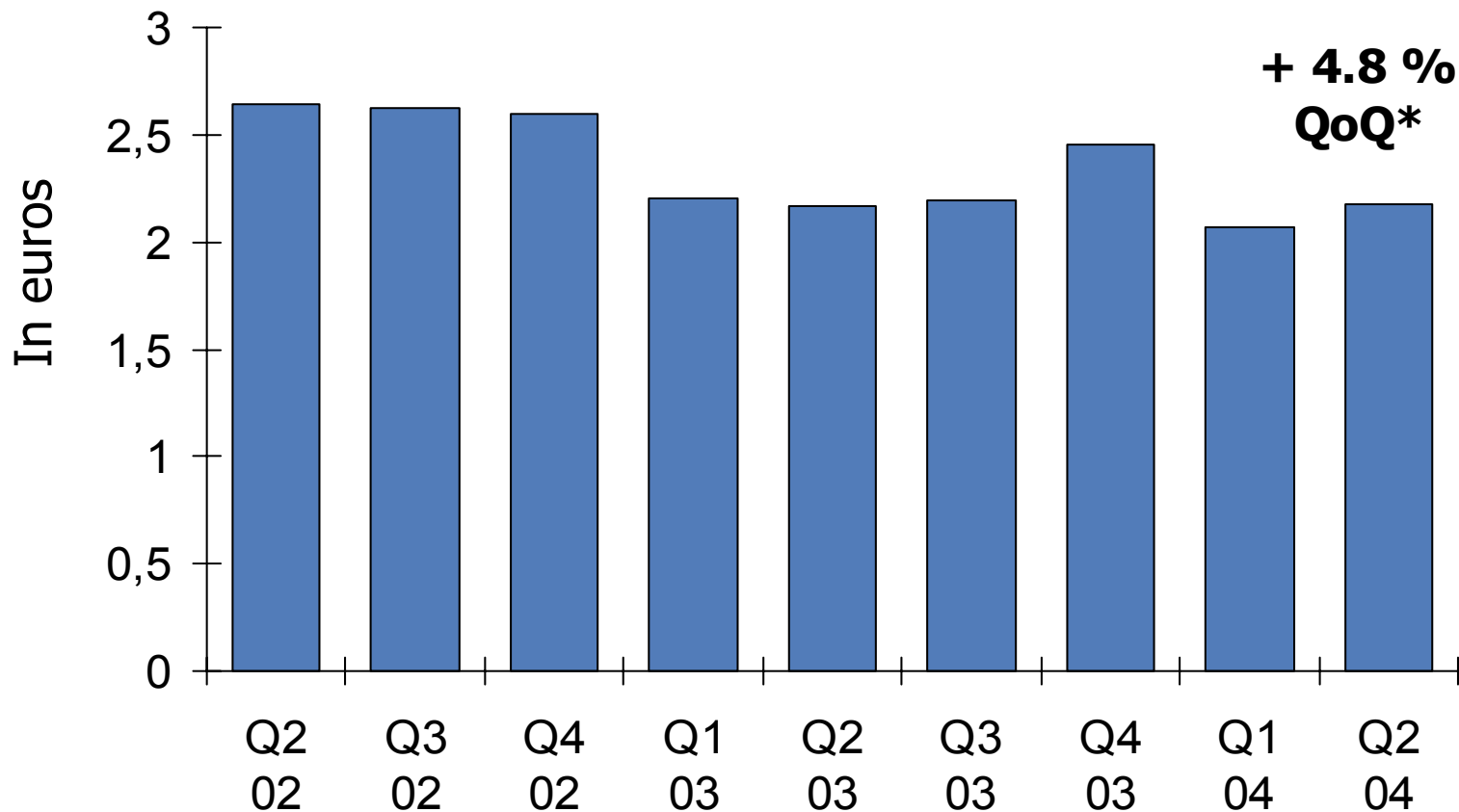
**32.3 %**



- Strong product mix improvement, offsetting price pressure
- Manufacturing spending improvement, due to productivity improvement

# Wireless cards ASPs

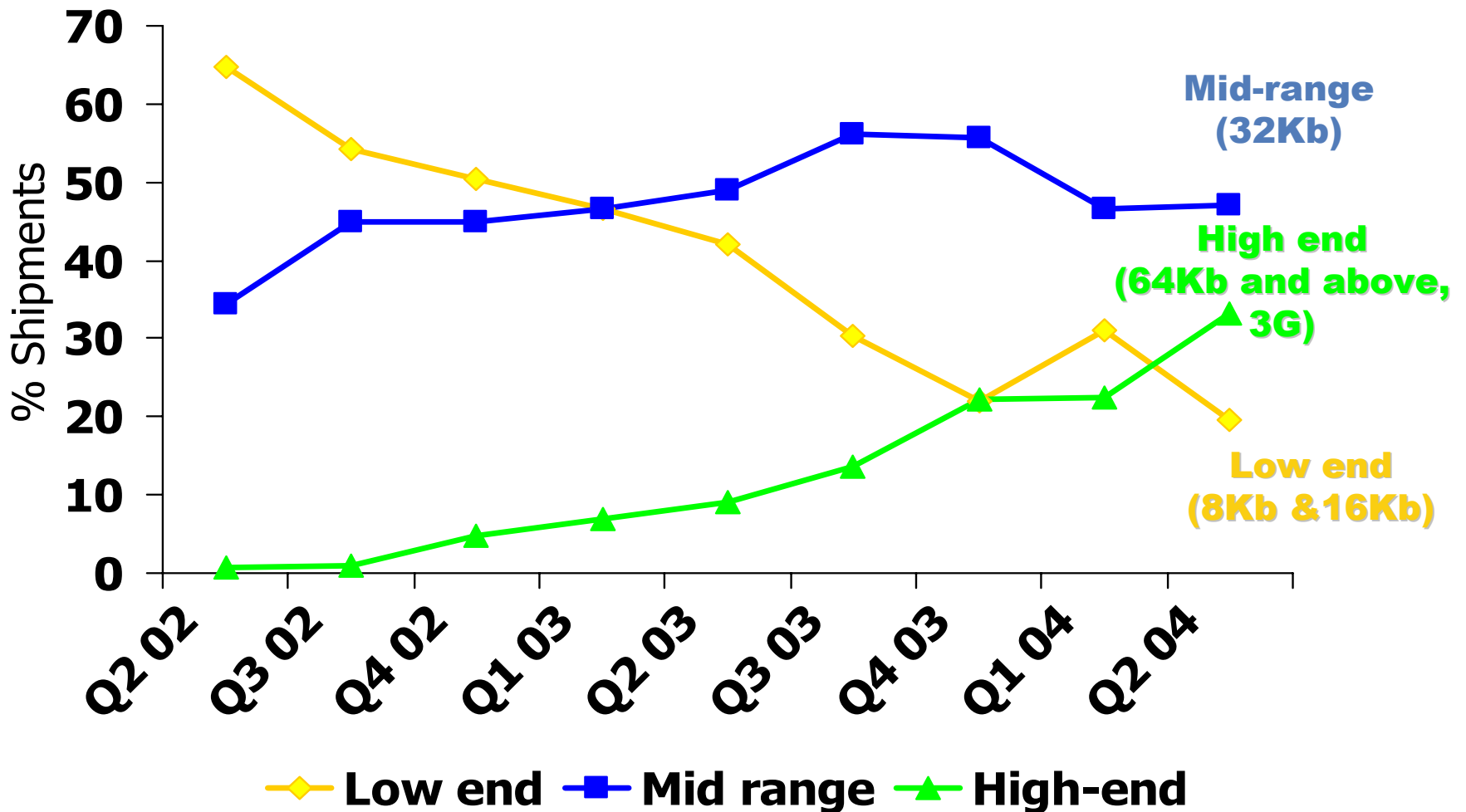
(Average Sales Price)



- ASP up 4.8 %, quarter-on-quarter, currency adjusted, due to more favorable product mix, more than compensating pricing pressure
- ASP up 4.1 % year-on-year, currency adjusted, driven by product mix improvement over the last 12 months

\* After adjusting for currency fluctuations

# Migration to high-end products

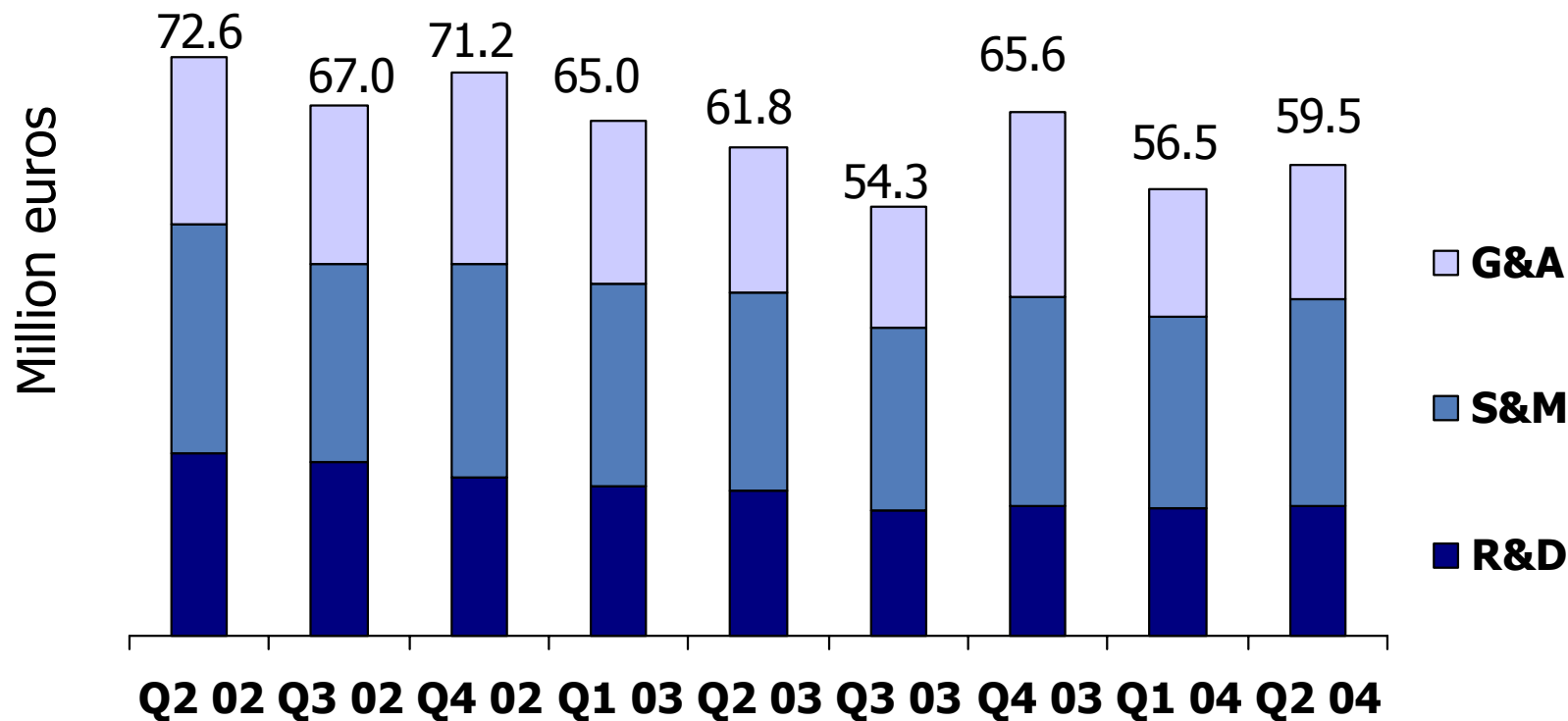


- Ongoing migration towards higher-end cards
- High-end cards (64Kb and above, 3G) account now for 33.4 % of total shipments (vs. 22.4 % in Q1 04)

# Operating expenses

(excluding goodwill and restructuring charges)

% of sales    35%   33%   36%   42%   36%   29%   28%   29%   28%



- 5.4 % operating expenses increase quarter-on-quarter mainly related to sales & marketing

# Restructuring and cost cutting initiatives update

In million euros	Provision	Cash Costs	Headcount reduction target	Annualized Savings Target
<u>2003 Plan Q2 04 actualization</u>				
<b>Restructuring</b>	85	70	951	49
<b>Cost cutting initiative</b>				49

- Restructuring plan in final stage:
  - Operating with one specialist PVC site in Europe (Havant in the UK)
  - Concentrating activities (mainly personalization) for Germany on one site in Filderstadt
  - Closing other German manufacturing facility in Herne
- Costs related are expected to be booked during Q3 04
- Headcount reduction: 827 at the end of Q2
- 14 redundancies implemented in Q2

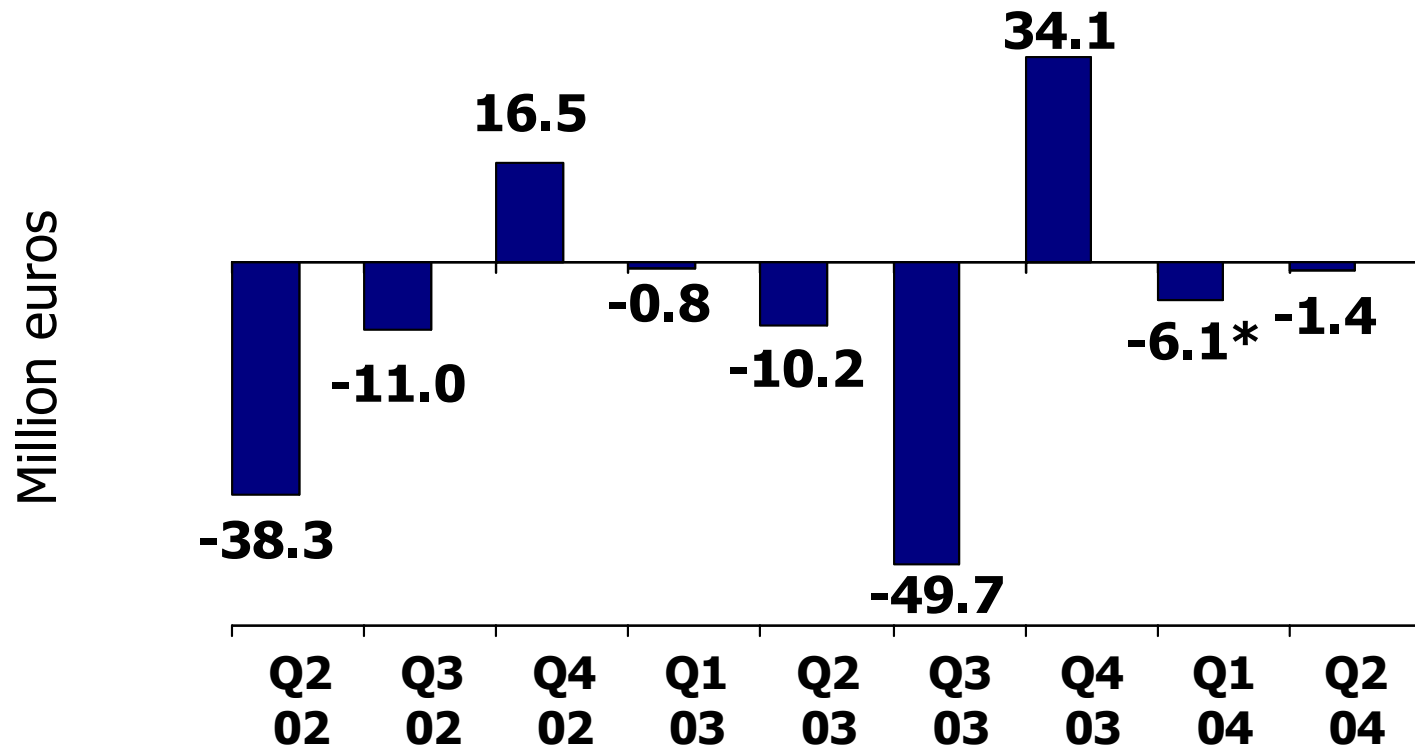
# Statement of income

Million euros	<b>Q2 04</b>	Q1 04	Q2 03
<b>Net sales</b>	<b>210.5</b>	197.3	172.4
<b>Operating income (loss) before restructuring and goodwill</b>	<b>8.5</b>	4.8	(13.9)
Goodwill amortization*	<b>(1.9)</b>	(1.9)	(4.1)
Non recurring items	<b>(0.7)</b>	0.2	(65.7)
Interests, net	<b>1.5</b>	1.3	2.8
Other result net*	<b>(4.6)</b>	(2.6)	0.2
Income tax*	<b>(1.7)</b>	(1.5)	(1.7)
<b>Net income (loss)</b>	<b>1.1</b>	0.3	(82.4)

- Improvement in operating income
- Q2 04 "Other result" mainly includes the cost of hedging

\* Adjusted for non recurring items

# Net cash flow change

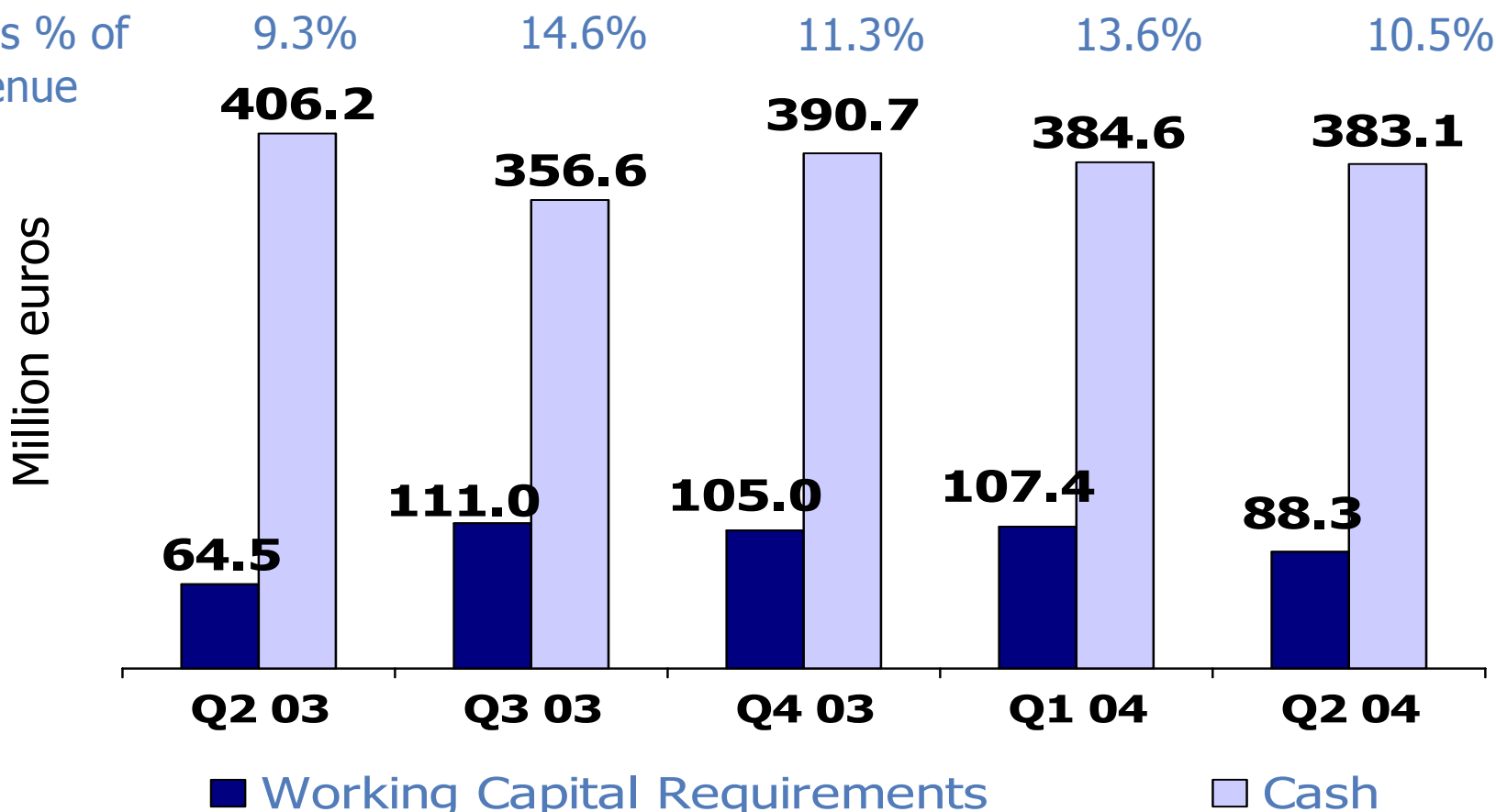


\* Including - € 22 m restricted cash related to a litigation

- Free cash flow of € 5.7 m before restructuring reflecting :
  - Profitability improvement
  - Outflow of € 7.8 m related to working capital requirement, reflecting growth of the business
  - € 5.7 m of capital expenditures
- Net cash flow also includes € 6.2 m of restructuring expenses

# Strong balance sheet

WCR as % of revenue



- WCR down 17.8 % led by:
  - The reclassification of € 34 m of long-term liability to short-term, related to the tax assessment in France previously disclosed
  - Tax assessment payment of € 34 m before December 31, 2004 of which approx. € 23 m is expected to be temporary (through the use of carry backs)
- DSO almost stable at **51 days in Q2 04**  
(50 days in Q1 04, 54 days in Q2 03)

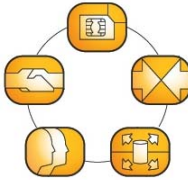
# Revenue and gross profit by business segment

million euros	Q2 2004	Q1 2004	Quarter-on-quarter change	Q2 2003	Year-on-year change
<b>Telecom</b>					
Net Sales	<b>154.0</b>	146.6	+5.1 %	124.2	+24.0 %
Gross Profit	<b>55.1</b>	49.7	+10.9 %	38.6	+42.8 %
Gross Margin	<b>35.8 %</b>	33.9%	-	31.1 %	-
<b>Financial Services</b>					
Net Sales	<b>44.7</b>	40.4	+10.7 %	38.8	+15.1 %
Gross Profit	<b>8.8</b>	9.1	- 3.8 %	6.8	+29.3 %
Gross Margin	<b>19.7 %</b>	22.7%	-	17.5 %	-
<b>Identity &amp; Security</b>					
Net Sales	<b>11.8</b>	10.3	+14.3 %	9.4	+26.5 %
Gross Profit	<b>4.1</b>	2.4	+71.9 %	2.4	+68.7 %
Gross Margin	<b>34.9 %</b>	23.2 %	-	26.2 %	-

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# Q2 2004: Telecom Business Highlights



- Market Environment:
  - Further quarter of sustained development of Wireless all over the world
  - Leading European operators relying increasingly on the SIM for operator and end-user centric services such as for phonebook and service provisioning
- Gemplus
  - Strong SIM card shipments recorded in Q2 2004: 59.6 MU, up 40.4% year-on-year and stable quarter-on-quarter
  - Product mix is improving, offsetting price pressure
  - 128K cards already delivered to "3" UK and Globe Telecom (Philippines)

# Q2 2004: Financial Services Update

- Market environment
  - EMV roll-out gaining momentum beyond the UK
  - Frost & Sullivan Competitive Strategy Award recognizes gain of substantial market share by Gemplus
- Gemplus
  - Continuing good performance in EMV migration:
    - Progress in Malaysia and South America
    - Additional contribution from France and Scandinavia
    - New contracts signed in emerging markets
  - Reduction of magnetic stripe cards revenue
  - Strong sales in Pay-TV and contactless cards for transportation

# Q2 2004: ID & Security Update



- **Market environment**

- Corporate security and government ID segments are addressing numerous and emerging businesses
- Strong market growth potential
- Business managed in a project mode

- **Gemplus**

- Successful implementation of strategy focused on subsystems based on software components, value-added services and high-end cards
- Conjunction of several new projects in Europe and United States leading to substantial gross margin improvement
- Year-on-year growth also driven by the UAE project, which offsets the completion of the successful delivery of ID solutions to the Royal Oman Police

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# Gemplus positioning

- Gemplus is a pure player dedicated to the “smartcard world”
- BUT, Gemplus is not a pure smartcard “manufacturer”:
- We cover all smartcard related technologies for the benefit of our customers
  - Cards
  - Smartcard readers
  - Middleware
  - OTA server software
  - Personalization software
  - Implementation and integration services
  - ...
- R&D is organized to build solutions for all these activities, to protect long term Gemplus value and grant profitability and sustainability versus smartcard manufacturers

# R&D Strategic Highlights

Gemplus' R&D investment supports its leadership strategy:

- Differentiation: high-end solution & services, and global offering
- Low cost cards for commodity market
- Active promotion of smart card adoption in new areas
- Continuous improvement efforts to lead state-of-the-art in terms of products functionalities and quality

# Differentiation

- R&D investment supports leadership strategy:
- Differentiation: high-end solution and services, global offering:
  - Wireless:
    - 3G card efficiency,
    - Over The Air high performance platforms for remote card management
    - Card issuing and card management flexibility
- Financial Services
  - Multi-applications cards: loyalty
  - High end personalization solutions
- ID: subsystems approach
  - Combi and contactless cards: security and flexibility (Java based),
  - Issuing solutions
  - Cards management system partnerships
- IT: cards and environment
  - High end cards (Pki based, contact/contactless)
  - Cards Applets
  - Readers & middleware

# Low cost products development

- Development of low cost cards for commodity markets:
  - Financial Services
  - Low end part of the Wireless Market
- Chip multisourcing policy
  - Fast porting capabilities
  - High level of expertise in silicon technology: qualification of new sources
- Low costs development centers
- Product rationalization:
  - Value analysis
  - Design to cost

# Active promotion of smart card adoption in new markets

Thanks to a Technology Incubator

- **Wifi:**
  - seamless network authentication
- **TPM:**
  - Active participation to the Trusted Computing Group Initiative.
  - Promote complementarities of the smartcard with TPM
- **Handsets applets security:**
  - promote role of the card to secure handset Java applets
  - Protect content delivery (DRM)
- **S-MMC:**
  - Protect content delivery

# Leading product development process

Using Software Quality Management Method:

- Capability Maturity Model (CMM)
- At a time when:
  - more and more small actors propose tentative smartcard OS implementation
  - OS are getting more and more complex
- CMM methodology increasingly used to grant software quality level
  - More and more advanced customers are asking for CMM strategy information from their vendors
- Gemplus is leading the way towards CMM adoption in the smartcard arena
  - All software development teams in France and Singapore are CMM level 2 certified

# R&D highlights

- More than 630 R&D engineers in the world
- 4 Research & Development centers
  - Organization based on expertise centers:
    - Research & Security
    - Operating systems Platform
    - Product Development Center
  - With cost optimized structure
  - And proximity to customers combining R&D and Integration Services resources
    - Europe, Asia-Pacific, China, USA
- Significant patent portfolio:
  - more than 2400 patents filled
- An extra 300 technical consultants throughout the world for integration and customer support

# R&D supporting our development of sales

- Wireless:
  - 100% of 3G network supplied already in 2003
  - Strong product mix evolution
- ID/ Security:
  - Corporate Security market penetration: Boeing, Pfizer
  - ID: complex project “subsystems” leadership: OMAN and UAE

## Conclusion:

R&D strategy of differentiation is enabling Gemplus to strengthen its relation of partnership with our customers and to maintain our long lasting leadership

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# 2004 Outlook

- Further evidence of Gemplus strong assets to capture markets opportunities:
  - Leading position in the industry
  - Innovation R&D strength
  - Global footprint
  - Seamless manufacturing capacity
  - Strong balance sheet
- Considering second quarter results and given the current outlook for exchange rates, **the Company revises upward its operating income guidance in the range of € 30 m for 2004, before restructuring and goodwill**

# Appendix

# Cash Flow Statement

Millions of euros	Q3 2002	Q4 2002	Q1 2003	Q2 2003	Q3 2003	Q4 2003	Q1 2004	Q2 2004
Net income (loss)	-38,6	-96,8	-37,9	-82,4	-13,1	-27,8	0,3	1,1
Depreciation & Amortization	40,9	40,1	20,4	39,6	16,6	18,5	15,2	13,7
Other adjustments to reconcile net income (loss) to net cash from operating activities	0,7	2,0	-0,9	7,4	3,2	18,5	1,3	4,0
Reduction of workforce and other exit costs, provision	6,3	5,7	3,2	39,8	4,7	7,3	-0,4	0,0
Provision for other non-recurring items	0,0	42,0	0,0	0,0	0,0	8,6	0,0	0,0
Change in working capital requirement	-0,5	24,1	30,7	-7,3	-29,0	26,5	18,9	-7,8
<b>Net cash flow from operating activities excluding non-recurring items</b>	<b>8,8</b>	<b>17,1</b>	<b>15,4</b>	<b>-2,8</b>	<b>-17,5</b>	<b>51,7</b>	<b>35,2</b>	<b>11,0</b>
Purchase of property, plant and equipment	-9,7	-1,4	-2,7	-2,6	-4,1	-5,9	-4,0	-5,7
Other elements of investing activities related to the operating cycle	-0,1	-1,8	-1,2	-0,1	-0,6	1,4	-1,6	0,4
<b>Free cash flow excluding non-recurring items</b>	<b>-0,9</b>	<b>13,9</b>	<b>11,5</b>	<b>-5,5</b>	<b>-22,2</b>	<b>47,2</b>	<b>29,6</b>	<b>5,7</b>
Reduction of workforce and other exit costs, cash outflow	-7,3	-10,5	-16,2	-12,3	-17,2	-11,2	-12,8	-6,2
Other non-recurring expenses	0,0	0,0	0,0	0,0	0,0	0,0	-22,0	0,0
<b>Free cash flow</b>	<b>-8,2</b>	<b>3,4</b>	<b>-4,7</b>	<b>-17,9</b>	<b>-39,4</b>	<b>36,0</b>	<b>-5,1</b>	<b>-0,6</b>
Sale of property, plant and equipment	0,0	1,4	0,0	0,0	0,0	0,0	0,0	0,0
Acquisitions	-1,7	-0,8	-0,7	0,0	0,0	-0,1	-1,7	0,8
Net cash provided by (used in) financing activities	1,5	-0,3	0,2	-1,5	-2,0	-3,1	0,7	-1,7
Effect of exchange rate changes on cash	-2,6	12,8	4,4	9,2	-8,3	1,3	0,0	0,0
<b>Net cash flow</b>	<b>-11,0</b>	<b>16,5</b>	<b>-0,8</b>	<b>-10,2</b>	<b>-49,7</b>	<b>34,1</b>	<b>-6,1</b>	<b>-1,4</b>
Cash at the beginning of the period	411,8	400,8	417,2	416,5	406,2	356,6	390,7	384,6
<b>Cash at the end of the period</b>	<b>400,8</b>	<b>417,2</b>	<b>416,5</b>	<b>406,2</b>	<b>356,6</b>	<b>390,7</b>	<b>384,6</b>	<b>383,1</b>