

Axalto 2004 Full-year Results

Operating Margin of 9%

USD 1.47 Earnings Per Share



Amsterdam, March 3, 2005 – Following the 2004 revenue release of January 26, 2005, that reported full-year revenue of USD 960 million, an increase of 25% versus 2003 and a rise of 19% at constant exchange rates, Axalto (Euronext: NL0000400653 – AXL) today reports its full-year results for the 2004 financial year ended 31 December 2004:

- Operating income: USD 86.4 million, up 80%
- Net income: USD 59 million, up 136%
- Return on capital employed: 11.4%
- Free cash flow: USD 128 million
- Net cash: USD 185 million

Commenting on these results, Olivier Piou, Axalto Chief Executive Officer, said: *“These results clearly validate our business model, which combines software value-add with high volume sales, growth and profitability. They attest to our ability to draw on our unique positioning, based on a broad global presence with well-established local positions, a well-balanced product portfolio, and a culture of profitable innovation.*

Over the course of the year Axalto's employees, many of whom are shareholders in the company, took their fate in hand and demonstrated their outstanding commercial dynamism. Their unflinching attention to excellence in the day-to-day execution is now combined with exemplary control of cash flows.

The outlook for each of our key markets in 2005 is excellent, fuelled by ongoing growth in worldwide demand for digital services that are practical, personalised and secure. We are more determined than ever to build on our leading position, and to create even more value for our customers and our shareholders.”

Axalto (in USD million)	FY 2003	FY 2004	Variation
Revenue	767.7	960.4	+ 25%
Gross profit <i>Gross margin (%)</i>	238.2 <i>31.0 %</i>	315.4 <i>32.8 %</i>	+ 32%
Operating income <i>Operating margin (%)</i>	47.9 <i>6.2 %</i>	86.4 <i>9.0 %</i>	+ 80%
Net income <i>Net margin (%)</i>	25.0 <i>3.3%</i>	59.1 <i>6.2 %</i>	+136%
Average number of shares	Not applicable	40.3 million	
Earnings per share (basic)	-	USD 1.47	

Axalto achieved a record year in 2004. Annual revenue increased by 25% compared to 2003, to USD 960.4 million.

Within the Cards segment, which achieved revenue increase of 23%, all major product lines contributed to the growth, led by the strength of the Mobile Communication and Financial Services product lines and an excellent performance by the Public Sector and Other products line that includes in particular the patent licensing activity. The Point-of-Sales Terminals segment achieved the strongest growth: + 52%.

Furthermore, all regions contributed to the momentum.

The Europe Middle-East Africa area continued to make the largest contribution to revenue, at USD 536 million. It also achieved the strongest growth at current exchange rates, + 33%, and + 21% at constant exchange rates compared with 2003.

The Americas achieved full-year growth of 29%, the strongest increase at constant exchange rates. It now represents nearly one-fifth of Axalto's total revenue, at USD 187 million.

Asia moved up 8% to USD 237 million, representing one-quarter of Axalto's revenue for the year.

Axalto delivered a record number of microprocessor cards in 2004. It confirmed its position as:

- The world's leading supplier of microprocessor cards, with a volume growth of 37%;
- The world's leading supplier of SIM cards, with 257 million SIM cards sold to mobile phone operators in 2004, an increase of 38%;
- The world's leading supplier of microprocessor banking cards, with 72 million cards sold to financial institutions during the year.

Axalto also confirmed its leading position in the Public Sector, Access and Other product line, with a 68% increase in microprocessor cards shipments, major new commercial successes and a significant increase in revenue derived from patent licensing activities.

Gross profit rose 32% compared with 2003, and gross margin improved by nearly 2 points, to 32.8% of sales, compared with 31.0% last year.

This excellent performance was achieved through the sales volumes increase in microprocessor cards, improvement in the product mix in Mobile Communication in all regions, the rise in revenue from the patent licensing activity, the success of the diversified component sourcing strategy, significant productivity improvement and strong control of production fixed operating costs.

Operating expenses came in at USD 229 million, representing 23.8% of full-year revenue, compared with 24.8% in 2003, an increase of 20% at current exchange rates and 13% at constant exchange rates.

Demonstrating the Group's strict cost controls, sales and marketing expenses that supported the strong revenue growth represented 11.4% of full-year revenue compared with 12% in 2003. General and administrative expenses represented 5.7% of revenue in 2004, compared with 6.4% in 2003.

Investment in research and development increased to 6.7% of revenue in 2004, from 6.4% in 2003, in line with the Group's strategy of profitable innovation.

Full-year expenses included a charge of USD 3.5 million relating to the continuous operating performance improvement plan, an impairment charge of USD 2.8 million relating to certain technologies acquired from Bull in 2001, and a write-down charge of USD 2.8 million relating to a production plant.

Axalto's profitability improved considerably:

- Operating income was USD 86.4 million, up 80% compared with 2003, leading to an operating margin of 9%.
- Net income was USD 59.1 million, i.e. a net margin of 6.2%. With an average number of shares in circulation of 40.3 million, Axalto delivered basic earnings of USD 1.47 per share for the year.

The strong growth in net income, well controlled capital expenditure that remained lower than amortization despite the strong increase in volume shipments, and strong reduction in working capital requirements enabled Axalto to generate USD 128 million in free cash flow, after USD 68 million in 2003.

As a result, Axalto's net cash position on December 31, 2004 was USD 185 million. Available cash and short-term investments were USD 224 million at year-end.

Average net capital employed for the year was USD 517 million. On the basis of net income, return on capital employed (ROCE) was 11.4%. On the basis of operating income after applying the global effective tax rate for the Group, return on capital employed (NOPAT) was 11.7%

About Axalto

Axalto (Euronext : NL0000400653 - AXL) is the world's leading provider of microprocessor cards (Gartner 2004) – the key to digital networks – and a major supplier of point-of-sale terminals. Its 4,500 employees come from 70 nationalities and serve customers in more than 100 countries, with worldwide sales reaching 3 billion smart cards to date. The company has 25 years' experience in smart card innovation and leads its industry in security technology and open systems.

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Additional Information

Segment information

Cards segment

<i>USD millions</i>	2003	2004	Variation	Variation at constant exchange rates
Revenue				
Mobile Communication	444.0	548.8	24%	19%
Financial Cards	160.3	196.2	22%	13%
Public Sector, Access and Other	62.5	98.4	57%	49%
Prepaid Phone Cards	49.9	39.7	-20%	-24%
Total revenue for Cards segment	716.6	883.1	23%	18%
Gross profit				
Mobile Communication	160.8	214.4	33%	
Financial Cards	26.5	42.1	59%	
Public Sector, Access and Other	30.0	37.8	26%	
Prepaid Phone Cards	9.4	3.1	-67%	
Total gross profit for Cards segment*	226.8	297.3	31%	
<i>Gross margin (%)</i>	<i>31.6%</i>	<i>33.7%</i>		
Operating expenses for Cards segment**	171.8	212.7	24%	
Operating income for Cards segment	55.0	84.7	54%	
<i>Operating margin (%)</i>	<i>7.7%</i>	<i>9.6%</i>		

* Cost of sales includes the following expenses: an impairment charge of USD 2.8 million for certain technologies acquired from Bull in 2001, USD 0.7 million related to the continuous operating performance improvement plan and a write-down charge of USD 2.8 million for a production plant. These expenses have been recorded for the most part during the second half and are broken down as follows: USD 2.1 million in Mobile Communication, USD 3.7 in Financial Cards, USD 0.3 million in Public Sector, Access and Other, and USD 0.2 million in Prepaid Phone Cards.

** Operating expenses include the following expenses relating to the continuous operating performance improvement plan: USD 0.5 million in research and development, USD 1.8 million in sales and marketing, and USD 0.5 million in general and administrative expenses.

Revenue in the Cards segment grew 23% compared with 2003 and 17% at constant exchange rates, driven by stronger activity in all microprocessor card product lines and in all three regions.

Gross margin increased by more than 2 percentage points to 33.7% compared with 31.6% in 2003.

Operating margin was 9.6% in 2004.

Mobile Communication

<i>USD million</i>	2003	2004	Variation	Variation at constant exchange rates
Revenue	444.0	548.8	24%	19%
Gross profit	160.8	214.4	33%	
Gross margin (%)	36.2%	39.1%		

Revenue in the Mobile Communication product line grew by 24% to USD 548.8 million in 2004, and more than 19% at constant exchange rates. This product line represented 57% of Axalto's total revenue.

The strong growth was mainly driven by a sharp rise in SIM card sales volumes in all three regions, up 38% to 257 million units compared with 186 million in 2003, and a better product mix.

Compared with 2003, the average SIM card selling price fell by 10.5% and 13.5% at constant exchange rates. This represents a relative slowdown compared with the price downtrend observed each year for the last three years. This evolution stems mainly from an improvement in the product mix, due to higher sales of high-end cards. In 2004, high-end cards represented 27% of SIM card shipments, compared with 14% in 2003.

The sharp rise in volumes, combined with lower component prices and a greater proportion of high-end products in sales, explain the strong increase in gross profit, which rose by 33% compared with 2003.

Gross margin increased sharply, by close to 3 percentage points to 39% compared with 36% in 2003.

Financial Cards

<i>USD million</i>	2003	2004	Variation	Variation at constant exchange rates
Revenue	160.3	196.2	22%	13%
Gross profit	26.5	42.1	59%	
Gross margin (%)	16.6%	21.5%		

Revenue in the Financial Cards product line came in at USD 196 million, an increase of 22% compared with 2003 and 13% at constant exchange rates.

Microprocessor card sales rose by 25% in volume to 72 million units, compared with 57 million in 2003, due in particular to the rapid migration to the new EMV standard in the UK and the start of the same EMV migration in a number of European and Asian countries in the second half of the year.

Gross profit in the Financial Cards product line rose 59% in 2004.

Gross margin improved by close to 5 percentage points and came in at over 21% compared with 17% in 2003. This improvement was mainly due to higher sales volume and productivity gains.

Public Sector, Access and Other

<i>USD million</i>	2003	2004	Variation	Variation at constant exchange rates
Revenue	62.5	98.4	57%	49%
Gross profit	30.0	37.8	26%	
Gross margin (%)	48.1%	38.4%		

Revenue in this product line came in at USD 98 million, up 57% compared with 2003 and 49% at constant exchange rates.

This rapid growth was due to higher sales of microprocessor cards and a significant increase in revenue derived from patents licensing.

Gross profit rose by 26%.

Despite the significant increase in contribution from patent licences, gross margin decreased by nearly 10 points due to a less favourable sales mix of microprocessor cards. This product line covers a wide variety of applications, each with different margin profiles.

Prepaid Phone Cards (memory cards)

<i>USD million</i>	2003	2004	Variation	Variation at constant exchange rates
Revenue	49.9	39.7	- 20%	- 24%
Gross profit	9.4	3.1	- 67%	
Gross margin (%)	18.8%	7.7%		

Revenue in the Prepaid Phone cards product line came in at USD 40 million in 2004, down 20% compared with 2003 and 24% at constant exchange rates.

This fall in revenue, which has continued for several years, reflects Axalto's strategy in a globally declining market of focusing on high-value-added microprocessor cards and only supplying memory cards to customers regarded as strategic.

The proportion of revenue represented by this product line further decreased, now accounting for 4% of Axalto's total revenue in 2004, versus 6% in 2003.

Gross profit fell sharply due to the decline in shipments and average selling prices, supporting the Group's vision regarding this product line.

Point-of-Sale Terminals segment

<i>USD million</i>	2003	2004	Variation	Variation at constant exchange rates
Revenue	51.0	77.3	52%	41%
Gross profit	11.4	18.1	58%	
Gross margin (%)	22.4%	23.4%		

Revenue in the Point-of-Sale Terminals (POS) segment rose by 52% compared with 2003 and 41% at constant exchange rates to USD 77 million, as a result of acceleration in growth in the second half of the year, particularly in Europe, due the shift among financial institutions to the new EMV standard, for which Axalto products are particularly effective.

During the first quarter Axalto refocused its Point-of-Sale activities on areas where it can make the most of its competitive advantages: product differentiation based on security, mobility and adaptability features as well as a strong after-sales support organisation.

The Point-of-Sale segment now has a set of core customers that lead their markets and want to build long-term relationships with companies able to supply and properly support Point-of-Sale terminals. These are mainly major financial institutions and approved international resellers.

Gross profit rose sharply by 58% to USD 18 million in 2004, corresponding to a gross margin of 23%, an improvement of one point compared with 2003.

2004 revenue and gross profit by period and by segment

<i>USD million</i>		H1 2004	H2 2004	<i>Variation</i>
<i>Cards segment Revenue</i>				
Mobile Communication		239.8	309.0	29%
Financial Cards		97.4	98.8	1%
Public Sector, Access and Other		43.3	55.1	27%
Prepaid Phone Cards		21.4	18.3	-14%
Total Cards Revenue		401.9	481.2	20%
<i>Point-of-Sale Terminals segment Revenue</i>				
		28.4	48.9	72%
Axalto Total Revenue		430.3	530.1	23%
		H1 2004*	H2 2004	<i>Variation</i>
<i>Cards segment Gross Profit**</i>				
Mobile Communication		89.2	125.2	40%
	<i>Gross margin (%)</i>	37.2%	40.5%	
Financial Cards		24.0	18.1	-24%
	<i>Gross margin (%)</i>	24.6%	18.3%	
Public Sector, Access and Other		17.2	20.6	20%
	<i>Gross margin (%)</i>	39.6%	37.5%	
Prepaid Phone Cards		2.5	0.5	-79%
	<i>Gross margin (%)</i>	11.8%	2.9%	
Total Cards Gross Profit		132.9	164.4	24%
	<i>Gross margin (%)</i>	33.1%	34.2%	
<i>Point-of-Sale Terminals segment Gross Profit</i>				
		6.2	11.9	91%
	<i>Gross margin (%)</i>	21.9%	24.3%	
Axalto Total Gross Profit		139.1	176.3	27%
	<i>Gross margin (%)</i>	32.3%	33.3%	

* After reclassification of some central IT costs (for USD 3 million) previously charged to cost of sales and reclassified as operating expenses.

** Cost of sales includes the following expenses: an impairment charge of USD 2.8 million for certain technologies acquired from Bull in 2001, USD 0.7 million related to the continuous operating performance improvement plan and a write-down charge of USD 2.8 million for a production plant. These expenses have been recorded for the most part during the second half and are broken down as follows: USD 2.1 million in Mobile Communication, USD 3.7 in Financial Cards, USD 0.3 million in Public Sector, Access and Other, and USD 0.2 million in Prepaid Phone Cards.

Revenue by region

Region	Segment	2003	2004	Variation (%)	Variation at constant exchange rates (%)
Asia	Cards	211.8	227.9	8%	8%
	POS	7.8	9.4	21%	21%
	Total	219.6	237.3	8%	8%
Europe, Middle-East, Africa	Cards	364.3	472.2	30%	18%
	POS	38.4	63.7	66%	51%
	Total	402.7	535.9	33%	21%
Americas	Cards	140.6	183.0	30%	30%
	POS	4.8	4.2	-12%	-12%
	Total	145.3	187.2	29%	29%
Total Cards		716.6	883.1	23%	18%
Total POS		51.0	77.3	52%	41%
Axalto total revenue		767.7	960.4	25%	19%

Growth was strongest in Europe Middle-East Africa in absolute terms.

The Americas benefited from strong demand for SIM cards resulting from the adoption of GSM standards by existing mobile networks and a simultaneous increase in subscribers to these networks.

Growth in Asia remained solid. It was particularly robust outside of China.

Consolidated balance sheet highlights at 31 December 2004

<i>USD million</i>	From audited combined balance sheet as at 31 December 2003	From consolidated balance sheet as at 31 December 2004	Variation (%)
Equity	541,2	705,0	30%
Cash and short-term investments	50,2	223,8	x 4.5
Net cash*	26.3*	185,0	x 7.0

*Net cash: available cash and short-term investments minus bank overdrafts and short-term, medium-term and long-term debt, including property leasing agreements.

The increase in Equity results from the net income of the year, the contribution of Schlumberger before the IPO, and the currency translation adjustment.

The USD 128 million free cash flow generated by Axalto in 2004 stems from:

- strong cash generation by operations, USD 167 million, produced by:
 - USD 59 million of net profit;
 - USD 52 million of depreciation charges and other adjustments to net income;
 - USD 56 million decrease in working capital requirements and other variations in assets & liabilities,
- partly offset by USD 39 million capital expenditure over the period, i.e. 4% of revenue, related mainly to production and personalization capacity increases in the Cards segment.

Axalto

**Combined financial statements as at December 31, 2002 and 2003
and consolidated financial statements
as at December 31, 2004**

Combined balance sheets ended December 31, 2002 and 2003 and consolidated balance sheet ended December 31, 2004

	Year ended December 31,		
	2002	2003	2004
	<i>(In thousands of US \$)</i>		
Assets			
Current assets			
Short-term investments and cash	\$ 28,069	\$ 50,154	\$ 223,820
Receivables, less allowance for doubtful accounts of \$20,409, \$19,436 and \$17,996	204,743	190,466	202,160
Receivables from related parties (Note 18)	4,913	12,666	1,895
Inventories, net (Note 9)	104,080	103,827	122,492
Deferred taxes on income (Note 13)	5,774	6,835	11,288
Other current assets (Note 10)	33,495	34,894	54,565
Total current assets	<u>381,074</u>	<u>398,842</u>	<u>616,220</u>
Property, plant and equipment, net (Note 7)	104,939	105,410	108,899
Deferred taxes on income (Note 13)	11,462	14,515	42,740
Goodwill (Note 8)	245,044	287,621	311,310
Intangible assets (Note 8)	29,401	31,016	24,964
Other long term assets	5,888	8,978	9,705
Total assets	<u>\$ 777,808</u>	<u>\$ 846,382</u>	<u>\$ 1,113,838</u>
Liabilities and Stockholders' equity / net investment			
Current liabilities			
Bank overdrafts and short- term loans	\$ 23,020	\$ 21,615	\$ 8,592
Accounts payable	76,631	94,812	126,644
Payables to related parties (Note 18)	24,903	10,263	146
Employee, other payables and accrued liabilities (Note 11)	110,102	130,186	187,866
Liability for taxes on income	8,243	11,036	20,548
Deferred tax liabilities (Note 13)	40	45	120
Total current liabilities	<u>242,939</u>	<u>267,957</u>	<u>343,916</u>
Long-term debt (Note 12)	2,300	2,287	30,249
Pensions and other employment benefits (Note 14)	8,763	11,175	15,013
Deferred tax liabilities (Note 13)	4,499	5,047	6,307
Other long-term liabilities	15,674	8,827	6,267
Total liabilities	<u>274,175</u>	<u>295,293</u>	<u>401,752</u>
Commitments and contingencies (Note 20)			
Minority interest in subsidiaries	14,854	9,876	7,059
Stockholders' equity / net investment			
Total Invested Equity	488,779	541,213	
<i>Common stock at Euro 1 par value, 150 million shares authorized, 40,490,668 shares outstanding</i>			50,604
<i>Additional paid-in capital</i>			550,312
<i>Schlumberger's net investment</i>			
<i>Retained income</i>			59,099
<i>Accumulated other comprehensive income/(loss)</i>			45,012
Total stockholders' equity / net investment	<u>488,779</u>	<u>541,213</u>	<u>705,027</u>
Total Liabilities and stockholders' equity / net investment	<u>\$ 777,808</u>	<u>\$ 846,382</u>	<u>\$ 1,113,838</u>

Combined statement of operations ended December 31, 2002 and 2003 and consolidated statement of operations ended December 31, 2004

	Year ended December 31,		
	2002	2003	2004
	<i>(In thousands of US \$)</i>		
Revenue	\$ 730,211	\$ 767,662	\$ 960,427
Cost of revenue	<u>629,350</u>	<u>529,447</u>	<u>645,027</u>
Gross profit	<u>100,861</u>	<u>238,215</u>	<u>315,400</u>
Operating expenses			
Research and engineering	53,575	49,034	63,962
Sales and marketing	84,874	91,935	109,842
General and administrative	<u>53,937</u>	<u>49,355</u>	<u>55,216</u>
Total operating expenses	<u>192,386</u>	<u>190,324</u>	<u>229,020</u>
Operating income	<u>(91,525)</u>	<u>47,891</u>	<u>86,380</u>
Foreign currency transaction loss, net	(10,669)	(9,939)	(5,715)
Interest income (expense), net	(7,515)	(5,309)	291
Other income, net	<u>1,344</u>	<u>1,672</u>	<u>4,297</u>
Income (loss) before taxes and minority interest	<u>(108,365)</u>	<u>34,315</u>	<u>85,253</u>
Tax expense (Note 13)	<u>(1,383)</u>	<u>(6,910)</u>	<u>(25,466)</u>
Income (loss) before minority interest	<u>(109,748)</u>	<u>27,405</u>	<u>59,787</u>
Minority interest	<u>(2,830)</u>	<u>(2,396)</u>	<u>(688)</u>
Net income (loss)	<u>\$ (112,578)</u>	<u>\$ 25,009</u>	<u>\$ 59,099</u>
Basic earnings per share (in US dollars)			1.47
Diluted earnings per share (in US dollars)			1.45
Average number of shares outstanding			40,295
Average number of shares outstanding assuming dilution			40,697

Combined statements of cash flows ended December 31, 2002 and 2003 and consolidated
statements of cash flows ended December 31, 2004

	Year ended December 31,		
	2002	2003	2004
	<i>(In thousands of US \$)</i>		
Cash flows from operating activities			
Net income (loss)	\$ (112,578)	\$ 25,009	59,099
Adjustments to reconcile net income (loss) to Net Cash provided by operating activities:			
Depreciation Intangible assets Bull-CP8 (Note 8)	93,160	-	2,758
Amortization	53,312	37,321	42,156
Deferred taxes	961	(1,011)	2,303
Non cash loss on disposal of fixed assets and write-offs	1,096	1,866	3,988
Share of losses of equity investees, net of dividends received	752	245	806
Changes in assets and liabilities:			
Accounts receivables, net	10,526	32,509	(1,838)
Receivables from related parties	6,206	(7,065)	17,054
Inventories, net	29,362	12,077	(10,750)
Accounts payable	(18,217)	5,335	22,215
Payables to related parties	(6,013)	(15,348)	(12,321)
Employee, other payables and accrued liabilities	(5,758)	7,006	43,305
Pensions	(498)	(338)	2,814
Estimated liability for taxes on income	(7,577)	2,887	9,055
Other assets and liabilities, net (1)	11,746	(16,573)	(13,563)
Net cash provided by operating activities	<u>56,480</u>	<u>83,920</u>	<u>167,081</u>
Cash flows from investing activities			
Capital expenditures (fixed assets)	(16,661)	(18,802)	(36,783)
Capital expenditures (intangible assets)	(2,973)	(1,145)	(2,547)
Proceeds from sale of fixed assets	1,336	3,909	407
Net cash used in investing activities	<u>(18,298)</u>	<u>(16,038)</u>	<u>(38,923)</u>
Cash flows from (used in) financing activities			
Net equity / Invested equity	128,436	(40,649)	30,699
Bank overdrafts and short term loans	(188,734)	(3,367)	(15,380)
Long term debt (1)	(1,684)	(2,558)	26,340
Net cash provided by (used in) financing activities	<u>(61,982)</u>	<u>(46,574)</u>	<u>41,659</u>
Net increase (decrease) in cash and short-term investments	(23,799)	21,308	169,817
Translation effect on cash and short-term investments	485	777	3,849
Cash and short-term investments, beginning of period	<u>51,384</u>	<u>28,069</u>	<u>50,154</u>
Cash and short-term investments, end of period	<u>\$ 28,069</u>	<u>\$ 50,154</u>	<u>223,820</u>

(1) In the Offering Circular published before the IPO and on which is the AMF visa dated May 17, 2004, the long term debt account included for \$11,978 and \$14,698, in 2002 and 2003 respectively, a financing arrangement consisting of a sale by Axalto, on a recourse basis, to a French financial institution of certain of our POS terminal operating lease contracts. As this debt was considered as a non financial debt for the determination of the \$45 million net cash position on IPO date in the pro-forma accounts, it was decided to reclassify these debts from "Long-term debt" to "Other long-term liabilities" which therefore aggregates in "Other assets and liabilities, net" in the Statement of Cash flow instead of "Long-term debt".

COMBINED AND CONSOLIDATED STATEMENTS OF STOCKHOLDER'S EQUITY / NET INVESTMENT

All amounts are in thousands of US dollars unless otherwise stated.

In thousands of US\$	Common stock		Additional paid-in capital	Shareholder's net investment			Net income	Other comprehensive income (loss)	Total
	Shares	Amount		Shareholder's invested equity	Accumulated Other Comprehensive Income	Shareholder's net investment			
<u>COMBINED ACCOUNTS</u>									
Invested equity as at December 31, 2002				433 704	55 075	488 779			488 779
Net income (loss)				25 009		25 009			25 009
Invested equity				(46 693)		(46 693)			(46 693)
<u>Other comprehensive income</u>									
Market value adjustments for cash flow hedges					2 491	2 491			2 491
Foreign currency translation adjustment					70 631	70 631			70 631
Alternative minimum pension liability					975	975			975
Unrealized gain (loss) on marketable securities					21	21			21
Invested equity as at December 31, 2003				412 020	129 193	541 213			541 213
<u>CONSOLIDATED ACCOUNTS</u>									
Stockholder's equity as at December 31, 2003	18,000	23	1 610						1 633
Contribution (Distribution) from Schlumberger				51 191		51 191			51 191
Recapitalisation and issuance of common stock, net capital contribution by Schlumberger Ltd	40,027,000	50 034	542 370	(463 211)	(129 193)	(592 404)			0
Capital increase reserved to employees	445,668	547	6 332						6 879
Net income							59 099		59 099
<u>Other comprehensive income</u>									
Market value adjustments for cash flow hedges								5 998	5 998
Foreign currency translation adjustment								40 490	40 490
Alternative minimum pension liability									
Unrealized gain (loss) on marketable securities								(1 476)	(1 476)
Stockholder's equity as at December 31, 2004	40,490,668	50 604	550 312	0	0	0	59 099	45 012	705 027

Note 1 Background and basis of Presentation

Background

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 NV through the Initial Public Offering, and divested its remaining 12.5% stake on September 17, 2004.

Basis of Presentation

The combined financial statements of Axalto for 2002 and 2003 were derived from the consolidated financial statements of Schlumberger Limited. The combined financial statements include the historical assets, liabilities, revenues and expenses that were directly related to the Axalto business within Schlumberger during the period presented.

The accompanying audited consolidated financial statements of Axalto and its subsidiaries as at December 31, 2004, have been prepared in accordance with generally accepted accounting principles for financial information in the United States of America. All intercompany transactions and balances have been eliminated in consolidation.

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 was 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 (losses) 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 NV were issued and subscribed by Schlumberger prior to the first listing with Euronext Paris on May 18, 2004.

Reclassification

Certain items from prior years have been reclassified to conform to the current year presentation.

Note 2 Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements of Axalto have been prepared in accordance with accounting principles generally accepted in the United States of America. All majority owned subsidiaries of Axalto have been consolidated in the consolidated financial statements. Investments representing 20-50% of the equity of the investee are accounted for under the equity method and are reflected within Other long-term assets in the balance sheet. Axalto’s pro-rata share of after-tax earnings of these equity method investees is included in Other income, net. Investments representing less than 20% of the equity of the investee are carried at cost less any decrease in value deemed to be other than temporary in nature. All intercompany accounts and transactions within Axalto are eliminated.

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 litigation 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.

Revenue Recognition

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.

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.

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 collectible. Axalto defers revenue but recognizes related costs when it determines that the collection of receivables is unlikely.

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.

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.

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. The resulting adjustments are charged or credited directly to the equity section of the combined or consolidated balance sheet.

Revenue and expenses are translated at the weighted-average exchange rates for the period.

Realized and unrealized transaction 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 years ended December 31, 2002 and 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 businesses. Foreign currency transaction gains (losses) included in the results of operations were \$(10.7) million and \$(9.9) million in 2002 and 2003 respectively.

For the year ended December 31, 2004, Axalto entered directly 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 statement of operations 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.

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 capitalization in accordance with SFAS 86.

Axalto capitalizes 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.

Amortization of capitalized 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 capitalized software development costs determined to be in excess of the net realizable value of the product are expensed immediately. The costs qualifying for capitalization were insignificant during the year ended December 31, 2002, because the period between achievement of technological feasibility and the general release of Axalto's products was of relatively short duration. In 2003, capitalized software development costs amounted to \$2.6 million, of which \$0.4 million were amortized at December 31, 2003. In 2004, additional capitalized software development costs were incurred for \$1.6 million, bringing the total balance at year end to \$4.2 million of which \$1.4 million were amortized at December 31, 2004.

Inventories

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

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:

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 expensed as incurred. Expenditures that substantially increase an asset's useful life are capitalized.

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.

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 years ended on December 31, 2002 and 2003. In addition, we determined our tax assets and liabilities for the years ended on December 31, 2002 and 2003 taking into consideration whether any of our subsidiaries and joint ventures belonged to a Schlumberger tax group in any relevant jurisdiction in each such year. To the extent that any of our tax assets and liabilities were held by companies that belonged to a Schlumberger tax group in any of these years, such tax assets and liabilities were transferred at the end of the relevant 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.

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, 2002, 2003 and 2004 because of their short maturities.

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 three 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 with major banks.

Goodwill

Effective January 1, 2002, Axalto adopted SFAS No. 142 (*Goodwill and Other Intangible Assets*). Under SFAS No. 142, goodwill and intangible assets with indefinite useful lives are no longer amortized, but are subject to impairment tests, initially upon adoption of SFAS No. 142 and subsequently on at least an annual basis. All other intangible assets (i.e. those with a definite useful life) must be amortized over their estimated useful lives, and are subject to tests if an impairment event occurs which indicates the asset may be impaired.

The main effects of adopting SFAS No. 142 on Axalto's financial statements for the year ended December 31, 2002 are:

- Assembled workforce, previously identified and amortized by Axalto as intangible asset, has been reclassified as goodwill as of January 1, 2002;
- Goodwill, previously amortized, is no longer amortized as from January 1, 2002.

As required by SFAS No. 142, Axalto undertook an initial review of goodwill impairment in the first quarter of 2002 and completed annual assessments in the fourth quarter of each of 2002, 2003 and 2004 where no impairment charge was recognized.

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.

Changes in Axalto's warranty liability provision, which is included as a component of "Employee, other payables and accrued liabilities" on the combined balance sheet, for the periods under review are as follows:

	Year ended December 31,		
	2002	2003	2004
Beginning balance	3,941	3,335	3,840
Changes during the period (net)	(606)	505	1,141
Ending balance	<u>3,335</u>	<u>3,840</u>	<u>4,981</u>

Currency Risk Management Contracts

Prior to June 30, 2003, the impact of foreign currency fluctuations on the company's forecasted cash flows was not hedged by Axalto or Schlumberger Limited. Since June 30, 2003, Axalto began to hedge a portion of the impact on forecasted cash flows of foreign currency movements through forward and option 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 forecasted transactions. When the forecasted transactions being hedged are no longer expected to occur, Axalto recognizes the gain or loss on the designated hedging financial instruments in the combined statement of operations.

Forward and option contracts are recorded in the balance sheet at their fair market value as "Other current assets". Unrealized gains and losses on hedging contracts are recorded in the Stockholders' Equity under Accumulated Other Comprehensive Income. Realized gains and losses from hedging instruments are recognized in the combined and consolidated statement of operations consistently with the underlying transactions being hedged (see Note 16).

Recent Accounting Pronouncements

In January 2003, the Emerging Issues Task Force (EITF) issued No.00-21 (*Accounting for Revenue Arrangements with Multiple Deliverables*). This EITF establishes the criteria for recognizing revenue in arrangements when several items are bundled into one agreement. EITF 00-21 does not allow revenue recognition unless the fair value of the undelivered element(s) is available and the element has stand-alone value to the customer. EITF 00-21 also provides guidance on allocating the total contract revenue to the individual elements based upon the standard fair value of each deliverable. This pronouncement did not have a material impact on Axalto's financial position, results of operations or cash flows.

In January 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No.46, (*Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51*). The primary objective of the interpretation is to provide guidance on the identification of financial reporting for entities over which control is achieved through means other than voting rights; such entities are known as variable-interest entities (VIE's). FIN 46 provides guidance that determines (1) whether consolidation is required under the "controlling financial interest" model of Accounting Research Bulletin No. 51 (ARB 51), *Consolidated Financial Statements*, or other existing authoritative guidance, or, alternative, (2) whether the variable-interest model under FIN 46 should be used to account for existing and new entities. This pronouncement did not have a material impact on Axalto's financial position, results of operations or cash flows.

In April 2003, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 149, (*Amendment of Statement 133 on Derivative Instruments and Hedging Activities*.) SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133. The new guidance amends SFAS No. 133 for decisions made as part of the Derivatives Implementation Group ("DIG") process that effectively required amendments to SFAS No. 133, and decisions made in connection with other FASB

projects dealing with financial instruments and in connection with implementation issues raised in relation to the application of the definition of a derivative and characteristics of a derivative that contains financing components. In addition, it clarifies when a derivative contains a financing component that warrants special reporting in the statement of cash flows. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. This pronouncement did not have a material impact on Axalto's financial position, results of operations or cash flows.

In May 2003, the FASB issued SFAS No. 150, (*Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*). SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. The adoption of SFAS No. 150 in the third quarter of 2003 did not have a material impact on Axalto's results of operation or financial position.

On November 24, 2004, the FASB issued SFAS No. 151, *Inventory Costs, an amendment of ARB No. 43, Chapter 4* (FAS 151). The standard adopts the IASB view related to inventories that abnormal amounts of idle capacity and spoilage costs should be excluded from the cost of inventory and expensed when incurred. Additionally, the Board made the decision to clarify the meaning of the term 'normal capacity'. The provisions of FAS 151 are applicable to inventory costs incurred during fiscal years beginning after June 15, 2005. This pronouncement will not have a material impact on Axalto's financial position, results of operations or cash flows.

Note 3 Consolidated entities

The consolidated financial statements as at December 31, 2004, include the accounts of Axalto Holding NV and of the following entities :

Country of incorporation	Company name	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%
China	Shanghai Solaic Smart Card Co Ltd	Indirect	31%
Spain	Axalto SP S.A.	Indirect	100%
United States	Axalto Inc	Direct	100%
United States	Axalto CP8 Inc	Indirect	100%
France	CP8 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%
France	Trusted Logic S.A.	Indirect	38%
France	Xiring S.A.	Indirect	22,7%
United Kingdom	Axalto Terminals Ltd	Indirect	100%
United Kingdom	Axalto UK Ltd	Direct	100%
United Kingdom	Axalto Cards Ltd	Indirect	100%
Hong Kong	CP8 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	Boolanakarn Holdings (Thailand) Ltd	Indirect	100%
Thailand	Axalto Industries (Thailand) Ltd	Indirect	100%
Turkey	Axalto Cards & Terminals Ltd Sirketi	Direct	100%

Note 4 Earnings per share

	Year ended December 31, 2004		
	Net income	Average shares outstanding	Earning per share
Basic	59 099	40 295	1.47
Dilutive effect of options		402	
Diluted	59 099	40 697	1.45

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.

In the combined accounts for the years ended on December 31, 2002 and 2003, no direct ownership relationship existed among all the various units comprising Axalto prior to the reorganization which occurred shortly before its listing with Euronext Paris. Therefore, no historical earnings per share are presented.

Note 5 Restructuring and Impairment Charges

Restructuring Charges

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

In 2002, Axalto recorded a pre-tax net charge of \$11,187, of which \$5,540 was recorded in cost of revenue, \$2,449 in research and engineering expenses, \$2,059 in sales and marketing expenses and \$1,139 in general and administrative expenses. The provision included severance costs for 350 employees, and reflected the rationalization of Axalto's activities. As of December 31, 2002, Axalto had a remaining provision for restructuring charges of \$4,025, relating to expected severance payments.

In 2003, \$1,135 of the remaining provision for restructuring charges recorded at December 31, 2002 was utilized. The remaining \$2,890 was credited to the corresponding expense line in the combined statement of operations. 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 \$1,017 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 provision accrued as at December 31, 2003. 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 2002, following the annual impairment test and 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 \$93,160 (\$81,275 on the CP8 patent portfolio and \$11,885 on the CP8 core and existing technologies) of which \$82,160 relates to the public sector, access and other, \$9,500 to the mobile communication product line and \$1,500 to the financial cards product line. The impairment mainly reflected lower projections for future cash flows generated by licensing fees and products based on these technologies due to the difficulties experienced by the telecommunication and technology industries.

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 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.

Note 6 Investment in Affiliated Companies

Axalto, Shanghai Post & Telecommunication Development Co. and Shanghai Feilo Co. Ltd operate a joint venture in which Axalto owns a 31% interest. Axalto records income from this joint venture using the equity method of accounting. The value of the investment is included in Other Long Term Assets in the combined balance sheets. Axalto's investment as of December 31, 2002, 2003 and 2004 was \$2.4 million, \$2 million and \$1.8 million respectively. Axalto's equity income from this joint venture was \$1,071 in 2002, \$51 in 2003 and \$76 in 2004.

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.

Note 7 Property, Plant and Equipment, net

Property, plant and equipment (net) consist of the following:

	Year ended December 31,		
	2002	2003	2004
Land	571	2,483	1,937
Buildings and improvements	48,865	69,746	76,942
Machinery and equipment	204,014	206,354	247,202
Total cost	253,450	278,583	326,081
Less: Accumulated depreciation	148,511	173,173	217,182
Fixed assets	104,939	105,410	108,899

Depreciation expense amounted to \$34,300 in 2002, \$31,915 in 2003 and \$35,310 in 2004. Capital expenditures amounted to \$16,661 for year ended December 31, 2002, \$18,802 for year ended December 31, 2003 and to \$36,783 for the year ended December 31, 2004.

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 \$8.7 million for year ended December 31, 2002, \$10.2 million for year ended December 31, 2003 and to \$4.4 million (after the \$2.9 million write-down) for the year ended December 31, 2004. 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.

Note 8 Goodwill and Other Intangible Assets

Goodwill recorded in the combined financial statements represents 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 carrying value of Goodwill and intangible assets for each of the years ended December 31, 2002, 2003 and 2004 amounted to:

	Year ended December 31,		
	2002	2003	2004
Gross book value	424,928	506,607	550,904
Less: Accumulated amortization and impairment charges	(150,483)	(187,970)	(214,630)
	274,445	318,637	336,274

The changes in carrying amount of goodwill in 2002 are as follows:

Balance at beginning of year	196,532
Bull CP8 Goodwill adjustment (a)	13,700
Reclassification of Assembled Workforce net of deferred taxes (b)	2,237
Foreign Currency Translation adjustment	32,575
Balance at end of year (c)	<u>245,044</u>

(a) Write-off of deferred taxes and increase in the purchase accounting reserve

(b) Following adoption of SFAS 142 on January 1, 2002

(c) Including \$181.6 million in goodwill relating to Bull CP8

The changes in the carrying amount of goodwill in 2003 were as follows:

Balance at beginning of year	245,044
Foreign Currency Translation adjustment	42,577
Balance at end of year	<u>287,621</u>

The changes in the carrying amount of goodwill in 2004 were as follows:

Balance at beginning of year	287,621
Foreign Currency Translation adjustment	23,689
Balance at end of year	<u>311,310</u>

Intangible assets principally comprise patents, software and technology. The following table shows the gross book value, accumulated amortization and amortization periods of intangible assets for each of the years ended December 31, 2002, 2003 and 2004:

	2002				
	Gross Book Value	Accumulated Amortization	Impairment charge	Net book value	Amortization Periods
Software	6,230	5,197	-	1,033	3 - 5 years
Technology	27,410	9,872	11,885	5,653	5 - 10 years
Patents	129,931	26,413	81,275	22,243	5 - 10 years
Other	1,695	1,223	-	472	1 - 15 years
	<u>165,266</u>	<u>42,705</u>	<u>93,160</u>	<u>29,401</u>	
	2003				
	Gross Book Value	Accumulated Amortization	Impairment charge	Net book value	Amortization Periods
Software	6,602	5,099	-	1,503	3 - 5 years
Technology	33,068	27,899	-	5,169	5 - 10 years
Patents	158,905	136,870	-	22,035	5 - 10 years
Other	3,432	1,123	-	2,309	1 - 15 years
	<u>202,007</u>	<u>170,991</u>	<u>-</u>	<u>31,016</u>	

	2004				Amortization Periods
	Gross Book Value	Accumulated Amortization	Impairment charge	Net book value	
Software	8,993	7,450	-	1,543	3 - 5 years
Technology	37,704	34,221	2,758	725	5 - 10 years
Patents	172,959	152,186	-	20,773	5 - 10 years
Other	2,968	1,045	-	1,923	1 - 15 years
	<u>222,624</u>	<u>194,902</u>	<u>2,758</u>	<u>24,964</u>	

The amortization of the other intangibles included in Axalto's results amounted to \$19.0 million in 2002, \$5.4 million in 2003 and \$6.8 million in 2004.

Based on the December 31, 2004 gross book value, amortization charges related to other intangibles for the next five years are expected to be \$4.9 million in 2005, \$3.9 million in 2006, \$3.4 million in 2007, \$3.3 million in 2008 and \$3.3 million in 2009.

Note 9 Inventory

Inventory consists of the following:

	Year ended December 31,		
	2002	2003	2004
Raw materials and spares	63,254	60,576	71,796
Work in progress	15,750	20,264	22,825
Finished goods	25,076	22,987	27,871
	<u>104,080</u>	<u>103,827</u>	<u>122,492</u>

The provision for obsolete and excess inventory aggregated \$12,261 as at December 31, 2002, \$17,324 as at December 31, 2003 and \$18,661 as at December 31, 2004.

Note 10 Other current assets

Other current assets consist of the following:

	Year ended December 31,		
	2002	2003	2004
Prepaid expenses	3,924	2,743	5,496
VAT recoverable & tax receivable	4,758	8,490	13,260
Advances to suppliers and related	4,106	3,861	5,886
Unbilled customers	12,430	5,301	10,739
Fair market value of currency risk hedging contracts	-	2,456	7,105
Other	8,277	12,043	12,079
	<u>33,495</u>	<u>34,894</u>	<u>54,565</u>

The increase between 2003 and 2004 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.

Note 11 Employee, other payables and accrued liabilities

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

	Year ended December 31,		
	2002	2003	2004
Payroll, vacation and employee benefits	45,249	51,502	70,405
Accrued expenses	36,072	36,644	50,700
Accrued VAT	11,210	6,836	11,112
Trade, warranty and accrued project losses	8,822	16,326	14,210
Deferred revenue	3,884	16,419	33,812
Other	4,865	2,459	7,627
	<u>110,102</u>	<u>130,186</u>	<u>187,866</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, in compliance with the provisions of the EITF 00-21 relative to the *Accounting for Revenue Arrangements with Multiple Deliverables*; higher deferred revenue in the Cards segment accounts for the balance of the increase.

Note 12 Long-Term Debt

For the year ended December 31, 2004, long-term debt includes:

- a finance lease for a production facility, amounting to \$1.4 million,
- a drawing of \$28.8 million on a syndicated bank facility of \$150 million, negotiated during 2004 with major commercial banks.

Note 13 Taxes on Income

Pretax income/(loss) subject to Netherlands and foreign income taxes for each of the three years ended December 31, 2002, 2003 and 2004 are as follows:

	Year ended December 31,		
	2002	2003	2004
Netherlands	-	-	(2,383)
Foreign	<u>(108,365)</u>	<u>34,315</u>	<u>87,636</u>
Total	<u>(108,365)</u>	<u>34,315</u>	<u>85,253</u>

The provision for income taxes for the years ended December 31, 2002, 2003, and 2004 consisted of the following benefit/(expense):

	Year ended December 31,		
	2002	2003	2004
Current tax:			
Netherlands	-	-	(76)
Foreign	<u>(4,676)</u>	<u>(8,787)</u>	<u>(19,362)</u>
	<u>(4,676)</u>	<u>(8,787)</u>	<u>(19,438)</u>
Deferred tax:			
Netherlands	-	-	-
Foreign	<u>3,293</u>	<u>1,877</u>	<u>(6,028)</u>
	<u>3,293</u>	<u>1,877</u>	<u>(6,028)</u>
Total income tax benefit/(expense)	<u>(1,383)</u>	<u>(6,910)</u>	<u>(25,466)</u>

At December 31, 2002, 2003 and 2004, net deferred tax assets were \$12,697, \$16,258 and \$47,601, respectively. The principal components of net deferred tax assets are as follows:

	Year ended December 31,		
	2002	2003	2004
Deferred Tax Assets			
Net Operating Losses	10,637	14,034	36,348
CP8 Technologies Patents Write Down	29,320	30,842	29,335
Employee and retiree benefits	2,217	2,577	6,004
Warranty, reserves and accruals	2,625	2,961	3,312
Depreciation and Amortization	2,852	4,651	2,450
Inventory reserve	878	1,396	541
Other	90	2,022	6,228
	<u>48,619</u>	<u>58,483</u>	<u>84,218</u>
Less: Valuation Allowance	<u>(31,383)</u>	<u>(37,133)</u>	<u>(30,190)</u>
Total Deferred Tax Assets	<u>17,236</u>	<u>21,350</u>	<u>54,028</u>
Deferred Tax Liabilities			
Depreciation and Amortization	(4,499)	(5,047)	(6,368)
Other	(40)	(45)	(59)
Total Deferred Tax Liabilities	<u>(4,539)</u>	<u>(5,092)</u>	<u>(6,427)</u>
Net Deferred Tax Assets	<u>12,697</u>	<u>16,258</u>	<u>47,601</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.

Reconciliation between the Netherlands income tax rate and the effective tax rate is:

	Year ended December 31,					
	2002		2003		2004	
	\$	%	\$	%	\$	%
Netherlands income tax	37,386	34.5	(11,839)	34.5	(29,412)	34.5
Impact of foreign operations & permanent differences	(7,386)	(6.81)	4,281	(12.48)	(4,557)	5.34
Changes in valuation allowance	<u>(31,383)</u>	<u>(28.96)</u>	<u>648</u>	<u>(1.89)</u>	<u>8,503</u>	<u>(9.97)</u>
	<u>(1,383)</u>	<u>(1.27)</u>	<u>(6,910)</u>	<u>20.13</u>	<u>(25,466)</u>	<u>29.87</u>

Note 14 Pension and Other Benefit Plans

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 2002, 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 sheets for the years ended December 31, 2002 and 2003. The combined statements of operations for 2002 and 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 \$1,250, \$1,429 and \$477 for the years ended December 31, 2002, 2003, and 2004 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, 2002 and 2003, as separate company information was not readily available, the combined balance sheets 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 \$111, \$163 and \$130 for the years ended December 31, 2002, 2003 and 2004 respectively.

In Germany, the Company recorded a pension expense of \$27 for the year ended December 31, 2002. In 2003, this pension expense was not significant. 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 \$1,315, \$1,320 and \$2,238 for the years ended December 31, 2002, 2003 and 2004 respectively.
- The Projected Benefit Obligation (PBO) computed by third party actuaries amounts to \$13,506 for the years ended December 31, 2003 and \$16,085 for the years ended December 31, 2004. 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 \$8.8 million, \$10.8 million and \$14.6 million for the years ended December 31, 2002, 2003 and 2004 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.

Note 15 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 NV. The Board of Axalto Holding NV, 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, 2002 and 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 no 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.

Until 2002, officers and key employees of Axalto were granted stock options under Schlumberger stock option plans. For all of the stock options granted, the exercise price of each option equals the market

price of Schlumberger stock on the date of grant; an option's maximum term is ten years, and options generally vest in 20% increments over five years. There were no grants to Axalto employees in 2003.

As required by SFAS No. 123, the fair value of each grant is estimated on the date of grant using the multiple option Black-Scholes option-pricing model. For 2002, the following weighted-average assumptions were used for the Schlumberger stock option grant: dividend of \$0.75; expected volatility of 36 %; risk-free interest rates of 4.73% and expected option lives of 5.07 years.

For 2004, the following assumptions were used for the Axalto stock option grant: no dividend, expected volatility of 25%, risk-free interest 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 2002 and 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 51,513 and 47,739 shares to Axalto employees in 2002 and 2003, respectively. 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 2002 and 2003: dividend of \$0.75; expected life of one year; expected volatility of 34% for 2002 and 28% for 2003; and risk-free interest rates of 1.74% for 2002 and 0.75% for 2003. The weighted-average fair value of those purchase rights granted in 2002 and 2003, was \$13.324 and \$7.910, respectively.

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 2002, 2003 and 2004. The table below reflects adjusted net income, had Axalto elected to adopt the fair value approach of Statement of Financial Accounting Standards No. 123, *Accounting for Stock Based Compensation*:

	Year ended December 31,		
	2002	2003	2004
Net income (loss)			
As reported	(112,578)	25,009	59,099
Adjusted	(117,968)	21,249	55,189

Note 16 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 flow 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 forecasted, 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 forecasted 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 recognized, offsetting changes in the value of the foreign currency costs.

At December 31, 2004, Axalto had pre-tax deferred realized and unrealized 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	
	<u>Carrying amount</u>	<u>Fair value</u>
Currency risk management contracts		
Foreign exchange forwards	222	222
Foreign exchange options	6,883	6,883
	<u>7,105</u>	<u>7,105</u>

Credit Concentration

As at December 31, 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.

Note 17 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 \$11,791 in 2002, \$9,736 in 2003, \$13,274 in 2004.

Note 18 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 2002 and 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:

	Year ended December 31,		
	2002	2003	2004
Revenue	13,208	6,909	2,780
Cost of revenue	7,819	4,341	1,398

	Year ended December 31,		
	2002	2003	2004
Accounts receivable	4,913	12,666	1,895
Accounts payable	24,903	10,263	146

Note 19 Segment information

Axalto has adopted SFAS No 131, (*Disclosures about Segments of an Enterprise and Related Information*). This statement requires enterprises to report information about operating segments in annual financial statements.

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,		
	2002	2003	2004
Revenue			
Cards			
Mobile Communication	363,406	443,987	548,799
Financial Cards	149,446	160,266	196,195
Public sector, Access and Other (1)	95,650	62,525	98,425
Prepaid Phone Cards	71,463	49,859	39,663
Total Cards	679,965	716,637	883,082
Point-of-Sales Terminals	50,246	51,025	77,345
Total Revenue	730,211	767,662	960,427

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

	Year ended December 31,		
	2002	2003	2004
Gross profit			
Cards			
Mobile Communication	110,521	160,818	214,354
Financial Cards	9,044	26,545	42,108
Public sector, Access and Other (1)	(49,958)	30,047	37,800
Prepaid Phone Cards	18,265	9,395	3,057
Total Cards	87,872	226,805	297,319
Point-of-Sales Terminals	12,989	11,410	18,081
Total gross profit	100,861	238,215	315,400

(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,		
		2002	2003	2004
Cards				
Restructuring charges		(2,201)	(268)	(463)
Impairment charges		(9,500)	-	-
	Mobile Communication	<u>(11,701)</u>	<u>(268)</u>	<u>(463)</u>
Restructuring charges		(2,567)	(174)	(164)
Impairment charges		(1,500)	-	(2,758)
	Financial cards	<u>(4,067)</u>	<u>(174)</u>	<u>(2,922)</u>
Restructuring charges		(742)	(43)	(60)
Impairment charges		(82,160)	-	-
	Public sector, Access and Other	<u>(82,902)</u>	<u>(43)</u>	<u>(60)</u>
Restructuring charges		-	-	(47)
Impairment charges		-	-	-
	Prepaid Phone Cards	<u>-</u>	<u>-</u>	<u>(47)</u>
Total Cards		<u>(98,670)</u>	<u>(485)</u>	<u>(3,492)</u>
Point of Sales Terminals				
Restructuring charges (1)		(30)	(1,421)	14
Impairment charges		-	-	-
Total Point-of-Sales Terminals		<u>(30)</u>	<u>(1,421)</u>	<u>14</u>
Total Axalto	Restructuring charges	(5,540)	(1,906)	(720)
	Impairment charges	<u>(93,160)</u>	<u>-</u>	<u>(2,758)</u>
		<u>(98,700)</u>	<u>(1,906)</u>	<u>(3,478)</u>

(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 7.

		Year ended December 31,		
		2002	2003	2004
Operating expenses				
	Cards	177,243	171,778	212,650
	Point-of-Sales Terminals	<u>15,143</u>	<u>18,546</u>	<u>16,370</u>
	Total operating expenses	<u>192,386</u>	<u>190,324</u>	<u>229,020</u>

In 2002, operating expenses for Cards include restructuring expenses of \$5,556. For the years ended December 31, 2003 and 2004, restructuring expenses recorded in operating expenses amounted to \$75 and \$2,821, respectively.

	Year ended December 31,		
	2002	2003	2004
Interest Expense, net			
Cards	(7,515)	(4,700)	1,045
Point-of-Sales Terminals	-	(609)	(754)
Total interest expense, net	<u>(7,515)</u>	<u>(5,309)</u>	<u>291</u>

	Year ended December 31,		
	2002	2003	2004
Equity in income of investees accounted for by the equity method			
Cards	923	422	378
Point-of-Sales Terminals	-	-	-
Total Equity in income of investees accounted for by the equity method	<u>923</u>	<u>422</u>	<u>378</u>

	Year ended December 31,		
	2002	2003	2004
Income (loss) before Taxes			
Cards	(106,196)	42,060	84,805
Point-of-Sales Terminals	(2,169)	(7,745)	448
Total Income (loss) before Taxes	<u>(108,365)</u>	<u>34,315</u>	<u>85,253</u>

Supplemental segment information

	Year ended December 31,		
	2002	2003	2004
Total assets			
Cards	735,401	801,298	1,071,898
Point-of-Sales Terminals	35,995	36,507	41,940
Total assets	<u>771,396</u>	<u>837,805</u>	<u>1,113,838</u>

	Year ended December 31,		
	2002	2003	2004
Depreciation and amortization expense			
Cards	51,529	36,516	40,189
Point-of-Sales Terminals	1,783	805	1,967
Total depreciation and amortization expense	<u>53,312</u>	<u>37,321</u>	<u>42,156</u>

Geographic Information

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

	Year ended December 31,		
	2002	2003	2004
Revenue			
North and South America	126,594	145,326	187,238
Europe, Middle East and Africa	387,750	402,746	535,885
Asia Pacific	215,867	219,590	237,304
Total revenue	<u>730,211</u>	<u>767,662</u>	<u>960,427</u>

	Year ended December 31,		
	2002	2003	2004
Long lived assets			
North and South America	42,233	37,621	49,218
Europe, Middle East and Africa	336,798	398,582	433,642
Asia Pacific	17,703	11,337	14,758
Total long lived assets	<u>396,734</u>	<u>447,540</u>	<u>497,618</u>

Significant Customers (as a percentage of revenue)

During each of the three years ended December 31, 2002, 2003 and 2004 no customer accounted for 10% or more of the total revenues.

Note 20 Commitments and contingencies

Axalto holds a 51% interest in SAIT, a Chinese joint venture. This joint venture has been fully consolidated within Axalto. In 2003, Schlumberger and the joint venture partner amended its articles of association and agreed the following:

- Axalto guarantees the profit of the joint venture 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 the joint venture until December 31, 2006.

This commitment has been accounted for as a FIN 45 guarantee. Therefore it has been fair valued, and the liability will be re-valued at the end of each reporting date. To date, management estimated that the fair value of the guarantee is not material.

Commitments concerning pensions are described in Note 14, those concerning financial instruments in Note 16, and those concerning leasing commitments in Note 17.

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.

This Agreement is described in further details in Note 19 to the combined financial statements attached to the Offering Circular.

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.

Note 21 Post closing events

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

Note 22 Reconciliation between US GAAP and IFRS

The combined financial statements as at December 31, 2002 and 2003 as well as the consolidated financial statements as at December 31, 2004 of Axalto have been prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP"), which differ in certain respects from International Financial Reporting Standards ("IFRS").

The choice of the US GAAP referential is explained by the fact that prior to its first listing, Axalto was part of the "Schlumberger Products", a division of Schlumberger Limited, a company listed on the New York Stock Exchange, and whose accounts are prepared under US GAAP.

As of date, Axalto has completed the analysis of the differences between US GAAP and IFRS applicable to its business, and is in the process of determining the effects of first time application options and of other IFRS on its financial statements.

A reconciliation of the main differences between US GAAP and IFRS and their impact on the net income and equity was presented in appendix to the audited combined accounts as at December 31, 2001, 2002 and 2003 (carrying the AMF stamp dated may 17, 2004) and in appendix to the half year consolidated accounts as at June 30, 2004. In compliance with the only approach possible at the time, these reconciliations considered that Axalto had always used IFRS and therefore did not take into account any first time application options.

Axalto will apply IFRS for the first time as at January 1, 2005. Therefore, its opening balance sheet in IFRS as at January 1, 2004 will take into account a certain number of first time application options in accordance with IFRS 1.

Axalto has therefore considered that it would not be appropriate to present for the year closed December 31, 2004 a reconciliation of its net income and of its equity in the form and according to the assumptions used for the reconciliations produced for the years 2001, 2002 and 2003 and for the half year 2004, that is without taking into account the impact of first time application options.

The company will release together with its half year 2005 financial statements, and no later than September 15, 2005, the following information in relation with the first time application of IFRS:

- a detailed description of the main differences between the US GAAP and the IFRS applicable to its business
- the first time application options that Axalto will have selected
- the reconciliations between the opening and closing balance sheets of 2004 and the income statement for the year 2004 established under US GAAP and IFRS

This information will report on the precise impact on the financial statements of the company of the first time application options and of transitioning to IFRS, on the basis of a norm by norm audited analysis.