# INSIDE Secure

# ANNUAL FINANCIAL REPORT 2012

driving trust™ inside SECURE

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**STATEMENT OF THE PERSON RESPONSIBLE**
**FOR THE ANNUAL FINANCIAL REPORT**

[TEXT INTENTIONALLY OMITTED.]

Société anonyme à directoire et directoire de surveillance au capital de 13 597 424,80 euros
Siège social : 41, parc Club du Golf, 13856 Aix-en-Provence cedex 3
399 275 395 RCS Aix-en-Provence

**REPORT OF THE MANAGEMENT BOARD**

[TEXT INTENTIONALLY OMITTED.]

# 1. Overview of the INSIDE Secure group

## 1.1 Business

INSIDE Secure Inside Secure ("the Company") and its subsidiaries (together "the Group") is a designer, developer and supplier of semiconductors and embedded software for securing transactions, content and digital identity, and operates on a fabless business model.

In 2012, the Group generated US$ 122 million in revenue.

The headquarters of the Company is located in Aix-en-Provence, France. The Group operates in Europe (research and development, sales and marketing, supply chain, administration), Asia (research and development, sales and marketing) as well as North America (Sales & Marketing). The Group employed 460 people at December 31, 2012, holds more than 650 patents, divided into 173 families of patents, including approximately 40% related to NFC and contactless and about 40% relative to security.

On September 30, 2010, the Group acquired the Secure Microcontroller Solutions (SMS) division of Atmel Corp. ("SMS division of Atmel") which provides semiconductor chips embedded in smart cards, mobile devices, acceptance devices, and infrastructure systems to secure the exchange of transactions for payment, transit, access, ID and other types of secure applications.

On December 1, 2012, the Group acquired Embedded Security Solutions (''ESS'') which designs and develops encryption-related security hardware intellectual property (IP) and software for a variety of industries, including the mobile and networking markets

Since February 17, 2012, shares in the Company are listed on the NYSE Euronext exchange in Paris under the Isin code FR0010291245. Proceeds from the issuance of the shares as part of the initial public offering ("IPO") was US$ 104.5 million (€ 79.3 million), including the share premium and prior the IPO fee and expense.

The Group operates a fabless business model, whereby manufacturing, assembly and testing are outsourced to third-party foundries (companies specializing in the manufacturing of semiconductors) and other outsourcing partners. The Group designs, develops and markets products offering various types of security protection for applications where information is required to be processed, stored or transferred with a high degree of security. The Group's solutions integrate secure architecture microcontrollers, routers, hardware-integrated security, embedded software providing the secure management of incoming and outgoing data, as well as cryptography algorithms. These solutions rely on the Group's know-how in radio frequency and analog semiconductor design, as well as the Group's security expertise

Since the acquisition of ESS, the Group operates in four complementary business segments, which target different markets, products, solutions and customers leveraging the Group's secure silicon and software platforms:

- Mobile NFC: Designs and markets microprocessor chips and software stacks to mobile handset makers and more generally the wireless space.
- Secure payments: Designs and markets microprocessor chips with embedded memory, modules and inlays, and software stacks for payment, transit fare collection, and loyalty applications.

- Digital security: Designs and markets memory and microprocessor platforms, pay TV, identification, access control, and other secure systems for anti-counterfeiting, intellectual property protection and machine-to-machine communication.
- Embedded security solutions: designs and develops encryption-related security hardware intellectual property (IP) and software for a variety of industries, including the mobile and networking markets.

### 1.2 Significant events of the past fiscal year

*Initial public offering*

The Company went public on the regulated market of NYSE Euronext in Paris on 17 February 2012.

The IPO of the Company was conducted through a public offering in France and an institutional offering in France and some other countries including the United States of America, in each case solely on issuing new shares. The prospectus made available to the public at the time of the IPO has been approved by the Autorité des marchés financiers February 6, 2012 under number 12-058.

The Management board, at its meeting of 17 February 2012, making use of the delegation which was granted by the extraordinary general meeting of shareholders of the Company on 20 January 2012, decided to increase the capital by a nominal amount of 3,325,300 euros, bringing it from 9,269,387.20 euros to 12,594 687.20 euros through the issue, without preferential subscription rights of shares by way of a public offering of 8,313,250 new shares at a price of 8.30 euros per share with a nominal value of 0.40 euro and an issue premium of 7.90 euros, representing a subscription for a total amount of premium issue included, of 68,999,975 euros, fully paid in cash.

The Company has also received on February 23, 2012 a letter from BNP Paribas, acting as stabilizing agent and acting in the name and on behalf of BNP Paribas and Natixis, joint lead managers and joint book runners of the IPO of the Company, notifying of the exercise by BNP Paribas of over-allotment option of up to 1,246,986 shares, representing 15% of the shares whose issue was decided by the Management board at its meeting of February 17, 2012. The Management board, at its meeting of 23 February 2012, making use of the delegation which was granted by the extraordinary general meeting of shareholders of the Company on 20 January 2012, decided to increase the nominal amount of the capital increase decided by the Management board of February 17, 2012 for a nominal amount of 498 794.40 euros, through the issue of 1,246,986 new shares with a nominal value of 0.40 euro each, issued at the same price those issued on 17 February 2012, at 8.30 euros per share, premium included, representing a subscription for a total amount of 10 349 983,80 euros, including share premium.

In total, at the time of its IPO, the Company realized a total capital increase of 79,349,958.80 euros, share premium included, and before deducting expenses related to the transaction of the share premium, representing 29.2% of the capital.

*Acquisition of Embedded Security Solutions*

On December 1, 2012, the Group acquired Embedded Security Solutions (‘‘ESS’’). ESS designs and develops encryption-related security hardware intellectual property (IP) and software for a variety of industries, including the mobile and networking markets. Revenue is generated through licenses, royalties, services and maintenance fees.

As part of the acquisition, research and development and sales and marketing teams were transferred to the Group. The seller also transferred intangible assets, including intellectual property licensing royalties and internally developed software, tangible assets, working capital (notably inventories, trade receivables and social and tax debts related to transferred employees) and cash.

Upon acquisition, Inside Secure paid a purchase price of $US 43,256 thousand based on an initial estimate of working capital requirements. Subsequently a reduction on the purchase price amounting to US$ 503 thousand was accorded to the Group to take into account the final amount of this working capital requirement. The payment of this purchase price reduction has not yet been received by the Group at the date of issuance.

The Group paid an additional US$ 1,750 thousand in January 2013 after certain precedent conditions were met and this amount could rise to US$ 3,438 thousand if all the conditions included in the agreement are met before April 1, 2013. Based on information available at the date of issuance, management considers that it will have to pay the entire additional amount.

*Evolution of the business*

2012 saw major changes in the business environment for INSIDE Secure, leading to a decrease in both its revenue and operating performance. INSIDE Secure notably suffered from the difficulty experienced by a number of major clients of its mobile NFC division, which were impacted by the transformation of the industry, and by a slowdown in the NFC market growth.

In this context, the Group implemented cost saving measures from the second half of 2012 onwards in order to reduce operational costs, focusing initially on external charges and expenses and on tangible and intangible capital expenditure all whilst preserving the means necessary to simultaneously complete several key research and development programmes.

### 1.3 Events after the reporting period

On March 6, 2013, the Company announced a project to adapt its strategy that will lead to a reorganization of its business on a global basis. The reorganization plan will be further detailed during the course of 2013. The impact of this plan on the consolidated financial statements will be accounted for once sufficient details and reliable estimates are known and constitute a constructive obligation for the Company.

### 1.4 Progress and challenges

See sections 1 above and 2 below.

## 2. Analysis of financial conditions and results of operations

### 2.1 Introductory comments

The consolidated financial statements of the group INSIDE Secure for the year ended December 31, 2012 and the report statutory auditors’ report on the consolidated financial statements are attached to the management report.

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) and IFRIC interpretations as adopted by the European Union. The main accounting policies are set out in note 2 of the notes to the consolidated financial statements for the year ended December 31, 2012, and critical accounting estimates and judgments are disclosed in note 4.

*Presentation currency of the consolidated financial statements*

The Group has elected the US dollar (or “$”) as presentation currency of its consolidated financial statements. The U.S. dollar is the functional currency of the Company, and the currency in which the majority of its transactions are denominated. It is the main currency used for the Group’s transactions and within the semiconductor industry in transactions between clients and suppliers.

The exchange rates of the US Dollar against the Euro (or “€”, or “EUR”), the main currency used by the Group after the US Dollar, are as follows for the years ended December 31, 2011 and 2012:

| **Dollar / Euro** | **2011** | **2012** |
|---|---|---|
| Closing | 1.2939 | 1.3194 |
| Average | 1.3917 | 1.3119 |

*Consolidated entities*

The consolidated financial statements as at December 31, 2012 include the accounts of the Company and the following entities:

| **Country** | **Entity** | **Percentage of ownership** | |
|---|---|---|---|
| | | **2011** | **2012** |
| United States | Inside Secure Corporation | 100% | 100% |
| Singapore | Inside Secure (Asia) Pte Ltd | 100% | 100% |
| Poland | Inside Secure Sp.z.o.o. | 100% | 100% |
| France | Vault-IC France SAS | 100% | 100% |
| United Kingdom | Vault-IC UK Ltd | 100% | 100% |
| Netherlands | Inside Secure B.V | - | 100% |
| Netherlands | Inside Secure Amsterdam B.V | - | 100% |
| Finland | Inside Secure Oy | - | 100% |

The Group acquired the Embedded Security Solutions business on December 1, 2012. As part of the transaction which consisted in a combination of acquisition of assets shares, the Group acquired 100% of the shares of Inside Secure B.V, which holds 100% of the shares of Inside Secure Amsterdam B.V and 100% of the shares of Inside Secure Oy, companies dedicated to R&D and product marketing.

*Supplementary non-IFRS financial information*

The Group uses performance indicators that are not strictly accounting measures (adjusted operating result, and adjusted income /(loss)) are defined below. These indicators are not defined under IFRS, and do not constitute accounting elements used to measure the Group’s financial performance. They should be considered in addition to, and not as a substitute for, any other operating and financial performance indicator of strict accounting nature, as presented in the Group’s Consolidated Financial Statements and the corresponding notes. The Group uses these indicators because it believes they are useful measures of its operating performance and of its operating cash flow generation. These indicators are not necessarily directly comparable to those of other companies, which may have defined or calculated their indicators differently than the Group, even though they use similar terms.

**Adjusted gross profit** is defined as gross profit before (i) the amortization of intangible assets and masks related to business combinations, (ii) any potential goodwill impairment, (iii) share-based payment expense and (iv) non-recurring costs associated with business combinations carried out by the Group.

**Adjusted operating income/(loss)** is defined as operating income/(loss) before (i) the amortization of intangible assets and masks related to business combinations, (ii) any potential goodwill impairment, (iii) share-based payment expense and (iv) non-recurring costs associated with business combinations carried out by the Group.

**Adjusted net income/(loss)** is defined as net income/(loss) before (i) the amortization of intangible assets and masks related to business combinations, (ii) any potential goodwill impairment, (iii) share-based payment expense, and (iv) non-recurring costs associated with business combinations carried out by the Group, and also takes into account the tax expense adjustment recorded in the income statement and related to restated elements.

Tables presenting reconciliations between the income statement figures in this document and the adjusted financial aggregates as defined above, for the years ended December 31, 2011 and 2012 are set forth in appendix to this report.

### 2.2 Consolidated income statement

#### 2.2.1 Revenue

<u>Fiscal Year 2012 - Revenue by Business Segment</u>

| (in thousands of US$) | 2012 | 2011 | year-on-year % |
|---|---|---|---|
| Mobile NFC | 43 261 | 47 961 | -10% |
| Secure payment | 31 788 | 43 246 | -26% |
| Digital security | 46 158 | 60 261 | -23% |
| Embedded security solutions | 840 | - | - |
| **Total** | **122 047** | **151 468** | **-19%** |

INSIDE Secure's consolidated revenue was down 19% year-on-year in 2012 at $122.0 million. Consolidated revenue incorporates Embedded Security Solutions ("ESS"), consolidated as from December 1st, 2012. Normalised revenue[1] totalled $148.2 million for the year 2012.

[1] *Normalised revenue is defined as the combined revenue of the historical activities of INSIDE Secure and ESS for the year ended December 31, 2012 excluding the accounting impacts related to the change of control over ESS which resulted in the non-recognition of a portion of revenue.*

2.2.2 Adjusted operating results and operating results

| (in thousand of dollars) | **2012** | **2011** | %var. |
|---|---|---|---|
| Revenue | 122 047 | 151 468 | -19,4% |
| **Adjusted gross profit** | **31 439** | **42 412** | -25,9% |
| *As a % of revenue* | *25,8%* | *28,0%* | |
| Research and development expenses | (33 218) | (32 746) | 1,4% |
| *As a % of revenue* | *-27,2%* | *-21,6%* | |
| Selling and marketing expenses | (17 511) | (16 907) | 3,6% |
| *As a % of revenue* | *-14,3%* | *-11,2%* | |
| General and administrative expenses | (8 780) | (8 810) | -0,3% |
| *As a % of revenue* | *-7,2%* | *-5,8%* | |
| Other gains / (losses), net | (2 025) | (0) | |
| **Adjusted operating expenses** | **(61 534)** | **(58 464)** | 5,3% |
| *As a % of revenue* | *-50,4%* | *-38,6%* | |
| **Adjusted operating income / (loss)** | **(30 095)** | **(16 052)** | 87,5% |
| *As a % of revenue* | *-24,7%* | *-10,6%* | |

**Adjusted gross profit** declined by $11 million in 2012, translating both a decrease in revenues and a decrease in the average gross margin due to a less favourable product mix (mainly translating lesser revenues in the Digital Security division which contribute strongly to the gross margin).

R&D expenses slightly increased in 2012 (+1.4%), with the NFC business attracting a greater share of spending (70% vs. 56% in 2011). The Group was thus able to simultaneously develop several major programmes: development of the latest version of NFC microcontroller, design of the next generation NFC technology in partnership with Intel, design of the proprietary embedded secure element, and the first sales of the PicoPulse™ chip (INSIDE Secure's "booster" technology).

Sales & marketing expenses, as well as General and administrative expenses increased by 2.2% in 2012 vs. 2011, but decreased in the second half vs. the first half of the year, excluding the impact of a $0.7 million allowance for doubtful trade account receivable recorded in the 4$^{th}$ quarter 2012.

The cost saving plan initiated in July 2012 started to bear fruit from the 4th quarter of the year, with a reduction in external charges, namely of outsourced R&D, and in tangible and intangible capital expenditure.

At constant exchange rates, ordinary operating expenses were reduced by 6% in the second half vs. H1 2012.

**Adjusted operating income** fell from a $16.1 million loss in 2011 (or 10.6% of revenues) to a $30.1 million loss in 2012 (24.7% of revenues), due mainly to NFC's disappointing performance.

Faced with deteriorating trading conditions from the second quarter 2012, the Group gradually implemented early cost cutting measures to reduce operating expenses, without however undermining the implementation of its innovation programme and of its major new products (such as the proprietary embedded security element and the Pulse product family based on the "booster" technology).

**Operating income** fell from a $24.5 million loss in 2011 to a $37.3 million loss in 2012.

### 2.2.3 Financial income/loss, net

Net financial items at December 31, 2012 represented an expense of $0.3 million, compared with a profit of $1.5 million for the year ended December 31, 2011. The deterioration is mainly due to the EUR/USD exchange rate fluctuation. Foreign exchange loss incurred in 2012 is mainly due to the impact of the revaluation at the closing rate of cash denominated in euros. Foreign exchange gains realised in 2011 were mainly due to a favourable trend in the EUR/USD exchange rate over 2011.

It is worth highlighting that realized operating exchange gains and losses over the year and the impact of the revaluation at the closing rate of operating assets and liabilities denominated in a currency other than the functional currency of the consolidated companies are now recorded under operating income (see section 27 of the notes to the consolidated financial statements for the year ended December 31, 2012). This presentation method compliant with IFRS was applied for the first time in 2012.

### 2.2.4 Income tax

The income tax was a charge of 74 thousand dollars in 2011 compared with an income (net) of 51 thousand dollars in 2012. The income (net) for the year 2012 is mainly due to two factors:

- The income tax expense in the subsidiary INSIDE Secure Corporation in the United States that generated a taxable income;
- Offset by the use of a previously unrecognized tax credit in the Vault-IC UK Ltd. branch for an amount of 156 thousand dollars.

### 2.2.5 Adjusted net income and net income

The Group's adjusted net loss widened from $14.6 million in 2011 to $30.3 million in 2012. Consolidated net income (IFRS), Group share for 2012 represented a loss of $37.5 million in total, and earnings per share amounted to $1.19 (compared with $1.06 at December 31, 2011).

### 2.2.6 Segment analysis

| (in thousand of dollars) | Mobile NFC | Secure payment | Digital security | Embedded security solutions | Common unallocated | Total 2012 |
|---|---|---|---|---|---|---|
| **Fiscal year ended December 31, 2012** | | | | | | |
| Revenue | 43 261 | 31 788 | 46 158 | 840 | - | 122 047 |
| *Contribution to revenue* | *35%* | *26%* | *38%* | *1%* | - | *100%* |
| Operating income | (31 757) | (5 022) | 2 853 | (1 116) | (2 237) | (37 278) |
| Adjusted operating income | (30 451) | (3 531) | 6 412 | (288) | (2 237) | (30 095) |
| *As a % of revenue* | *-70%* | *-11%* | *14%* | *-34%* | | *-25%* |

| (in thousand of dollars) | Mobile NFC | Secure payment | Digital security | Embedded security solutions | Common unallocated | Total 2011 |
|---|---|---|---|---|---|---|
| **Fiscal year ended December 31, 2011** | | | | | | |
| Revenue | 47 961 | 43 246 | 60 261 | - | - | 151 468 |
| *Contribution to revenue* | *32%* | *29%* | *40%* | - | - | *100%* |
| Operating income | (18 251) | (11 489) | 8 674 | - | (3 396) | (24 462) |
| Adjusted operating income | (17 258) | (9 271) | 13 153 | - | (2 676) | (16 052) |
| *As a % of revenue* | *-36%* | *-21%* | *22%* | | | *-11%* |

Note: Unallocated expenses correspond to unused capacity not allocated to business segments

**Mobile NFC**

Revenues totalled $43.3 million for the year, down 10% versus 2011, mainly due to a strong decline in mobile handset sales by Blackberry, the Group's main client, and to the postponement until 2013 of their new generation *smartphones* (Blackberry 10).

In the 4th quarter 2012, Mobile NFC sales increased 28% sequentially, to $11.6 million, supported mainly by the segment's two major clients (Blackberry and Intel), without however showing signs of sustained recovery on this segment for INSIDE Secure.

Over the quarter, the Group sold its first volumes of its NFC PicoPulse chip (INSIDE Secure's “booster” technology) which provides the main functions of NFC in a single packaging, including the antenna, on a SIM card), and introduced its proprietary embedded security element in the market.

The decline in the operating result was less in the 2nd half of the year, but amounted to -$30.5 million in 2012 (which explains the totality of the Group's loss), versus -$17.3 million in 2012.

Beyond the negative impact of the decrease in revenue, this loss was aggravated by increased R&D expenses, namely in new value-added products, such as the NFC “Booster” or the Group's proprietary embedded security element. However, the Group believes that it has incurred the major share of its research and development costs in 2012 as several major research programmes have been conducted simultaneously.

**Secure Payment**

After a sharp decline in sales at the start of the year, the segment recovered during the last months of the year. Sales rose 7% Q-o-Q and 28% Y-o-Y at $8.8 million in the 4th quarter. Contact chip sales for the European EMV market stabilised while contactless chip sales in the US market rose slightly, helping to limit the decline in sales to $31.8 million for the year.

However market dynamics remain unchanged overall: the US contactless payment market is still impacted by the anticipated migration towards a new EMV-type standard.

The adjusted operating loss for this segment was reduced to $3.5 million in 2012, down 71% compared with 2011. The loss has been divided by 2.1 in the 2nd half 2012 compared with the 1st half.

**Digital Security**

In 2012, Digital security sales totalled $46.2 million, down 23% compared with 2011. At $10.0 million, 4th quarter 2012 sales were down 12% compared with the 3rd quarter. This is due to several reasons:

- Products designed for electronic document identification saw a severe decrease in sales, an anticipated result of the transition phase on the sale by Atmel of its SMS business and its integration into the Group;
- Secure module sales to various clients were down, due to lower demand in 2012 compared with a strong year in 2011;
- Conditional access products (such as Pay-TV products), posted firm growth, driven in particular by new customers. However, the latter has been insufficient to offset the decline in sales of the product lines mentioned above.

Marketing and sales efforts aimed at broadening the digital security product and service offering toward markets offering good growth potential, such as anti-counterfeiting, smart metering and machine-to-machine solutions have not yet enabled the Group to offset the lower revenues from its legacy businesses. In smart metering, INSIDE Secure achieved its first *design-ins* in the third quarter. The Group also announced several new distribution agreements in Europe and Latin America thus broadening its business footprint. The Group intends to invest more in this division in 2013.

Adjusted operating income amounted to $6.4 million in 2012, representing 14% of this segment's revenue.

**Embedded Security Solutions**

On December 1, 2012, INSIDE Secure finalised the acquisition of Embedded Security Solutions, a high expertise business which designs and develops encryption-related security hardware, intellectual property (IP) and software for a variety of industries, including the mobile and networking markets.

This strategic acquisition has enabled INSIDE Secure to reinforce its know-how in the fast-growing security solutions market, and brought INSIDE Secure complementary offerings for a complete security architecture, as well as additional solutions for securing both content (Digital Rights Management or "DRM") and data exchange (Virtual Private Network or "VPN").

Revenues are generated in the form of royalties, licence fees and sales of maintenance services. Consolidated as from December 1, 2012, ESS contributed $840 thousand to the Group's revenues in 2012. The normalised[2] consolidated revenue for December 2012 amounted to $1.1 million and

[2] *ESS normalised revenue is defined as the revenue of the ESS business over the considered period excluding the accounting impacts related to the change of control over ESS which resulted in the non-recognition of a portion of revenue*

$5.4 million for the 4th quarter 2012. For the full year 2012, ESS' normalised revenue stand at $26.8 million (vs. $25.3 million in 2011).

In 2013, the revenue, as prepared in accordance with IFRS, will be reduced by $2 million due to the change of control of ESS, which led to the elimination of some deferred revenue corresponding to license agreements signed and paid ahead of the divesture. As a result, and to provide a meaningful basis for comparison (like for like), INSIDE Secure will report both its consolidated revenue under IFRS and its normalised revenue. It is also worth highlighting that ESS' revenue can vary significantly from one quarter to another, depending mainly on the product mix (licence fees, royalties); on the date the Group is notified of the sales level recorded by its clients which determines the amount of variable royalties it receives; and on the amount of the contracts signed over a given period.

ESS reported an adjusted operating loss of $0.3 million. Over a single month however, and given the transition, ESS' adjusted operating income does not give a fair representation of this business segment's typical performance.

### 2.2.7 Non IFRS measures – Reconciliation of consolidated results (IFRS) with adjusted results

The tables below present reconciliations between the income statement figures in this document and the adjusted financial aggregates as defined above, for the years ended 31 December 2011 and 2012:

| (in thousand of dollars) | December 31, 2012 IFRS | Business combinations | Share-based payment | Other non-recurring costs | December 31, 2012 adjusted |
|---|---|---|---|---|---|
| Revenue | 122 047 | | | | 122 047 |
| Cost of sales | (93 504) | 2 734 | 163 | | (90 608) |
| **Gross profit** | **28 543** | **2 734** | **163** | **-** | **31 439** |
| *As a % of revenue* | *23,4%* | | | | *25,8%* |
| R&D expenses | (35 370) | 1 783 | 369 | | (33 218) |
| Selling & marketing expenses | (18 010) | | 499 | | (17 511) |
| Genaral & administrative expenses | (9 630) | | 850 | | (8 780) |
| Other (losses)/gains, net | (2 811) | | | 786 | (2 025) |
| **Operating income / (loss)** | **(37 278)** | **4 517** | **1 880** | **786** | **(30 095)** |
| *As a % of revenue* | *-30,5%* | | | | *-24,7%* |
| Finance income, net | (258) | | | | (258) |
| Income tax expense | 51 | | | | 51 |
| **Net income** | **(37 485)** | **4 517** | **1 880** | **786** | **(30 302)** |

| (in thousand of dollars) | December 31, 2011 IFRS | Business combinations | Share-based payment | Other non-recurring costs | December 31, 2011 adjusted |
|---|---|---|---|---|---|
| Revenue | 151 468 | | | | 151 468 |
| Cost of sales | (112 004) | 2 835 | 113 | | (109 056) |
| **Gross profit** | **39 464** | **2 835** | **113** | **-** | **42 412** |
| *As a % of revenue* | *26,1%* | | | | *28,0%* |
| R&D expenses | (34 536) | 1 462 | 328 | | (32 746) |
| Selling & marketing expenses | (18 175) | 716 | 553 | | (16 907) |
| Genaral & administrative expenses | (9 817) | | 1 007 | | (8 810) |
| Other (losses)/gains, net | (1 398) | 885 | | 513 | (0) |
| **Operating income / (loss)** | **(24 462)** | **5 898** | **2 000** | **513** | **(16 052)** |
| *As a % of revenue* | *-16,1%* | | | | *-10,6%* |
| Finance income, net | 1 503 | | | | 1 503 |
| Income tax expense | (74) | | | | (74) |
| **Net income** | **(23 033)** | **5 898** | **2 000** | **513** | **(14 622)** |

Note: Unallocated expenses correspond mainly to unused capacity not allocated to business segments

### 2.2.8 Consolidated balance sheet

*Selected information on consolidated balance sheet:*

| In thousands of US$ | As at December 31, 2011 | 2012 |
|---|---|---|
| Non-current assets | 34 227 | 86 177 |
| Cash and cash equivalents | 20 940 | 66 321 |
| Other urrent assets | 52 677 | 40 626 |
| Current assets | 73 618 | 106 947 |
| **Total assets** | **107 845** | **193 124** |
| Total equity | 57 594 | 121 725 |
| Non-current liabilities | 14 708 | 22 729 |
| Current liabilities | 35 542 | 48 669 |
| **Total equity and liabilities** | **107 845** | **193 124** |

### 2.2.9 Equity

Note 17 of the Notes to the consolidated financial statements for the year ended December 31, 2012 and consolidated statement of changes in equity prepared in accordance with IFRS included in the financial statements provides details on the share capital increase and changes in equity over the years 2012 and 2011.

### 2.2.10 Liquidity

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid securities (essentially monetary securities). Cash and securities are used to finance operating activities of the Group. As at December 31, 2012, investments in securities presented within the cash and cash equivalents have a maturity of less than twelve months.

As at December 31, 2012, the Group's cash position stood at $66.3 million compared with $20.9 million in 2011 and $95.5 million as at June 30, 2012 (after the initial public offering of INSIDE Secure on the NYSE Euronext market in Paris on February 12, 2012).

The resilience of the cash position at year end, despite the $41.6 million disbursement for the acquisition of ESS, is a result of the Group's efforts to optimize its operating resources and reduce its working capital requirement. In the 2nd half of 2012, the Group thus managed to improve its cash position by $12.4 million.

The Group's net cash position stood at $59.6 million as at December 31, 2012, compared with $18.5 million for the year ended December 31, 2011.

### 2.2.11 Sources of funding

Since its creation, the Company has financed its operating loss through equity, by carrying out share capital increases and marginally by getting payments for research tax credit, grants and repayable advance granted by OSEO (French government agency).

In 2011, the Group entered into factoring agreements whereby it transferred certain receivables in Euros and Dollars to Natixis Factor for a renewable period of two years, including a deposit and backed by a credit insurance contract. Since the risk of non-recoverability and delays in payment has been transferred to the bank, the receivables transferred under these contracts are no longer recorded in the balance sheet.

As at December 31, 2012, transferred receivables amount to $12.8 million (vs. $11.1 million as at December 31, 2011), cash received net of factoring reserve amounts to $12.3 million as at December 31, 2012 (vs. $10.6 million as at December 31, 2011)

Even though the Group has elected to present its consolidated financial statements in US Dollars, being incorporated in France, it proceeds to share capital increase in Euros. During 2011 and 2012, the Company completed several capital increases as follows:

In 2011, share capital increases were completed for a total amount of $ 446 thousand (€ 314 thousand) for both issuance and subscription of warrants.

With its IPO on the NYSE Euronext market in Paris in February 2012, the Group realized a capital increase of $104.6 million (€79.3 million) before deduction of IPO costs directly linked to the operation and recorded as a reduction of share premium

2.2.12 Consolidated cash flow statement

*Selection information on the consolidated cash flow statement:*

| | As at December 31, | |
|---|---|---|
| **In thousands of US$** | **2011** | **2012** |
| **Cash and cash equivalents at beginning of the year** | **41 178** | **20 940** |
| Net cash used in operating activities | (11 010) | (12 508) |
| Net cash used in investing activities | (7 993) | (48 509) |
| Net cash generated by / (used) in financing activities | (965) | 106 604 |
| Effect of exchange rate fluctuations (1) | (268) | (206) |
| **Cash, cash equivalents at end of the year** | **20 940** | **66 321** |

(1) Element with no impact on cash which comes from the conversion into U.S. dollars of cash denominated in other currencies.

### 2.2.13 Net cash used in operating activities

| In thousands of US$ | As at December 31, 2011 | 2012 |
|---|---|---|
| Loss for the year | (23 033) | (37 485) |
| Adjustments for non cash items | 15 428 | 12 549 |
| **Cash used in operations before changes in working capital** | **(7 605)** | **(24 936)** |
| Cash used in changes in working capital : | | |
| Inventories | (9 111) | 5 873 |
| Trade receivables, net of trade receivables transferred | 12 066 | 3 957 |
| Trade and other payables | 2 535 | (4 189) |
| Non refundable advance on order backlog | - | 6 460 |
| Other receivables net of other liabilities | (8 573) | (210) |
| **Cash used in changes in working capital** | **(3 083)** | **11 891** |
| Others (Interest received, net, income tax paid) | (322) | 537 |
| **Net cash used in operating activities** | **(11 010)** | **(12 508)** |

Net cash used in operating activities amounted to -$12.5 million in 2012 vs. -$11.0 million in 2011.

Net cash used in operations before changes in working capital increased by $17.3 million from $7.6 million in 2011 to $24.9 million in 2012. Cash used in operating activities (before changes in working capital) is explained by the increase of the operating loss generated by the Group. This deterioration was partly offset by a $11.9 million reduction in working capital requirement during the year.

The significant decrease in working capital requirement in 2012 is mainly explained by the combination of the following factors:

- Inventories fell by 25% compared with December 31, 2011 (and 31% vs. June 30, 2012). Working capital requirement was therefore very low at the end of 2012.

- Payment by a customer during the second semester of 2012 of a non-refundable advance on order backlog to be delivered at the latest June 30 2013 for a total amount of $6.5 million.

- The research tax credit recognized in 2010, which had given rise to a tax audit, was paid in full to the Group on July 4, 2012 for a total amount of $4.2 million (3,2 million Euros), the tax audit having led to no adjustment.

### 2.2.14 Net cash used in investing activities

| In thousands of US$ | As at December 31, 2011 | 2012 |
|---|---|---|
| Acquisition of business, net of cash acquired | - | (41 635) |
| Purchases of property and equipment | (4 367) | (2 119) |
| Purchases of intangible assets | (1 029) | (2 718) |
| Research and development capitalized costs | (1 188) | (973) |
| Payments corresponding to intangible liabilities | (1 409) | (1 064) |
| **Net cash used in investing activities** | **(7 993)** | **(48 509)** |

Cash flow used in financing activities stood at $48.5 million in 2012 (vs. $7.9 million in 2011) of which $41.6 million correspond to the acquisition of ESS net of cash acquired.

During the year 2012, the Group also purchased tangible and intangible fixed assets for $4.8 million (vs. $5.4 million in 2011) and significantly limited during the second half of 2012.

In 2012, development expenses related to two research projects for a total amount of $ 973 thousand were capitalized ($1,188 thousand in 2011). These two projects, both with duration of three years, are financed through repayable advances in case of success.

On December 1, 2012, the Group completed the acquisition of ESS. On completing the transaction, INSIDE Secure paid a purchase price consideration of $41.6 million net of cash acquired and after an adjustment based on an initial estimate of the working capital of the transferred business. In January 2013, the Group requested a $0.5 million reduction on the purchase price based on the final working capital requirement; the said amount is due to be paid to the Group in March 2013. In addition, INSIDE Secure made a $5.2 million additional payment in the first quarter of 2013 upon the fulfillment of certain conditions as all the conditions set out in the agreement are met by April 1st, 2013.

### 2.2.15 Net cash generated by / (used) in financing activities

| | **As at December 31,** | |
|---|---|---|
| **In thousands of US$** | **2011** | **2012** |
| Proceeds from issuance of ordinary shares, net of issuance costs | 446 | 104 950 |
| Direct costs paid related to the IPO | (2 039) | (5 840) |
| Repayable advance | 852 | 2 491 |
| Proceeds from / (Repayment of) borrowings, net of issuance costs | - | 5 852 |
| Principal repayment under finance lease | (225) | (463) |
| Treasury shares | - | (501) |
| Settlement of foreign exchange hedging instruments | - | (161) |
| Bank overdraft | - | 276 |
| **Net cash generated by / (used) in financing activities** | **(965)** | **106 604** |

*Year 2011*

In 2011, the Company paid direct costs related to the IPO amounting to $2 million. The Company also carried out a share capital increase for $265 thousand (€181 thousand, share premium included) as part of the exercise of redeemable warrants. New warrants were also issued for $181 thousand (€130 thousand.)

Since 2011, the Group benefits from repayable advances from OSEO (French government agency) for research and innovation programs. The Group received in 2011 the first repayable advance amounting to $852 thousand.

*Year 2012*

With its IPO on the NYSE Euronext market in Paris in February 2012, the Group completed a capital increase of $98.7 million (€75.0 million) after deduction of IPO fee and expenses.

In 2012, the Group also received $2.5 million from OSEO relating to research and innovation programs (such advances are repayable only if the sales targets defined contractually are met).

Lastly, the financing of the research tax credit, recognized in 2011, obtained from a financial institution which does not qualify for de-recognition according to IFRS, is presented within financial liabilities. Its maturity was set to June 2015. This financing amounts to $5.million and corresponds to 90% of the research tax credit receivable. The remaining 10% will be paid to the Company in June 2015 at the maturity of the contract; as a consequence the financial debt will be extinguished.

Excluding this financing, the Group contracted no significant financial debt in 2012.

### 2.2.16 Commitments

Total commitments for the Group as at December 31, 2012 amount to $28.7 million (vs. $52 million as at December 31, 2011). Commitments are detailed in note 33 of the consolidated financial statements as at December 31, 2012. The most important commitment relates to a wafer purchase agreement whereby the Company committed to purchase a minimum number of wafers from the company LFoundry before September 30, 2014 and for a maximum amount of $27 million at as December 21, 2012 (v. $48,8 million as at December, 2011).

## 3. Main risks and uncertainties to which the Company and the Group are exposed – Use of financial instruments

The risks associated with the business activities conducted by the Company and the Group, and the risk coverage and insurance related thereto are described in Appendix C of this management report.

## 4. Corporate Governance and Internal Control

The report prepared by the Chairman of the Supervisory Board on corporate governance, internal control and risk management of the Company is included in Appendix 1 of this Annual Financial Report. The dedicated Report of the Statutory Auditors reviewing the Chairman’s report is included in Appendix 2 of this Annual Financial Report.

## 5. Research and Development

### 5.1 A key element in the success of the Group

The Group commits significant resources to its research and development activities, which represents a key element in its success. These investments lead to the creation of new products, the integration of new functionalities in its semiconductors, the development and improvement of its software, while perfecting the security of its products.

The research and development activities of the Group comprises 265 of its employees (for the most part, designers of semiconductors, developers of embedded software and applications, security engineers and integration and testing engineers), together with, on average, approximately thirty developers contracted by engineering companies and service providers. They are mainly based in Aix-en-Provence (France), Rousset (France), East Kilbride (Scotland), Vught (The Netherlands), Amsterdam (The Netherlands), and Helsinki (Finland).

In 2012, gross expenditures relative to the research and development activities of the Group (net of the research tax credit and grants) represented 29.2% of its consolidated revenue (22.8% in 2011).

5.2 The Group's technologies

The technological core of the Group is composed of the following main areas of activity:

- Designing semiconductors: the design of low power chips, the architecture of microprocessors and of systems-on-chip, analog (radiofrequencies) and digital design, signal processing, security and cryptography;

- Developing software: embedded "real time" operating systems, software, middleware and applications layers and testing protocols; and

- Systems integration and packaging.

From a functional point of view, the core expertise of the Group lies in the areas of secure microcontrollers, with embedded memory and low power consumption, near field communication ("NFC") technology, transactions security and the architecture of microcontrollers.

The Group has been developing secure semiconductors and embedded software since 1995 and its history is punctuated by major innovations in the industry (for further information, please refer to section 5.1.5 "Key events in the development of the Company's business activities" of the Registration Document of the Company filed with the *Autorité des marchés financiers* (French financial markets authority) on May 16th, 2011). In recent years, it has also received numerous awards; this industry recognition highlights the research and development talents of the Group in various technical areas.

As a result of the ESS acquisition (please refer to section 1.2), the Group has enriched its technological expertise with regard to security. ESS develops intellectual property and security software using encryption algorithms. As such, ESS develops a wide range of software and toolkits based on set standards, for digital rights management ("DRM"), intended for mobile operators, service providers, and platform integrators on the server side, as well as DRM solutions on the client side for device manufacturers and suppliers of semiconductors, applications software, and platform integrators. The portfolio of ESS also includes security toolkits as well as intellectual property for the design of semiconductors and security processors for security on mobile devices and networks.

The Group plays a leading role within standardization organizations and a number of other industry organizations. As such, it is a sponsor of the NFC Forum, a member of EMVCo (as both a member of its Advisory Board and a technical expert), of the APSCA (Asia Pacific Smart Card Association), of the APTA (American Public Transportation Association), of the ETSI (European Telecommunications Standards Institute), of Eurosmart, Global Platform and of the SmartCard Alliance and founding member of the OSPT (Open Standard for Public Transport) Alliance where it chairs the Board of Managers.

## 6. Foreseeable developments and future prospects of the Company and the Group

2012 saw major changes in the business environment for INSIDE Secure leading to a decrease in both its revenue and operating performance. INSIDE Secure notably suffered from the difficulty experienced by a number of major clients of its mobile NFC division, which were impacted by the transformation of the industry, and by a slowdown in the NFC market growth.

These changes have forced the Group to swiftly adjust its development strategy and adjust its priorities on its major markets:

- On the **NFC** market: by giving priority to an innovative and differentiated offering with products such as the NFC Pulse family (INSIDE Secure's "booster" technology) and a proprietary secure element; and by leveraging the Group's patent portfolio through an ambitious licensing programme.

- On the **embedded security** market: thanks to its technology and to the acquisitions completed (Atmel-SMS in 2010 and Embedded Security Solutions ("ESS") in 2012), the Group is already a leader in solutions to secure data, transactions and communications between people, services and connected devices. INSIDE Secure intends to reinforce its global offer for the entire value chain of security applications:

    - By leveraging the ESS business to widen the Group's embedded security solutions offer on the entire value chain with a positioning at application level (eg. Virtual private network, data-protection) and to diversify the Group's revenue model with high-yield patents and royalties.

    - By combining the different technologies that the Group owns and masters in security platforms, a portfolio of solutions is being developed to address numerous markets (payments, identification, machine-to-machine, smart grid, data and intellectual property protection, fight against counterfeit, data storage or exchange…)

In this context, the Group announced on March 7, 2013 the implementation of an adjusted organization in line with this new strategy and launch of a reorganization project of its worldwide activities, which might lead to the potential reduction of around 20% of the global workforce. This project will be carried out in accordance with the laws and regulations of all relevant territories. As far as France is concerned, the project will be the subject to an "information and consultation process" with employee representative bodies. Embedded Security Solutions, acquired by the Group in December 2012, is not affected by this reorganisation. This reorganisation should lead to the disbursement of an amount estimated at $7 million. The Group aims to reduce operating expenses by $13 million on an annualised basis once the project has been fully implemented.

These measures should enable INSIDE Secure to reach the break-even point and to return to growth.

In the changing and increasingly competitive NFC market, INSIDE Secure maintains key strengths and an undisputed know-how. The Group's R&D investments will be more targeted, thus enabling, by leveraging its strengths and IP portfolio, the market launch of more differentiated products such as the proprietary embedded security element or the “booster” offering. Consistent with this focus, the Group announced in February 2013 of the commercialisation of the ComboPulse™ secured NFC module, a solution integrating the PicoPulse™ NFC “booster” chip, a VaultSEcure™ Java Card secure element, an antenna and all passive components in a small-size and ready-to-use module enabling easier NFC deployment at a reduced cost in many electronic devices such as tablets, personal media players and entry-level mobile phones and other smart mobile devices).

On the Secure Payment segment, the Group continues to focus its efforts on developing a semiconductor platform in order to position itself in the US payments market where the rollout of next generation smart card technology is expected to begin in 2013. The first platform developed by the Group for the adoption of the EMV standard in the US has recently been certified by Mastercard, and the VISA certification is on-going.

In 2013, the Group intends to step up its investments in its Digital Security division. More broadly, and in line with its strategic refocusing, the Group will strengthen its embedded, technology-intensive, solutions offering in markets increasingly interconnected with on-board security in all forms. By combining the expertise obtained through completed acquisitions, namely of ESS, the Group will thus offer solutions for securing content at the heart of some critical applications (Digital Rights Management or "DRM"), digital security and transactions.

## 7. Environmental and Corporate Information

### 7.1 Corporate Information

#### 7.1.1 Staff

As of December 31, 2012, the Group has a total of 460 employees on staff.

The distribution of employees, broken down per country, is as follows:

- 255 employees in France (assigned to 5 different work sites: Aix-en-Provence, Rousset, Sophia Antipolis, Cergy Pontoise, and Montigny-le-Bretonneux),
- 75 employees in Scotland,
- 37 employees in The Netherlands,
- 21 employees in Finland,
- 6 employees in Poland,
- 2 employees in Germany,
- 31 employees in Asia (Singapore, South Korea, China, Taiwan, Thailand), and
- 33 employees in North America (United States, Canada).

The distribution of these 460 employees, broken down per department, is as follows:

| | |
|---|---|
| Research and development | 240 |
| Operations | 93 |
| Sales and marketing | 78 |
| Support and administrative | 49 |

In recent years, the Company has mainly hired candidates with "expert" profiles. Due to their experience, they are able to meet the technological challenges inherent in the markets it conducts business in. Currently, the hiring strategy of the Company is to hire a mix of profiles, with a higher preference for "junior-level" profiles. Apprenticeships and mandatory long-term engineering post-graduate residencies are also a preferred source of recruitment for the Company.

### 7.1.2 Work hours

Company executives and non-executives (*salariés cadres et non cadres*) work 39 hours per week. They accumulate 0.62 days of overtime per month, or a total of 6.82 days per year. Absenteeism within the company is fairly weak; it is lower than the national averages for the business sector of the Company.

### 7.1.3 Labor relations and review of collective bargaining agreements

Mandatory annual negotiations (*négociations annuelles obligatoires*, hereinafter "NAO") took place in the French offices of the Group over the course of the 4th quarter of 2012 and resulted in the renewal of existing agreements.

The French companies of the Group, namely INSIDE Secure and Vault-IC France, each have a works council. INSIDE Secure has a dedicated employee delegation comprised of 6 permanent members and 6 alternates. The most recent elections took place in June 2011. Two labor unions are represented (FO and CFE CGC) in addition to persons "unaffiliated with any labor union". Vault-IC France also has a dedicated employee delegation comprised of 2 permanent members and 2 alternates. Permanent members are affiliates of the FO and CFTC labor unions.

### 7.1.4 Safety and hygiene

Every day, the Company works with the members of CHSCT in order to comply with the requirement for and guarantee good work conditions to its employees. The Company complies with applicable legal provisions in this domain.

At the Group level, the number of work-related and traveling injuries, as well as work-related illnesses, is not high.

- Number of work-related and traveling injuries reported in 2012: 6
- Number of cases of work-related illnesses reported in 2012: 0

### 7.1.5 Training

<u>Professional training within the Group</u>

The annual training initiative aims to ensure that employees are properly trained to carry out their work responsibilities and offers training focused on skills development.

Training initiatives set up by the Company are typically technical and concern job-related skills. These programs are essential for acquiring the skills to master necessary technical advancements that meet the specificities of the markets in which the Company conducts its business activities. They also help in introducing new professional tools and new work methods. This explains why such programs must be completed as soon as possible and with the best experts / trainers in the field.

Other training initiatives aim to develop cross-disciplinary skills. Here are some examples: (i) learning to work in a cross-disciplinary way in an international multi-worksite environment in which setting challenging goals and ensuring client satisfaction are top priorities, or (ii) continuing education in the development of linguistic abilities, in particular in English, which is necessary for operating in the international environment of the Company.

The goal set by the Group is to ensure that all of its employees can benefit from at least one training initiative per year.

Training partnerships

The Company often utilizes external training initiatives organized with institutions and organizations it has established partnerships with (*conventionnés*) and selected pursuant to calls for tenders. Once selected, they become true partners with which the Group works closely to meet its needs in knowledge acquisition and skills development.

The sharing of knowledge

Training within the Group also relies increasingly on the formal sharing of experience through the creation of internal training initiatives. Such internal training initiatives play an important role and the Company acknowledges this transfer of knowledge by ensuring that its internal trainers have the pedagogical skills necessary to complete this task. The professionalization of internal trainers is currently considered a priority.

Training review

Since the training of its staff represents a significant investment for the Group, measuring its effectiveness is necessary. The review process is still most often based on the impressions of participants on the training they received. Although this feedback is necessary, it is not sufficient; this is why the Company wishes to gradually implement a process to enable trainers to evaluate interns based on the knowledge they acquired.

7.1.6 Fair treatment in the workplace

(i) Gender equality

The Company aims to promote the equality of wages between men and women with similar levels of skill and experience. For that reason, the Company ensures that wages are equal when employees are hired and monitors aggregate wages paid by gender to ensure that wage increases benefit men and women proportionally.

As shown in the table below, the average salary of women in the ETAM category is higher than that of men, and in the executives category the difference in salary between men and women is due to the absence of women in executive management positions (*cadres dirigeants*), which in turn is not so much due to a Company choice as it is due to the absence of female candidates for these types of positions in the business sector of the Company.

*Annual base salary as of December 31, 2012:*

| Women | | Men | |
|---|---|---|---|
| Executives | ETAM | Executives | ETAM |
| € 47,573 | € 29,285 | € 63,057 | € 26,550 |

(ii) Anti-discrimination Policy

The Company fights against all forms of personal discrimination in all areas (hiring, promotions, disciplinary actions, training…).

In order to achieve this, it has implemented the following measures:

- No pictures on the resumes of candidates applying for jobs
- Note on job posts mentioning that the job is available to employees with disabilities
- Monthly monitoring of the equality of access to training for both women and men
- Directing managers to ensure equal access to training for all at the time of creation of their team training program.

(iii) Hiring and integration of employees with disabilities

The Company offers all of its employment positions to all potential employees without discrimination. Despite this policy, the Company believes that it hires an insufficient number of employees with disabilities, which prompted it to establish a partnership with Agefiph in order to find solutions for meeting its requirement in this area. Commissioning external companies that hire workers with disabilities in the office supplies business is, in particular, another method the Company uses to meet its requirement.

7.1.7 Social activities

The Company contributes to social activities promoted by labor organizations in France pursuant to legal provisions put in place for that purpose. Budgets benefiting social activities promoted by foreign organizations are also in place. These contributions cover, either partly or fully, the participation of employees mainly in athletic, cultural, and musical activities and events.

7.2 Environmental information

Due to the fact that the Company does not carry out any manufacturing activities in its offices (fabless model), it is not exposed to any significant direct risks of environmental harm. However, the Company pays close attention to the environmental impact of its products and is attentive to its manufacturing partners' compliance with environmental regulations. The foundries with which the Group does business as well as the subcontractors responsible for testing its products have been certified ISO 14001 (a widely recognized standard at the international level for environmental management systems), as is the majority of the subcontractors responsible for the assembly of its products.

As such, the Group closely monitors compliance with the various environmental regulations applicable across the globe.

The various worksites of the Group do not produce any waste that could harm the ecological equilibrium, natural habitats, or endangered flora and fauna.

Compliance of the business activities of the Company with legal and regulatory provisions applicable to the environment

The business activities of the Group are subject to the RoHS directive (*Restriction of the use of certain hazardous substances in electrical and electronic equipment*) (2002/95/EC), which limits the use of six substances that present both health and environmental hazards and that could be used in the manufacturing of electrical and electronic equipment, namely four heavy metals (Hg, Pb, Cd and CrVI) and two flame retardants (PBB and PBDE). Although the Group does not manufacture its own products, the Group ensures that its suppliers and subcontractors comply with this directive. In this context, all of the subcontractors of the Group disclose their RoHS analyses for the products they deliver.

REACH regulations also require information to be disclosed to clients in the event that an SVHC (Substance of Very High Concern) is present in a product at a mass concentration higher than 0.1%. In order to meet its obligations, the Group closely monitors the list of SVHC candidates updated by the European Chemicals Agency (ECHA) and takes the necessary steps with its suppliers to ensure that the products introduced to the market do not contain such substances at higher concentrations than the levels specified. The Group also closely monitors the SVHC list as it appears in Appendix XIV of REACH in order to ensure that the products of the Group do not risk being banned from the market.

The Waste Electrical and Electronic Equipment Directive ("WEEE") (2002/96/CE) allows for manufacturers to organize and finance the collection, processing, and valuation of their products at end-of-life. In order to avoid any related risk of pollution, a specialized third party company is commissioned to reprocess all of the waste resulting from equipment and products. In addition, whenever necessary, the Group reprocesses wafers and masks at its East Kilbride worksite (Scotland).

Measures taken to control and reduce the consumption of resources in water, raw materials, and energy

In 2013, the Company plans to regroup all of its Aix-en-Provence and Rousset based staff under one roof in a building labeled "BBC" (*Bâtiment Basse Consommation*, or Low Consumption Building).

In addition, a procedure has been put in place within the Company aimed at the disposal and recycling of the following waste: silicon wafers and micro-packaged chips, electrical and electronic equipment, power cells and batteries, toner and ink cartridges, and paper.

Internal services for environmental management

The quality control department of the Company is responsible for the system that manages environmental matters. All employees of the Group are briefed with respect to environmental concerns during a mandatory training module on quality.

## 7.3 Societal Commitment

### 7.3.1 The importance of subcontracting

In an effort to perform at the highest level and to remain competitive, the Company must remain very reactive and flexible. In addition, to grow beyond the limits of its own corporate structure and reinforce these two criteria, the Company has decided to seek external technical assistance.

Therefore, the Company currently works with approximately forty external service providers retained through calls for tenders. This technical assistance is mainly exercised in France.

Furthermore, the Group works with foundries and subcontractors for the testing of its products.

As such, the Group closely monitors compliance with the various environmental regulations applicable across the globe.

The Group ensures that its suppliers and subcontractors comply with this directive.

#### 7.3.2 Loyalty Practices

The Company carries out its business activities in compliance with rules of integrity. In November 2012, it implemented an ethics charter that defines the principles and values that comprise the fundamental standards of conduct expected of its employees mainly in the following areas:

- Fighting against all forms of discrimination
- Prohibiting anti-competition practices
- Prohibiting child labor and forced labor
- Preserving the confidentiality of information
- Preventing fraud
- Preventing conflicts of interest
- Allowing employees to associate freely and to engage in collective bargaining
- Prohibiting acts of corruption and influence peddling
- Relationship with shareholders and financial markets

## 8. Statutory results of INSIDE Secure S.A.

### 8.1 Analysis of the business trends and results

[TEXT INTENTIONALLY OMITTED.]

### 8.2 Statutory income statement

[TEXT INTENTIONALLY OMITTED.]

### 8.3 Statutory balance sheet

[TEXT INTENTIONALLY OMITTED.]

### 8.4 Indebtedness of the Company in relation to the volume and complexity of business

[TEXT INTENTIONALLY OMITTED.]

8.5 Distribution of profits (losses)

At the General Shareholders' Meeting, it was proposed to carry forward the loss generated in the financial year ended on December 31, 2012, representing the amount of EUR (32,311,382), and to include it in the "losses carried forward" line item, which will now reach the aggregate amount of EUR (92,586,048).

8.6 Reminder of distributed dividends

The Company has not distributed any dividends over the course of the past three financial years.

8.7 Non tax-deductible expenses

In accordance with the provisions of Article 223 *quater* of the French General Tax Code, the General Shareholders' Meeting must, in particular, approve the charges and expenses that cannot be fiscally deducted discussed in Article 39-4 of that same Code.

The corporate financial statements for the past financial year do not show any charge or expense that cannot be fiscally deducted as discussed in Paragraph 4 of Article 39 of the French General Tax Code.

8.8 Related-party Agreements

The special report of the Statutory Auditor details the agreements discussed in articles L. 225-86 *et seq.* of the French Commercial Code.

8.9 Table of financial results for the past five financial years

The tables discussed in Article R. 225-102 of the French Commercial Code and detailing the financial results of the Group and the Company over the course of the past five financial year are attached to this report and can be found in Appendices A-1 and A-2.

8.10 Delegations of authority with respect to share capital increases

In accordance with the provisions of Paragraph 4 of Article L. 225-100 of the French Commercial Code, a summary table of the currently valid and effective delegations of authority and power granted by the General Shareholders' Meeting to the Management Board for the purpose of carrying out share capital increases pursuant to the provisions of articles L. 225-129-1 and L. 225-129-2 of said Code, is attached to this report and can be found in Appendix B. The table details the use of such delegations over the course of the financial year.

The additional reports drafted by the Management Board and the Statutory Auditors at the time the Management Board uses the delegations granted to it are disclosed pursuant to applicable legal provisions.

8.11 Employee shareholding

As of the final day of the financial year, the equity holdings of employees in the share capital of the Company, calculated in accordance with the provisions of Article L. 225-102 of the French Commercial Code (in other words held in the context of collective employee shareholding), was equal to 0%[3]. The Company believes that, to its knowledge, employees of the Company hold approximately 4.1% of its share capital via direct shareholding.

8.12 Senior management of the Company

Pursuant to the decision dated May 11, 2011, the Supervisory Board renewed the term of office of Mr. Rémy de Tonnac as Chairman of the Management Board and the term of office of Mr. Pascal Didier as General Manager (*directeur général*). As such, Mr. Rémy de Tonnac and Mr. Pascal Didier represent the Company in its relations with third parties as Chairman of the Management Board and General Manager, respectively.

8.13 Information pertaining to the corporate officers (*mandataires sociaux*)

In accordance with the provisions of Article L. 225-102.1 of the French Commercial Code, the aggregate compensation and benefits of all kinds paid to each corporate officer over the course of the past financial year, by both the Company and companies in which the Company holds equity interests in the meaning of Article L. 233-16 of the French Commercial Code, are presented below:

Compensation paid to corporate officers

The information included below has been prepared in reference to the AFEP-MEDEF corporate governance code of publicly-traded companies, as updated in April 2010.

**Overview of the Compensation, stock options, and free shares granted to each member of the Management Board (*dirigeant mandataire social*)**

| | 2011 | 2012 |
|---|---|---|
| Rémy de Tonnac – Chairman of the Management Board | | |
| Compensation owed for the financial year | € 265 247 | € 261 831 |
| Valuation of stock options granted in the financial year | Not Applicable | € 28 564 |
| Valuation of shares granted free of charge in the financial year | Not Applicable | Not Applicable |
| Total | € 265 247 | € 290 395 |

[3]Article L. 225-102 of the French Commercial Code: the report that the Management Board presents to the General Shareholders' Meeting provides an annual account of the state of the equity stake held by employees in the share capital of the Company as of the last day of the financial year. It also shows the ratio, to the share capital, of the shares held by the employees of the Company and companies related to it in the meaning of Article L. 225-180 in the context of the company savings plan (*plan d'épargne d'entreprise*) provided for under Article L. 3332-1 to L. 3332-28 of the French Labor Code, and of the shares held by current and former employees in the context of *fonds communs de placement d'entreprise* (French collective employee shareholding vehicle(s), or "FCPE(s)") (…). Also included in this ratio are the shares that employees hold via direct shareholding during the lock-up periods provided for under articles L. 225-194 and L. 225-197, under Article 11 of the French Law dated August 6, 1986 pertaining to the terms and conditions of privatization (*la loi du 6 août 1986 relative aux modalités des privatisations*), and under Article L. 3324-10 of the French Labor Code.

| | 2011 | 2012 |
|---|---|---|
| Richard Vacher Detournière – member of the Management Board | | |
| Compensation owed for the financial year | € 206 428 | € 221 001 |
| Valuation of stock options granted in the financial year | Not Applicable | Not Applicable |
| Valuation of shares granted free of charge in the financial year | Not Applicable | Not Applicable |
| Total | € 206 428 | € 221 001 |

| | - | 2012 |
|---|---|---|
| Pierre Garnier – member of the Management Board (1) | | |
| Compensation owed for the financial year | | € 113 479 |
| Valuation of stock options granted in the financial year | | Not Applicable |
| Valuation of shares granted free of charge in the financial year | | € 144 952 |
| Total | | € 258 431 |

| | 2011 | 2012 |
|---|---|---|
| Pascal Didier – General Manager, member of the Management Board | | |
| Compensation owed for the financial year | € 172 517 | € 172 596 |
| Valuation of stock options granted in the financial year | Not Applicable | Not Applicable |
| Valuation of shares granted free of charge in the financial year | Not Applicable | € 8 102 |
| Total | € 172 517 | € 180 698 |

| | 2011 | 2012 |
|---|---|---|
| Christian Fleutelot – member of the Management Board | | |
| Compensation owed for the financial year | € 182 217 | € 175 853 |
| Valuation of stock options granted in the financial year | Not Applicable | Not Applicable |
| Valuation of shares granted free of charge in the financial year | Not Applicable | Not Applicable |
| Total | € 182 217 | € 175 853 |

(1) Pierre Garnier joined the Company on August 20th, 2012

The Supervisory Board decided that members of the Management Board would be required to hold, in registered form and until the termination of their duties on the Management Board, 10% of the number of shares issued as a result of the exercise of stock options or the effective vesting of free shares.

**Overview of the compensation of each member of the Management Board**

The table below shows the compensation due to members of the Management Board of the Company for the financial years ended December 31, 2011 and 2012 and the compensation paid to those members for the said years.

| | 2011 | | 2012 | |
|---|---|---|---|---|
| | Due[(1)] | Paid[(2)] | Due[(1)] | Paid[(2)] |
| Rémy de Tonnac – Chairman of the Management Board | | | | |
| Fixed portion* | € 216 134 | € 216 134 | € 218 707 | € 218 707 |
| Variable portion* [(3)] | € 48 933 | € 77 211 | € 32 420 | € 48 933 |
| Extraordinary compensation* | Not Applicable | 0 | Not Applicable | Not Applicable |
| Attendance fees | Not Applicable | 0 | Not Applicable | Not Applicable |
| Benefits in kind* | € 180 | € 180 | € 10 704 | € 10 704 |
| Total | € 265 247 | € 293 525 | € 261 831 | € 278 344 |

| | 2011 | | 2012 | |
|---|---|---|---|---|
| | Due[(1)] | Paid[(2)] | Due[(1)] | Paid[(2)] |
| Richard Vacher Detournière – Member of the Management Board | | | | |
| Fixed portion* | € 165 007 | € 165 007 | € 166 657 | € 166 657 |
| Variable portion* [(3)] | € 41 301 | € 45 741 | € 52 234 | € 58 148 |
| Extraordinary compensation* | Not Applicable | Not Applicable | Not Applicable | Not Applicable |
| Attendance fees | Not Applicable | Not Applicable | Not Applicable | Not Applicable |
| Benefits in kind* | € 120 | € 120 | € 120 | € 120 |
| Total | € 206 428 | € 210 868 | € 221 001 | € 224 925 |

| | 2011 | | 2012 | |
|---|---|---|---|---|
| | Due(1) | Paid(2) | Due(1) | Paid(2) |
| Pierre Garnier(4) – Member of the Management Board | | | | |
| Fixed portion* | | | € 70 641 | € 70 641 |
| Variable portion* (3) | | | € 40 838 | 0 |
| Extraordinary compensation* | | | Not Applicable | Not Applicable |
| Attendance fees | | | Not Applicable | Not Applicable |
| Benefits in kind* | | | Not Applicable | Not Applicable |
| Total | | | € 113 479 | € 70 641 |

| | 2011 | | 2012 | |
|---|---|---|---|---|
| | Due(1) | Paid(2) | Due(1) | Paid(2) |
| Pascal Didier – General Manager, member of the Management Board | | | | |
| Fixed portion* | € 145 963 | € 145 963 | € 146 786 | € 146 786 |
| Variable portion* (3) | € 26 434 | € 42 322 | € 25 690 | € 26 434 |
| Extraordinary compensation* | Not Applicable | Not Applicable | Not Applicable | Not Applicable |
| Attendance fees | Not Applicable | Not Applicable | Not Applicable | Not Applicable |
| Benefits in kind* | € 120 | € 120 | € 120 | € 9 423 |
| Total | € 172 517 | € 188 405 | € 172 596 | € 182 642 |

| | 2011 | | 2012 | |
|---|---|---|---|---|
| | Due(1) | Paid(2) | Due(1) | Paid(2) |
| Christian Fleutelot – member of the Management Board | | | | |
| Fixed portion* | € 158 715 | € 158 715 | € 160 302 | € 160 302 |
| Variable portion* (3) | € 20 141 | € 15 000 | € 12 183 | € 20 141 |
| Extraordinary compensation* | Not Applicable | 0 | Not Applicable | Not Applicable |
| Attendance fees | Not Applicable | 0 | Not Applicable | Not Applicable |
| Benefits in kind* | € 3 361 | € 3 361 | € 3 368 | € 3 368 |
| Total | € 182 217 | € 177 076 | € 175 853 | € 183 811 |

(1) for the fiscal year
(2) over the course of the fiscal year
(3) the variable portion includes annual profit-sharing (*intéressement*)
(4) Pierre Garnier jointed INSIDE Secure on August 20, 2012
* On a gross basis before taxes

The variable portion of the compensation of Rémy de Tonnac and Pascal Didier, for the financial year ended December 31, 2012, were determined by the Supervisory Board of the Company, based on a proposal from the compensation and appointment committee, according to the following criteria: (i) Company financial objectives for up to 60%, and (ii) qualitative objectives (priority actions for the Company, for example, the launching of new products) for up to 40%.

For the financial year ended December 31, 2012, the variable portion of the compensation of the other members of the Management Board, by virtue of their respective employment contracts, was determined based on the following criteria: (i) individual qualitative objectives (priority actions for their areas of responsibilities, for example, certification of products) for up to 80%, and (ii) Company financial objectives for up to 20%.

The table below offers additional information on the conditions of compensation and other benefits granted to members of the Management Board:

| Members of the Management Board | Employment Contract | | Additional Pension Plan | | Compensation or benefitis owed or likely to be owed as a result of termination of duties or a change in duties | | Compensation associated with a non-compete clause | |
|---|---|---|---|---|---|---|---|---|
| | Yes | No | Yes | No | Yes | No | Yes | No |
| Rémy de Tonnac, Chairman of the Management Board | | X | | X | X | | X | |
| *Term of office began on:* | May 11, 2011 | | | | | | | |
| *Term of office will end on:* | Following the Annual Shareholders' Meeting approving the financial statements for the financial year ended on December 31, 2014 | | | | | | | |
| Richard Vacher Detournière Member of the Management Board | X | | | X | X | | X | |
| *Term of office began on:* | May 11, 2011 | | | | | | | |
| *Term of office will end on:* | Following the Annual Shareholders' Meeting approving the financial statements for the financial year ended on December 31, 2014 | | | | | | | |
| Pierre Garnier Member of the Management Board | X | | | X | | X | X | |
| *Term of office began on:* | November 21, 2012 | | | | | | | |
| *Term of office will end on:* | Following the Annual Shareholders' Meeting approving the financial statements for the financial year ended on December 31, 2014 | | | | | | | |

| Members of the Management Board | Employment Contract | | Additional Pension Plan | | Compensation or benefitis owed or likely to be owed as a result of termination of duties or a change in duties | | Compensation associated with a non-compete clause | |
|---|---|---|---|---|---|---|---|---|
| Pascal Didier<br>General Manager and Member of the Management Board | X | | | X | X | | X | |
| *Term of office began on:* | May 11, 2011 | | | | | | | |
| *Term of office will end on:* | Following the Annual Shareholders' Meeting approving the financial statements for the financial year ended on December 31, 2014 | | | | | | | |
| Christian Fleutelot<br>Member of the Management Board | X | | X | | | X | | X |
| *Term of office began on:* | May 11, 2011 | | | | | | | |
| *Term of office will end on:* | Following the Annual Shareholders' Meeting approving the financial statements for the financial year ended on December 31, 2014 | | | | | | | |

At its meeting dated February 19, 2013, the Supervisory Board decided to adjust the terms of the severance compensation that Rémy de Tonnac and Pascal Didier benefit from. Each of them has heretofore the right to claim such compensation in the event of:

(i) termination or non-renewal of his term of office as member of the Management Board (or dismissal) for a reason other than gross negligence (*faute lourde*) in the meaning of the jurisprudence of the labor division of the French Supreme Court (*chambre sociale de la cour de cassation*),

(ii) resignation for good cause (either due to a significant reduction in duties and responsibilities, a reduction in compensation (including fixed compensation, benefits in kind, target variable compensation, or severance compensation), or a change in his or her work location to another country, in every case without his or her consent) within six months of a change in control of the Company in the meaning of Article L. 233-3 of the French Commercial Code, or

(iii) termination or resignation of his term of office as member of the Management Board (or dismissal), following a significant disagreement between the Supervisory Board and the Management Board regarding the strategy carried out by the Management Board, irrespective of whether such strategy was carried out pursuant to a change in control of the Company.

The Supervisory Board will determine the amount of severance compensation paid to the member in question in the following way:

Maximum severance compensation will be equal to the sum of the gross fixed compensation received by the member in question over the course of the year preceding that during which his or her resignation, termination, or dismissal took place, plus the gross variable compensation received by the member in question over the course of the two years preceding that during which his or her resignation, termination, or dismissal took place (hereinafter referred to as the

"Maximum Amount"), it being hereby understood that the effective date of his or her resignation, termination, or dismissal will be defined as, depending on the case, the date on which the member in question receives the termination letter (or letter of dismissal), or the date on which the Company receives the resignation letter.

Their share in profits will be subject to and the amount adjusted based on the arithmetic average of the rate of achievement of the objectives that determine the variable portion of the compensation of the member in question over the course of the last two financial years preceding his or her resignation, termination, or dismissal. As such, if this average is:

- strictly lower than 20%, no severance compensation will be paid out,
- between 20% and 50%, the member in question will receive severance compensation in an amount equal to the gross fixed compensation for the year in which his or her resignation, termination, or dismissal took place,
- higher than or equal to 50%, the member in question will receive severance compensation in an amount equal to 100% of the Maximum Amount.

This severance compensation will include the amount of any statutory compensation (which includes, as the case may be, any compensation provided for by law and under any applicable labor agreement), yet exclude any amounts associated with potential non-compete compensation. However, in the event that the amount to which the member in question has a rightful claim as severance compensation and non-compete compensation is higher than twice the amount of the fixed compensation and target variable compensation (assuming that, pertaining to the variable portion, all objectives are fully reached) owed to the member in question in the year in which his or her resignation, termination, non-renewal, or dismissal took place, the amount of his or her severance payments will be reduced in such a way as to ensure that such amount, to which is added any non-compete compensation, does not exceed twice the amount of the fixed compensation and target variable compensation. In addition, it should be noted that, insofar as necessary, the amount of severance compensation paid to the member in question cannot be lower than the minimum amount provided for by law and under any applicable labor agreement.

It should be noted, insofar as necessary, that no severance compensation will be owed in the event that the term of office of the member in question is terminated or non-renewed, or that the member in question is dismissed or resigns from his or her duties as corporate officer, while remaining an employee of the Group, assuming that he or she is neither subject to a significant reduction in his or her duties, responsibilities, or compensation (including his or her fixed compensation, benefits in kind, target variable compensation, or severance compensation) nor subject to a transfer of his or her work location to another country, and further assuming that such decisions were made without his or her consent.

Severance compensation will be paid within 30 days of the member's effective departure from the Group.

In addition, the member in question will have the right to exercise or to be immediately granted all of the stock options, free shares, and any other capital profit-sharing instruments he or she benefits from, insofar as this is legally feasible and assuming that it does not have significant adverse effects on the tax or social security treatment applicable to the Group.

The terms applicable to the severance compensation that Richard Vacher Detournière benefits from remain unchanged (for more information see section 8.1.12 of the 2011 Annual Financial Report).

**List of board positions held and job duties performed by members of the Management Board and of the Supervisory Board in any other companies**

| Name | Main job duties performed at any other companies | Other positions held on the board of any other companies |
|---|---|---|
| Rémy de Tonnac<br><br>Chairman of the Management Board | Not Applicable | - YesPay Limited (United Kingdom) – Director<br>- INSIDE Secure S.A. (France) – Chairman of the Management Board<br>- INSIDE Secure Corp. (United States) – Chairman of the Board of Directors<br>- INSIDE Secure (Asia) Ltd Pte (Singapore) - Director |
| Richard Vacher Detournière<br><br>Member of the Management Board | Not Applicable | - INSIDE Secure SA (France) – Member of the Management Board and Chief Financial Officer<br>- INSIDE Secure France SAS – Chief Executive Officer<br>- INSIDE Secure B.V (The Netherlands) - Director<br>- INSIDE Secure Amsterdam B.V (The Netherlands) - Director<br>- INSIDE Secure Oy (Finland) - Director<br>- Vault-IC UK Ltd (United Kingdom) – Director<br>- Knowings SA (France) – Director |
| Christian Fleutelot<br><br>Member of the Management Board | Not Applicable | - INSIDE Secure S.A. (France) – Member of the Management Board<br>- Vault-IC France SAS (France) – Chief Executive Officer |
| Pascal Didier<br><br>General Manager | Not Applicable | - INSIDE Secure S.A. (France) – Member of the Management Board and General Manager and Corporate Secretary<br>- INSIDE Secure France SAS – Permanent representative of the Company that acts as Chairman<br>- INSIDE Secure Corp. (United States) - Director<br>- INSIDE Secure (Asia) Ltd Pte (Singapore) - Director<br>- INSIDE Secure Poland SP zo.o. (Poland) – Manager (*gérant*)<br>- Vault IC France SAS – Permanent representative of the Company that acts as Chairman |

| Name | Main job duties performed at any other companies | Other positions held on the board of any other companies |
|---|---|---|
| Pierre Garnier<br><br>Member of the Management Board | Not Applicable | - Yellovent SAS (France) - Chairman |
| Alex Brabers<br><br>Chairman of the Supervisory Board | GIMV, Executive Vice President for Venture Capital | - Gimv Arkiv Tecnology Fund (Belgium) – Director<br>- Gimv Arkiv Technology Fund II (Belgium) - Director<br>- Automation (Belgium) - Director<br>- I&I Leuven (Belgium) - Director<br>- OTN Systems (Belgium) - Director<br>- Nomadesk (Belgium) - Director<br>- Oree (United States) - Director<br>- Telenet (Belgium) - Director<br>- Festival Van Vlaanderen (Belgium) – Director<br>- Several Investment Vehicles managed by Gimv<br>- EVCA (Belgium) - Director |
| Jean Schmitt<br><br>Vice Chairman of the Supervisory Board | JoltTech Capital, Managing Director | - Celsius X VI II (France) - Director<br>- Heptagon – Director<br>- JS Maintenance SAS (FR)<br>- Superjolt SAS (FR) and its subsidiary Jolt SAS (FR) – Chairman<br>- Groupe Hattemer SAS (FR) – Chairman<br>- JoltTech SAS (FR) – Chief Executive Officer |
| Patrick Schwager Jones<br><br>Member of the Supervisory Board | Not Applicable | - Lattice Semiconductor Corp (United States) – Chairman of the Board of Directors<br>- Fluidigm (United States) - Director<br>- Epocrates Inc. (United States) - Chairman of the Board of Directors<br>- Vesta inc. (United States) – Director<br>- Dialogic Inc. – Chairman of the Board of Directors |
| Ronald Black *<br><br>Member of the Supervisory Board | Rambus, Chairman | - EnOcean (Germany) – Director |
| Glenn Collinson<br><br>Member of the Supervisory Board | Not Applicable | - Wolfson Microelectronics Group Plc (United Kingdom) - Director<br>- Solar Press Ltd (United Kingdom) – Director<br>- Neul Ltd (United Kingdom) – Director |

| Name | Main job duties performed at any other companies | Other positions held on the board of any other companies |
|---|---|---|
| Joëlle Toledano<br><br>Member of the Supervisory Board | Not Applicable | - Résidentiel Numérique (France) – Director<br>- Agence Nationale des Fréquences (ANFR) (France) – Director |
| *Fonds stratégique d'investissement*<br><br>Represented by Thierry Sommelet<br><br>Member of the Supervisory Board | Not Applicable | - AD Industrie (France) – Member of the Collegial Committee<br>- Altrad (opco) (France) – Director<br>- Altrad Investment Authority – Member of the Monitoring Committee<br>- Assystem (France) – Member of the Supervisory Board<br>- CDC Entreprises Capital Investissement (France) – Director<br>- Cegedim (France) – Director<br>- Constellium (Omega Holdco B.V.) – Director<br>- Crystal (Ercom) (France) – Member of the Supervisory Board<br>- Cylande SA (France) – Director<br>- De Dietrich (France) – Director<br>- Eramet (France) – Director<br>- Eutelsat Communications (France) – Director<br>- Farinia (France) – Director<br>- Fidec (Cylande) (France) – Member of the Monitoring Committee<br>- Financière Du Millénium (Gruau) (France) – Director |

| Name | Main job duties performed at any companies | Other positions held on the board of any companies |
| --- | --- | --- |
| *Fonds stratégique d'investissement*<br><br>Represented by Thierry Sommelet<br>Member of the Supervisory Board | Not Applicable | - FSI PME Portefeuille (France) – Director<br>- FT1CI (STM) (France) – Director<br>- Greenbureau SA – Chairman of the Supervisory Board (Thierry Sommelet as official name)<br>- Grimaud (Groupe Grimaud La Corbière) (France) – Director<br>- HIME (Saur) (France) – Director<br>- Mäder (France) – Director<br>- Meca Dev (Mecachrome) (France) – Member of the Monitoring Committee<br>- NGE (France) – Member of the Strategic Committee<br>- Novasep Holding SAS (France) – Member of the Supervisory Board<br>- Paprec Holding (France) – Director<br>- Sequana (France) – Director<br>- Soprol (venture capital company for oleaginous goods) (France) – Director<br>- Tinubu Square (France) – Director<br>- Tokheim Luxco SA – Director<br>- Tokheim Luxco 2 SA – Director<br>- Vergnet (France) – Member of the Supervisory Board<br>- Viadeo (France) – Director<br>- Tyrol Acquisition 1 (holding company of TDF) – Director<br>- Tyrol Acquisition 2 (holding company of TDF) – Director |

| Name | Main job duties performed at any companies | Other positions held on the board of any companies |
|---|---|---|
| Sofinnova Partners<br>Represented by Olivier Sichel<br>Member of the Supervisory Board | Not Applicable | - OpenERP (Belgium) – Permanent representative<br>- Solutions30 (France) – Permanent representative<br>- Taptu (Great Britain) – Director<br>- Twenga (France) – Permanent representative<br>- Mydeco (Great Britain) – Permanent representative<br>- blueKiwi (France) – Permanent representative<br>- Sofipost (France) – Director<br>- Osconseil – Chairman<br>- LeGuide.com – Chairman and Chief Executive Officer |

* *On February 28, 2013, Ronald Black resigned from his duties as member of the Supervisory Board of the Company.*

## 9. Other corporate information

9.1 Significant equity stakes acquired in companies with registered headquarters located in France or takeovers of such companies and disposals of such equity stakes

In accordance with the provisions of Article L. 233-6 of the French Commercial Code, the Company affirms that it has not, over the course of the 2012 financial year, acquired any equity or disposed of any equity in a company for which the registered headquarters are located in France.

In addition, within the context of the acquisition of Embedded Security Solutions dated December 1, 2012, the Company acquired 100% of the shares of INSIDE Secure B.V, which held 100% of the shares of INSIDE Secure Amsterdam B.V and 100% of the shares of INSIDE Secure Oy. These companies are mainly concerned research and development activities and the marketing of software products.

9.2 Businesses of subsidiaries and of held companies

INSIDE Secure S.A. is the parent company of the Group and its main operating company. It holds a major portion of the assets of the Group and is concentrating on most operating flows associated with the business (which include handling practically all purchased inventories and invoicing the customers of the Group).

As of December 31, 2012, the Company held an equity interest in the following subsidiaries (all of which are wholly owned):

- INSIDE Secure Corporation (Redwood City, California, United States) is a subsidiary in which the Company holds a 100% equity stake. Its main business activity is sales development and technical support. As of December 31, 2012, this subsidiary had 33 employees on staff.

- INSIDE Secure Poland Sp z o.o. (Warsaw, Poland) is a subsidiary in which the Company holds a 100% equity stake. Its main business activity is research and development. As of December 31, 2012, this subsidiary had 6 employees on staff.

- INSIDE Secure Asia Pte Ltd. (Singapore) is a subsidiary in which the Company holds a 100% equity stake. Its main business activity is research and development. As of December 31, 2012, this subsidiary had 8 employees on staff.

- Vault-IC UK Ltd. (London, United Kingdom) is a subsidiary in which the Company holds a 100% equity stake. Its main business activities, which are carried out at its only worksite located in East Kilbride (Scotland), are research and development and product engineering. The Company acquired this subsidiary in the context of the acquisition of the SMS business of Atmel Corp. on September 30, 2010. As of December 31, 2012, this subsidiary had 75 employees on staff.

- Vault-IC France SAS (Paris, France) is a subsidiary in which the Company holds a 100% equity stake. The Company acquired this subsidiary in the context of the acquisition of the SMS business of Atmel Corp. It is a passive holding company for which business transactions are carried out at its secondary office in Rousset, France, which had 75 employees on staff as of December 31, 2012.

- INSIDE Secure B.V. (Vught, The Netherlands) is a subsidiary in which the Company holds a 100% equity stake. Its main business activities are research and development and the marketing of intellectual property blocks intended for the design of security processors. The Company acquired this subsidiary in the context of the acquisition of the ESS business on December 1, 2012. As of December 31, 2012, this subsidiary had 30 employees on staff.

- INSIDE Secure Amsterdam B.V. (Amsterdam, The Netherlands) is a subsidiary in which INSIDE Secure B.V. holds a 100% equity stake. Its main business activities are research and development and software marketing. As of December 31, 2012, this subsidiary had 7 employees on staff.

- INSIDE Secure Oy (Helsinki, Finland) is a subsidiary in which INSIDE Secure B.V. holds a 100% equity stake. Its main business activities are research and development and software marketing. As of December 31, 2012, this subsidiary had 21 employees on staff.

- INSIDE Secure France SAS (Aix-en-Provence, France) is a subsidiary in which the Company holds a 100% equity stake. The Company created this subsidiary in December 2012. It carries out no commercial activity and does not have any employees on staff.

Main information on the assets of the companies of the Group can be summarized as follows (expressed in functional currency and in accordance with IFRS):

| **Consolidated assets as of December 31, 2012**<br><br>In thousands of Dollars | Vaut-IC UK Ltd. | Vaut-IC France | ESS Subsidiaries | Other Subsidiaries | INSIDE Secure | **Consolidated Total** |
|---|---|---|---|---|---|---|
| Fixed assets | 4 417 | 4 212 | 140 | 285 | 77 123 | **86 177** |
| Cash and cash equivalents | 79 | 450 | 1 028 | 945 | 63 819 | **66 321** |
| Inventories | 0 | 0 | 0 | 0 | 17 350 | **17 350** |
| Intangible liabilities | 0 | 0 | 0 | 0 | 12 218 | **12 218** |
| Accounts payable | 215 | 1 197 | 106 | 19 | 26 798 | **28 335** |

## 9.3 Information on share capital distribution and own shares held – Share repurchase program

*Share Capital Distribution*

In accordance with the provisions of Article L. 233-13 of the French Commercial Code, and based on the information received pursuant to articles L. 233-7 and L. 233-12 of said code, the identity of the shareholders who, to the Company's knowledge, directly or indirectly hold more than a twentieth, a tenth, three twentieths, on fifth, one quarter, one third, half, two thirds, eighteen twentieths, or nineteen twentieths of the share capital or voting rights at general shareholders' meetings of the Company as of December 31, 2012 is provided below:

| Shareholders | As of December 31, 2012 | | |
|---|---|---|---|
| | Number of Shares | % of the share capital | % of the voting rights |
| FCPR Sofinnova Capital V | 4 695 488 | 13.81 | 13.82 |
| GIMV N.V. | 4 254 171 | 12.51 | 12.52 |
| Fond Stratégique d'Investissement | 2 423 991 | 7.13 | 7.14 |

In July 2012, Invesco Ltd., a company established in the United States, acting on behalf of funds it manages, notified that on July 3, 2012 it exceeded the 5% threshold on INSIDE Secure equity and voting rights held, and that it currently held on behalf of said funds 1,658,197 INSIDE Secure shares and an equivalent amount of voting rights, or 5.04% of the share capital and voting rights of the Company. This threshold crossing is a result of an acquisition of INSIDE Secure shares on the market. Invesco Ltd. notified that on April 8, 2013 it fell below the 5% threshold on INSIDE Secure equity and voting rights held and that its current holdings on behalf of said funds were equal to 1,654,216 shares, or 4.87% of the share capital and voting rights, following a sale of Inside shares on the market.

*Treasury shares*

Other than the shares acquired in the context of a liquidity agreement, the Company does not hold any other treasury shares.

*Share Repurchase Program*

On March 8, 2012, the Company entered into a liquidity agreement with Natixis and allocated an amount of EUR 500,000 to it.

*Number of shares acquired and sold over the course of the 2012 financial year*

Under the liquidity agreement, over the course of the 2012 financial year,

- 526,265 shares were acquired at the average share price of EUR 3.9015, and
- 499,913 shares were sold at the average share price of EUR 3.3822.

The Company did not repurchase any of its own shares for other reasons.

*Number and value of treasury shares held as of December 31, 2012*

Based on the acquisitions and sales completed over the course of the financial year, the balance of the liquidity agreement was equal to 26,352 as of December 31, 2012. As of that date, the value of the portfolio was equal to EUR 74,313.64 based on the closing price on December 31, 2012, or EUR 2.82.

The Company did not notify any other company to declare that it held more than 10% of its share capital.

The Company does not have any cross ownership equity and therefore has not sold any of its own shares.

9.4 Restrictions imposed by the Board regarding the exercise of granted stock options or the sale of shares granted free of charge to senior executives (*dirigeants*).

Please refer to the paragraph on the "Compensation paid to the corporate officers" in the section above entitled "Information pertaining to corporate officers".

9.5 Changes that occurred over the course of the financial year regarding the share capital distribution – Adjustment of the terms of conversion and the conditions applicable to the subscription or exercise of securities granting access to the share capital and of stock options.

| | Number | Par value (Euros) | Share Capital (Euros) |
|---|---|---|---|
| 1. Shares comprising the share capital at the beginning of the financial year | 21 724 324 | 0.40 | 8 689 729.60 |
| 2. Shares cancelled over the course of the financial year | N/A | N/A | N/A |
| 3. Shares issued during the financial year | | | |
| January 20, 2012: conversion of the Class D preferred shares into ordinary shares | 1 449 144 | 0.40 | 9 269 387.20 |
| February 17, 2012: share capital increase as a result of the initial public offering | 8 313 250 | 0.40 | 12 594 687.20 |
| February 23, 2012: share capital increase as a result of the exercise of the over-allocation option | 1 246 986 | 0.40 | 13 093 481.60 |
| April 6, 2012: share capital increase by consideration in cash (exercise of stock options) | 40 481 | 0.40 | 13 109 674.00 |
| April 6, 2012: definitive vesting of free shares | 69 138 | 0.40 | 13 137 329.20 |
| December 20, 2012: definitive vesting of free shares | 1 116 000 | 0.40 | 13 583 729.20 |
| December 20, 2012: share capital increase by consideration in cash (exercise of stock options) | 34 239 | 0.40 | 13 597 424.80 |
| Shares comprising the share capital at the end of the financial year | 33 993 562 | 0.40 | 13 597 424.80 |

No adjustment of the terms of conversion and the conditions applicable to the subscription or exercise of securities granting access to the share capital and of stock options was made over the course of the past financial year other than the mathematical adjustment resulting from the four to one split in the par value of the shares, as decided by the Combined Ordinary and Extraordinary Shareholders' Meeting dated May 11, 2011.

## 9.6 Fluctuation of the security – Risk of share price fluctuation

From the first listing of the shares of the Company on the NYSE Euronext regulated market in Paris on February 17, 2012 until the close of business on the day preceding that on which this report was drafted on April 24, 2013 (or 300 French stock market trading days), 18,184,969 securities were exchanged.

The security, which traded at EUR 8.3 when the shares were initially listed, had dropped to EUR 2.42 by the date on which this report was drafted (closing price on the previous day).

The lowest recorded share price was equal to EUR 1.8 on 7 March 2013 and the highest recorded share price was equal to EUR 9.99 on 20 March 2012.

The stock market capitalization of the Company as of 24 April 2013 (based on the closing price on the previous day) was equal to EUR 79,563,705.

### 9.7 Overview of the transactions of over EUR 5,000 in value involving the securities of the Company carried out by senior executives and the persons referred to in Article L. 621-18-2 of the French Monetary and Financial Code and completed over the course of the past financial year

Not applicable.

### 9.8 Information required pursuant to Article L. 225-100-3 of the French Commercial Code

#### 9.8.1 Share Capital Structure of the Company

| Shareholders | As of December 31, 2012 | | |
|---|---|---|---|
| | Number of shares | % of the share capital | % of the voting rights |
| FCPR Sofinnova Capital V | 4 695 488 | 13.81 | 13.82 |
| GIMV N.V. | 4 254 171 | 12.51 | 12.52 |
| Fond stratégique d'investissement | 2 423 991 | 7.13 | 7.14 |
| Members of the Management Board | 633 072 | 1.86 | 1.86 |
| Treasury shares | 26 352 | 0.08 | 0°% |
| Free float | 21 9060 488 | 64.60 | 64.65 |

#### 9.8.2 Statutory restrictions on the exercise of voting rights and on share transfers or the clauses notified to the Company pursuant to the terms of Article L. 233-11 of the French Commercial Code

Not applicable

#### 9.8.3 Direct or indirect equity interests held in the share capital of the Company of which it is aware by virtue of articles L. 233-7 and L. 233-12 of the French Commercial Code

Please refer to the section above entitled "Information on share capital distribution and own shares held – Share repurchase program".

### 9.8.4 List of holders of any securities bearing special control rights and the description of such rights

The Company has no knowledge of the existence of any special control rights.

### 9.8.5 Control mechanisms in place in the event of a potential employee shareholding system, whenever the control rights are not exercised by such employees

The Company has not implemented any employee shareholding system that could contain control mechanisms whenever the control rights are not exercised by the staff.

### 9.8.6 Agreements between shareholders of which the Company is aware and that could trigger restrictions on the transfer of shares and on the exercise of voting rights

Not applicable

### 9.8.7 Rules applicable to the appointment and replacement of members of the Management Board and to amending the By-Laws

The rules applicable to such matters are statutory and in compliance with the law.

### 9.8.8 Powers of the Management Board, in particular the issuance or repurchase of shares

The Combined Ordinary and Extraordinary Shareholders' Meeting of the Company dated January 20, 2012 authorized the Management Board to implement, for a period of eighteen months from the date of such Meeting, a share repurchase program under provisions of articles L. 225-209 *et seq.* of the French Commercial Code and the market practices accepted by the AMF, under the precedent and non-retroactive condition of the initial public offering of the Company (which took place on February 17, 2012). The principal terms of this authorization are as follows:

Maximum number of shares to be purchased: 10% of the total number of shares, at any time, being specified that, when shares are acquired in order to improve the liquidity of the shares of the Company, the number of shares used to calculate this limit is the number of shares purchased minus the number of shares sold during the authorized period and when the shares are acquired to be held and subsequently delivered as payment or in exchange during a merger, division or contribution, the number of shares purchased may not exceed 5% of the total number of shares;

Purpose of the share repurchase:

- ensure the liquidity of shares under a liquidity contract to be concluded, as the case may be, with an investment services provider, in compliance with the charter of ethics of the *Association française des marchés financiers* (AMAFI) dated March 8, 2011,
- meet obligations related to stock option plans, free share plans, employee savings plans, or other grants of shares to employees and corporate officers of the Company or of the companies related to it,
- deliver shares in connection with the exercise of rights attached to securities giving access to the share capital;
- acquire shares to be held and subsequently exchanged or used as payment in connection with potential external growth transactions, or
- cancel all or part of the shares acquired in this way,

- maximum purchase price (excluding fees and commission): 200% of the price per share that will be retained for the initial public offering of the Company.

Regarding this point, it is hereby reminded that on March 8, 2012 the Company had signed a liquidity contract with Natixis and had allocated EUR 500,000 to it. The transaction summary for this liquidity contract over the course of 2012 is described in section 9.3 above.

9.8.9 Agreements entered into by the Company that are modified or terminated in the event of a change in control of the Company

In the course of its business activities, the Company has signed or renewed various significant contracts that would be modified or terminate in the event of a change in control of the Company:

- *Core license agreement* between Atmel Corp. and the Company on September 30, 2010,

- *Patent License Agreement* between Atmel Corporation and Cryptography Research Inc. on August 12, 2009 transferred to the Company in the context of the acquisition of the SMS business of Atmel Corporation,

- *Tamper Resistance License Agreement* between the Company and Cryptography Research, Inc. on July 1, 2009,

- *Technology License Agreement* between ARM Limited and the Company on October 1, 2010 and amended on March 30, 2011,

- *NFC Technological License Agreement* between Intel Corp. and the Company that took effect on August 23, 2011,

- *ESF3-110 Technology License Agreement* between Silicon Storage Technology, Inc., Silicon Storage Technology B.V. and the Company on June 13, 2011.

The main terms of these significant contracts are described in Chapter 22 (“Key Contracts”) of the Registration Document filed with the AMF on May 16, 2011 under number I.11-027 and of its first update filed with the AMF on October 25, 2011 under number D.11-0480-A01.

9.8.10 Agreements providing for compensation for the members of the Management Board or the staff, in the event of their resignation or dismissal without an actual or serious reason (*sans cause réelle ou sérieuse*) or if their employment contract is terminated as a result of a public offering

Please refer to section 8.1.12 above.

The Management Board

# APPENDIX TO THE REPORT OF THE MANAGEMENT BOARD

# Appendix A-1

## Summary of results of the Group for the last five years

[TEXT INTENTIONALLY OMITTED.]

# Appendix A-2

## Summary of results of the Company for the last five years

[TEXT INTENTIONALLY OMITTED.]

# Appendix B

## Table of delegations of power granted to the Management Board for carrying out share capital increases

At the General Shareholders' Meeting dated May 11, 2011, the Management Board was granted a certain number of delegations of power to carry out share capital increases. Such delegations were not used and were cancelled at the General Shareholders' Meeting dated January 20, 2012. It should be noted that the Management Board did not use any delegation of power applicable to share capital increases over the course of the financial year ended on December 31, 2011.

As of the date of this report, the delegations of power applicable for share capital increases that are currently valid are those delegations of power described below and granted to the Management Board at the General Shareholders' Meeting dated January 20, 2012, it being specified that prior to using one of the delegations, the Management Board must submit the principle of the planned transaction to the Supervisory Board:

| | ***Maximum nominal amounts (in Euros)*** | ***Amount used by the Management Board*** | ***Outstanding Balance*** |
|---|---|---|---|
| *1. Delegation of power granted to the Management Board to increase share capital by issuing ordinary shares or any securities giving immediate or future access to share capital, with preferential subscription right* | *6 285 121* | *None applicable* | *6 285 121* |
| *2. Delegation of power granted to the Management Board to increase share capital by issuing ordinary shares or any securities giving immediate or future access to share capital without preferential subscription rights and public offering as well as with the ability to establish a priority right (1) (2)* | *6 105 546* | *3 325 300 + 498 794.40 (pursuant to the delegation discussed in row 5 below)*<br><br>*3 824 094.40* | *2 281 451.60* |
| *3. Delegation of power granted to the Management Board to increase share capital by issuing ordinary shares or any securities giving immediate or future access to share capital without preferential subscription rights, to the benefit of qualified investors or a restricted circle of investors* | *2 514 048, within the limit of 20% of the share capital per 12-month period* | *None applicable* | *2 514 048* |
| *4. Delegation granted to the Management Board for the purpose of setting the issuance price in accordance with the terms and conditions determined at the General Shareholders' Meeting in the event of an issuance without preferential subscription rights within the limit of 10% of the share capital* | - | *None applicable* | - |

| | | | |
|---|---|---|---|
| *5. Delegation of power granted to the Management Board to increase the number of shares to be issued in case of an increase in share capital, with or without preferential subscription rights, to be decided based on previous delegations* | *within 15% of the initial issue* | *498 794.40 (to be deducted from the delegation discussed in row 2 above)* | |
| *6. Delegation of power granted to the Management Board to issue ordinary shares or securities giving access to the share capital of the Company, in case of public offer including an exchange component initiated by the Company* | *2 514 048* | *None applicable* | *2 514 048* |
| *7. Delegation of power granted to the Management Board to increase share capital in order to compensate contributions in kind of shares or securities giving access to the share capital of third-party companies, excluding a public exchange offer* | *1 257 024, within 10% of the share capital existing on the date of the transaction in question* | *None applicable* | *1 257 024* |
| *8. Delegation of power granted to the Management Board to increase share capital by incorporating premiums, reserves, profits or other, by the issue and allocation of free shares or by raising the par value of existing shares or by a combination of these two methods* | *2 000 000* | *None applicable* | *2 000 000* |

(1) At its meeting dated February 17, 2012, the Management Board used this delegation and decided to increase the share capital by the nominal amount of EUR 3,325,300, which effectively raises it from EUR 9,269,387.20 to EUR 12,594,687.20, via the issuance, without preferential subscription rights through a public offering, of 8,313,250 new shares of par value EUR 0.40 each at the price of EUR 8.30 each, which represents an issuance premium of EUR 7.90 and an aggregate subscription amount of EUR 68,999,975 (issuance premium included).

(2) At its meeting dated February 23, 2012, the Management Board used this delegation and decided to increase the nominal amount of the share capital increase agreed upon on February 17, 2012 by a nominal amount of EUR 498,794.40, based on the issuance of 1,246,986 new shares of par value EUR 0.40 each, issued at the same price as those issued on February 17, 2012, in other words at the price of EUR 8.30 each (issuance premium included), which represents an aggregate subscription amount of EUR 10,349,983.80 (issuance premium included).

# Appendix C

## Main risks and uncertainties to which the Company is exposed – Use of financial instruments by the Company

*The Company conducted a review of the risks which could have a significant adverse impact on the Group, its business activities, its financial condition, results of operations, future outlook, or its ability to achieve its objectives and considers that the most significant risks are those described herein.*

*However, investors should also be aware that other risks, either unknown or not – considered likely at the date of this report – could have a material adverse effect on the Group, its business activities, financial condition, results, or future outlook, were they to materialize.*

### 1. Risks associated with the Group's business and industry

**The semiconductor industry has historically experienced significant fluctuations.**

The semiconductor industry is cyclical. In addition to changes in the general economic climate, which can result in imbalances between supply and demand, it is subject to rapid technological changes, which create growth in demand for new products followed by a period of slower growth once these new products are widely adopted by the market. The slower rate of growth typically continues until the next technological development, at which point the pattern begins again.

This cyclical nature of the industry affects the Group in the following three ways:

- any decrease in demand for the products marketed by the Group has an adverse impact on its business activities, its revenues, its cash condition and, as a result, its financial condition;

- a significant portion of the Group's costs is fixed and a significant portion of its variable costs is committed through advance payments on future sales. As such, the Group may not be able to adjust its expenses rapidly enough to offset any unanticipated shortfall in revenue following a shift to a new phase in the development cycle. This would have an adverse impact on the Group's margins, operating income, cash and financial condition; and

- furthermore, the Group does not own any manufacturing capacity, resulting in a reliance on subcontractors for the manufacturing, assembly, testing and shipping of its products. During periods of high demand, competition for access to the services of these subcontractors increases. When the cycle shifts and demand slows, such subcontractors may decide to reduce the amount of their capacity to adjust for this market change. As such, the Group may experience difficulty in obtaining access to the manufacturing services it relies on to achieve its sales projections or it may be subjected to price increases imposed by its subcontractors. This would have an adverse impact on the Group's revenues, margins, operating income, cash and financial condition.

The terms of the contracts governing the relationships between the Group and its clients and subcontractors only partially allow the Group to protect itself against exposure to these risks (for further information, refer in particular to "– The Group subcontracts the manufacturing, assembly, testing and shipping of its products to third parties and one such third party could fail to fulfill its obligations to meet deadlines and comply with specified conditions" and "– The Group's clients could cancel their orders, change the quantity ordered, or delay their production"). The Group could be unable to accurately estimate the demand for its products and, as a result, either be unable to use its inventory or, conversely, be unable to satisfy the orders placed by its clients").

**The Group operates in a very competitive environment and must contend with competitors that are larger than the Group. If the Group were no longer competitive vis-à-vis other market players, it could fail to increase and/or maintain its market share or the amount of revenues it generates.**

Some of the Group's competitors have longer operating histories in the sector, with access to significantly greater resources, have more established reputations and a larger base of existing customers than those of the Group. Their long-established positions in these markets have enabled them to forge strong relationships with their clients, which could be an advantage for them notably due to their access to information about market trends and future demand. The significant resources available to more sizeable competitors enable them to be more reactive in competing for technology, benefit from economies of scale, expand their portfolio of products and benefit from higher credibility in front of existing and potential clients of the Group. Lastly, some competitors may offer clients bundled solutions with complementary products or have the ability to adopt a more aggressive pricing policy. This could affect the Group's ability to gain or maintain its market share.

Due to the very competitive environment of the semiconductor sector and to the high costs associated with the design and manufacturing of semiconductors, the industry demonstrates a trend toward consolidation, which intensifies the risk described above and leads to, in particular, large companies acquiring smaller ones. This trend is expected to continue.

In the NFC market, the Group is competing with companies such as NXP Semiconductors and, since 2012, Broadcom and Qualcomm. In the secure payment and digital security markets, the Group competes with companies such as NXP Semiconductors, Samsung Electronics, Infineon Technologies and STMicroelectronics. Other companies could enter into direct competition with the Group if they were to sign licensing agreements with third parties for technology, software and intellectual property, or if they were to develop their own technology, which would allow them, in particular, to address the developing NFC market.

The Group's competitiveness depends on several factors, including:

- its ability to predict market needs (particularly by identifying new ones) and to develop products to successfully meet them;
- its ability to deliver products in large volumes on a timely basis at competitive prices;
- its ability to accurately understand the price points and performance metrics of competing products in the market;
- its products' performance and cost-effectiveness relative to those of its competitors;
- its ability to maintain and develop relations with its key clients; and
- its ability to conform to industry standards while developing new and proprietary technologies to offer products and features previously not available in the payments market.

If the Group is unable to remain competitive against its current or future competitors, or if it contends with market rivals that are more successful as a result of, in particular, their larger size, this will adversely impact its market shares, revenues, financial condition and development.

**The Group could be unsuccessful in developing and selling new products on a timely and cost-effective basis or in penetrating new markets.**

The markets in which the Group conducts its business activities, as well as those markets it targets, are characterized by rapidly changing technologies and industry standards, technological obsolescence and frequent product introductions. They are also characterized by intense price competition, the introduction of new products being a distinguishing factor enabling companies to demand higher prices. Therefore, in order to protect its market position, the Group must be able to predict technological changes and design, develop, market and support new products and enhancements on a timely and cost-effective basis.

The development of technologies and new marketable products is complex and usually requires significant long-term investments. The Group could experience delays in completing these developments and, as a result, find itself attempting to penetrate the market with an obsolete technology or one in which a competitor is already very well established. The Group could even develop products based on a standard that is ultimately not retained by the industry. Furthermore, the Group's development costs could be excessive compared to the price at which the Group would be able to market its products. These types of risks, if they were to materialize, would have an adverse impact on the Group's business activities, revenues, financial condition and future development.

**The development of the Group's NFC business depends on the overall development of the NFC applications market and its acceptance by customers, as well as on customer demand.**

To date, NFC technology has not been widely adopted by mobile operators, mobile handset and consumer electronics manufacturers. In addition, the infrastructure that would enable NFC technology to be used for multiple applications, including payments, has not yet been widely deployed on a global basis.

Furthermore, there are some existing and emerging technologies that could potentially address some applications which are targeted by the Group's NFC solutions and which may be preferred to the NFC solutions offered by the Group. Solutions including short message service (SMS) and online payment websites already exist to enable payments to be made from mobile devices. In peer-to-peer communications, existing technologies such as wireless-LAN and Bluetooth can enable direct communication and data transfer between mobile devices.

Additionally, in many countries the use of contactless technology for applications such as payments or transportation is not yet widespread.

NFC technology or the NFC applications market could fail to develop or develop more slowly than expected. Products developed by the Group and integrating NFC technology could potentially fail to meet market demand (particularly if consumers are reluctant to adopt the technology), or simply not be adopted by the Group's clients on a sufficiently large scale. Under these circumstances, significant investments in time and resources committed by the Group to this technology could be lost, in full or in part and the development of the Group, its business activities and financial condition could be affected.

**The development of the security products and solutions of the Group depends on the development of the market for mobile and network security systems, on it being accepted by users, as well as on customer demand.**

The market for the mobile and network security solutions of the Group depends on, in particular :

- the perceived ability of its products and services to address real customer problems,

- the perceived quality, price, user friendliness and interoperability of its products and services as compared to those of its competitors,
- the market's perception of how easy or difficult it is for the Group to deploy its products, especially in complex network environments,
- the continued evolution of electronic commerce as a viable means of conducting business,
- market acceptance and use of new technologies and standards,
- the public's perception of the need for secure electronic commerce and communications over both wired and mobile networks,
- the ability of the Group to effectively adapt to the pace of technological change, and
- general economic conditions, which among other things, influence how much money the clients and potential clients of the Group are willing to spend on such technology.

If the Group were unable to face such circumstances, its revenues, results, financial condition and development would be negatively affected.

**The success of the Group is dependent, in particular, on an increase in demand for the supply of integrated security products.**

The clients of the Group can postpone the purchase, stop using, or decide not to renew the use license for the integrated security products of the Group, and some clients of the Group could also decide to terminate licensing contracts at any time. The contracts signed with the clients of the Group generally provide for basic licensing rights, access fees for technologies and/or fees established on a per unit basis, usage fees or a percentage of revenues for products that integrate the technology of the Group, as well as service and maintenance fees. A certain number of key contracts also provide for capped fees whenever the volume of sales announced by certain clients exceeds set thresholds. Consequently, a portion of the revenues of the Group is not recurrent, which makes them harder to predict. Since the levels of expenditures rely in part on the projections of future revenues, and since expenditures are, for the most part, fixed in the short run, the Group could be unable to adjust its spending fast enough in order to offset an unexpected drop in revenues, which could have an adverse impact on its results, its financial position, and its development.

**The success of the Group will depend, in particular, on the timely market introduction of new security products with new or improved functionalities.**

The future financial performance of the Group will depend, in particular, on its ability to meet the needs and specifications of its customers by improving its mobile and network security solutions and by developing products with new and improved functionalities. The Group allocates significant resources to the identification of new market trends and to the development of products in order to anticipate the demand for security solutions. However, customers could lose interest in the solutions of the Group, which makes the Group unable to guarantee that the demand for its solutions will continue to develop as projected. The Group must develop new products and improve existing products in order to meet the rapidly evolving needs of customers. The success of new functionalities is dependent on several factors, including their timely introduction to the market and their market acceptance. The Group could be unable to improve its existing solutions or to develop new solutions, or be unable to introduce these solutions to the market in a timely fashion. The Group could face delays in the development and market introduction of its solutions, which could render them obsolete or unsellable once introduced. Customers could also postpone their purchases in order to wait for the introduction of new products. If the solutions of the Group are not considered competitive, in particular if it is unable to improve on existing solutions or to introduce new ones in a timely fashion, the Group could no longer be perceived as a leader in its field, its reputations might be negatively impacted, the value of its brand could be diminished, and its financial performance could be adversely affected. In addition, uncertainties regarding the time frame of availability and the nature of the functionalities of new products could result in an increase in research and development expenses with no assurance of future revenues.

Such circumstances would have an adverse impact on the revenues of the Group and, in so doing, on its results, its financial position, and its development.

**Historically, the average selling price of the Group's products have tended to decrease over time. This trend could become more pronounced in the future.**

The semiconductor industry is characterized by significant sales price erosion, which is particularly acute once a product has been on the market for some time and as volumes increase over time. Therefore, the average selling price for semiconductor solutions is on a downward historical trend. This trend could become more pronounced in the future and the Group could be unable to offset this drop in prices with an increase in volume or the development of new or enhanced semiconductor solutions on a timely and cost-effective basis, or even to reduce its costs, which would prove particularly difficult considering the Group is entirely dependent on subcontractors for the manufacturing, assembly, testing and shipping of its products. Even if the Group were able to achieve either of these goals, any resulting improvements still might not be sufficient to offset the decrease in prices.

These events, if they were to materialize, would have an adverse impact on the Group's gross margin and, therefore, on its results, financial condition and development.

**The Group could face higher costs for the manufacturing of its products and be unable to pass such higher costs on to its clients.**

The semiconductor business is characterized by ongoing competitive pricing pressure from customers and competitors, generating a limited capacity to pass the increase in the cost of the Group's products to its clients. Consequently, any increase in the manufacturing costs of the Group's products, whether related to adverse purchase prices, yield discrepancies or other factors, could reduce the Group's gross profit margin and operating income. The Group and its subcontractors have entered into framework supply agreements, which often provide for an annual price negotiation. Consequently, the Group could be unable to either obtain price reductions or to predict or prevent price increases imposed by its suppliers, in particular due to the fact that the Group relies on a limited number of suppliers for the manufacturing, assembly, testing and shipping of its products.

These events, if they were to materialize, would have an adverse impact on the Group's gross margin and, therefore, on its results, financial condition and development.

**The majority of markets on which the Group operates are characterized by large customers with significant market share and buying power who may use a number of companies to develop and provide semiconductors which fulfill similar functions to the Group's products.**

Several of the Group's targeted markets, particularly the NFC market for mobile handsets, payment cards and conditional access cards for Pay TV, are characterized by the presence of sizeable clients with significant market share and buying power.

In some markets where the number of clients is limited or where clients use several suppliers, the Group's competitors could increase their volumes to the Group's detriment, which could lead the Group's clients to seek to renegotiate the financial conditions of their contracts to their advantage.

These types of events, if they were to materialize, would have an adverse impact on the Group, its business activities, financial condition, results and development.

**The Group is dependent on certifications from third parties, such as Visa and MasterCard, in order to sell its products for use in some applications and could lose these certifications.**

The sale of some of the Group's products requires compliance with standards and protocols established by third parties and, in some instances, a certification from those parties, granted for three years and based on evaluations conducted by independent laboratories. Although the Group considers, as of the date of this Registration Document, that the risk of non-renewal of all or part of these certifications is low, if this were to happen it could prevent the Group from selling those products that failed to be certified and, as a result, would have an adverse impact on the Group, its business activities, financial condition, results and development.

**The Group could experience setbacks in transitioning to more advanced wafer fabrication process technologies or in achieving higher levels of product integration in the design of its semiconductors.**

In order to secure and improve its competitiveness, the Group intends to continue to invest in the development of increasingly "smaller geometries" and to achieve higher levels of design integration. These ongoing efforts require the Group to regularly change the manufacturing processes applied by its foundry partners for its semiconductor solutions. The Group could experience setbacks and delays as a result of its reliance on foundries to endorse and integrate new production processes. The Group cannot guarantee that its contracted foundries or its test and assembly subcontractors will be able to effectively manage the transition to new processes or, if they failed to do so, that it would be able to find new subcontractors able to successfully complete this transition. If the subcontractors upon which the Group relies are not able to complete this transition toward smaller geometries on a timely basis, or if the Group is not able to achieve a higher level of integration in the design of its products or fails to achieve this level of integration on a timely basis, this could have an adverse impact on the Group, its business activities, revenues, results, financial condition and development.

## 2. Risks associated with the lack of ownership of any industrial infrastructure

**The Group outsources the manufacturing, assembly, testing and shipping of its products to third parties and one such third party could fail to fulfill its obligations in a timely manner and in compliance with set specifications.**

The Group outsources the manufacturing, assembly, testing and shipping of its products to third parties. As such, the Group relies on its suppliers in terms of quantity, quality, yield and costs of services and products. The Group cannot maintain the same level of oversight and control over these outsourced operations as it would if these operations were carried out internally.

The Group relies on only a limited number of suppliers and, for certain products, on just a single qualified foundry. As such, the leading supplier of the Group, its top five suppliers and its top ten suppliers, represented 28%, 56% and 67% of its purchases in 2012 respectively, and 23%, 63% and 78% of its purchases in 2011 respectively. The supply agreements existing between the Group and its main partners are, generally signed for three to five years and are, for the most part, renewable tacitly every year. If one of these partners decided to terminate its relationship with the Group, to sign an agreement with a competitor, or to change the quantities it delivers to the Group or the conditions under which the deliveries are made, this could affect the Group's ability to deliver its products to its clients in a timely manner and in sufficient volume, which would impact the Group's sales and damage its business relations.

Any one of these events would have an adverse impact on the business activities of the Group, its revenues, results, financial condition and development.

On September 28, 2010, within the context of the acquisition of the SMS business of Atmel Corp., the Company entered into a supply agreement with LFoundry Rousset SAS, modified by amendment dated March 19, 2012, under the terms of which the Company undertakes to purchase, at pre-determined prices, a minimum annual number of wafers until September 30, 2014, while the Company retains priority access to the manufacturing capabilities of LFoundry. LFoundry Rousset SAS is a subsidiary of LFoundry GmbH in Germany, which has the same shareholders and financial ties with Landshut Silicon Foundry GmbH. However, Landshut Silicon Foundry GmbH is currently subject to court-ordered liquidation proceedings. The supply the Company relies on from the LFoundry group is exclusively provided by LFoundry Rousset SAS. The executive officers of the LFoundry GmbH group have stated that LFoundry Rousset SAS was not affected by shutdown at Landshut Silicon Foundry GmbH. However, these challenges coupled with the financial fragility of LFoundry Rousset SAS could have adverse repercussions on the manufacturing capabilities of LFoundry Rousset SAS as well as on its ability to meet its obligations under its contracts with the Company. As a result, the Company is working to qualify an alternate supply source that it could start doing business with in 2013, if appropriate.

**If the foundries the Group relies on for the manufacturing of its products fail to provide satisfactory levels of output or quality, the Group's reputation and its client relationships could be negatively affected.**

The Group does not own any industrial facilities. Its products are manufactured, assembled and tested by subcontractors, particularly by Global Foundries, UMC and LFoundry. Minor deviations in the manufacturing process can result in substantial decreases in yields and in some cases, cause production to be suspended. Changes in the manufacturing process or the inadvertent use of defective materials by the Group's foundries can trigger serious manufacturing defects or result in lower than anticipated manufacturing yields or unacceptable performance.

Most of these problems are difficult to detect at an early stage of the manufacturing process and could be time consuming and expensive to correct. A foundry which provides insufficient output levels, or the existence of defects, integration problems, or other performance-related problems associated with the manufacturing of semiconductors could, in addition to its direct impact on sales and revenues, damage the Group with respect to its client relationships, tarnish its reputation or require the Group to pay damages to its clients. If the Group's subcontractors are not able to provide acceptable products, the Group will have to find other subcontractors, which could take time and carry additional costs. These risks are increased for certain products for which the Group currently has only one supplier.

These types of events, if they were to materialize, would have an adverse impact on the Group's business activities, revenues, results, financial condition and development.

## 3. Risks associated with types of clients

**The Group's clients could decide not to integrate the Group's semiconductor solutions in their products or their products could fail to be commercially successful.**

The Group sells semiconductor solutions to original equipment manufacturers (or "OEMs") and to smart card manufacturers who integrate them into their products and also to original design manufacturers (or "ODMs") that integrate the Group's semiconductor solutions in the products they provide to OEMs. As such, the Group relies on OEMs and smart card manufacturers to continue to integrate its semiconductor solutions in their own lines of commercialized products.

First, the Group must invest a substantial amount of capital in the development of new semiconductor solutions, with no guarantee that clients will select them and integrate them in their products (which, if selected and integrated by clients, results in a "design win"). Achieving design wins is all the more important given that it is typically very difficult for a client to switch suppliers of semiconductor solutions. An absence of design wins therefore would have an adverse impact on the Group's revenues, results and financial condition.

Once they are selected, the Group's semiconductor solutions are usually integrated into the clients' products at the design stage, before such products are introduced to the market. The Group has no guarantee that the products marketed by its clients will attain commercial success. In addition, if the Group's semiconductor solutions contain defects affecting their performance or their compliance with certification standards after they have been selected and integrated in the products of the Group's clients, not only would the sales of these products be directly and adversely affected, but such clients could refuse to consider the Group's semiconductor solutions when they design new products. This risk is heightened for the Group's NFC products, because NFC is rapidly emerging and most of its customers do not have significant experience designing products using NFC related semiconductor and software solutions. If the Group's semiconductor solutions do not meet the expectations of its clients, or if the products marketed by the Group's clients fail to meet the expectations of their own clients or are not accepted by consumers, the revenues, results and financial condition of the Group would be harmed.

**NFC technology could be integrated into other semiconductors or systems not currently marketed by the Group.**

The history of the semiconductor industry shows a trend to continually seek to reduce cost and component count by integrating new features previously requiring several components into a single semiconductor. That is what happened, for example, in the mobile handset industry with the development of single chip solutions *(System-on-Chip)* incorporating not only the baseband and radio frequency functionality, but also components which incorporate several functions or connectivity standards such as Bluetooth, FM radio and Wireless-LAN.

Within this context, in December 2012 Broadcom announced that a semiconductor combining wireless-LAN, Bluetooth, FM Radio and NFC connectivity standards would become available in 2013.

In the mobile device market (e.g., handsets, tablets and laptops), the Group's business focuses on the NFC controller and the NFC secure element (separate or integrated into the NFC controller). The Group's current or prospective customers may choose to adopt architectures which integrate one or both of these solutions within another semiconductor element, such as the application processor, SIM card processor, Bluetooth, FM or Wireless LAN semiconductor or module.

Should this happen, the Group would face a competitive disadvantage relative to semiconductor vendors that already have these technologies in their product portfolios and, in some instances, are developing integrated semiconductors which incorporate NFC technology. This would have an adverse impact on the Group's development, business activities and financial condition.

**The Group generates a significant portion of its revenues through a limited number of customers. The Group could fail to retain its key clients or to expand its business relationships.**

A significant portion of the Group's total revenue is attributable to a limited number of customers and the Group anticipates that this will continue to be the case for the foreseeable future. These customers may decide not to purchase the Group's semiconductor solutions at all, to purchase fewer semiconductor solutions than they did in the past or to alter the terms on which they purchase its products. Insofar as a customer represents a significant percentage of the Group's accounts receivable, the Group is exposed to the risk of insolvency or late payment from any one of them. As of the date of this report, the amount of bad debt is not significant (see Note 14 of the Notes to the Consolidated Financial Statements of the Group for the financial year ended on December 31, 2012).

The top client of the Group, its top five clients, and its top ten clients represented, respectively, 30%, 63% and 83% of its revenues for 2012, and 30%, 59% and 78% of its revenues for 2011.

The loss of any key client, a significant decrease in revenues, or any issue with collection of receivables from clients could impact the Group's financial condition and the operating income.

**The Group's clients could cancel their orders, change the quantities ordered, or delay their production. The Group could be unable to accurately estimate the demand for its products and, as such, either be unable to sell its inventory or, conversely, be unable to satisfy client's orders.**

The Group and its clients have not signed any long-term purchase agreements for committed quantities. All sales are made on a purchase order basis which allows its customers to cancel, amend or delay product purchase commitments with little or no notice to the Group and without penalty. Given that production lead times often exceed the amount of time required to fulfill orders, the manufacturing process often begins in advance of orders, relying on an imperfect demand forecast for every customer to project volumes and product mix.

The Group's forecasts depend on the accuracy of the forecasts prepared by its clients, changes in market conditions, changes in the Group's product order mix and demand for the products marketed by its customers. Excessively optimistic forecasts, obsolete forecasts due to changes in market conditions or cancelled or delayed orders could significantly impact the Group by triggering a sudden drop in revenues while the corresponding production costs have already been incurred, or result in excessive or obsolete inventory that the Group may not be able to clear.

Conversely, in the past, clients have sometimes substantially increased the size of their orders with limited notice. If the Group were not able to accurately predict this change and, therefore, not be able to meet the demands of its clients by the set deadline, clients could cancel their orders and request damages or approach other competitors for their supply.

For example, this is the case with respect to the relationship between the Company and its client BlackBerry (formerly RIM), which in the 2012 financial year represented the main source of its revenues on the mobile NFC market segment, and should continue to represent the main source of its revenues on this market segment. Given that one of the focus areas of the Group's development strategy is to take advantage of its position as historical leader on the NFC technology market, a drop in demand for Blackberry products featuring this technology could have a significant adverse impact on the business, revenues, income, financial position and the development of the Company.

Any one of these events would have an adverse impact on the Group's business activities, revenues, results, cash condition and, therefore, its financial condition.

**In addition to its own semiconductor solutions and proprietary software, the Group could provide its customers with other components i.e., the Group would resell components, manufactured by third parties and integrated by the Group, which would result in a reduction of its average gross margin.**

In some cases, the Group sells third party products, which it purchases directly from suppliers and integrates in solutions invoiced to its clients as part of its overall supply to such clients. The Group generates profit margins that are significantly lower for these products and than those generated by selling its own products. For example, the Group currently integrates and resells the NFC-secure element from Infineon Technologies as part of a complete NFC solution.

If the Group were to integrate more third party components, its gross margin would decline, which would have an impact on its results, financial condition and development.

**The Group provides solutions that offer its clients security features that third parties may attempt to circumvent.**

The Group's core business is to provide semiconductors, software and, more generally, platforms intended to protect the integrity of the products' operating functionality, the information stored within the product and of any communication within it. These solutions are central to protecting the revenues, business models and/or interests of the Group's customers. For example, such solutions include preventing fraudulent bank payment card transactions, protecting national borders, ensuring that only customers who pay for television content are allowed to receive it and maintaining the security of confidential information.

Considerable efforts can be deployed by those attempting to breach the security of systems within which the Group's solutions are integrated. Any successful breach of the security of the Group's products or of the systems within which they are integrated (whether or not due to a breach in the security of the Group's products) could cause financial or other damage to the Group's clients, which would damage the reputation and the business activities of the Group.

**The high level of complexity of the Group's semiconductor solutions could lead to unforeseen delays or expenses as a result of undetected defects or faulty design.**

The Group's semiconductor solutions are highly complex and could contain defects or design errors that, if significant, could impair their performance or prevent compliance with industry standards. If such a situation were to occur, the Group could be unable to correct these defects within a reasonable time. Correcting these errors could cause delays in production or generate significant costs. This risk is even more significant given that the Group outsources the manufacturing, assembly, testing and shipping of its products to third parties and, as such, cannot maintain the same level of oversight and control over these outsourced operations as it could if these operations were carried out internally.

If the design defects of the products marketed by the Group are not identified until after they are introduced to the market, additional costs could be incurred due to product recalls, repairs and replacements. In addition, the Group typically provides one to three-year warranties on its products. Therefore, the Group could be required to issue refunds on its products and might face claims for damages filed by its clients.

The occurrence of any one of these events would have an adverse impact on the Group's business activities, results, financial condition and development.

## 4. Risks associated with intellectual property

**The Group relies, to a large extent, on the exclusive nature of its intellectual property. However, the Group could be unable to secure the rights necessary to guarantee meaningful protection or commercial advantage.**

The Group relies, to a large extent, on its intellectual property rights and its trade secrets in order to protect its products and technologies from misappropriation by others.

The Group could experience setbacks in obtaining patents or other intellectual property rights. In addition, the rights secured could prove insufficient to ensure meaningful protection or a commercial advantage.

In particular, the Group cannot guarantee that:

- the pending patent applications filed by the Group will result in the issue of a patent;
- the patents granted to the Group, as well as its other intellectual property rights, will not be challenged, cancelled, or circumvented;

- its trade secrets will not be divulged;
- the extent of the protection provided by the Group's patents will be sufficient to protect it from competition and from third party patents protecting similar mechanisms;
- its products do not infringe on patents held by third parties; and
- the standards adopted by the industry and with which the Group complies do not violate the rights of third parties.

In addition, the Group has not to date filed patent applications or applications for other intellectual property rights in all countries in which it conducts its business. The Group's ability to protect its intellectual property rights represents a significant expense associated with, in particular, patent application filing and patent renewal fees, amounts paid to inventors and for the management of its other intellectual property rights, which could increase, notably if the Group must take legal action to defend its rights.

Similarly, monitoring the unauthorized use of products is a difficult task and the Group cannot be absolutely certain that it will successfully avoid breaches and unauthorized uses of its technologies, in particular in foreign countries where its rights are not as well protected as they are elsewhere.

Furthermore, the Group's competitors could independently develop or could have already developed similar technologies. Lastly, the Group may be required to grant licenses on its patents as a result of its participation in various standards organizations.

In addition, in the conduct of its business, the Group must frequently grant third parties access to sensitive information that is not always protected by a patent. By signing confidentiality agreements, the Group ensures that these third parties undertake not to misappropriate, use or share this information. However, the Group cannot guarantee that these third parties comply with these agreements, that it will be notified in the event these agreements are breached or even that the damages it could potentially receive will be sufficient to offset the financial impact of the breach on its business, including any waiting time before the Group receives payment of the damages in question.

If the Group were unable to protect significant elements of its intellectual property rights and technology, its business activities, development and financial condition would be adversely impacted.

**Any potential dispute involving the Group's patents or any other intellectual property rights could include the Group's industry partners and customers, which would result in indemnification obligations of the Group.**

The persons or legal entities to which the Group has granted licenses or provided products or services could be implicated in litigation concerning the violation of patents or rights held by third parties, in connection with such licenses, products or services. Some of the Group's clients have already received notifications in writing from third parties seeking to enforce their alleged proprietary rights over certain technologies and recommending that the Group's clients obtain a license from such third parties. In accordance with the terms of the contracts it has signed with its clients, the Group could be required to defend and compensate its clients in the event of any legal action taken against them based on an alleged violation of intellectual property rights held by third parties, in connection with the Group's patents, products or services. Such litigation could also hinder the business of the Group's clients and, therefore, trigger a decrease in the sales of its technologies and its products. This would have an adverse impact on the Group's business activities, development, results and financial condition.

## 5. Legal Risks

To the Company's knowledge, there are no other government, legal or arbitration proceedings, including any pending or threatened proceedings, that are expected to have or have had in the past 12 months a significant adverse effect on the Company's financial condition or profitability or on the Group.

## 6. Financial Risks

### 6.1 Risks associated with currency exchange rates

**A significant portion of the Group's revenues and its payments made to suppliers are expressed in U.S. dollars, while a large portion of its operating expenses and a number of its assets and liabilities are expressed in other currencies, mainly in euros.**

The Company's functional currency is the U.S. dollar, which is also the currency used to present its Consolidated Financial Statements. The Group's sales and, likewise, the payments made to its major suppliers are, for the most part, expressed in U.S. dollars while a large portion of its operating expenses and a portion of its assets and liabilities are expressed in other currencies, mainly in euros and to a smaller extent in British sterling. Consequently, the Group's operating income and cash flows are subject to fluctuations due to changes in foreign currency exchange rates, primarily the U.S. dollar to euro exchange rate. For example, in the event that the euro/dollar exchange rate fluctuates within a range of + 10% to – 10%, the Group estimates that the impact, in absolute terms, would have been $382 thousand on its operating income and $300 thousand on its shareholders' equity for the financial year ended December 31, 2012. In order to mitigate this risk, since 2009 the Group has implemented an exchange rate risk coverage policy for these currencies for the purpose of maintaining its profitability and its cash condition. However, the Group cannot guarantee that this risk coverage policy will protect it efficiently from any fluctuations in exchange rates (see also Note 3.1(a) entitled "Currency Exchange Risk" of the Notes to the Consolidated Financial Statements for the financial year ended on December 31, 2012).

### 6.2 Credit risks, interest rate risks, and risks associated with cash management

As of the date of this report, the Group has not contracted any significant financial debt and, therefore, believes that it is not exposed to a significant risk associated with interest rate fluctuations. However, the Group plans to diversify its sources of financing in the future by gradually relying on bank loans, which could result in exposure to this risk in the future.

The Group uses a conservative approach in its management of available cash. Cash and cash equivalents include available cash and current financial instruments held by the Group (which, for the most part, are French monetary SICAVs (*Société d'Investissement à Capital Variable*, or open-ended collective investment schemes), and time deposits). As of December 31, 2012, available cash and investment securities held by the Group were mainly invested in financial instruments with maturities of less than 12 months.

### 6.3 Risks associated with off-balance sheet commitment

The total amount of off-balance sheet commitments recorded by the Group as of December 31, 2012 was $28.7 million (against $52.4 million as of December 31, 2011). These off-balance sheet commitments are described in Note 33 of the Notes to the Consolidated Financial Statements for the financial year ended on December 31, 2012. The Group's main off-balance sheet commitment corresponds to a commitment to purchase a minimum number of wafers from LFoundry through September 30, 2014, for an amount capped at $27.1 million (against $48.7 million as of December 31, 2011).

### 6.4 History of operating losses – Risks associated with projected losses

**The Group has a history of operating losses that could continue.**

The Group has accumulated losses over time and may be unable to achieve or sustain profitability in the future.

The Group was established in 1995 and has been incurring losses since that time. Net losses rose to $23.0 million in 2011 and to $37.5 million in 2012. As of December 31, 2012, accumulated losses since June 2005, the date on which the Group carried out its share capital reduction followed by a share capital increase in the amount of €1 million, were $134.1 million.

In order to develop its products and ensure that its business expands, the Group believes significant investment will be necessary, including research and development expenses and business, marketing and administrative expenses. As a publicly traded company, the Group will also incur additional legal and accounting fees, as well as other expenses in connection with its listing on the stock exchange. Furthermore, the Group could face unforeseen setbacks, complications or shipment delays that may generate additional expenses. As a result of these additional expenses, the Group would have to achieve and maintain higher revenues in order to protect its profitability. The positive growth trend of recent years may not be sustainable. Accordingly, the Group could be unable to ensure or maintain the profitability of its business and, as such, could continue to incur significant losses in the future.

### 6.5 Risks associated with fluctuations in the Company's revenues and operating income

**Fluctuations in quarterly or annual revenues and operating income, as well as difficulties in forecasting them could cause the market price of the Company's Shares to fall.**

Historically, the Group's revenues and operating income have fluctuated significantly and are expected to continue to do so in the future. As a result, the comparison of revenue and operating income over successive periods is not a reliable method for predicting future performance. In the future, the Group's revenues and operating income could be insufficient to meet the projections of market analysts and investors, which could cause the price of the Company's Shares to drop.

### 6.6 Risks associated with the absence of dividend distributions in the near future

**The Company has never paid dividends and does not plan to do so in the near future.**

To date, the Company has not paid out any dividends to its shareholders and does not intend to do so in the near future. Unless the general shareholders' meeting decides otherwise, it is expected that any potential dividends will be reinvested in the Company.

### 6.7 Liquidity risks – Future equity capital requirements and additional financing

**The Company could be required to increase its share capital or to seek additional financing in order to ensure its continued development.**

Since its creation, the Company has financed its development through equity, by carrying out share capital increases targeted at venture capital funds and industrial partners and, in February 2012, in the context of a public offering carried out in conjunction with the admission of its shares on the NYSE Euronext regulated stock exchange in Paris, France. The Group has never relied on any significant bank loans. Consequently, the Group believes that it is not exposed to a liquidity risk associated with accelerated repayment requirements that may be contained in certain bank loans.

The Company conducted a specific review of its liquidity risk and believes that it will be able to meet all of its upcoming payment obligations for the next twelve months.

The Company will continue to require significant amounts of financing in order to develop its technologies and market its products. Under these conditions, the Group may be unable to self-finance its growth in the future, which would require the Group to seek other sources of financing, in particular through subsequent share capital increases.

The level of financing required and its allocation over time depends on factors that the Group generally cannot control, such as:

- higher costs and slower progress than those projected for its research and development programs;
- expenses incurred in connection with preparing, filing, protecting and preserving its patents and other intellectual property rights;
- spending required to meet the technological developments in the market and to ensure the manufacturing and marketing of the Group's products; and
- new opportunities for developing new products or acquiring technologies, products or companies.

The Group may be unable to secure additional capital when it is needed and this capital may not be available under terms acceptable to the Group. If the required funds were not available, the Group could be required to:

- postpone, reduce, or cancel research programs;
- secure funds through industrial partnership agreements that may force the Group to waive the rights it holds over some of its technologies or products; or
- grant licenses or execute agreements under terms that could be less favorable to the Group than those it could have obtained in a different context.

In addition, insofar as the Company raises capital through the issuance of new shares, the equity interest of its shareholders could be subject to dilution. Debt financing, assuming it is available, could also be costly and require the Group to comply with restrictive covenants. If one or more of these risks were to materialize, it could have a significant adverse impact on the Group, its business activities, financial condition, results, development, future outlook, or on the market price of the Company's shares.

Lastly, over the course of the fourth quarter of 2011, the Group signed factoring contracts in euros and U.S. dollars with Natixis Factor for a renewable term of two years, including a guarantee fund and featuring an underlying credit insurance contract. Since the risk associated with recovering these receivables is now transferred to Natixis Factor, the receivables sold under this factoring program are no longer be accounted for on the Group's balance sheet. As of December 31, 2012, the receivables sold were financed in the amount of $12.3 million. The termination of these contracts could have an adverse impact on the financial position of the Group.

### 6.8 Risk associated with dilution

**The Company could, in the future, issue new shares or other equity-linked financial instruments in order to finance its development, or as part of its employee and management incentives policies.**

As indicated above in "– Liquidity risks – Future equity capital requirements and additional financing", the Company may issue new shares or new equity-linked financial instruments in order to finance its development.

In addition, within the context of its employee and management incentive policies, the Company has consistently, throughout its history, issued or granted warrants (*bons de souscription d'actions*, or "BSA(s)"), stock options and free shares. As such, in the event that all the equity-linked financial instruments are exercised in full and that all free shares that remain subject to a vesting period are effectively acquired, 1,418,677 new Shares would be issued, resulting in the dilution of approximately 4.2% of the current share capital (which represents a "fully diluted" share capital of EUR 14,164,895.60, split up into 35,412,239 shares). The Company will continue to issue or grant new equity-linked financial instruments.

The equity interest of shareholders will be diluted as a result of such transactions.

### 6.9 Tax Risks

#### 6.9.1 Risks associated with the French research tax credit

In order to finance its business activities, the Company has opted for the French tax regime of the Research Tax Credit (*Crédit d'impôt recherche* or "CIR"), which consists of offering a tax credit to companies making significant investment in research and development. CIR research expenses eligible for the tax credit for research include, in particular, wages and salaries, consumables, services outsourced to certified research institutions (public or private) and expenses related to intellectual property.

Even though the Company complies with the requirements regarding record-keeping and eligibility of research expenses, the tax authorities may nevertheless decide to challenge the methods of calculation used to determine the research and development expenses declared by the Company or to suspend the CIR due to a change in regulations. If this were to occur, it could have a significant adverse impact on the Group's financial condition and development.

#### 6.9.2 Tax loss carryforwards

The tax loss carryforwards of the Company were €125 million as of December 31, 2012. In principle, these tax loss carryforwards can be carried over indefinitely under the conditions of Article 209-I paragraph 3 of the French General Tax Code. However, this carryover right can be questioned in the event that the interested company were restructured or forced to change its business to such an extent that it would qualify as a "profound change" in business activities within the meaning of Article 221-5 of the French General Tax Code, as construed by the tax authorities. As of the date of this report, the Company cannot guarantee that the tax authorities will not attempt to use this provision as a basis to challenge its right to tax loss carryforwards. If such a challenge were to occur, it could have an adverse impact on the Group, its results, financial condition and development.

#### 6.9.3 Risks associated with the Group's international businesses

The Group conducts its business activities in many countries, and mainly in Europe, the Asia Pacific region and in North America. As such, 86% and 85% of the Company's revenues were generated in foreign countries in 2012 and 2011, respectively.

Due to this international presence, the Group is subject to taxation in many jurisdictions. The overall tax liability borne by the Group in such jurisdictions depends, in particular, on the legal interpretation of local tax regulations, on international tax treaties, on the fiscal policy enforced in each of these jurisdictions and on the applicable transfer pricing policy. Changes in these tax regulations could have an adverse impact on the Company's overall tax liability and its subsidiaries and, as such, on its results, financial condition and development.

The Group relies on the guidelines established by the OECD, particularly in terms of transfer pricing. In so doing, the Group undertakes to review the process of determination of these prices in an effort to ensure the security of completed transactions. However, as of the date of this report, the Group cannot guarantee that the tax authorities in the relevant jurisdictions will not seek to challenge its transfer pricing policy. Such a challenge could have a significant adverse impact on the Company's overall tax liability and that of its subsidiaries and, consequently, on its results, its financial condition and its development.

#### 6.9.4 Other tax risks

The Company was subject to a tax audit covering the financial years ended on December 31, 2008, 2009, and 2010. The tax audit did not trigger any readjustments.

## 7. Risks associated with the Group's organizational structure

### 7.1 Risks of dependence on key employees

**The Group could lose key personnel and be unable to attract new qualified employees.**

The Group's future success will depend, in part, on its ability to attract, retain and motivate highly qualified management, research and development, engineering and sales and marketing personnel. The Group's employees in research and development represent a particularly significant asset as they are the source of its innovations. The Group also plans to recruit additional design and applications engineers. The Group could fail to retain or attract enough technical and engineering personnel to achieve its growth plans. Additionally, in order to expand its client base and increase its sales to existing clients, the Group will need to hire additional qualified sales personnel. Competition in the recruitment of qualified employees is intense, given the lack of qualified people in the Group's sector and the Group could be unable to retain or attract them.

If the Group was unable to recruit and train qualified employees quickly, its growth would be affected. In addition, if the Group were unable to retain its existing employees, ensuring its future development would be difficult. This would have an adverse impact on the Group's business activities, revenues, financial condition and future outlook.

### 7.2 Risks associated with growth management

**The Group could be unable to successfully integrate acquired companies and businesses.**

The development of the Group relies on, in particular, the acquisition of additional companies and/or businesses. The Group is unable to guarantee the successful integration of recently acquired companies and businesses, the integration of services and staff and, lastly, the projected impact of such synergies. Although the Group conducts due diligence work and takes integration steps prior to completion of the acquisition, it could be confronted, in particular, with integration problems and difficulties establishing synergies, on both the operational and staff levels, with events challenging the liability of the Company, as a result of, in particular, a higher number of labor or intellectual property disputes, with the loss of long-term clients, with the failure to achieve the objectives set within the context of its acquisitions, and with difficulties ensuring there is no interruption in the provision of services to clients of acquired businesses.

These types of events, if they were to materialize, would have an adverse impact on the Group's business activities, results, financial condition and development.

In particular, the Group completed two significant acquisitions since 2010:

*Secure Microcontroller Solutions*

On September 30, 2010, the Group completed the acquisition of the Secure Microcontroller Solutions business of Atmel Corp ("SMS"). The Group estimates that approximately half of its consolidated revenue, totaling $122 million in 2012, are attributable to products originating from the SMS business. Consequently, a significant proportion of its sales volumes and revenues from products were generated through this acquisition.

In addition, while Atmel Corp. was seeking a potential acquirer for its SMS business, some of its clients sought alternative supply sources given the uncertainty related to the continuation of the SMS business or the identity of the potential acquirer. Sales of semiconductors for the payments market of the SMS business over the course of the 2011 and 2012 financial years were therefore lower than in 2010, on a pro forma basis. Due to strategic priorities and to commercial and financial opportunities, the Group chose not to systematically seek to regain these lost clients or to maintain its market share for some of the product lines it has been marketing for a long time.

Additionally, there is a risk of impairment of the assets acquired in the context of the takeover of the SMS business that have been accounted for at fair value in the Consolidated Financial Statements (in particular, the acquired patents, masks and goodwill totaling the net amount of $15.0 million as of December 31, 2012).

*Embedded Security Solutions*

On December 1st, 2012, the Group acquired Embedded Security Solutions (“ESS”). ESS designs and develops technologies for the purpose of creating a portfolio of intellectual property rights and security software based on encryption algorithms intended for various industries, including the mobile telephony and networks markets.

ESS was one of two business segments operated by an American company listed on the Nasdaq that was taken over by an publicly listed American group in the summer of 2012. When the latter sought to sell it, the Group acquired ESS on December 1st, 2012. In this context, over the course of the second half of the 2012 financial year, some of its customers may have sought to secure their supply from ESS competitors. Regaining these lost customers could prove to be a difficult, lengthy, and/or costly endeavor for the Group, with no guarantees that it will succeed in doing so.

In addition to the risks associated with the integration of ESS, there is a risk of impairment of assets acquired in the context of the acquisition of the ESS business, which were accounted for at their fair value in the consolidated financial statements (particularly the intangible assets and goodwill stated therein for a total amount of $45.8 million as of December 31, 2012 – see also Note 5 of the Notes to the Consolidated Financial Statements established as of December 31, 2012).

**Future acquisitions of companies, businesses, assets or technologies could lead to difficulties in integrating new entities, occupy the time and attention of the management team and distract it from the Group’s core business, dilute the equity holdings of existing shareholders or adversely impact the Group’s financial results.**

Within the framework of its external growth strategy, the Group could seek to acquire additional companies, businesses, or technologies in order to continue developing its own business activities, improve its competitiveness in its market or penetrate new markets. The Company cannot guarantee that opportunities for acquisitions will be available or that the acquisitions the Company may undertake will be profitable. Furthermore, the completion of such acquisitions may generate difficulties integrating new entities, mobilize the management team and distract it from the Group’s core business, dilute the equity holdings of existing shareholders or adversely impact the Group’s financial results and, as such, have a significant adverse impact on the Group.

**If the Group fails to successfully manage its development, it could be unable to execute its business plan and its results of operations could be affected accordingly.**

The Group's future results of operations mainly depend on its ability to successfully manage its development and growth.

In order to remain competitive and manage its development, the Group must constantly improve its equipment and technologies and deploy significant efforts in terms of research and development, requiring not only significant investments in this area, but also investments in sales and marketing. The Group could also be forced to make such investments before some of the benefits expected from them can be attained. The return on investment could either be lower, or achieved more slowly than expected, or not materialize at all, which could negatively affect the Group's operating income.

In addition, the Group must constantly seek to adapt its management policies, its administrative, financial, and operating tools and systems, as well as its control processes. It must also adapt its structure to the changes in technologies and targeted markets and, more generally, to changes in its strategy, and recruit and train qualified staff.

If the Group is unable to efficiently manage its development, it could be unable to take advantage of market opportunities or to develop the products the market is expecting, it could fail to maintain the quality of its products, be unable to execute its business plan, and be unable to adapt itself quickly enough to its technological, competitive, and market environments. Any of these events, if they were to materialize, would have an adverse impact on the Group, its business activities, financial condition, results and development.

### 7.3 Risks associated with the restructuring of the Group

On March 6, 2013, the Group announced a plan to change its strategy, which will result, in particular, in the launching of a plan to reorganize its worldwide business activities. This plan, which might lead to the reduction of around 20% of the global workforce, will be detailed in 2013. If the expected savings generated from this restructuring were lower than anticipated, or if the Group were unable to implement such restructuring, or if such restructuring were more costly and/or lengthier than planned or, more generally, if the Group were unable to implement an efficient structure that was well-adapted to the strategic and business challenges it faces, its results, financial position, and development would be adversely impacted.

### 7.4 Regulatory Risks

**Because the Company provides cryptology solutions and services, its takeover, the acquisition of all or part of one of its business lines, or the crossing of a threshold of one third of its share capital could, among other things, require the prior authorization of governmental authorities.**

The Company provides cryptology solutions and services. As a result, pursuant to the provisions of the French Monetary and Financial Code, a takeover of the Company (within the meaning of Article L. 233-3 of the French Commercial Code) or the direct or indirect acquisition of all or part of a business line of the Company by (i) a physical person that is not a citizen of a Member State of the European Community ("EC"), or of a State party to the agreement on the European Economic Area that has signed a *convention d'assistance administrative* (convention on mutual administrative assistance) with France, or an employee of a company with registered headquarters located in one of these States, or a physical person with French citizenship that is not a resident of such States, in accordance with Article R. 153-2 of the French Monetary and Financial Code (a "Non EC Investor") or (ii) a physical person that is a citizen of a Member State of the European Community ("EC"), or of another State party to the agreement on the European Economic Area that has signed a *convention d'assistance administrative* (convention on mutual administrative assistance) with France, or an employee of a company with registered headquarters located in one of these States, or a physical person with French citizenship that is a resident of such States, in accordance with Article R. 153-4 of the French Monetary and Financial Code (an "EC investor"), could be subject to the prior authorization of the French minister responsible for the French economy. Similarly, the acquisition of more than 33.33% of the Company's share capital by a Non EC Investor could also be subject to prior authorization of the French minister responsible for the French economy. Prior authorization from the governments of other countries could also be required for similar reasons. There is no guarantee that these authorizations would be granted or that, if granted, the terms of such authorizations would not discourage any potential acquirers. The existence of such conditions precedent to an acquisition of the Company could have an adverse impact on its share price.

## 8. Risks associated with the environment

**The Group's business activities are subject to certain environmental regulations regarding the use of hazardous substances and the management of its waste.**

The Group's business activity is subject to the RoHS directive (*Restriction of the use of certain hazardous substances in electrical and electronic equipment*) (2002/95/EC) restricting the use of six substances harmful to human health and the environment that may be included in the chemical composition of electric or electronic equipment, namely four heavy metals (Hg, Pb, Cd and CrVI) and two flame retardants (PBB and PBDE). Although the Group does not manufacture its own products, the Group ensures, to the extent possible, that its suppliers and subcontractors comply with this directive. In this context, all of the Group's subcontractors provide their RoHS reports on the products they deliver.

REACH (*Registration, Evaluation, Authorization and restriction of Chemicals*) is a French regulation (CE No. 1907/2006) allowing for the identification through registration and gradual elimination of the most hazardous chemical substances (the substance itself, or in mixtures and products). Its mission is to develop a better understanding of the uses of chemical substances produced or imported into the European Union and to control the risks associated with their use. Under REACH, the Group imports and introduces "articles" to the market that contain certain substances not intended to be discarded under normal or reasonably predictable conditions and, conversely, does not market any "substance", or "mixture", within the meaning of the REACH regulations. The Group is therefore exempt from the applicable filing requirements. REACH regulations also require the disclosure of information to clients in the event that SVHCs (*Substances of Very High Concern*) are found in an article in concentrations higher than 0.1% of their mass. To fulfill its obligations, the Group regularly checks the SVHC candidate list updated by the European Chemicals Agency (ECHA) and takes all necessary measures to confirm the compliance of its suppliers in order to ensure that the products it introduces to the market do not contain such substances in concentrations higher than the set level. The Group also verifies the SVHC list as included in Appendix XIV of REACH in order to ensure that the Group's products are not exposed to the risk of being banned from the market.

The directive *Déchets d'équipements électriques et électroniques* (2002/96/CE) (directive on waste electrical and electronic equipment, or "WEEE") sets forth that the producers are responsible for organizing and financing the collection, treatment and valuation of their products at the end of their life cycle. In order to avoid the risk of any related pollution, a specialized third party company reprocesses all of the waste from equipment and products. In addition, whenever necessary, the Group reprocesses wafers and masks on its worksite in East Kilbride (Scotland).

Compliance with these regulations is expensive and any restrictions in addition to these regulations would generate additional costs for the Group. Furthermore, the regulations are complex and any violation by the Group could lead to payment of fines or penalties or trigger liability claims against it. These events, if they were to materialize, would have an adverse impact on the Group's financial condition and development.

## 9. Other risks

Some natural disasters, such as floods, earthquakes, tsunamis, or volcano eruptions, could cause damage to the industrial equipment of the suppliers to whom the Group outsources the manufacturing, assembly, or testing of its products and could also cause damage to the direct or indirect suppliers of these subcontractors. It could disrupt operations, cause delays in the production and delivery of its products or trigger expenses due to repair, replacement, or other needs. For example, most of the Group's semiconductors are manufactured and assembled by subcontractors located in Asia. The risk associated with earthquakes and tsunamis in this region is significant due to the geographic proximity of major seismic fault lines to the location of the plants of the Group's subcontractors and to the location of their own suppliers. Even if these plants were not directly affected, a major natural disaster would undoubtedly impact the industry's supply and distribution chains. Any disruptions resulting from these events could cause significant delays in the production or shipping of the Group's products as well as significant increases in shipping costs until the Group is able to transfer the manufacturing, assembly, testing and shipping of its products from the affected subcontractor to another one.

Such events, if they were to materialize, would have an adverse impact on the Group's business activities, results, financial condition and development.

## 10. Changes in legislation and tax and regulatory policies

The Group's business activities are subject to the risk of a change in legislation, tax policies or regulations. These changes could have a significant adverse impact on the Group, its business, financial condition, results, development and future outlook.

## 11. Insurance and risk coverage

The Group has secured insurance policies with various insurance companies in order to cover all of the significant risks it is exposed to. Most of these risks are covered by insurance policies subscribed in France. The Group also has specific and/or local coverage in order to comply with regulations applicable in certain locations.

These insurance policies are reviewed on a regular basis and adjusted, as the case may be, in order to account for a change in revenues, in business activities exercised, and in the risks the various companies of the Group are exposed to.

In addition, the Group has implemented internal preventative mechanisms aimed at maintaining operations and limiting the impact of a significant loss in the event of a major disaster. As such, several secure data backup systems have been put in place to protect source codes and all of the electronic data kept on servers and workstations at the offices of the various entities of the Group. These backups are completed on two separate sites.

In 2012, the Group paid out EUR 506 thousand for all of its insurance policies.

In the 2012 financial year, the amount of insurance policies applicable to the entire Group can be broken down in the following way per major risk category:

All of the companies of the Group benefit from an insurance policy covering their professional civil liability and the products, representing EUR 8.5 million in aggregate guaranteed coverage.

An insurance policy also covers the civil liability associated with the operation of INSIDE Secure SA and its subsidiaries, representing EUR 10 million in aggregate guaranteed coverage, and a professional multi-risk insurance policy (which covers operating losses and damages to goods) representing EUR 117 million in aggregate guaranteed coverage (sum of all ceilings set per claim).

The Group also took out an insurance policy covering the risks associated with the liability of the directors and corporate officers of INSIDE Secure SA and its subsidiaries, representing EUR 20 million in aggregate guaranteed coverage for 2012, as well as an insurance policy for key persons representing EUR 2 million in aggregate guaranteed coverage.

The Group also benefits from an insurance policy covering the transportation of its staff and its merchandise, as well as the IT-related risks based on the overall value of its IT equipment. The amounts borne by the Company and its subsidiaries with respect to local insurance plans that comply with legal and regulatory requirements applicable in each country must also be added to these insurance totals.

# FINANCIAL INFORMATION RELATED TO ASSETS, FINANCIAL CONDITION AND RESULTS OF OPERATIONS

# Consolidated financial statements of the INSIDE Secure group as at December 31, 2012

# Consolidated income statement

| In thousands of US$ | Note | Year ended December 31, 2011 | 2012 |
|---|---|---|---|
| **Revenue** | 6, 7 | **151,468** | **122,047** |
| Cost of sales | | (112,004) | (93,504) |
| **Gross profit** | | **39,464** | **28,543** |
| Research and development expenses | 26 | (34,536) | (35,370) |
| Selling and marketing expenses | | (18,175) | (18,010) |
| General and administrative expenses | | (9,817) | (9,630) |
| Other gains / (losses), net | 27 | (1,398) | (2,811) |
| **Operating loss** | **6** | **(24,462)** | **(37,278)** |
| Finance income / (loss), net | 30 | 1,503 | (258) |
| **Loss before income tax** | | **(22,959)** | **(37,536)** |
| Income tax expense | 31 | (74) | 51 |
| **Loss for the year** | | **(23,033)** | **(37,485)** |
| **Attributable to:** | | | |
| Equity holders of the Company | | (23,033) | (37,485) |
| **Earnings per share attributable to the equity holders of the Company during the year** | | | |
| **Basic earnings per share** | 17, 32 | (1.06) | (1.19) |
| **Diluted earnings per share** | 17, 32 | (1.06) | (1.19) |

## Consolidated statement of comprehensive income

| In thousands of US$ | Year ended December 31, 2011 | 2012 |
|---|---|---|
| Loss for the year | (23,033) | (37,485) |
| Other comprehensive income: | | |
| Actuarial loss on post employment benefit obligations | (105) | (345) |
| Financial instrument fair value changes | (1,773) | 937 |
| Currency translation differences | (351) | 537 |
| Other comprehensive income for the year, net of tax | (2,229) | 1,128 |
| **Total comprehensive income for the year** | **(25,262)** | **(36,357)** |
| **Attributable to:** | | |
| Equity holders of the Company | (25,262) | (36,357) |
| Non-controlling interests | - | - |
| **Total comprehensive income for the year** | **(25,262)** | **(36,357)** |

## Consolidated balance sheet - Assets

| In thousands of US$ | Note | As at December 31, 2011 | 2012 |
|---|---|---|---|
| Goodwill | 8 | 3,251 | 15,152 |
| Intangible assets | 9 | 6,877 | 42,052 |
| Property and equipment | 10 | 16,812 | 12,810 |
| Other receivables | 15 | 7,287 | 16,163 |
| **Non-current assets** | | **34,227** | **86,177** |
| Inventories | 13 | 23,276 | 17,350 |
| Trade receivables | 14 | 18,711 | 16,462 |
| Other receivables | 15 | 10,474 | 6,669 |
| Derivative financial instruments | 12 | 216 | 145 |
| Cash and cash equivalents | 16 | 20,940 | 66,321 |
| **Current assets** | | **73,618** | **106,946** |
| **Total assets** | | **107,845** | **193,124** |

# Consolidated balance sheet – Equity and liabilities

| In thousands of US$ | Note | As at December 31, 2011 | 2012 |
|---|---|---|---|
| Ordinary shares | 17 | 11,369 | 17,822 |
| Share premium | 17 | 133,021 | 225,570 |
| Other reserves | 19 | 9,772 | 12,386 |
| Retained earnings | 19 | (73,535) | (96,568) |
| Income / (loss) for the year | | (23,033) | (37,485) |
| **Equity attributable to equity holders of the Company** | | **57,594** | **121,725** |
| Non-controlling interests | | - | - |
| **Total equity** | | **57,594** | **121,725** |
| Intangible liabilities - Non-current portion | 5 | 11,711 | 10,635 |
| Financial debts | 21 | 963 | 6,902 |
| Repayable advances | 22 | 852 | 3,443 |
| Retirement benefit obligations | 23 | 1,183 | 1,749 |
| **Non-current liabilities** | | **14,708** | **22,729** |
| Intangible liabilities - Current portion | 5 | 1,168 | 1,583 |
| Financial instruments | 11 | 1,348 | 179 |
| Trade and other payables | 20 | 29,977 | 28,335 |
| Additional payment on ESS acquisition | 5 | - | 5,188 |
| Financial debts | 21 | 357 | 808 |
| Provisions for other liabilities and charges | 24 | 318 | 754 |
| Deferred income | 25 | 2,372 | 11,822 |
| **Current liabilities** | | **35,542** | **48,669** |
| **Total liabilities** | | **50,250** | **71,399** |
| **Total equity and liabilities** | | **107,845** | **193,124** |

# Consolidated statement of changes in equity

| **In thousands of US$** | **Attributable to equity holders of the Company** | | | | | **Non controlling interests** | **Total equity** |
|---|---|---|---|---|---|---|---|
| | **Share capital** | **Share premium** | **Other reserves** | **Retained earnings** | **Total** | | |
| **Balance at January 1, 2011** | **11,342** | **134,873** | **10,001** | **(73,535)** | **82,682** | **-** | **82,682** |
| Loss for the year | - | - | - | (23,033) | (23,033) | - | (23,033) |
| Actuarial loss on retirement benefit obligations | - | - | (105) | | (105) | - | (105) |
| Financial instruments at fair value | - | - | (1,773) | | (1,773) | - | (1,773) |
| Currency translation differences | - | - | (351) | | (351) | - | (351) |
| **Total other comprehensive income** | **-** | **-** | **(2,229)** | **(23,033)** | **(25,262)** | **-** | **(25,262)** |
| Employees share option scheme : | | | | | - | | - |
| Value of employee services | - | - | 2,000 | - | 2,000 | - | 2,000 |
| Proceeds from shares/ warrants issued | 27 | 419 | - | - | 446 | - | 446 |
| Share capital increases during the year | - | - | - | - | - | | - |
| Direct costs paid related to the IPO | - | (2,271) | - | - | (2,271) | | (2,271) |
| **Balance as at December 31, 2011** | **11,369** | **133,021** | **9,771** | **(96,568)** | **57,594** | **-** | **57,594** |
| **Balance at January 1, 2012** | **11,369** | **133,021** | **9,771** | **(96,568)** | **57,594** | **-** | **57,594** |
| Loss for the year | - | - | - | (37,485) | (37,485) | - | (37,485) |
| Actuarial loss on retirement benefit obligations | - | - | (345) | - | (345) | - | (345) |
| Financial instruments at fair value | - | - | 937 | - | 937 | - | 937 |
| Currency translation differences | - | | 537 | - | 537 | - | 537 |
| **Total other comprehensive income** | **-** | **-** | **1,129** | **(37,485)** | **(36,357)** | **-** | **(36,357)** |
| Employees share option scheme : | | | | | - | | - |
| Value of employee services | - | - | 1,880 | - | 1,880 | - | 1,880 |
| Proceeds from shares issued | - | 361 | - | - | 361 | - | 361 |
| Share capital increases during the year | 6,453 | 98,028 | 107 | - | 104,588 | - | 104,588 |
| Direct costs paid related to the IPO | - | (5,840) | - | - | (5,840) | - | (5,840) |
| Treasury shares | - | - | (501) | - | (501) | - | (501) |
| **Balance as at December 31, 2012** | **17,822** | **225,570** | **12,386** | **(134,053)** | **121,725** | **-** | **121,725** |

# Consolidated cash flow statement

| In thousands of US$ | Notes | December 31, 2011 | December 31, 2012 |
|---|---|---|---|
| **Loss for the year** | | **(23,033)** | **(37,485)** |
| Adjustments for: | | | |
| Depreciation of tangible assets | 10 | 6,829 | 6,797 |
| Amortization of intangible assets | 9 | 2,089 | 2,538 |
| Impairment of assets acquired as part of acquisition of business | 27 | 1,713 | - |
| Reversal of intangible liabilities | 27 | (829) | - |
| Impairment of receivables | 14 | (5) | 664 |
| Impairment of inventories | 13 | 2,824 | 151 |
| (Profit) / loss on disposal of property and equipment | | - | (13) |
| Share-based payment | | 2,000 | 1,880 |
| Change in retirement benefit obligation | 23 | 281 | 144 |
| Finance income, net | | 805 | 18 |
| Income tax | 31 | 74 | (51) |
| Variation in provisions for risks | 24 | (354) | 421 |
| **Cash used in operations before changes in working capital** | | **(7,605)** | **(24,936)** |
| **Changes in working capital** | | | |
| Inventories | 13 | (9,111) | 5,873 |
| Trade receivables | 14 | 1,013 | 2,243 |
| Trade receivables transferred | 14 | 11,052 | 1,714 |
| Other receivables | | (1,748) | (368) |
| Research tax credit and grants | 15 | (6,327) | (2,878) |
| Trade and other payables | | 2,535 | (4,189) |
| Non refundable advance on order backlog | 25 | - | 6,460 |
| Other payables | | (498) | 3,036 |
| **Cash used in changes in working capital** | | **(3,083)** | **11,891** |
| **Cash used in operations** | | **(10,688)** | **(13,046)** |
| Interest received, net | | (128) | 612 |
| Income tax paid | | (194) | (74) |
| **Net cash used in operating activities** | | **(11,010)** | **(12,508)** |
| **Cash flows from investing activities** | | | |
| Acquisition of business, net of cash acquired | 5 | - | (41,635) |
| Purchases of property and equipment | 10 | (4,367) | (2,119) |
| Purchases of intangible assets | 9 | (1,029) | (2,718) |
| Research and development capitalized costs | 9 | (1,188) | (973) |
| Payments corresponding to intangible liabilities | 5 | (1,409) | (1,064) |
| **Net cash used in investing activities** | | **(7,993)** | **(48,509)** |
| **Cash flows from financing activities** | | | |
| Proceeds from issuance of ordinary shares, net of issuance costs | 17 | 446 | 104,950 |
| Direct costs paid related to the IPO | 17 | (2,039) | (5,840) |
| Repayable advance | 22 | 852 | 2,491 |
| Proceeds from / (Repayment of) financial debts, net of issuance costs | 21 | - | 5,852 |
| Principal repayment under finance lease | | (225) | (463) |
| Treasury shares | | - | (501) |
| Settlement of foreign exchange hedging instruments | | | (161) |
| Bank overdraft | | - | 276 |
| **Net cash generated by / (used) in financing activities** | | **(965)** | **106,604** |
| **Net increase / (decrease) in cash and cash equivalents** | | **(19,969)** | **45,587** |
| Cash and cash equivalents at beginning of the year | 16 | 41,178 | 20,940 |
| Effect of exchange rate fluctuations | | (269) | (206) |
| **Cash, cash equivalents at end of the year** | **16** | **20,940** | **66,321** |
| Elements with no cash impact: | | | |
| New finance leases | | 1,093 | 352 |

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# Notes to the consolidated financial statements

## 1. *General information*

Inside Secure ("the Company") and its subsidiaries (together "the Group") is a designer, developer and supplier of semiconductors and embedded software for securing transactions, content and digital identity, and operates on a fabless business model.

On September 30, 2010, the Group acquired the Secure Microcontroller Solutions (SMS) division of Atmel Corp. ("SMS division of Atmel") which provides semiconductor chips embedded in smart cards, mobile devices, acceptance devices, and infrastructure systems to secure the exchange of transactions for payment, transit, access, ID and other types of secure applications.

Since February 17, 2012, shares in the Company are listed on the NYSE Euronext exchange in Paris (compartment B) under the Isin code FR0010291245. Proceeds from the issuance of the shares as part of the initial public offering was US$ 104.5 million (€ 79.3 million).

On December 1, 2012, the Group acquired Embedded Security Solutions (''ESS'') which designs and develops encryption-related security hardware intellectual property (IP) and software for a variety of industries, including the mobile and networking markets

The Company is a limited liability company ("société anonyme") incorporated and domiciled in France. The address of its registered office is 41, Parc Club du Golf, 13856 Aix-en-Provence cedex 3, France.

The consolidated financial statements were authorized for issue by the Board of Directors on March 5, 2013 ("Date of issuance").

## 2. *Summary of significant accounting policies*

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below.

### *2.1 Basis of preparation*

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) and IFRIC interpretations as adopted by the European Union. IFRS are available on the web site of the European Commission:
http://ec.europa.eu/internal_market/accounting/ias_en.htm

The consolidated financial statements have been prepared under the historical cost convention, except for derivative instruments which include currency forward contracts and options which are shown at fair value.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Group's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 4.

### 2.1.1 Presentation currency

According to IAS 21 § 38, the Group has elected to present its consolidated financial statements in US Dollars. The US Dollar is the functional currency of the Company and the currency in which the majority of transactions within the Group are denominated. The functional currency for Inside Secure Corporation (USA) is the US Dollar, for Inside Secure (Asia) Pte Ltd the Singapore Dollar, for Inside Secure Sp.z.o.o. (Poland) the Zloty, for Vault-IC UK Ltd the Pound Sterling, and for Vault-IC France SAS, Inside Secure B.V (Netherlands), Inside Secure Amsterdam B.V and Inside Secure Oy (Finland) the Euro.

The exchange rates of the US Dollar against the Euro, the main currency used by the Group after the US Dollar, are as follows for the years ended December 31, 2011 and 2012:

| Dollar / Euro | 2011 | 2012 |
|---|---|---|
| Closing | 1.2939 | 1.3194 |
| Average | 1.3917 | 1.3119 |

### 2.1.2 New and amended standards adopted by the Group

The following new and amended standards whose application is mandatory for the current year from January 1, 2012 do not have a significant impact on the consolidated financial statements for the year ended December 31, 2012:

- Amendment to IFRS 7, ‘‘Financial Instruments Disclosures”

The Group chose not to early adopt the following new and amended standards and interpretations whose application is not mandatory until after January 1, 2013:

- Amendment to IAS 1 ‘‘Presentation of Items of Other Comprehensive Income’’
- Amendment to IAS 19 ‘‘Employee Benefits’’ in particular accounting for defined benefit plans
- IFRS 10 ‘‘Consolidated Financial Statements’’
- IFRS 11 “Joint Arrangements’’
- IFRS 12 ‘‘Disclosure of Interests in Other Entities’’
- IFRS 13 ‘‘Fair Value Measurement’’
- Amendment to IAS 27 ‘‘Separate Financial Statements’’
- Amendment to IAS 28 ‘‘Investments in Associates and Joint Ventures’’
- Amendment to IFRS 7 ‘‘Offsetting Financial Assets and Financial Liabilities’’

The Group considers that these new and amended standards and interpretations should not have a significant impact on its results or financial situation. At this stage, the Group has not entered into investment project or research and development activities with partners which could fall under the scope of IFRS 10 and 11.

## 2.2 Consolidation

Subsidiaries are all entities (including special purpose entities, if any) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The Group uses the acquisition method of accounting to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Group, including any potential purchase price adjustments. Purchase price adjustments made after the allocation period of 12 months following acquisition date are reevaluated at each closing date at fair value through the income statement Acquisition-related costs are expensed as incurred in the line item ‘‘Other (losses)/gains, net”. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognized directly in the statement of comprehensive income.

Inter-company transactions, balances and unrealized gains on transactions between Group companies are eliminated. Unrealized losses are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

The Group has no minority interests or associates

### *2.3 Segment reporting*

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing the performance of the operating segments, has been identified as the Management Board that makes strategic decisions. The Management Board is composed of the corporate officers of the Company.

### *2.4 Foreign currency translation*

*(a) Functional and presentation currency*

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (“the functional currency”). The consolidated financial statements are presented in U.S. dollars (“$”), which is the Company's functional and presentation currency.

*(b) Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions.

Foreign exchange gains and losses relating to exchange differences affecting revenue and operating expenses concluded during the year, as well as the impact of the revaluation at closing rates of operating assets and liabilities denominated in currencies other than the functional currency of the consolidated companies, are recognized in operating result.

Foreign exchange gains and losses relating to financial transactions settled during the year as well as the impact of the revaluation at closing rates of cash denominated from foreign currencies into US Dollars, are recognized in financial result.

*(c) Group companies*

The results and financial position of all Group entities (none of which has the currency of a hyper-inflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each balance sheet line item presented are translated at the closing rate at the date of that balance sheet;

- income and expenses for each income statement line item are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions); and

- all resulting exchange differences are recognized as a separate component of equity in the line item "Currency translation differences"

## *2.5 Impairment of non-financial assets and cash-generating units*

Non-financial assets including intangible and tangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. For the purposes of assessing the value in use, with the exception of certain intangible assets dedicated to specific products (see note 2.6), non-financial assets are generally grouped by operating segments identified by the Group which constitutes the lowest level for the definition of a cash-generating unit.

## *2.6 Goodwill and other intangible assets*

*(a) Goodwill*

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in "intangible assets". Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill related to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose. Management has determined its cash-generating units to be the corresponding operating segments, which constitute the lowest level for the definition of a cash-generating unit.

*(b)Intellectual property licensing royalties*

The intellectual property licensing royalties contracts transferred to the Group as part of the acquisition of ESS relate to royalties for technology developed and licensed before the transfer date. The portfolio of intellectual property licensing royalties to be received is recognized as an intangible asset as the commercial and technological efforts were made before the business combination. This intangible asset is amortized through net income in the line item ‘‘Cost of sales’’ as the corresponding revenue is recognized.

*(c) Backlog*

Backlog corresponds to accumulated unfulfilled purchase or sales order contracts transferred to the Group as part of the acquisition of the SMS division of Atmel Corporation. Backlog is recognized as an intangible asset corresponding to the commercial efforts made before the business combination. This intangible asset is amortized through net income in the line item “Selling and marketing expenses” as the Group operates under a fabless business model and had not incurred any expenses relating to the commercial effort which generated the backlog transferred to it at the date of the business combination.

*(d) Acquired patented technologies*

Acquired patented technology is shown at acquisition cost less accumulated amortization.

Each acquired technology dedicated to a specific product is individually tested for impairment based on the expected output of the related product whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When a technology is not dedicated to a specific product but is widely used, the cash generating unit used for impairment testing is the operating segment in which the technology is used.

When an acquired patented technology is no longer used, the corresponding gross value and accumulated amortization are written off.

Acquired patented technologies are subsequently depreciated within the line item “Research and development expenses” when they are used for project engineering design and “Cost of sales” when they are used in production.

*(e) Software licenses*

Acquired computer software licenses are capitalized on the basis of the costs incurred to acquire and bring to use the specific software. This capitalized software includes software transferred as part of business combinations. These costs are amortized over the estimated useful lives of the software.

Costs associated with developing or maintaining computer software programs are recognized as an expense as incurred.

*(f) Research and development*

Research expenditure is recognized as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved solutions) are recognized as intangible assets when the following criteria are fulfilled:

- it is technically feasible to complete the intangible asset so that it will be available for use;
- management intends to complete the intangible asset and use or sell it;
- there is an ability to use or sell the intangible asset;
- it can be demonstrated how the intangible asset will generate probable future economic benefits;
- adequate technical, financial and other resources necessary to complete the development and to use or sell the intangible asset are available; and
- the expenditure attributable to the intangible asset during its development can be reliably measured.

Other development expenditures that do not meet these criteria are recognized as an expense as incurred.

Research and development expenses financed through repayable advances are capitalized to the extent that the Group has the resources necessary to successfully complete certain precisely defined development programs and will benefit from the future economic advantages, either through the abandonment of the repayable advance or through the cash flows generated by the future sales of products developed.

### *2.7 Property and equipment*

Business premises comprise mainly the head office in Aix-en-Provence (France) and the facilities in East Kilbride (Scotland) and Rousset (France). Aix-en-Provence mainly hosts the corporate functions including Sales and marketing, and Research and Development (R&D) activities. East Kilbride hosts R&D and product engineering. Rousset is dedicated to R&D and marketing. The Group rents the building in East Kilbride under a long lease and the premises in France under operating leases.

Furniture and other office equipment relate to office and computing equipment.

Equipment comprises technical equipment dedicated to R&D, engineering and testing activities. R&D may result in the making of masks which are considered as the end product of this activity. The costs to design and produce these masks are expensed as incurred within the line item "Research and development expenses". When the design is finalized, the manufacturing of the masks for the purpose of usage during production is assigned to sub-contractors. The associated cost is recognized in fixed assets. In addition, masks acquired as part of a business combination are recognized as equipment in the balance sheet. These masks are subsequently depreciated within the line item "Research and development expenses" when they are used for project engineering design and "Cost of sales" when they are used in production.

All property and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

All repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Depreciation is calculated using the straight-line method to bring the cost of assets to their residual values over their estimated useful lives, as follows:

- Buildings 20 years
- Facilities and leasehold improvements 5 to 15 years
- Computer and R&D equipment 1 to 3 years
- Production equipment 1 to 5 years
- Masks acquired through business combination 2 to 5 years
- Furniture and other office equipment 3 to 8 years

The assets' residual values deemed material and their useful lives are reviewed and adjusted if appropriate at each balance sheet date.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized within "Other (losses)/gains, net" in the income statement.

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. For the purposes of assessing the value in use, assets are grouped by operating segment which constitutes the lowest level for the definition of the cash generating unit.

## 2.8 Financial assets

### 2.8.1 Classifications

The Group classifies its financial assets in the following categories: at fair value through profit or loss, as loans and receivables, or as available-for-sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except when they have maturities greater than 12 months after the balance sheet date. These are classified as non-current assets.

The Group has no available-for-sale financial assets.

### 2.8.2 Measurement

Changes in the fair value of monetary securities which are denominated in a currency other than the functional currency (certain monetary securities of the Company are denominated in Euros) and which result from translation differences are recognized in the line item «Finance income / (loss), net".

### 2.8.3 Impairment

For the loans, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rates. The carrying amount of the asset is reduced and the amount of the loss is recognized in the income statement in a line item dependent upon the nature of the loan.

If in a subsequent period the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the reversal of the previously recognized impairment loss is recorded in the income statement in the same line item.

## 2.9 Derivative financial instruments and hedging activities

Derivatives are initially recognized at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value. The method of recognizing the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as hedges of a particular risk associated with a recognized asset or liability or a highly probable forecast transaction (cash flow hedge).

At the inception of the transaction, the Group documents the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items.

The fair values of various derivative instruments used for hedging purposes are disclosed in note 11. Movements in the hedging reserve in shareholders' equity are shown in the consolidated statement of changes in equity. The full fair value of a hedging derivative is classified as a non-current asset or liability when the remaining maturity of the hedged item is more than 12 months and as a current asset or liability when the remaining maturity of the hedged item is less than 12 months. Trading derivatives are classified as a current asset or liability.

**Cash flow hedge**

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognized in other comprehensive income. The gain or loss relating to the ineffective portion is recognized immediately in the income statement within «Finance income / (loss), net".

Amounts accumulated in equity are reclassified to profit or loss in the periods when the hedged item affects profit or loss (for example, when the forecast sale that is hedged takes place).

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognized when the forecast transaction is ultimately recognized in the income statement.

When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement within "Finance income, net".

**Derivatives that do not qualify as hedge accounting**

Certain derivative instruments do not qualify as hedge accounting. Such derivatives are classified as assets or liabilities at fair value through profit or loss, and changes in the fair value of any derivative instruments that do not qualify as hedge accounting are recognized immediately in the income statement. The income statement impact of such derivatives is presented in the line item "Finance income, net".

**Fair value estimation**

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1).
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

The following table presents the Group's assets and liabilities that are measured at fair value as at December 31, 2011:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Trading derivatives | - | - | - | - |
| Derivatives used for hedging | - | - | 216 | 216 |
| **Total assets** | **-** | **-** | **216** | **216** |
| **Liabilities** | | | | |
| Trading derivatives | - | - | 350 | 350 |
| Derivatives used for hedging | - | 602 | 396 | 998 |
| **Total liabilities** | **-** | **602** | **746** | **1,348** |

The following table presents the Group's assets and liabilities that are measured at fair value as at December 31, 2012:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Trading derivatives | - | - | - | - |
| Derivatives used for hedging | - | 41 | 104 | 145 |
| **Total assets** | **-** | **41** | **104** | **145** |
| **Liabilities** | | | | |
| Trading derivatives | - | - | - | - |
| Derivatives used for hedging | - | 179 | - | 179 |
| **Total liabilities** | **-** | **179** | **-** | **179** |

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry Group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Group is the current bid price. These instruments are included in level 1. No derivative financial instruments fall into this category.

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. These valuation techniques maximize the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2. This category includes currency forward contracts.

If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3. This category includes currency options.

## *2.10 Inventories*

Inventories are stated at the lower of cost and net realizable value. Cost is determined using the First In First Out (FIFO) method. The cost of semi-finished goods and finished goods comprises wafer purchase costs, assembly sub-contracting expenses, other direct costs, tests and product engineering based on normal operating capacity. It excludes borrowing costs and the impact of unused capacity. Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

The Group also provides inventory allowances for excess and obsolete inventories

## *2.11 Trade receivables*

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less, they are classified as current assets. If not, they are presented as non-current assets.

A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payments are considered indicators that the trade receivable is impaired. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in the income statement within "Selling and marketing expenses”. When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables. Subsequent recoveries of amounts previously written off are credited against “Selling and marketing expenses” in the income statement.

### *2.12 Cash and cash equivalents*

The cash invested in short term securities corresponds to investments which are fully redeemable at any time but do not meet the criteria of cash and cash equivalents as defined by the AMF. Indeed, these securities include penalty clauses in case of early redemption calculated based on future market conditions which are uncertain by definition. Management considers that this cash invested in short term securities is not necessary to cover its short term needs and that, in any case, the penalties would not be significant with regards to the amounts at stake.

Cash and cash equivalents includes cash in hand, deposits held at call with banks and other short-term highly liquid securities with original maturities of three months or less and with a negligible risk of change in value.

Bank overdrafts are shown within financial debts in current liabilities on the balance sheet.

### *2.13 Share capital*

Ordinary shares are classified as equity. Incremental costs directly attributable to the issuance of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

### *2.14 Trade payables*

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities.

Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

### *2.15 Financial debts*

Financial debts comprise bank overdrafts that are classified as current liabilities. Financial debts also include finance leases.

### *2.16 Current and deferred income tax*

The tax expense for the period comprises current and deferred tax. Tax is recognized in the income statement, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case the tax is also recognized in other comprehensive income or directly in equity, respectively.

The current income tax charge is calculated on the basis of the tax laws enacted or substantially enacted at the balance sheet date in the countries where the Company’s subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from the initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit nor loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized. Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

## *2.17 Research tax credit and government grants*

Research tax credits are provided by various governments to give incentives for companies to perform technical and scientific research. These research tax credits are presented as a reduction of “Research and development expenses” in the income statement when companies that have qualifying expenses can receive such grants in the form of a tax credit irrespective of taxes ever paid or ever to be paid, the corresponding Research and Development effort has been completed and the supporting documentation is available.

These tax credits are included in “Other receivables - current portion” or “non-current” in the balance sheet taking into account the timing of expected cash inflows.

In addition, grants may be available to companies that perform technical and scientific research. Such grants are typically subject to performance conditions over an extended period of time. The Group recognizes these grants in the income statement as a reduction of “Research and development expenses” over the cost of the corresponding research and development program and when confirmation of the grant has been received.

Aid for research and development activities can take the form of repayable advances. A loan which is non-repayable under certain conditions is treated like a government grant (accounted for in the income statement on a pro rata basis as a deduction of research and development expenses) when the organization granting the advance has confirmed that no repayment is required. Otherwise it is classified as a liability.

## *2.18 Employee benefits*

*(a) Pension obligations*

The Group has both defined benefit (mainly for French employees) and defined contribution plans. A defined contribution plan is a pension plan under which the Group pays fixed contributions into a separate entity. The Group has no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods. A defined benefit plan is a pension plan that is not a defined contribution plan. Typically defined benefit plans define an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation.

The liability recognized in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date. The defined benefit obligation is calculated annually using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in the statement of recognized income and expense (SoRIE) in the period in which they arise.

For defined contribution plans, the Group pays contributions to publicly administered pension insurance plans on a mandatory basis. The Group has no further payment obligations once the contributions have been paid. The contributions are recognized as employee benefit expense when they are due. Prepaid contributions are recognized as an asset to the extent that a cash refund or a reduction in the future payments is available.

The Group provides no other post-employment benefits to its employees.

*(b) Termination benefits*

Termination benefits are payable when employment is terminated by the Group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognizes termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy.

*(c) Bonus plans*

The Group recognizes a liability and an expense for bonuses and incentive schemes based on a formula which takes into account the profit allocated to the shareholders of the Group after certain adjustments. The Group recognizes a provision when contractually obliged or if there is a past practice that has created a constructive obligation.

### *2.19 Share-based payments*

The Group operates a number of equity-settled, share-based compensation plans, under which the Group receives services from employees as consideration for equity instruments of the Group. The fair value of the employee services received in exchange for the grant of the instrument is recognized as an expense. The total amount to be expensed is determined by reference to the fair value of the instrument granted:

- including any market performance condition (for example increase in share price) and non-vesting conditions (for example, the requirement for employees to save);

- excluding the impact of any service and non-market performance vesting conditions (for example, profitability, sales growth targets and remaining an employee of the entity over a specified time period). Service and non-market vesting conditions are included in assumptions about the number of instruments that are expected to vest.

The total expense is recognized over the period during which all of the specified vesting conditions are to be satisfied. At the end of each reporting period, the entity revises its estimates of the number of instruments that are expected to vest based on these vesting conditions. It recognizes the impact of the revision to original estimates, if any, in the income statement, with a corresponding adjustment to equity. When the instruments are exercised, the Company issues new shares. The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the instruments are exercised.

### *2.20 Provisions*

Provisions for claims are recognized when: the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated.

Provisions are not recognized for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense.

### *2.21 Intangible liabilities*

Intangible liabilities relate to management's estimate of fair value of above market royalty-based intellectual property license agreements for existing or future products. The Group values these license agreements based on their fair value in normal market conditions. When the royalties to be paid exceed their fair value, the Group recognizes an intangible liability corresponding to the discounted value of the difference between the best estimate of the royalties to be paid based on the contract and forecasted sales and the fair value.

Intangible liabilities are amortized in the line item "Cost of Sales" on the basis of the number of units using this intellectual property sold during the year compared to the number of units expected to be sold. The assumptions regarding the number of units expected to be sold is revised on a regular basis.

### *2.22 Revenue recognition*

Revenue comprises the fair value of the consideration received or receivable for the sale of product and services in the ordinary course of the Group's activities. Revenue is shown net of value-added tax, returns and discounts and after eliminating sales within the Group.

The Group recognizes revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and when specific criteria have been met for each of the Group's activities as described below.

The Group sells its customers a range of semiconductor platforms and solutions.

*(a) Revenue recognition- Sale of products*

The Group's products 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 except for customary warranty terms. Revenue is recognized for products upon delivery when title and risk pass, the price is fixed and determinable and collectability is reasonably assured.

(b) Revenue recognition- Service revenue

Revenue from services is recognized over the period when services are rendered and collectability is reasonably assured.

Licenses for software that do not require specific development are recognized in revenue when the legal right to use the license has been granted or in accordance with specific contractual conditions.

Revenue corresponding to the development of specific software platforms is recognized using the percentage of completion method as the development process progresses (according to criteria applied on a consistent basis). Under the percentage of completion method, the extent of progress towards completion is measured based on actual costs incurred relative to total estimated costs. Losses on contracts are recognized during the period in which the loss first becomes probable and can be reasonably estimated.

*(c) Revenue recognition – Intellectual property licensing royalties*

Royalties relate to revenue from technology licensed to certain customers of the Group, and can be fixed and / or variable. Fixed royalties are recognized on a straight-line basis over the contractual periods during which they are generated. Variable royalties are generally based on sales made by customers and are by definition difficult to estimate. To ensure revenue is recorded in the proper accounting period, the Group principally relies on the notifications received from customers. In general notifications are received from customers during the quarter following delivery of goods.

*(d) Revenue recognition – Maintenance*

As a general rule, the sales of software licenses are accompanied by a maintenance contract that includes regular updates and the providing of technical assistance. Revenue related to maintenance activities is recognized on a straight-line basis over the contractual period.

*(e) 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.

*(f) Collectability*

As part of the revenue recognition process, the Group determines whether trade receivables and notes receivable are reasonably assured of collection based on various factors, and whether there has been deterioration in the credit quality of customers that could result in the inability to sell those receivables.

*(g) Deferred and unbilled revenue*

Deferred revenue includes amounts that have been billed as per contractual terms but have not been recognized as income.

### *2.23 Cost of sales*

Cost of sales is primarily composed of the cost of products and solutions sold, including wafer purchase costs, assembly sub-contracting expenses, tests and product engineering, royalties and other direct attributable costs.

### *2.24 Earnings per share*

Basic earnings per share are calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year. Diluted earnings per share are computed by dividing net income attributable to equity holders of the Company by the weighted average number of shares outstanding, adjusted for the effects of all dilutive potential ordinary shares.

Dilutive instruments are taken into account when, and only when, their dilutive effect decreases earnings per share or increases loss per share from continuing operations.

A reconciliation of the weighted average number of ordinary shares outstanding during the period and the weighted average number of shares outstanding, adjusted for the effects of all dilutive potential ordinary shares, is presented in note 31.

### *2.25 Leases*

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lesser) are charged to the income statement on a straight-line basis over the period of the lease.

Leases for which the Group substantially assumes all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the lease's commencement at the lower of the fair value of the leased property and the present value of the minimum lease payments.

## **3.** *Financial risk management*

### *3.1 Financial risk factors*

The Group's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's financial performance.

The Management Board provides principles for the overall management of risks such as foreign exchange risk, credit risk and liquidity risk.

*(a) Market risk*

The Group operates internationally and is exposed to foreign exchange risk arising from transactions denominated in currencies other than the US dollar, the functional and presentation currency of the Company.

The operating result and cash flows of the Group are affected by foreign exchange rate fluctuations, principally by fluctuations between the Euro and the US Dollar. For example, the Group estimates that for the year ended December 31, 2012 the impact in absolute terms of a variation of +10% or -10% of this rate would have been + or – US$ 382 thousand on its operating result and US$ 300 thousand on equity. To mitigate this risk, the Group has implemented a hedging policy to preserve its profitability and cash levels.

The Group mitigates its exposure to foreign currency fluctuations by matching its cash inflows and outflows denominated in the same currency to the extent possible, resulting in a natural hedge. The Group also uses derivative financial instruments such as currency forward contracts and options to hedge against foreign currency fluctuations.

*(b) Credit risk*

Credit risk is managed on a Group wide basis. Credit risk arises from cash and cash equivalents, derivative financial instruments and deposits with banks and financial institutions, as well as credit exposures to customers, including outstanding receivables and committed transactions.

*(c) Liquidity risk*

Cash flow forecasting is performed by the Finance department. Management monitors rolling forecasts of the Group's liquidity requirements to ensure it has sufficient cash to meet operational needs.

Such forecasting takes into consideration the Group's financing plans. The Group treasury invests surplus cash in interest bearing current accounts, time deposits and money market deposits, choosing instruments with appropriate maturities or sufficient liquidity to provide sufficient head-room as determined by the above-mentioned forecasts.

In the fourth quarter of 2011, the Group entered into a factoring contract in Euros and Dollars with Natixis Factor, which is still ongoing. This contract includes a deposit and is backed by a credit insurance agreement. Since the risk of non recoverability and delays in payment has been transferred to the bank, the receivables transferred under these contracts are no longer recorded in the balance sheet.

### *3.2 Capital risk management*

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders, gain benefits for partners and maintain an optimal capital structure.

In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, repay capital to shareholders or issue new shares

## **4.** *Critical accounting estimates and judgments*

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

*(a) Revenue recognition*

The Group derives its revenue principally from sales of products and solutions as well as license-based royalties. The timing of revenue recognition and the amount of revenue actually recognized depends upon the specific terms of each arrangement with customers (transfer of risk) and the nature of the Company's deliverables and obligations. For royalties, the Group generally does not obtain formal confirmation of the level of sales made by customers until the quarter following product delivery. Determination of the appropriate amount of revenue recognized involves certain judgments and estimates that the management believes are reasonable, but actual results may differ from management's estimates.

*(b) Intangible assets and liabilities*

Intangible assets and liabilities include acquired patented technologies, backlog and the recognition of above market royalty-based intellectual property license agreements. Upon acquisition, these assets and liabilities were recognized at fair value which required certain judgments and estimates that Management believed were reasonable. On a regular basis, the Group reassesses the fair value of these intangible assets and liabilities leading to a potential adjustment of the carrying amount through an impairment charge or an accelerated amortization.

*(c) Share-based payments*

The Group grants options to purchase Company's common shares and other equity instruments to management, employees and third parties. The determination of the fair value of share-based compensation on the date they are granted uses an option-pricing model (Monte-Carlo or Black and Scholes) which is affected by assumptions regarding a number of complex and subjective variables. These variables include, but are not limited to, the fair value of the Company's common shares, the expected common share price volatility over the term of the instrument and actual and projected instrument holders' exercise behaviors. There is an inherent high degree of subjectivity involved when using such option-pricing models to determine share-based compensation under IFRS 2.

*(d) Fair value of derivatives and other financial instruments*

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. The Group uses its judgment to select a variety of methods and make assumptions that are mainly based on market conditions existing at the end of each reporting period.

*(e) Accounting for income taxes*

The Group is subject to the income tax laws of France and those of the foreign jurisdictions in which it has business operations. These tax laws are often complex and subject to different interpretations by the tax payer and the relevant governmental taxing authorities. The Group must make judgments and interpretations about the application of these tax laws when determining the provision for income taxes.

The Group must also assess the likelihood that each of its deferred tax assets will be realized. Unless there is strong evidence that an entity currently generating losses will become profitable, the policy of the Group is to recognize deferred tax assets only when the tax jurisdiction where it conducts business has generated a taxable profit in two consecutive years

## **5.** *Business combinations*

*Secure Microcontroller Solutions*

On September 30, 2010 the Company acquired Atmel Corporation's (Nasdaq: ATML) Secure Microcontroller Solutions ("SMS") business. This business designs and markets microcontroller products and solutions that protect data contained in embedded memories against a wide variety of attacks and offers firmware and turnkey solutions to customers with no security expertise.

The goodwill recognized upon acquisition amounting to US $2,993 thousand was allocated to the ''Digital security'' operating segment. Given the financial performance of this segment, Group management does not consider any impairment of the goodwill necessary. The variation of goodwill from US $ 3,251 thousand as at December 31, 2011 to US $ 3,246 thousand as at December 31, 2012 is exclusively due to foreign exchange rate variations, certain assets acquired and liabilities assumed being accounted for in entities having a functional currency different from the US Dollar.

As part of the allocation of the purchase price consideration, the Group recognized a certain number of identifiable intangible and tangible assets, notably related to patented technologies, backlog and masks. In addition, the Group recognized an intangible liability corresponding to an unfavorable licensing agreement.

The impact of the related depreciation and amortization of identifiable tangible and intangible assets, and reversals on intangible liabilities, on the 2011 and 2012 income statements is as follows (amounts in thousand dollars):

| Item | Income statement line item | 2011 | 2012 |
|---|---|---|---|
| Depreciation of masks | Cost of sales | (2,835) | (2,462) |
| Depreciation of masks | Research and development expenses | (552) | (681) |
| Amortization of patented technologies | Research and development expenses | (909) | (1,076) |
| Amortization of backlog | Selling and marketing expenses | (716) | - |
| Reversal of intangible liabilities | Cost of sales | 1,409 | 1,064 |
| **Impact on operating loss** | | **(3,603)** | **(3,155)** |
| Undiscounting of intangible liabilities | Finance income / (loss), net | (625) | (581) |
| **Impact on loss for the year** | | **(4,228)** | **(3,736)** |

*Embedded Security Solutions*

On December 1, 2012, the Group acquired Embedded Security Solutions (‘‘ESS’’). ESS designs and develops encryption-related security hardware intellectual property (IP) and software for a variety of industries, including the mobile and networking markets. Revenue is generated through licenses, royalties, services and maintenance fees.

As part of the acquisition, research and development and sales and marketing teams were transferred to the Group. The seller also transferred intangible assets, including intellectual property licensing royalties and internally developed software, tangible assets, working capital (notably inventories, trade receivables and social and tax debts related to transferred employees) and cash.

Upon acquisition, Inside Secure paid a purchase price of $US 43,256 thousand based on an initial estimate of working capital requirements. Subsequently a reduction on the purchase price amounting to US$ 503 thousand was accorded to the Group to take into account the final amount of this working capital requirement. The payment of this purchase price reduction has not yet been received by the Group at the date of issuance.

The Group paid an additional US$ 1,750 thousand in January 2013 after certain precedent conditions were met and this amount could rise to US$ 3,438 thousand if all the conditions included in the agreement are met before April 1, 2013. Based on information available at the date of issuance, management considers that it will have to pay the entire additional amount.

The goodwill corresponding to the excess of the purchase price consideration (including any potential purchase price adjustments) compared to the combined total of the fair value of the assets acquired, the identifiable intangible assets and the liabilities assumed, amounts to US$ 11,906 thousand, and is mainly attributable to the expertise of the assembled workforce and the expected synergies that will result from the combination of activities. This goodwill is allocated to the ‘‘Embedded Security Solutions’’ operating segment.

On acquisition date, the net assets transferred represented US$ 2,088 thousand in the accounts of the seller. The Company has performed a preliminary allocation of the purchase price consideration over assets acquired and liabilities assumed.

The initial value of the identifiable assets and liabilities and the preliminary allocation of the purchase price consideration are summarized below:

| | Note | In thousands of dollars |
|---|---|---|
| Cash paid at closing (before working capital adjustment) | | 42,813 |
| Estimated working capital adjustment | | 443 |
| **Cash paid at closing** | | **43,256** |
| Final working capital adjustment | | (503) |
| Additional payment upon completion of conditions | (1) | 5,188 |
| **Purchase price consideration (i)** | | **47,940** |

| | Net book value | Fair value adjustments | | Fair value |
|---|---|---|---|---|
| Intangible assets | - | 33,906 | (2) | 33,906 |
| Property, plant and equipment | 139 | - | | 139 |
| Inventory | 99 | - | | 99 |
| Other assets | 2,998 | (115) | (3) | 2,883 |
| Cash and cash equivalents | 1,621 | - | | 1,621 |
| Other liabilities | (1,150) | | | (1,150) |
| Deferred income | (1,619) | 155 | (4) | (1,464) |
| **Net assets acquired and liabilities assumed (ii)** | **2,088** | **33,946** | | **36,034** |
| **Goodwill (i) - (ii)** | | | | **11,906** |

The initial amount of goodwill mentioned above remains likely to change during the course of the 12 month allocation period authorized by IFRS 3.

(1) The contract includes potential purchase price adjustments which could rise up to US$ 5,188 thousand. This additional payment is subject to certain conditions being met before April 1, 2013. As part of this agreement the Group has already paid an amount of US$ 1,750 thousand to the seller in January 2013. Based on the information available at the date of issuance, management considers that it will have to pay the entire additional amount.

(2) The US$ 33,906 thousand of intangible assets relate to :

a. Intellectual property licensing royalties contracts relating to technologies patented and developed by ESS, amounting to US$ 31, 576 thousand. These licensing royalties were valued using the discounted cash flow method based on an estimated useful life of 5 years for the technologies concerned. Amortization expenses for this intangible asset will be recognized in the income statement in the line item ‘‘Cost of sales’’ as the corresponding revenue is recognized.

b. Software developed internally amounting to US$ 2,330 thousand. This software has been valued based on the cost approach. Amortization expenses for this intangible asset will be recognized in the income statement over a useful life of 3 years.

(3) An additional provision for trade receivables has been recorded to provide for difficulties in collecting outstanding amounts from certain customers.

(4) Deferred income relating to support and maintenance services have been adjusted to take into account the 10% margin generally recognized on these activities.

External costs directly attributable to the acquisition amount to US$ 554 thousand and have been recognized in ‘‘Other (losses)/gains, net’’.

The impact of the acquisition is presented in the line item ‘‘Acquisition of ESS, net of cash acquired’’ in the consolidated cash flow statement for an amount of US$ 41, 635 thousand. This amount reflects the payment of US$ 43,256 thousand net of the cash acquired amounting to US$ 1,621 thousand.

The contribution of ESS activity to Group revenue since December 1, 2012 amounts to US$ 840 thousand. ESS recorded an operating loss of (US$ 1,116) thousand during the same period.

ESS was identified as an operating segment in the financial statements of its former group, prior to acquisition .Over the period January 1 to November 30 2012, the seller reported for ESS a consolidated revenue of US$ 25,786 thousand and an operating result of US$ 7,462 thousand. The seller does not provide any information regarding the net income of its operating segments. The combined revenue of ESS and the Group, which is composed of Inside Secure and its subsidiaries, for the 12 month period ended December 31, 2012 amounts to US$ 147,832 thousand. The combined operating result for the period amounts to a loss of (US$ 29,815) thousand. The historical figures of ESS are presented under US GAAP and do not take into account the effects of the purchase price allocation carried out by the Group. The conversion to IFRS and the taking into consideration of the effects of the purchase price allocation, if the acquisition had been completed as at January 1, 2012, could result in figures that are significantly different to the combined historical data reported in this paragraph.

As mentioned above, as part of the acquisition of ESS, certain fair value adjustments were made, leading to the recognition of assets acquired and liabilities assumed. This resulted in the increase in the calculation basis for post-acquisition amortization expenses.

The impact of these adjustments on the different line items in the 2012 income statement breaks down as follows (amounts in thousand dollars):

| **Item** | **Income statement line item** | **2012** |
|---|---|---|
| Amortization of intellectual property licensing royalties | Cost of sales | (230) |
| Amortization of internally developed software | Cost of sales | (43) |
| Amortization of internally developed software | Research and development expenses | (22) |
| **Impact on operating loss** | | **(295)** |
| **Impact on loss for the year** | | **(295)** |

## 6. *Operating segment information*

Management has determined the operating segments based on the reports reviewed by the Management Board that are used to make strategic decisions.

Since the acquisition of ESS, the Group operates in four complementary business segments, which target different markets, products, solutions and customers leveraging the Group’s secure silicon and software platforms:

- Mobile NFC: Designs and markets microprocessor chips and software stacks to mobile handset makers and more generally the wireless space.

- Secure payments: Designs and markets microprocessor chips with embedded memory, modules and inlays, and software stacks for payment, transit fare collection, and loyalty applications.
- Digital security: Designs and markets memory and microprocessor platforms, pay TV, identification, access control, and other secure systems for anti-counterfeiting, intellectual property protection and machine-to-machine communication.
- Embedded security solutions: designs and develops encryption-related security hardware intellectual property (IP) and software for a variety of industries, including the mobile and networking markets.

The segment information provided to the Management Board for the reportable segments for the year ended December 31, 2011 is as follows:

| **(in thousand dollars)** **As at December 31, 2011** | **Mobile NFC** | **Secure Payments** | **Digital Security** | **Embedded security solutions** | **Common unallocated** | **Total per management reporting** | **Reconciliation to IFRS** | **Consolidated IFRS reporting (audited)** |
|---|---|---|---|---|---|---|---|---|
| Revenue | 47,961 | 43,246 | 60,261 | - | - | 151,468 | - | 151,468 |
| Operating loss (*) | (18,251) | (11,489) | 8,674 | - | (3,396) | (24,462) | - | (24,462) |
| Adjusted operating loss | (17,258) | (9,271) | 13,153 | - | (2,676) | (16,052) | | Non IFRS measure |
| Adjusted EBITDA | (16,762) | (7,858) | 15,054 | - | (2,676) | (12,242) | | Non IFRS measure |
| Finance income / (loss), net | | | | | 1,503 | 1,503 | - | 1,503 |
| Income tax expense | | | | | (74) | (74) | - | (74) |
| **Net loss** | - | - | - | - | **(1,967)** | **(23,033)** | - | **(23,033)** |

(*) Unallocated amount corresponds to industrial variances (US$ 2,539 thousand) and impairment of assets acquired as part of acquisition of SMS business (US$ 614 thousand).

The segment information provided to the Management Board for the reportable segments for the year ended December 31, 2012 is as follows:

| **(in thousand dollars)** **As at December 31, 2012** | **Mobile NFC** | **Secure Payments** | **Digital Security** | **Embedded security solutions** | **Common unallocated** | **Total per management reporting** | **Reconciliation to IFRS** | **Consolidated IFRS reporting (audited)** |
|---|---|---|---|---|---|---|---|---|
| Revenue | 43,261 | 31,788 | 46,158 | 840 | - | 122,047 | - | 122,047 |
| Operating loss (*) | (31,757) | (5,022) | 2,853 | (1,116) | (2,237) | (37,278) | - | (37,278) |
| Adjusted operating loss | (30,451) | (3,531) | 6,412 | (288) | (2,237) | (30,095) | | Non IFRS measure |
| Adjusted EBITDA | (28,523) | (2,279) | 8,197 | (281) | (2,237) | (25,123) | | Non IFRS measure |
| Finance income / (loss), net | | | | | (258) | (258) | - | (258) |
| Income tax expense | | | | | 51 | 51 | - | 51 |
| **Net loss** | - | - | - | | **(2,444)** | **(37,485)** | - | **(37,485)** |

* Unallocated amount corresponds to industrial variances (US$ 2,237 thousand)

Adjusted operating result and Adjusted EBITDA are not measures of operating performance or liquidity under IFRS.

The Group presents Adjusted operating result and Adjusted EBITDA because management believes they are useful measures of the Group's operating performance and operating cash flow generation. Adjusted operating result is defined as operating profit/(loss) revised to exclude the effects of share based payment and nonrecurring items of revenue or gain and expense or loss such as acquisition, restructuring, amortization and depreciation of acquired intangible and tangible assets as part of a business combination. Adjusted EBITDA is defined as operating profit/(loss) before interest, taxes, depreciation, and amortization revised to exclude the effects of share based payment and nonrecurring items of revenue or gain and expense or loss such as acquisition and restructuring.

Adjusted operating result and Adjusted EBITDA as presented may not be strictly comparable to measures with similar names as presented by other companies.

The reconciliation from Company reporting to consolidated IFRS reporting (audited) is as follows:

| **As of December 31, (in thousand dollars)** | **2011** | **2012** |
|---|---|---|
| **Operating loss as per IFRS** | **(24,462)** | **(37,278)** |
| Share based paymets | 2,000 | 1,880 |
| Amortization and depreciation of acquired assets from SMS | 5,012 | 4,222 |
| Amortization and depreciation of acquired assets from ESS | - | 295 |
| Impairment of assets acquired as part of acquisition of SMS business | 1,713 | - |
| Reversal of intangible liabilities | (829) | - |
| Direct transaction costs related to acquisitions | - | - |
| Restructuring expenses | 514 | 786 |
| **Adjusted operating loss** | **(16,052)** | **(30,095)** |
| | | |
| Depreciation and amortization of tangible and intangible assets | 3,810 | 4,972 |
| **Adjusted EBITDA** | **(12,242)** | **(25,123)** |

The revenue by geographical region for the years ended December 31, 2011 and 2012 is as follows:

| **(in thousand dollars)** | **Asia** | **Europe, Middle East Africa, Latin America** | **North America** | **Total** |
|---|---|---|---|---|
| 2011 | 14,148 | 73,548 | 63,772 | 151,468 |
| 2012 | 8,436 | 59,382 | 54,229 | 122,047 |

Geographically, management has allocated revenue based on the location where the goods are delivered or the services are rendered, except for the sales with three major customers, which were allocated based on the location of their head offices

The top ten customers of the Group represented 83% and 78% of the total consolidated turnover in 2012 and 2011 respectively.

Two customers each represented more than 10% of the total consolidated turnover in 2012 and 2011. This breaks down as follows:

| **As of December 31, 2011 (in thousand dollars)** | **Invoiced amount** | **Segment** |
|---|---|---|
| Client 1 | 45,793 | Mobile NFC |
| Client 2 | 16,109 | All segments |

| **As of December 31, 2012 (in thousand dollars)** | **Invoiced amount** | **Segment** |
|---|---|---|
| Client 1 | 36,743 | Mobile NFC |
| Client 2 | 13,897 | Digital Security |

## 7. *Revenue*

Revenue for the years 2011 and 2012 breaks down as follows:

| **(in thousand dollars)** | **Year ended December 31, 2011** | **2012** |
|---|---|---|
| Revenue from sale of products | 150,689 | 115,120 |
| Revenue from development and license agreements | 779 | 6,336 |
| Revenue from maintenance | - | 298 |
| Revenue from royalties | - | 293 |
| **Total** | **151,468** | **122,047** |

Over the period the Group has performed services relating to a contract signed in 2011 with Intel Corporation. The agreement includes a non exclusive and non transferable license of the Group's NFC technology to Intel, the provision of development, support and engineering services so as to facilitate the integration of its NFC technology into the Intel environment and the sale of chips made by Intel or its subcontractors. Revenues relating to the development phase are recognized using the percentage of completion method based on the specific costs incurred on the project. The corresponding direct development costs are recorded in "Cost of sales". The Group recorded US$ 6,178 thousand in revenue in 2012 (US$ 779 thousand in 2011) based on the progress of the work performed. The "deferred income" amounting to $3,860 thousand recorded as at December 31, 2012 corresponds to prepayments received from Intel Corporation.

## 8. *Goodwill*

Goodwill breaks down as follows:

| **(in thousand dollars)** | **Segment** | **As at December 31, 2011** | **2012** |
|---|---|---|---|
| SMS activity | Digital Security | 3,251 | 3,246 |
| ESS activity | Embedded Security Solutions | - | 11,906 |
| **Total** | | **3,251** | **15,152** |

The goodwill related to the acquisition of SMS is allocated to the ''Digital security'' operating segment. Given the financial performance of this segment, Group management does not consider any impairment of the goodwill necessary.

The goodwill related to the acquisition of ESS is allocated to the ''Embedded Security Solutions'' operating segment and results from the negotiated price based on the business plans prepared for the purpose of the acquisition process. Given the information available at the date of issuance, Group management does not consider any impairment of the goodwill necessary.

## 9. *Intangible assets*

Intangible assets break down as follows:

| (in thousand dollars) | Backlog | Patented technologies | Software licenses | Royalties on intellectual property | Internally developed software | Technology in development | Total |
|---|---|---|---|---|---|---|---|
| **Year ended December 31, 2011** | | | | | | | |
| **Opening net book amount** | **717** | **5,372** | **553** | **-** | **-** | **-** | **6,641** |
| Additions | - | - | 1,160 | - | - | - | **1,160** |
| Exchange differences | - | - | (24) | - | - | - | **(24)** |
| Impairment | - | - | - | - | - | - | **-** |
| Retirement | - | - | - | - | - | - | **-** |
| Work in progress | - | - | - | - | - | 1,188 | **1,188** |
| Amortization charge | (717) | (910) | (462) | - | - | - | **(2,088)** |
| **Closing net book amount** | **-** | **4,462** | **1,227** | **-** | **-** | **1,188** | **6,877** |
| **At December 31, 2011** | | | | | | | |
| Cost or valuation | 1,544 | 5,651 | 4,479 | - | - | 1,188 | **12,862** |
| Accumulated amortization and impairment | (1,544) | (1,190) | (3,251) | - | - | - | **(5,985)** |
| **Net book amount** | **-** | **4,461** | **1,227** | **-** | **-** | **1,188** | **6,877** |
| **Year ended December 31, 2012** | | | | | | | |
| **Opening net book amount** | **-** | **4,462** | **1,227** | **-** | **-** | **1,188** | **6,877** |
| Acquisitions | - | - | 2,825 | - | - | - | **2,825** |
| Acquisition of business | - | - | - | 31,576 | 2,330 | - | **33,906** |
| Exchange differences | - | - | 10 | - | - | - | **10** |
| Impairment | - | - | - | - | - | - | **-** |
| Retirement | - | - | - | - | - | - | **-** |
| Work in progress | - | - | - | - | - | 973 | **973** |
| Amortization charge | - | (1,076) | (1,167) | (230) | (65) | - | **(2,538)** |
| **Closing net book amount** | **-** | **3,385** | **2,895** | **31,346** | **2,265** | **2,161** | **42,052** |
| **At December 31, 2012** | | | | | | | |
| Cost or valuation | 1,544 | 5,651 | 7,320 | 31,576 | 2,330 | 2,161 | **50,582** |
| Accumulated amortization and impairment | (1,544) | (2,266) | (4,424) | (230) | (65) | - | **(8,529)** |
| **Net book amount** | **-** | **3,385** | **2,896** | **31,346** | **2,265** | **2,161** | **42,052** |

Amortization expenses of US$ 2,538 thousand have been recorded in 2012 within research and development, selling and marketing, and general administration expenses according to the assets allocation (US$ 2,088 thousand in 2011).

In 2012, development expenses related to two research projects for a total amount of US$ 973 thousand were capitalized (US$ 1,188 in 2011). These two projects, both with a duration of three years, are financed through repayable advances (see note 21) and through classic grants. Capitalized research expenses correspond only to the project financed through repayable advances. In the event that the projects are terminated, the carrying value of the related capitalized expenses is written off through net income and the advances, which are then definitely granted, are recognized as a profit to net income, thereby offsetting the previously recorded expense.

Finance leases included within intangible assets corresponding to software break down as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| Gross book value | 719 | 826 |
| Accumulated amortization | (349) | (529) |
| **Net book value** | **371** | **297** |

## 10. *Property and equipment*

Property and equipment break down as follows:

| (in thousand dollars) | Leasehold improvement | Equipment | Furniture and other office equipment | Masks | Total |
|---|---|---|---|---|---|
| **Year ended December 31, 2011** | | | | | |
| **Opening net book amount** | **3,408** | **3,518** | **1,473** | **12,153** | **20,552** |
| Additions | 83 | 3,110 | 1,875 | 438 | **5,507** |
| Exchange differences | (117) | (31) | (144) | (340) | **(633)** |
| Impairment | (614) | - | - | (1,100) | **(1,714)** |
| Retirement | - | - | - | - | - |
| Work in progress | - | (70) | - | - | **(70)** |
| Depreciation charge | (824) | (1,652) | (936) | (3,416) | **(6,829)** |
| **Closing net book amount** | **1,936** | **4,874** | **2,268** | **7,734** | **16,813** |
| **At December 31, 2011** | | | | | |
| Cost or valuation | 4,202 | 9,593 | 4,627 | 12,792 | **31,214** |
| Accumulated depreciation | (2,266) | (4,719) | (2,359) | (5,057) | **(14,401)** |
| **Net book amount** | **1,936** | **4,874** | **2,268** | **7,734** | **16,813** |
| **Year ended December 31, 2012** | | | | | |
| **Opening net book amount** | **1,936** | **4,874** | **2,268** | **7,734** | **16,813** |
| Additions | 146 | 998 | 575 | 735 | **2,454** |
| Acquisition of business | 9 | 17 | 114 | - | **140** |
| Exchange differences | 66 | 80 | (12) | 144 | **278** |
| Impairment | - | - | - | - | - |
| Retirement | - | (48) | (14) | - | **(62)** |
| Work in progress | - | (115) | 25 | - | **(90)** |
| Depreciation charge | (472) | (2,288) | (912) | (3,124) | **(6,796)** |
| Depreciation retirement | - | 32 | 43 | - | **75** |
| **Closing net book amount** | **1,685** | **3,549** | **2,086** | **5,490** | **12,811** |
| **At December 31, 2012** | | | | | |
| Cost or valuation | 4,650 | 10,374 | 5,519 | 13,806 | **34,348** |
| Accumulated depreciation | (2,965) | (6,825) | (3,432) | (8,316) | **(21,538)** |
| **Net book amount** | **1,685** | **3,549** | **2,086** | **5,490** | **12,811** |

Depreciation expenses of US$ 6,797 thousand have been recognized in 2012 within cost of sales, research and development expenses, selling and marketing expenses, and general and administrative expenses according to the assets' allocation (US$ 6,829 thousand in 2011).

Lease rentals amounting to US$ 2 318 thousand (US$ 2, 528 thousand in 2011) relating to the lease of buildings and furniture are included in the income statement.

Finance leases included in property and equipment above, are as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| Gross book value | 1,412 | 1,683 |
| Accumulated depreciation | (155) | (559) |
| **Net book value** | **1,257** | **1,124** |

## 11. *Financial instruments by category*

The accounting policies for financial instruments have been applied to the line items below:

| **December 31, 2011**<br>**Assets** | **Loans and receivables** | **Assets at fair value through profit and loss** | **Derivatives used for hedging** | **Available for sale** | **Total** |
|---|---|---|---|---|---|
| Derivative financial instruments | - | - | 216 | - | 216 |
| Trade and other receivables | 36,472 | - | - | - | 36,472 |
| Cash and marketable securities | 20,550 | 390 | - | - | 20,940 |
| **Total** | **57,022** | **390** | **216** | **-** | **57,628** |

| **Liabilities** | **Liabilities at fair value through profit and loss** | **Derivatives used for hedging** | **Other financial liabilities at amortized cost** | **Total** |
|---|---|---|---|---|
| Bank overdrafts | - | - | - | - |
| Finance lease liabilities | - | - | 1,320 | 1,320 |
| Derivative financial instruments | 350 | 998 | - | 1,348 |
| Trade and other payables | - | - | 29,977 | 29,977 |
| **Total** | **350** | **998** | **31,297** | **32,645** |

| **December 31, 2012**<br>**Assets** | **Loans and receivables** | **Assets at fair value through profit and loss** | **Derivatives used for hedging** | **Available for sale** | **Total** |
|---|---|---|---|---|---|
| Derivative financial instruments | - | - | 145 | - | 145 |
| Trade and other receivables | 39,567 | - | - | - | 39,567 |
| Cash and marketable securities | 63,929 | 2,392 | - | - | 66,321 |
| **Total** | **103,496** | **2,392** | **145** | **-** | **106,033** |

| **Liabilities** | **Liabilities at fair value through profit and loss** | **Derivatives used for hedging** | **Other financial liabilities at amortized cost** | **Total** |
|---|---|---|---|---|
| Bank overdrafts | - | - | - | - |
| Finance lease liabilities | - | - | 1,209 | 1,209 |
| Financing of the Research tax credit receivable | - | - | 6,225 | 6,225 |
| Derivative financial instruments | - | 179 | - | 179 |
| Trade and other payables | - | - | 33,214 | 33,214 |
| **Total** | **-** | **179** | **40,648** | **40,827** |

## 12. *Derivative financial instruments*

Derivative financial instruments break down as follows:

| | 2011 | | 2012 | |
|---|---|---|---|---|
| | **Assets** | **Liabilities** | **Assets** | **Liabilities** |
| Currency forward contracts - cash flow hedges | - | 602 | 41 | 179 |
| Currency forward contracts - held for trading | - | - | - | - |
| Currency options - cash flow hedges | 216 | 396 | 104 | - |
| Currency options - held for trading | | 350 | - | - |
| **Total** | **216** | **1,348** | **145** | **179** |
| *Of which current portion* | **216** | **1,348** | **145** | **179** |
| *Of which non current portion* | **-** | **-** | **-** | **-** |

The fair value of a hedging derivative is classified as a non-current asset or liability if the remaining maturity of the hedged item is more than 12 months and as a current asset or liability if the maturity of the hedged item is less than 12 months.

The ineffective portion recognized in the profit or loss that arises from cash flow hedges amounts to a loss of US$ 47 thousand (US$ 57 thousand in 2011).

*(a) Currency forward contracts*

The notional principal amounts of the outstanding forward foreign exchange contracts at December 31, 2012 were US$ 19, 551 thousand (US$ 17, 159 thousand in 2011).

The hedged highly probable forecast transactions denominated in foreign currencies are expected to occur at various dates during the next 12 months. Gains and losses recognized in the hedging reserve in equity on forward foreign exchange contracts as at December 31, 2012 are recognized in the income statement in the period or periods during which the hedged forecast transaction affects the income statement.

The maximum exposure to credit risk at the reporting date is the fair value of the derivative assets in the balance sheet.

*(b) Currency options*

The notional principal amounts of the outstanding currency options at December 31, 2012 were US$ 1,979 thousand (US$ 8,410 thousand in 2011).

The hedged highly probable forecast transactions denominated in foreign currencies are expected to occur at various dates during the next 12 months. Gains and losses recognized in the hedging reserve in equity on currency options as at December 31, 2012 are recognized in the income statement in the period or periods during which the hedged forecast transaction affects the income statement.

The maximum exposure to credit risk at the reporting date is the fair value of the derivative assets in the balance sheet.

## 13. *Inventories*

Inventories break down as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| Semi-finished and finished goods | 27,163 | 21,389 |
| Less: provision for impairment of obsolete items | (3,887) | (4,038) |
| | **23,276** | **17,350** |

Movements on the Group provision for impairment of obsolete inventories are as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| At January 1 | (1,063) | (3,887) |
| Impairment of obsolete items | (4,624) | (3,421) |
| Inventory written off during the year | 955 | 1,640 |
| Unused amounts reversed | 845 | 1,630 |
| **At December 31** | **(3,887)** | **(4,038)** |

Impairment of obsolete items relates to inventory levels judged in excess, particularly when assessed in relation to backlog as well as obsolete technology. The Group recognized the provision for inventory depreciation in the line item “Cost of sales”.

## 14. *Trade receivables*

Net trade receivables break down as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| Trade receivables | 18,760 | 17,175 |
| Less: provision for impairment of trade receivables | (49) | (713) |
| **Trade receivables, net** | **18,711** | **16,462** |

Trade receivables break down as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| Trade receivables invoiced | 20,824 | 13,103 |
| Trade receivables accrued invoices | 779 | 6,809 |
| Credit notes to be issued | (2,843) | (2,736) |
| **Trade receivables** | **18,760** | **17,175** |

Trade receivables that are less than three months past due are not considered for impairment. As at December 31, 2012, trade receivables of US$ 4 622 thousand were overdue but not impaired. These relate to a number of customers for whom there is no history of default.

The ageing analysis of these trade receivables is as follows:

| (in thousand dollars) | Total | Not past due | 1 to 30 | 30 to 60 | 60 to 90 | 90 to 120 | Above 120 |
|---|---|---|---|---|---|---|---|
| 2011 | 20,824 | 16,481 | 2,938 | 281 | 5 | 832 | 287 |
| 2012 | 13,103 | 8,482 | 2,337 | 1,059 | 306 | 65 | 855 |

As at December 31, 2012, trade receivables of US$ 713 thousand (US$ 49 thousand as at December 31, 2011) were provided for. The impaired receivables mainly relate to one customer.

The provision for impairment of receivables breaks down as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| At January 1 | (54) | (49) |
| Provision for receivables impairment | - | (677) |
| Receivables written off during the year as uncollectible | - | - |
| Unused amounts reversed | 5 | 13 |
| **At December 31** | **(49)** | **(713)** |

The recording and reversal of a provision for receivables impaired has been included in the line item “Selling and marketing expenses” in the income statement. Amounts recognized in the allowance account are written off when there is no expectation of recovering the related cash amount.

The carrying amounts of the Group’s trade and other receivables are denominated in the following currencies:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| US dollar | 21,625 | 18,131 |
| Euro | 6,019 | 4,845 |
| Other currencies | 1,590 | 155 |
| | **29,235** | **23,131** |

The maximum exposure to credit risk at the reporting date is the carrying value of each class of receivable mentioned above. The Group does not hold any collateral as security.

In 2011, the Group entered into factoring agreements whereby it transferred certain receivables in Euros and Dollars to Natixis Factor for a renewable period of two years, including a deposit and backed by a credit insurance contract. Since the risk of non-recoverability and delays in payment has been transferred to the bank, the receivables transferred under these contracts are no longer recorded in the balance sheet.

The amount of receivables transferred with maturities later than December 31 for which substantially all of the risks and rewards have been transferred and which are therefore no longer recorded in the balance sheet within accounts receivable is as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| Trade receivables transferred | 11,052 | 12,766 |
| Factoring reserve | (442) | (436) |
| **Cash received as at December 31,** | **10,610** | **12,330** |

As at December 31, 2012, the total amount of transferred receivables is US$ 12,766 thousand (US$ 11,052 as at December 31, 2011).

## 15. *Other receivables*

Other receivables break down as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| Deposits | 486 | 1,091 |
| Research tax credit | 10,952 | 15,071 |
| VAT receivables | 2,946 | 1,288 |
| Pre-payments | 1,145 | 468 |
| Factoring reserve | 442 | 436 |
| Other receivables | 735 | 1,919 |
| Prepaid | 1,056 | 2,560 |
| **Other receivables** | **17,762** | **22,832** |
| *Other receivables - Non-current portion* | *7,287* | *16,163* |
| *Other receivables - Current portion* | *10,474* | *6,669* |

As the Group is no longer eligible to immediate reimbursement of the Research Tax Credit (RTC) since 2011, the RTC receivable acquired during 2012 is recorded in the line item "Other receivables – Non-current portion". In accordance with generally accepted accounting principles, the RTC receivable is not discounted.

The Group has maintained the RTC receivable acquired in 2011 within "Other receivables – Non-current portion" (US$ 6,502 thousand). A factoring contract has been implemented with a financial institution for which the term is June 2015 (see Note 21). This agreement resulted in the recognition of a liability in financial debts in accordance with IAS 39.

The research tax credit receivable related to 2010 was audited by the tax authorities and the Ministry of Research before being paid on July 4, 2012 for a total amount of US$ 4,168 thousand (€ 3,207 thousand). The tax audit did not lead to any adjustments.

The variation in research tax credit receivable over the year is as follows:

| (in thousand dollars) | |
|---|---|
| **At January 1** | **10,952** |
| Research tax credit for 2012 | 7,863 |
| Cash received in 2012 related to the research tax credit for 2010 | (4,168) |
| Exchange differences | 424 |
| **As at December 31, 2012** | **15,071** |

## 16. *Cash and cash equivalents*

Cash and cash equivalents break down as follows:

| (in thousand dollars) | As at December 2011 | As at December 2012 |
|---|---|---|
| Cash at bank and on hand | 20,550 | 27,380 |
| Marketable securities (1) | 390 | 2,392 |
| Short term securities (2) | - | 36,549 |
| **Cash and cash equivalent** | **20,940** | **66,321** |

(1) Marketable securities correspond to joint investment schemes measured at fair value against profit and loss. These securities are considered as cash equivalents as they are highly liquid, have sensitivity to interest rates of less than 0.25, have a volatility of almost 0 and are part of an investment strategy which excludes shares

(2) Short term securities correspond to investments which meet the criteria of cash and cash equivalents as defined by the AMF.

## 17. *Share capital*

The variations of share capital break down as follows:

| (in thousand dollars except number of shares) | Number of shares | Ordinary shares | Share premium | Total |
|---|---|---|---|---|
| **As at January 1, 2011** | **5,419,405** | **11,342** | **134,873** | **146,215** |
| Division of par value by 4 | 16,258,215 | - | - | - |
| Share capital increases | 46,704 | 27 | 238 | 265 |
| Subscription of warrants | - | - | 181 | 181 |
| Direct costs paid related to the project of IPO | - | - | (2,271) | (2,271) |
| **As at December 31, 2011** | **21,724,324** | **11,369** | **133,021** | **144,390** |
| Share capital increases | 9,560,236 | 5,039 | 99,513 | **104,552** |
| Share conversion | 1,449,144 | 764 | (764) | **-** |
| Free shares vesting | 1,185,138 | 614 | (614) | **-** |
| Exercise of stock options | 74,720 | 37 | 361 | **398** |
| Direct costs paid related to the IPO | - | - | (5,840) | **(5,840)** |
| Contribution to restricted reserve | - | - | (107) | **(107)** |
| **As at December 31, 2012** | **33,993,562** | **17,822** | **225,570** | **243,393** |

*Year ended December 31, 2011*

In 2011, following the decision of the general meeting of May 11, 2011, the nominal value of the Company's shares was divided by four in order to bring the share price of € 1.60 to € 0.40 and, as a result, to multiply the number of shares by four in order to increase the number of shares from 5,419,405 to 21,677,620.

The Company also carried out a share capital increase as part of the exercise of redeemable warrants through the issue of 46,704 new shares. This operation led to an increase in the share capital of US$ 27 thousand and US$ 238 thousand in share premium.

The total number of outstanding ordinary shares is 21,724,324 as at December 31, 2011 (5,419,405 shares as at December 31, 2010). Each share has a nominal value of € 0.40. All outstanding shares are fully paid.

External costs net of tax incurred in 2011 and directly related to the IPO project are recorded as a reduction of share premium as they concern the issue of new shares and the project was finalized post closing in February 2012.

*Year ended December 31, 2012*

Since February 17, 2012, shares in the Company are listed on the NYSE Euronext exchange in Paris (compartment B). Proceeds from the issuance of the shares as part of the initial public offering was US$ 104.5million (€79.3 million), which represents a capital increase of €5,039 thousand and an increase in share premium of US$ 99,513 thousand. This operation led to the issue of 9 560 236 new shares.

External costs net of tax incurred by the Company and directly related to the IPO are recorded as a reduction of share premium.

By decision of the General Meeting of January 20, 2012, category D preference shares were converted into ordinary shares. A capital increase was recorded on this date of U$ 764 thousand with an equal decrease in share premium and 1 449 144 new shares were issued.
Free shares whose acquisition was conditional on the realisation of the IPO were definitively acquired on March 6, 2012 and on December 16, 2012. The share capital increased by US$ 614 thousand through the issue of 1,185,138 new shares.

The Company also carried out a share capital increase as part of the exercise of certain stock options, through the issuance of 74 720 new shares. This operation led to an increase in the share capital of US$ 37 thousand and US$ 361 thousand in share premium.

The total number of outstanding shares is 33 993 562 as at December 31, 2012 (21 724 324 as at December 31, 2011). Each share has a nominal value of €0.40.All issued shares are paid.

## 18. *Share-based payments*

Share options, free shares and stock purchase warrants (BSA) are granted to management, employees and third parties (service providers). As at December 31, 2012, the following share options, free shares and stock purchase warrants (BSA) were granted by the Company.

| **Plan** | **Date of allocation** | **Exercise price in $ per share** | **Vesting / Conditions** | **Number of instruments** | **Expiration date** |
|---|---|---|---|---|---|
| BSA 2007-02 | 30/08/2007 | 9.60 | 3 years - graded vesting | 9,200 | 10/10/2017 |
| BSA 2007-4 | 30/08/2007 | 9.60 | 1 year - graded vesting | 3,000 | 30/08/2017 |
| BSA 2007-4 (2ième tranche) | 18/12/2008 | 10.31 | 1 year - graded vesting | 3,000 | 18/12/2018 |
| BSA 2006-1 | 20/11/2006 | 5.06 | 1 year - graded vesting | 46,704 | 20/11/2016 |
| BSA 2005-5 | 17/02/2006 | 4.68 | No vesting period, it can excercised at the date of allocation. | 15,732 | 20/10/2015 |
| BSA 2006-2 | 20/11/2006 | 5.06 | 4 years - graded vesting | 18,400 | 20/11/2016 |
| BSA 2007-3 | 21/09/2007 | 9.91 | 2 years - graded vesting and need to be part of the Advosiry Board | 4,000 | 21/09/2017 |

| Plan | Date of allocation | Exercise price in $ per share | Vesting / Conditions | Number of instruments | Expiration date |
|---|---|---|---|---|---|
| BSA 2007-3 (2eme tranche) | 21/09/2007 | 9.91 | 2 years - graded vesting and need to be part of the Advosiry Board | 4,000 | 21/09/2017 |
| BSA 8 | 02/10/2008 | 13.98 | 3 years - graded vesting | 12,800 | 02/10/2018 |
| BSA 2005-1 | 15/06/2006 | 7.28 | No vesting period, it can excercised at the date of allocation. | 43,332 | 15/06/2016 |
| BSA 2005-3 | 15/06/2006 | 7.28 | No vesting period, it can excercised at the date of allocation. | 52,000 | 15/06/2016 |
| BSA 12 | 01/10/2010 | 6.52 | No vesting period but conditions exist such as IPO or merger/acquisitions of more than 50% of the Company and the market share price must be higher than €25,5 ($35) | 200,000 | 01/10/2015 |
| Free shares Pool 1 | 28/07/2005 | - | Vesting occurs if:<br>- Exit (Transfer of more than 90% of shares or IPO)<br>- If exit occurs before 2 years, service condition of 2 years<br>=>Minimum 2 years maximum 10 years from 28/07/2005<br>Number of shares depend on the exit price (between €15 ($21) and €45 ($62)) | 113,200 | NA |
| Free shares Pool 2 | 28/07/2005 | - | Vesting occurs if:<br>- Exit (Transfer of more than 90% of shares or IPO)<br>- If exit occurs before 2 years, service condition of 2 years<br>=>Minimum 2 years maximum 10 years from 28/07/2005<br>Number of shares depend on the exit price (between €45 ($62) and €63,75 ($87)) | 138,264 | NA |
| Adition to pool 2 | 17/02/2006 | - | Vesting occurs if:<br>- Exit (Transfer of more than 90% of shares or IPO)<br>- If exit occurs before 2 years, service condition of 2 year<br>-25% at the end of each years since the allocation date.<br>=>Minimum 2 years maximum 10 years from 17/02/2006<br>Number of shares depend on the exit price (between €57,51 ($79) and €70 ($96)) | 69,096 | NA |
| Other free shares | 17/02/2006 | - | 4 years - graded vesting | 83,092 | NA |
| Other free shares - Pool A | 02/06/2006 | - | 2 years - graded vesting and to be member of the board | 38,048 | NA |
| Other free shares - Pool B | 02/06/2006 | - | 3 years - graded vesting and to be member of the board | 19,024 | NA |
| Other free shares - Pool C | 02/06/2006 | - | 4 years - graded vesting and to be member of the board | 19,024 | NA |
| Other free shares | 03/11/2008 | - | 4 years - those shares can t be allocated if they lead to own more than 10% of the total of shares | 20,000 | NA |
| Other free shares - Pool A | 17/12/2010 | - | 2 years - graded vesting - IPO and market conditions :<br>€25,5 ($35) if IPO within 12 months, €29 ($40) if IPO between 12 and 24 months, €34 ($47) if IPO after 24 months | 1,116,000 | NA |
| Other free shares - Pool B | 17/12/2010 | - | 4 years - graded vesting - IPO and market conditions :<br>€25,5 ($35) if IPO within 12 months, €29 ($40) if IPO between 12 and 24 months, €34 ($47) if IPO after 24 months | 110,000 | NA |
| Free shares | 17/10/2012 | - | Graded vesting - 50% after 2 years, 75% after 3 years and 100% after 4 years<br>Average of the stock price for the 20 days | 160,000 | NA |

| **Plan** | **Date of allocation** | **Exercise price in $ per share** | **Vesting / Conditions** | **Number of instruments** | **Expiration date** |
|---|---|---|---|---|---|
| | | | preceeding October 17, 2014, must be above €2,30 ($3) | | |
| Free shares | 20/12/2012 | - | Graded vesting - 50% after 2 years, 75% after 3 years and 100% after 4 years<br>Average of the stock price for the 20 days preceeding October 17, 2014, must be above €3,22 ($4,27) | 10,000 | NA |
| SO 2005 - 1 Pool 3 | 28/07/2005 | 0.48 | 4 years - graded vesting, minimum share price of €100 ($137) at exit date. | 113,200 | 16/06/2015 |
| SO 2005 - 1 Pool 4 | 28/07/2005 | 0.48 | 4 years - graded vesting, minimum share price of €120 ($164) at exit date. | 102,240 | 16/06/2015 |
| SO 2005 - 02 first grant | 17/02/2006 | 4.68 | 4 years - graded vesting. | 96,908 | 20/10/2015 |
| SO 2005 - 02 second grant | 02/06/2006 | 5.05 | 4 years - graded vesting. | 51,904 | 12/09/2016 |
| SO 2006 - 01 | 02/06/2006 | 5.05 | 4 years - graded vesting. | 273,200 | 02/06/2016 |
| Options 2007-1-F (15 200) et Options 2006-1-B (5 400) | 03/11/2008 | 12.89 | 5 years - graded vesting and to be member of the board | 82,400 | 19/06/2017 |
| Options 2006-1 | 02/02/2007 | 9.19 | 4 years - graded vesting and to be member of the board | 105,200 | 16/04/2017 |
| Options ESS | 20/12/2012 | 3.84 | 4 years vesting<br>Part of the options will be granted based on internal performance criteria of the ESS business. | 300,000 | 16/04/2017 |

Options are conditional on the holder completing a certain number of years of service (the vesting period). Certain options are exercisable subject to the common share of the Group achieving a certain value. The Group has no legal or constructive obligation to repurchase or settle the options in cash.

The number of stock purchase warrants outstanding and their related weighted average exercise prices are as follows:

| | **2011** | | **2012** | |
|---|---|---|---|---|
| | **Average exercise price in $ per share** | **Number of financial instruments (in thousands)** | **Average exercise price in $ per share** | **Number of financial instruments (in thousands)** |
| As at January 1st | 7 | 348 | 7 | 300 |
| Granted | - | - | - | - |
| Void | - | - | 10 | (58) |
| Exercised | 7 | (48) | - | - |
| Expired | - | - | - | - |
| **As at December 31** | **7** | **300** | **7** | **242** |

No stock purchase warrants were granted in 2012. 58,000 stock purchase warrants became void in 2012.

The number of options outstanding and their weighted average exercise price is as follows:

| | 2011 | | 2012 | |
|---|---|---|---|---|
| | Average exercise price in $ per share | Number of financial instruments (in thousands) | Average exercise price in $ per share | Number of financial instruments (in thousands) |
| As at January 1st | 8 | 1,172 | 8 | 1,132 |
| Granted | - | - | 4 | 300 |
| Void | 11 | (39) | 11 | (661) |
| Exercised | - | - | 5 | (75) |
| Expired | - | - | - | |
| **As at December 31** | **8** | **1,133** | **5** | **696** |

75,000 stock options were exercised in 2012 (none in 2011). 300,000 stock options were granted in 2012 (non in 2011). 661,000 stock options became void in 2012 (39,000 in 2011).

The number of free shares outstanding and their weighted average exercise price is as follows:

| | 2011 | | 2012 | |
|---|---|---|---|---|
| | Average exercise price in $ per share | Number of free shares (in thousands) | Average exercise price in $ per share | Number of free shares (in thousands) |
| As at January 1st | - | 1,315 | - | 1,315 |
| Granted | - | - | - | 680 |
| Can be sold | - | - | - | - |
| Acquired | - | - | - | (1,185) |
| Void | - | - | - | - |
| **As at December 31** | **-** | **1,315** | **-** | **810** |

In 2012, 680,000 free shares were granted (none in 2011) and 1,185,000 were definitely acquired.

The valuation of share options, free shares and stock purchase warrants can be summarized as follows:

| Plan | Valuation model | Share price at grant date (US$) | Risk free rate | Volatility | Expected maturity (*) |
|---|---|---|---|---|---|
| BSA 2007-02 | B&S | 9.6 | 4.50% | 51% | 3 |
| BSA 2007-4 | B&S | 10.275 | 4.50% | 51% | 3 |
| BSA 2007-4 (2nd tranche) | B&S | 9.325 | 1.60% | 71% | 2 |
| BSA 2006-1 | B&S | 5.3 | 4.50% | 51% | 5 |
| BSA 2005-5 | B&S | 5 | 3.30% | 49% | 3 |
| BSA 2006-2 | B&S | 5.175 | 3.50% | 49% | 5 |
| BSA 2007-3 | B&S | 11.1 | 4.50% | 51% | 5 |
| BSA 2007-3 (2nd tranche) | B&S | 10.825 | 3.00% | 71% | 4 |
| BSA 8 | B&S | 13.375 | 1.20% | 71% | 4 |
| BSA 2005-1 | B&S | 7.275 | 4.00% | 49% | 4 |
| BSA 2005-3 | B&S | 7.275 | 4.00% | 49% | 4 |
| BSA 12 | B&S | 6.525 | 1.50% | 57% | 4 |
| SO 2005 - 1 Pool 3 | B&S | 0.475 | 3.30% | 49% | 10 |
| SO 2005 - 1 Pool 4 | B&S | 0.475 | 3.30% | 49% | 10 |
| SO 2005 - 02 first grant | B&S | 4.675 | 3.50% | 49% | 6 |
| SO 2005 - 02 second grant | B&S | 5.05 | 4.00% | 49% | 7 |
| SO 2006 - 01 | B&S | 5.05 | 4.50% | 51% | 7 |
| Options 2007-1-F (15,200) and Options 2006-1-B (5,400) | B&S | 12.9 | 3.20% | 51% | 4 |
| Options 2006-1 | B&S | 9.175 | 4.50% | 51% | 7 |
| Options ESS | B&S | 3.84 | 4.50% | 75% | 4 |
| Free shares pool 1 | Share price at grant date | 0.475 | NA | NA | NA |
| Free shares pool 2 | Share price at grant date | 0.475 | NA | NA | NA |
| Free shares - addition to pool 2 | Share price at grant date | 4.7 | NA | NA | NA |
| Other free shares | Share price at grant date | 4.7 | NA | NA | NA |

| Plan | Valuation model | Share price at grant date (US$) | Risk free rate | Volatility | Expected maturity (*) |
|---|---|---|---|---|---|
| Other free shares | Share price at grant date | 4.975 | NA | NA | NA |
| Pool A | Share price at grant date | 4.975 | NA | NA | NA |
| Pool B | Share price at grant date | 4.975 | NA | NA | NA |
| Pool C | Share price at grant date | 4.975 | NA | NA | NA |
| Other free shares | Share price at grant date | 12.9 | NA | NA | NA |
| Pool A | MC | 6.3 | NA | NA | NA |
| Pool B | MC | 6.3 | NA | NA | NA |
| Other free shares | MC | 2.8 | NA | NA | NA |
| Other free shares | MC | 3.4 | NA | NA | NA |

MC : Monte-Carlo valuation model
B&S : Black & Sholes valuation model
(*) Determined based on a peer group analysis

## 19. *Retained earnings and other reserves*

Retained earnings and other reserves break down as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| As at January 1 | (63,533) | (86,795) |
| Loss for the year | (23,033) | (37,485) |
| Share based payments | 2,000 | 1,880 |
| Actuarial loss on retirement benefit obligations | (105) | (346) |
| Financial instruments at fair value | (1,773) | 937 |
| Contribution to restricted reserve | - | 107 |
| Currency translation differences | (351) | 537 |
| Treasury shares | | (501) |
| **As at December 31,** | **(86,795)** | **(121,668)** |
| Of which: | | |
| Retained earnings | (96,567) | (134,053) |
| Legal reserve | - | - |
| Restricted reserves | 2,553 | 2,661 |
| Other comprehensive income | (725) | (135) |
| Share based payments | 8,424 | 10,304 |
| Currency translation differences | (480) | 57 |
| Treasury shares | - | (501) |
| **As at December 31,** | **(86,795)** | **(121,668)** |

In France, companies must transfer 5% of their annual profit to a legal reserve until the reserve reaches 10% of the share capital. The Group having generated losses in the past, no contribution has been made to this reserve.

In October 2012, the Company transferred US$ 107 thousand to restricted reserves to secure the issue of free shares.

## 20. *Trade payables*

Trade and other payables break down as follows:

| **(in thousand dollars)** | **2011** | **2012** |
|---|---|---|
| Trade payables | 16,205 | 12,301 |
| Accrued expenses | 10,910 | 11,142 |
| Social security and other taxes | 2,596 | 3,304 |
| Advances from customers | 266 | 1,588 |
| **Total** | **29,977** | **28,335** |

## 21. *Financial debts*

Financial debts break down as follows:

| **(in thousand dollars)** | **2011** | **2012** |
|---|---|---|
| **Non-current** | | |
| Research tax credit financing | - | 6,225 |
| Obligations under finance lease | 963 | 677 |
| | **963** | **6,902** |
| **Current** | | |
| Obligations under finance lease | 357 | 532 |
| Bank overdrafts | - | 276 |
| **Total** | **1,320** | **7,710** |

A factoring contract for the research tax credit receivable for the year ended December 31, 2011, recorded as an asset on the balance sheet has been implemented with a financial institution in June 2012 and its term is June 2015. This financing amounting to US$ 5,940 thousand corresponds to 90% of the research tax credit receivable. The remaining 10% will be paid to the Company in June 2015 at the maturity of the contract. The cash received represents an amount of US$ 5,390 thousand, net of interest and commissions for a total amount of $550 thousand. Interest and commissions have been recognized in prepaid expenses and are spread over the duration of the contract. Given that the financing of the RTC is denominated in Euros, the amount presented on the balance sheet can be affected by exchange rate fluctuations.

Obligations under finance leases are effectively secured as the rights to the leased asset revert to the lessor in the event of default.

## 22. *Repayable advances*

Other debts break down as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| Repayable advances | 852 | 3,443 |
| **Total** | **852** | **3,443** |
| *Other payables - Non-current portion* | *852* | *3,443* |
| *Other payables - Current portion* | - | - |

The Group benefits from repayable advances from OSEO for research and innovation programs. These advances are repayable if and only if the contractually defined commercial objectives are achieved. The Group received additional repayable advances amounting to US$ 2,591 in 2012. No advance was repaid or recognized as definitively acquired during 2011 and 2012. The repayment of these advances is subject to revenue objectives being achieved on the related projects.

## 23. *Retirement benefit obligations*

The Group operates a defined benefit pension plan in France and its obligations to employees in terms of retirement benefits are limited to a lump sum payment based on remuneration and length of service, determined for each employee. In the UK the Group operates under a defined contribution plan whereby the Company's liability is limited to its contributions.

The amounts recognized in the balance sheet are determined as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| Present value of unfunded obligations | 1,183 | 1,749 |

The movement in the defined obligation over the year is as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| As at January 1 | 897 | 1,183 |
| Current service cost | 121 | 144 |
| Interest cost | 46 | 52 |
| Actuarial (losses)/gains | 109 | 353 |
| Exchange differences | 10 | 17 |
| Liabilities assumed as part of a business combination | - | - |
| **As at December 31** | **1,183** | **1,749** |

The amounts recognized in the income statement are as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| Current service cost | 121 | 144 |
| Interest cost | 46 | 52 |
| **As at December 31** | **167** | **196** |

The principal actuarial assumptions used were as follows:

| | 2011 | 2012 |
|---|---|---|
| Discount rate | 4.30% | 3.00% |
| Salary growth rate | 3% | 3% |
| Inflation rate | 2% | 2% |

Assumptions regarding future mortality expectations are set based on actuarial advice in accordance with published statistics and experience in France.

The liability recognized as at December 31, 2012 takes into account the latest regulations in terms of pension obligations.

The sensitivity of the overall pension liability to changes in the weighted principal assumption is as follows:

| | Change in assumption | Impact on overall liability |
|---|---|---|
| Discount rate | Increase/decrease of 8.3% | Decrease/Increase of 4.5% |

## 24. *Provisions for other liabilities and charges*

Provisions for other liabilities and charges break down as follows:

| (in thousand dollars) | Employee related litigations | Customer claims | Others | Total |
|---|---|---|---|---|
| **As at January 1, 2011** | **213** | **397** | **75** | **685** |
| Charges / (credited) to the income statement: | | | | |
| - Additional provisions | - | - | - | - |
| - Unused amounts reversed | - | (163) | (61) | **(224)** |
| - Used during the year | - | (130) | - | **(130)** |
| Exchange differences | (8) | (4) | (1) | **(13)** |
| **As at December 31, 2011** | **205** | **100** | **13** | **318** |

| (in thousand dollars) | Employee related litigations | Customer claims | Others | Total |
|---|---|---|---|---|
| **As at January 1, 2012** | **205** | **100** | **13** | **318** |
| Charges / (credited) to the income statement: | | | | |
| - Additional provisions | - | 299 | 200 | **498** |
| - Unused amounts reversed | - | - | - | - |
| - Used during the year | (21) | (57) | - | **(78)** |
| Exchange differences | 6 | 6 | 4 | **15** |
| **As at December 31, 2012** | **190** | **348** | **217** | **754** |

*(a) Employee litigation*

The Group is subject to legal proceedings arising in the ordinary course of business. Management does not expect that the ultimate costs necessary to resolve these matters will have a material adverse effect on the Group’s consolidated financial position, result of operations or cash flows.

*(b) Customer claims*

Customer claims relate to matters which may result in credit notes being issued, or deductibles being paid to insurers in the event of litigations covered by insurance policies.

*(c) Other provisions*

The Group records research tax credit in the income statement when all conditions described in note 2.17 are respected. In certain cases, all the necessary documentation may not be available. In this case, the corresponding research tax credit is recorded as an asset but the receivable is provided for.

## 25. *Deferred income*

Deferred income breaks down as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| Maintenance | - | 1,122 |
| Licenses | 2,372 | 4,240 |
| Non refundable advance on order backlog | - | 6,460 |
| **As at December 31,** | **2,372** | **11,822** |

Deferred income for maintenance mainly relates to contracts acquired from ESS (see Note 5)

Deferred income for licenses mainly relates to the prepayments received from Intel Corporation (see Note 7).

The Company entered into an agreement with a customer during the second half of 2012. At the maturity of this contract, the Company received a non repayable advance related to order backlog to be delivered before June 30, 2013 at the latest. This amount will be recognized in revenue when the products are delivered which will be by June 30, 2013 at the latest.

## 26. *Research and development expenses*

Research and development expenses break down as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| Research and development expense | 41,833 | 43,810 |
| Share base payment | 328 | 369 |
| Research tax credit | (7,054) | (7,863) |
| Grants | (571) | (946) |
| **Total** | **34,536** | **35,370** |

The amount of the research tax credit varies according to the corresponding research effort, which can fluctuate significantly by period according to the nature and progress of ongoing projects and the grants received.

## 27. *Other (losses) /gains, net*

Other (losses)/gains, net break down as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| Transaction costs related to acquisition of ESS | - | (554) |
| Restructuring program linked to acquisition of SMS | (514) | (232) |
| Impairment of assets acquired as part of acquisition of the SMS business | (1,713) | - |
| Reversal of intangible liabilities non recurrent | 829 | - |
| Foreign exchange gains/ (losses) on operating activities | - | (2,025) |
| **Total** | **(1,398)** | **(2,811)** |

Operating exchange gains and losses relate to exchange differences affecting revenue and operating expenses concluded during the year as well as the impact of their revaluation at closing rates of operating assets and liabilities denominated in currencies other than the functional currency of the consolidated companies. The classification of operating exchange gains and losses within other operating losses and gains, net which is the preferred method under IFRS was applied for the first time in 2012.

## 28. *Expenses by nature*

Expenses by nature break down as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| Purchase of wafers including inventory variation | 71,116 | 60,020 |
| Semi finished goods and consumables used | 21,649 | 15,896 |
| Depreciation, amortization, impairment charges and write offs | 4,468 | 4,972 |
| Employees and compensation benefits | 45,461 | 47,432 |
| Subcontracting and temporary work force | 10,318 | 7,982 |
| External services | 7,030 | 11,900 |
| Travel expenses and entertainment | 4,103 | 3,768 |
| Buildings and office leases | 2,950 | 2,921 |
| Advertising, promotion and trade shows | 1,112 | 1,158 |
| Fees, commissions and royalties | 5,349 | 5,305 |
| Grants and research tax credit | (7,625) | (8,570) |
| External transaction costs related to acquisition | 436 | 533 |
| Amortization and depreciation of acquired assets | 6,273 | 4,517 |
| Others | 3,292 | 1,491 |
| **Total** | **175,930** | **159,325** |

## 29. *Employee benefit expense*

Employee benefit expense breaks down as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| Wages and salaries including termination benefits | 30,207 | 33,715 |
| Social security costs | 11,063 | 11,697 |
| Share options granted to management and employees | 2,000 | 1,880 |
| Pension costs - defined benefit plan | 190 | 141 |
| **Total** | **43,461** | **47,432** |

## 30. *Finance income and expense*

Finance income and expense breaks down as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| Foreign exchange loss | (4,628) | (1,394) |
| Interest expense | (876) | (854) |
| **Finance costs** | **(5,504)** | **(2,248)** |
| Foreign exchange gain | 6,936 | 1,118 |
| Interest income | 71 | 872 |
| **Finance income** | **7,007** | **1,990** |
| **Finance income / (loss), net** | **1,503** | **(258)** |

Foreign exchange gains and losses relating to financial transactions settled during the year as well as the impact of the revaluation at closing rates of cash denominated in Euros into US Dollars, are recognized in financial result.

## 31. *Income tax expense*

The income tax expense breaks down as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| Tax calculated at domestic tax rates applicable to profits in the respective countries | | |
| - United Kingdom | - | 156 |
| - USA | (69) | (90) |
| - Singapore | - | (0) |
| - Poland | (5) | (8) |
| - Netherland | - | (8) |
| - Finland | - | - |
| | **(74)** | **51** |

The effective income tax charge differs from the theoretical amount that would arise from applying the income tax rate calculated based on rates applicable in France as a result of the following elements:

| | 2011 | 2012 |
|---|---|---|
| Loss before income tax | (22,959) | (37,380) |
| Theoretical income tax (tax rate of 34.43%) | 7,905 | 12,870 |
| Effect of different tax rates in foreign tax jusridictions | (44) | (30) |
| **Tax effect of** | | |
| Unrecognized tax losses during the period | (9,606) | (14,784) |
| Research tax credit not liable to income tax | 2,519 | 2,644 |
| Share based payment | (688) | (687) |
| Other permanent differences | (159) | 37 |
| **Effective income tax** | **(74)** | **51** |

The unrecognized deferred tax assets as at December 31, 2012 amount to US$ 56,773 thousand (US$ 40,851 as at December 31, 2011) mainly corresponding to the tax effect on the net operating losses carried forward in the French companies which can be used against future taxable profits for an unlimited number of years.

## 32. *Earnings per share*

*(a) Basic*

Basic earnings per share are calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year:

| | 2011 | 2012 |
|---|---|---|
| Loss attributable to equity holders of the Company (in thousand dollars) | (23,033) | (37,485) |
| Weighted average number of ordinary shares in issue | 21,703,410 | 31,586,909 |
| **Basic loss per share ($ per share)** | **(1.06)** | **(1.19)** |

The variation in earnings per share mainly results from the share capital increases realized over the year which have an impact on the weighted average number of shares.

*(b) Diluted*

Diluted earnings per share are calculated by adjusting the weighted average number of ordinary shares outstanding with the shares which would be issued as a consequence of the exercising of dilutive financial instruments.

The Group has three categories of dilutive potential financial instruments: free shares, warrants, and stock options

The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercising of the dilutive instruments:

| | 2011 | 2012 |
|---|---|---|
| Weighted average number of ordinary shares in issue | 21,703,410 | 31,586,909 |
| Adjustments for: | | |
| - Free shares | - | 509,870 |
| - Warrants | 34,132 | - |
| - Stock options | 187,620 | - |
| Adjustments for treasury method | (157,506) | - |
| Weighted average number of ordinary shares for diluted earnings per share | 21,767,656 | 32,096,779 |
| **Diluted loss per share ($ per share)** | **(1.06)** | **(1.17)** |

The final vesting of certain free shares, warrants and stock options plans was conditional on the occurrence of an initial public offering or a change in control. As the IPO was realized on February 17, 2012, the free shares, warrants and options relating to the plans concerned have been included in the calculation of the diluted earnings per share.

Warrants and stock options related to on-going plans have an exercise price exceeding the share price as at December 31, 2012 and have therefore not been taken into account for the calculation of the diluted earnings per share.

For the purposes of the table above, warrants and stock options are included in the diluted earnings per share calculation through the treasury stock method. The treasury stock method assumes that the proceeds from the exercise of warrants and stock options are used to repurchase common stock.

For accounting purposes, when dilutive instruments have the result that the dilutive loss per share is less than the basic loss per share, the impact of dilutive instruments is not taken into account.

## 33. *Commitments*

### *(a) Capital commitments*

Capital expenditure contracted for at the balance sheet date but not yet incurred is as follows:

| (in thousand dollars) | 2011 | 2012 |
|---|---|---|
| Equipment | - | 288 |
| Intangible assets - Licenses | - | - |
| **Total** | **-** | **288** |

### *(a) Operating lease commitments*

The Group leases offices under non-cancellable operating lease agreements. The majority of lease agreements are renewable at the end of the lease period at market rates.

The Group also leases certain equipment under cancellable operating lease agreements.

The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

| **(in thousand dollars)** | **2011** | **2012** |
|---|---|---|
| Gross finance lease liabilities - minimum lease payment | | |
| No later than 1 year | 1,356 | 738 |
| Later than 1 year and no later than 5 years | 1,932 | 199 |
| Later than 5 years | - | - |
| **Total** | **3,288** | **937** |

In December 2012, the Company entered into a leasing agreement for an off-plan property which will be the new base for its registered office. The initial duration of the lease is six years. As part of this contract, signed in August 2012, the Company has committed to renting approximately 5500 square meters of office space from the availability date of the building, envisaged to be in July 2013. The future rent payments over six years amount to approximately US$ 6,016 thousand and are not included in the table presented above.

*(c) Other commitments*

| **(in thousand dollars)** | **2011** | **2012** |
|---|---|---|
| Raw material purchasing | 48,690 | 27,061 |
| Committed finance lease - Material not yet received | - | - |
| Security bonds | 390 | 390 |
| **Total** | **49,080** | **27,451** |

A Wafer purchase agreement between Atmel Corp. and the Company was signed as part of the acquisition of the SMS division of Atmel on September 30, 2010, whereby the Company committed to partially take on the obligation previously held by Atmel to purchase a minimum number of wafers from the company LFoundry on an annual basis for 48 months beginning on the acquisition date and on a declining basis, at prices predetermined in the contract.

## **34.** *Related party transactions*

(a) Transactions with related companies

Three of the members of the Company’s Supervisory Board are also members of the Board of Mobiwire (formerly Sagem Wireless, now in liquidation) in 2011. The Group conducted transactions with Mobiwire in the first quarter of 2011. Each transaction was for a non-significant amount and was negotiated without the personal involvement of the Supervisory Board members and Management believes that they were made on an arm’s length basis in line with market practices and conditions.

The Group purchases audit and consulting services from the company Leyton & Associés who share a common shareholder with the Group in the investment firm GIMV. These services were negotiated under normal market conditions, without the involvement of the common shareholder, and amounted to US$ XXX thousand and US$ 227 thousand for 2012 and 2011 respectively.

(b) Key management compensation

Key management is composed of Management Board members. The compensation paid or payable to key management for employee services is as follows:

| **In thousand dollars** | **2011** | **2012** |
|---|---|---|
| Salary | 1 451 | 1 519 |
| Share based compensation expenses | 1 184 | 920 |
| **Total** | **2 635** | **2 439** |

## 35. *Events after the reporting period*

On March 5, 2013, the Company announced a project to adapt its strategy that will lead to a reorganization of its business on a global basis. The reorganization plan will be further detailed during the course of 2013. The impact of this plan on the consolidated financial statements will be accounted for once sufficient details and reliable estimates are known and constitute a constructive obligation for the Company.

There are no other significant events occurring since December 31, 2012 to report.

## 36. *Consolidated entities*

The consolidated financial statements as at December 31, 2012 include the accounts of the Company and the following entities:

| **Country** | **Entity** | **Percentage of ownership** | |
|---|---|---|---|
| | | **2011** | **2012** |
| United States | Inside Secure Corporation | 100% | 100% |
| Singapore | Inside Secure (Asia) Pte Ltd | 100% | 100% |
| Poland | Inside Secure Sp.z.o.o. | 100% | 100% |
| France | Vault-IC France SAS | 100% | 100% |
| United Kingdom | Vault-IC UK Ltd | 100% | 100% |
| Netherlands | Inside Secure B.V | - | 100% |
| Netherlands | Inside Secure Amsterdam B.V | - | 100% |
| Finland | Inside Secure Oy | - | 100% |

As disclosed above, the Group acquired Embedded Security Solutions on December 1, 2012. As part of the transaction which was a combination of an asset and a share deal, the Group acquired 100% of the shares of Inside Secure B.V (formerly AuthenTec B.V), which holds 100% of the shares of Inside Secure Amsterdam B.V (formerly AuthenTec Amsterdam B.V) and 100% of the shares of Inside Secure Oy (formerly AuthenTec Oy), companies dedicated to R&D and product engineering.

# Statutory auditors' report on the consolidated financial statements

**PricewaterhouseCoopers Audit**
63 rue de Villiers
92200 Neuilly-sur-Seine

**Antoine OLANDA**
38 parc du Golf
13856 Aix-en-Provence

## STATUTORY AUDITORS' REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

**For the year ended December 31, 2012**

*This is a free translation into English of the statutory auditors' report on the consolidated financial statements issued in French and is provided solely for the convenience of English speaking users. The statutory auditors' report includes information specifically required by French law in such reports, whether modified or not. This information presented below is the audit opinion on the consolidated financial statements and includes an explanatory paragraph discussing the auditors' assessments of certain significant accounting and auditing matters. These assessments were considered for the purpose of issuing an audit opinion on the consolidated financial statements taken as a whole and not to provide separate assurance on individual account balances, transactions or disclosures.*

*This report should be read in conjunction with, and construed in accordance with, French law and professional auditing standards applicable in France.*

To the Shareholders,

In compliance with the assignment entrusted to us by the Shareholders' General Meeting, we hereby report to you, for the year ended December 31, 2012, on:

- the audit of the accompanying consolidated financial statements of Inside Secure;
- the justification of our assessments ; and
- the specific verification required by law.

The consolidated financial statements have been approved by the Management Board. Our role is to express an opinion on these financial statements based on our audit.

### I. Opinion on the consolidated financial statements

We conducted our audit in accordance with professional standards applicable in France; those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit involves performing procedures, using sampling techniques or other methods of selection, to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made, as well as the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

In our opinion, the consolidated financial statements give a true and fair view of the assets and liabilities and of the financial position of the Group as at December 31, 2012 and of the results of its operations for the year then ended, in accordance with International Financial Reporting Standards as adopted by the European Union.

**II. Justification of our assessments**

The accounting estimates used in the preparation of the financial statements as at December 31, 2012 take into account the specific nature of the technology industry in which the Company operates. It is in this context that in accordance with the requirements of article L.823-9 of the French Commercial Code *(code de commerce)* relating to the justification of our assessments, we bring to your attention the following matters:

As stated in note 4 to the consolidated financial statements, "Critical accounting estimates and judgments", the Company is required to make certain estimates and assumptions, specifically with regards to revenue recognition, the impairment of non-financial assets, particularly of goodwill and of other intangible assets and liabilities, share-based payments, the fair value of derivatives and other financial instruments and accounting for income taxes.

The policies adopted in this respect are disclosed in note 2 to the consolidated financial statements, 'Summary of significant accounting policies'. For all of these estimates, we reviewed the available documentation, assessed the reasonableness of the assessments made by Management and verified that the relevant notes included appropriate disclosures of the assumptions used.

These assessments were made as part of our audit of the consolidated financial statements taken as a whole, and therefore contributed to the opinion we formed which is expressed in the first part of this report.

**III. Specific verifications**

As required by law, we have also verified in accordance with professional standards applicable in France the information presented in the Group's management.

We have no matters to report as to its fair presentation and consistency with the consolidated financial statements.

Neuilly-sur-Seine and Aix-en-Provence, March 5, 2013

The statutory auditors

PricewaterhouseCoopers Audit — Antoine Olanda

Philippe Willemin
Partner

**Statutory financial statements of INSIDE Secure SA as at December 31, 2012**

[TEXT INTENTIONALLY OMITTED.]

**Statutory auditors report on the statutory financial statements**

[TEXT INTENTIONALLY OMITTED.]

# APPENDIX

# Appendix 1

## Chairman's report on corporate governance, internal control and risk management

Société anonyme à directoire et directoire de surveillance au capital de 13 597 424,80 euros

Siège social : 41, parc Club du Golf, 13856 Aix-en-Provence cedex 3

399 275 395 RCS Aix-en-Provence

**CHAIRMAN'S REPORT ON CORPORATE GOVERNANCE, INTERNAL CONTROL AND RISK MANAGEMENT**

Dear Shareholders,

In accordance with the provisions of Article L. 225-68 of the French Commercial Code, as Chairman of the Supervisory Board I have the honor of presenting this report to you, in which you will find information on the composition of the Supervisory Board and the application of the principle of equal male and female representation on the Board, the conditions under which the work of this Board was prepared and organized over the course of the 2012 financial year, as well as the internal control and risk management procedures put in place by the Company.

This report, which was prepared by the corporate secretary and the finance departments of the Company, was submitted to the Audit Committee before being approved by the Supervisory Board at its meeting dated April 24, 2013.

## 1. Corporate governance and representation of women and men on the Supervisory Board

INSIDE Secure (or the "Company") is a French *société anonyme* (joint stock company) with a Management Board and a Supervisory Board. It was established on November 30, 1994.

At its meeting held on March 31, 2011, the Supervisory Board (or the "Board") approved its internal charter, which was amended on November 21, 2012. This charter details, in particular, the rules applicable to the operation of the Board, the rules of conduct, and the obligations of the members of the Supervisory Board of the Company, and the terms and conditions of operation of the Board and the committees. The main provisions of the Board's internal charter are reiterated hereafter.

At its meeting held on March 31, 2011, the Supervisory Board decided to use as its reference the corporate governance code of publicly-traded companies published by the AFEP and MEDEF in December 2008, reviewed in April 2010 and approved by the *Autorité des Marchés Financiers* (French financial markets regulator, or "AMF") as a code of reference for corporate governance (the "AFEP-MEDEF Code"). This code is available on the MEDEF website (www.medef.com), among other places.

The goal of the Company is to comply with all of the recommendations contained in the AFEP-MEDEF Code.

In particular, the Company intends to comply with the following recommendations:

- ensuring that the Supervisory Board is composed of and maintains a presence of at least 20% women within a time frame of 3 years and of at least 40% women within a time frame of 6 years as from the date on which the securities of the Company were admitted to trading on the NYSE Euronext regulated stock exchange in Paris, France,

- ensuring that, by the expiration of the aforementioned 6-year period, whenever the Board is composed of 9 members the difference between the number of members of each gender is not higher than 2.

To this end, the General Shareholders' Meeting dated June 29, 2012 appointed Joëlle Toledano as member of the Supervisory Board.

Lastly, in July 2012, the number of members on the Audit Committee was extended to three, two of which are independent. Therefore, the Audit Committee complies with the recommendations of the AFEP-MEDEF Code according to which an audit committee must be composed of at least 2/3 independent members.

### 1.1. Composition of the Supervisory Board

Pursuant to applicable legal and statutory provisions, the Supervisory Board is composed of at least three members and at most nine, appointed by shareholders at the General Shareholders' Meeting for a term of three years. They are eligible for reelection at expiration of their term of office. In the event that a seat becomes vacant, the members of the Supervisory Board may coopt other members under the conditions set by law and applicable regulations.

In accordance with the terms of its internal charter, the Supervisory Board undertakes to make all efforts to ensure that it is composed of at least a majority of independent members in the meaning of the AFEP-MEDEF Code. Those members of the Board who do not entertain any relationship with the Company, its Group, or its management that could potentially compromise their freedom of judgment are considered independent.

As of December 31, 2012, the Supervisory Board was composed of 8 members. The Supervisory Board considers that six of its eight members are independent. Patrick Jones, Glenn Collinson, Ronald Black, Jean Schmitt, Joëlle Toledano and the *Fonds stratégique d'investissement* (Strategic Investment Fund) effectively meet the criteria defined in the corporate governance code of publicly-traded companies published by the AFEP-MEDEF, as revised in April 2010, insofar as they:

- are not currently or were not over the course of the past five years, either employees or corporate officers of the Company, and either employees or corporate officers of one of its subsidiaries;

- are not corporate officers of a company in which the Company exercises, either directly or indirectly, a role as director or in which a Company employee appointed as such or a corporate officer of the Company (either currently in office or having been in office during the past five years at least) exercises a role as director,

- are not clients, suppliers, investment bankers, finance bankers (i) that are key for the Company or the Group, or (ii) for which the Company or its Group represent a significant portion of their business,

- do not have any close familial ties with a corporate officer,

- have not acted as auditors of the Company over the course of the past five years, and
- have not been members of the Board of the Company for more than twelve years.

The members of the Supervisory Board who represent significant shareholders of the Company can be considered independent provided they do not participate in the control of the Company. Beyond a 10% share capital and voting rights threshold, the Board must, based on the report delivered by the compensation and appointment committee, systematically review the status of independence of its members while taking into account the distribution of the share capital of the Company and the existence of potential conflicts of interest.

With respect to the above, the Supervisory Board determined that although the *Fonds stratégique d'investissement* holds approximately 7.1% of the share capital, it could still be qualified as an independent member.

In addition, at least one of the independent members must have specific skills in finance or accounting in order to be appointed to the Audit Committee, which is the case for Patrick Jones (please refer to the summary of his professional experience included below).

The following table details the composition of the Supervisory Board as of December 31, 2012. As of that date, the Supervisory Board of the Company had eight members.

| **Name of individual or Company** | **Initial date and expiration date of the term of office** |
|---|---|
| Alex Brabers (Chairman of the Board) | Term of office beginning on May 11, 2011 and expiring at the end of the General Shareholders' Meeting convened to approve the financial statements for the financial year ended on December 31, 2013 |
| Jean Schmitt (Vice-Chairman of the Board) | Term of office beginning on June 30, 2010 and expiring at the end of the General Shareholders' Meeting convened to approve the financial statements for the financial year ended on December 31, 2012 |
| Patrick Schwager Jones | Term of office beginning on June 29, 2012 and expiring at the end of the General Shareholders' Meeting convened to approve the financial statements for the financial year ended on December 31, 2014 |
| Ronald Black (1) | Term of office beginning on June 29, 2012 and expiring at the end of the General Shareholders' Meeting convened to approve the financial statements for the financial year ended on December 31, 2014 |
| Glenn Collinson | Term of office beginning on May 11, 2011 and expiring at the end of the General Shareholders' Meeting convened to approve the financial statements for the financial year ended on December 31, 2013 |
| *Fonds stratégique d'investissement* represented by Thierry Sommelet | Term of office beginning on June 30, 2010 and expiring at the end of the General Shareholders' Meeting convened to approve the financial statements for the financial year ended on December 31, 2012 |

| Name of individual or Company | Initial date and expiration date of the term of office |
|---|---|
| Sofinnova Partners, represented by Olivier Sichel | Term of office beginning on January 20, 2012 and expiring at the end of the General Shareholders' Meeting convened to approve the financial statements for the financial year ended on December 31, 2014 |
| Joëlle Toledano | Term of office beginning on June 29, 2012 and expiring at the end of the General Shareholders' Meeting convened to approve the financial statements for the financial year ended on December 31, 2014 |

(1) To complete this information, please note that on February 28, 2013 Ronald Black resigned from his duties as member of the Supervisory Board.

The management report provides the list of functions and terms of office held in other companies as well as the main function exercised by each member of the Board.

**Alex Brabers** - Chairman of the Supervisory Board, member of the Audit Committee and of the Compensation and Appointment Committee
Alex Brabers is GIMV's Executive Vice President for Venture Capital and is responsible for the firm's investments in the fields of IT and communications. With more than twenty years of experience in the venture capital industry, Alex brings invaluable knowledge of growth capital financing to INSIDE. He has been involved in the sales or initial public offerings of numerous companies. Alex is a director of Telenet (Euronext Brussels symbol: TNET), Nomadesk, VirtenSys and OTN Systems. He also previously sat on the board of Option International, Barconet, Telos, Emme and Mobistar. Prior to signing on with GIMV in 1990, he worked in banking, initially as a trader in international money market instruments, then as a strategic planner. Alex has a Master's degree in economics from Louvain University.

**Jean Schmitt** – Vice Chairman of the Supervisory Board, Chairman of the Compensation and Appointment Committee
Jean Schmitt is the managing director of JoltTech Capital, a private equity management company, specialized in capital investment in European technological SME/mid-cap companies. Before founding JoltTech Capital, Jean Schmitt spent 10 years as a partner at Sofinnova Partners, where he led the investment team in the technology and information sector. Jean Schmitt is the founder of SLP InfoWare, one of the worldwide leaders in predictive CRM software for the telecommunications sector, which he sold to Gemplus in 2000. He then held the joint roles of CEO of SLP InfoWare and Vice President for Telecoms Solutions & Applications at Gemplus. Jean Schmitt founded and sold three other companies before founding SLP InfoWare. Jean Schmitt is currently a member on the board of directors of Celsius (France) and Heptagon (Singapore), and Chairman of Groupe Hattemer SAS (France). Jean Schmitt is a graduate of the *Ecole Nationale Supérieure des Télécommunications* (ENST) in Paris and holds a postgraduate degree in artificial intelligence. Jean has been lecturing at the "Telecom Paris" engineering school since 2005.

**Patrick Jones** – Supervisory Board Member, Chairman of the Audit Committee and member of the Compensation and Appointment Committee
Patrick Jones is currently Chairman of the board of directors for Lattice Semiconductor (Nasdaq symbol: LSCC), a fabless semiconductor company, Epocrates Inc. (Nasdaq symbol: EPOC), a provider of mobile solutions and services to healthcare professionals, and Diaologic Inc. (Nasdaq symbol: DLGC). He also sits on the board of directors of Fluidigm (Nasdaq symbol: FLDM), a creator and manufacturer of integrated fluidic systems for biology, and of Vesta Inc., a designer of electronic payment solutions for the telecommunications industry. In addition, he previously sat on the board of many high-tech firms financed by venture capital investors. From 1998 to 2001, Patrick was Senior Vice President and CFO of Gemplus SA (currently integrated into Gemalto), the smart card market leader, for which he successfully oversaw the initial public offering on the New York and Paris stock exchanges. He had previously served as Vice President for Finance and Corporate Controller at Intel and CFO at LSI Logic, a manufacturer of specialized semiconductors. He began his career as an

engineer at IBM, before working for Singer Company in Thailand, France and Singapore. He has an MBA in finance from Saint Louis University (United States) and is a graduate of the University of Illinois-Urbana-Champaign (United States).

**Ronald Black** – Supervisory Board Member and member of the Compensation and Appointment Committee
Ronald Black is the CEO of Rambus (Nasdaq symbol: RMBS) and a director for EnOcean. Previously, he was the CEO of MobiWire (formerly Sagem Wireless France), Chairman and CEO of UPEK (which merged with AuthenTec and was later sold to Apple in 2012) and before that Chairman and CEO of Wavecom, a French wireless solutions provider listed on the Euronext Paris securities market. Ronald has held several senior executive roles within other companies as well. Specifically, he was Executive Vice President of the client systems group at Agere Systems, Vice President and General Manager of next-generation networks at Gemplus (now Gemalto) and General Manager of communications systems for the semiconductor product sector at Motorola (now Freescale). He also occupied a number of senior management posts in IBM Microelectronics' Power PC Micro-processors group, as well as in its Development and Electronic Packaging Applications groups. He has a Master's degree in science and a PhD in engineering and materials science from Cornell University in New York.

**Glenn Collinson** – Supervisory Board Member
The co-founder of Cambridge Silicon Radio Plc. (LSE symbol: CSR), Glenn Collinson oversaw the development of CSR from its formation in 1998 to its listing as a public company in 2004, first as Marketing Director and then as Sales Director. Since stepping down from the CSR board in 2007, his time has been taken up with directorships at Neul Ltd., a mobile wireless data services provider, at Solar Press Ltd, a company focused on the development of organic photovoltaic modules, and at Wolfson Microelectronics plc. (LSE symbol: WLF), a London Stock Exchange-listed supplier of analog and mixed-signal chips for general consumer and professional applications. Other posts Glenn has held include director of Sonaptic Ltd, from April 2005 to July 2007, when it was sold to Wolfson, director of DiBcom SA, a fabless company specialized in the design of chips for mobile devices and portable televisions until July 2012, and director of Microemissive Displays group plc., from April to November of 2008. Prior to co-founding CSR, he was Senior Engineer and Marketing Manager at Cambridge Consultants Ltd (1996-1998) and Design Engineer and Marketing Manager at Texas Instruments (1989-1996). He is a member of the Institution of Engineering and Technology and holds a Bachelor of Science in physics and a Master of Science in electronics from Durham University, as well as an MBA from Cranfield University.

**Thierry Sommelet** – Permanent representative of FSI (*Fonds stratégique d'investissement*), Supervisory Board Member
Before joining FSI in 2009 as an Investment Director, Thierry Sommelet was Head of Investments in the *développement numérique des territoires* (Regional Digital Development) service of the *Caisse des Dépôts*, where he was responsible for investments in the digital sector. Thierry's career began in the financial markets with Crédit Commercial de France (now HSBC), in Paris and New York, where he was in charge of risk management. In 1996, he joined Renaissance Software (now Infinity), a supplier of software to financial institutions, managing its London-based European financial engineering team. From 2000 to 2001, he took charge of development and Internet strategy at media company InfosCE. He then moved to *Caisse des dépôts* in 2002. Thierry Sommelet sits on the board of directors of the following companies: TDF, 3S Photonics, Mäder and Sipartech. He is a graduate of the ENPC civil engineering school in Paris and earned an MBA from Insead, the international business school.

**Olivier Sichel** – Permanent Representative of Sofinnova Partners, Supervisory Board Member
Since July 2012, Olivier Sichel is the Chairman and Chief Executive Officer of LeGuide.com, the European leader in online shopping guides. Having joined Sofinnova Partners as a Partner in 2006, he became a venture partner in 2012. He held various operational posts at France Telecom from 1998 to 2000, before being appointed Chief Executive Officer of Alapage.com in 2000, a web-based retail company acquired by Wanadoo, and Chief Executive Officer of Wanadoo in 2002. In 2004, Olivier

Sichel managed the reintegration of Wanadoo into the France Telecom group while taking on the management of its "fixed-line and Internet" division. He then carried out the merger of the fixed-line telephone teams with Wanadoo in all of Europe and was, in particular, one of the early contributors to the launch of the Livebox and of VoIP. While at Sofinnova Partners, Olivier invested in OpenERP, Solutions30, Taptu, and Twenga. He has served as a director for Streamezzo (sold to Amdocs), Sprice (sold to TravelPort), and blueKiwi (sold to Atos). He currently serves as director for Solutions30 and Sofipost, and as a non-voting member of the board of directors of Volubill. Olivier graduated from ESSEC Business School (France) and from ENA (*Ecole Nationale d'Administration*) (France) and is an Inspector of Finance (*inspecteur des finances*) in France.

**Joëlle Toledano** – Supervisory Board Member
With a PhD in both mathematics and economics, Joëlle Toledano has pursued a career in higher education along with a career in business. She started out as a research associate with the *Centre National de la Recherche Scientifique* (French National Center for Scientific Research) before becoming a lecturer (*maître de conférences*) in Economics at the University of Rouen (France). At the same time, she held various management posts in IT and telecommunications companies. As such, she became Vice-President of Alcatel TITN and of Alcatel-Answare from 1987 to 1989, followed by CEO of CCMC Ressources Humaines. She then joined the La Poste group as Head of Strategy in 1993, before becoming its Head of European and National Regulation in 2001. A professor at the *Universités à SUPELEC* (Paris) since 2005, Joëlle Toledano was a member of the college of the *Autorité de régulation des communications électroniques et des postes* (ARCEP) from 2005 to late 2011.

### 1.2. Duties of the Supervisory Board

The Supervisory Board is subject to the provisions of the French Commercial Code, to articles 15 to 17 of the By-Laws of the Company, and to the internal charter it adopted.

In particular, the Supervisory Board is responsible for:

- exercising permanent oversight of the management of the Company by the Management Board,
- appointing those members of the Management Board responsible for defining the strategy of the Group and for managing it,
- setting the compensation of the members of the Management Board,
- authorizing the agreements and commitments discussed in articles L. 225-86 and L. 225-90-1 of the French Commercial Code,
- suggesting statutory auditors for appointment at the General Shareholders' meeting,
- approving the Chairman of the Board's report on corporate governance and internal control.

It checks the quality of information disclosed to shareholders and to the markets.

There are no statutory limitations to the powers of the Management Board.

### 1.3. Conditions under which the work of the Supervisory Board was prepared and organized

In order to efficiently participate in the work and deliberations of the Board, each member of the Board requests the documents he or she deem useful. Such requests must be sent to the Management Board or, as the case may be, any other senior executive.

Each member of the Board is allowed to meet with the main executives of the company, provided prior notification is sent the Management Board. The members of the Management Board can attend these meetings unless the Board member in question refuses. The members of the Management Board can speak at any Board meeting.

The Management Board informs the Board on a regular basis regarding the financial position, cash position, financial commitments of the Company and the Group, as well as regarding any significant events that may have occurred.

Lastly, any new member of the Board can request to receive training on the specificities of the Company and its Group, their business activities and their business sectors.

The Board meets as often as necessary in the corporate interest of the Company and at least once per quarter. No later than on the last meeting of the financial year, the Board sets the dates of its quarterly meetings to be held in the following financial year. The members of the Board are notified by letter, facsimile, or email at least eight (8) days prior to each meeting. The Board can also be convened by any means available, even verbally, if all the active members of the Board are present or represented at the meeting.

All documents, in final or draft form, are sent, handed, or made available to the members of the Board within a reasonable time frame prior to the meeting, in order to inform them regarding the agenda of the meeting and any questions subject to the Board's review.

In addition, at each meeting the Board is updated regarding the financial position, the cash position, and the commitments of the Company.

The members of the Board can attend Board meetings via video-conferencing or any other means of telecommunication. This attendance method is not valid for deciding on the following matters: (i) appointing, terminating, or setting the compensation of members of the Management Board, and (ii) reviewing and auditing the annual financial statements, including the consolidated financial statements, and reviewing the management report including the management report of the Group.

The means put in place must enable the identification of those in attendance and guarantee their effective participation.

The minutes of the meeting lists those members using video-conferencing or any other means of telecommunication to attend the meeting.

Annually, the Board reviews its terms and conditions of operation and, at least once every three years, complete a formal evaluation with the assistance of an external consultant, as the case may be. The purpose of this evaluation is also to ensure that important questions are adequately prepared and debated, and to assess the contribution of each member to the work completed by the Board based on his or her abilities and implication, in particular.

### 1.4. Report on the activity of the Board over the course of the 2012 financial year

Over the course of the past financial year, the Supervisory Board of the Company met 14 times. The Chairman of the Board chaired these meetings, it being specified that the average attendance rate of all members of the Board for the financial year was equal to 82%.

## 1.5. Audit Committee

The audit committee (the "Audit Committee") was created in 2006. Its members adopted a new internal charter on March 31, 2011, which was approved by the Supervisory Board that same day.

The goal of the Audit Committee, acting under the exclusive and collective authority of the members of the Supervisory Board of the Company and in order to ensure the quality of internal control procedures and of the reliability of the information provided to shareholders and to the financial markets, is to monitor all issues associated with the establishment and auditing of accounting and financial information and, to this end, in particular:

- to monitor the process under which financial information is prepared,
- to monitor the effectiveness of internal control and risk management systems and, in particular:
  - to evaluate the internal control processes as well as any measures adopted for the purpose of solving any significant potential internal control dysfunctions,
  - to review the annual work plan of the auditors,
  - to assess the relevance of the risk monitoring procedure,
- to monitor the legal auditing of the annual financial statements and consolidated financial statements by the Statutory Auditors and, in particular:
  - to review the assumptions retained in the financial statements, to study the corporate financial statements of the Company and the annual, half-year and, as the case may be, quarterly consolidated financial statements before they are reviewed by the Supervisory Board, while having regularly kept abreast of the financial position, cash position, and commitments of the Company, in particular off-balance sheet data,
  - to assess the merits of the choice in accounting principles and methods, in consultation with the Statutory Auditors,
  - to discuss the merits of the accounting principles and methods retained, the effectiveness of accounting auditing procedures, and all other relevant matters with the members of the Management Board in charge of financial concerns as well as with the Chief Financial Officer, from the end of any given financial year to the date on which the Audit Committee will seek to approve the draft version of the annual financial statements,
- to review the significant transactions for which a conflict of interests may have occurred,
- to issue a recommendation on the Statutory Auditors suggested for appointment at the General Shareholders' meeting and to review the conditions applicable to their compensation,
- to monitor the status of independence of the Statutory Auditors and, in particular:
  - to suggest the setting of rules that the Statutory Auditors can resort to with respect to duties other than the auditing the financial statements in order to guarantee the independence of the auditing services of the financial statements provided by such Statutory Auditors in compliance with the law, regulations, and recommendations applicable to the Company, and to ensure that such rules are well applied,
  - to authorize any decision to resort to the Statutory Auditors for work other than the auditing of the financial statements,

- to review the conditions governing the use of financial derivatives,
- to monitor the status of significant disputes on a regular basis,
- to review the procedures implemented by the Company with respect to the receipt, filing, and processing of claims pertaining to accounting matters and accounting audits carried out internally, to issues surrounding the auditing of the financial statements, as well as to documents sent anonymously and confidentially by employees and that may call into question any practices used in accounting or in the auditing of the financial statements, and
- generally, to provide any advice and to formulate any appropriate recommendations regarding the matters set forth above.

If possible, the Audit Committee is composed of at least three members of the Supervisory Board appointed by the Supervisory Board, it being specified that at least two thirds of the members of the Audit Committee must be, insofar as possible, independent members in accordance with the criteria defined in the corporate governance code of publicly-traded companies published by the AFEP-MEDEF in December 2008 and revised in April 2010, which the Company uses as a reference.

In selecting the members of the Audit Committee, the Supervisory Board ensures that they are independent, that at least one independent member of the Audit Committee has specific skills in finance or accounting, and that all the members have basic skills in finance and accounting.

The members of the Audit Committee are:

- Patrick Jones (Chairman, financial expert, and independent member),
- Alex Brabers (Chairman of the Supervisory Board), and
- Thierry Sommelet (permanent representative of the *Fonds stratégique d'investissement*).

These three individuals were selected based on their accounting and financial skills, it being specified that Patrick Jones and Thierry Sommelet also meet the independence criteria retained by the Company and reiterated in the internal charter of the Board.

The Audit Committee can speak with any member of the Management Board of the Company and visit with or interview the heads of operating or functional entities that may be of assistance to the Audit Committee in completing its assignment. Should the Audit Committee choose to do so, it gives prior notice to the Chairman of the Supervisory Board and the Chairman of the Management Board of the Company. In particular, the Audit Committee has the authority to interview persons who participate in the preparation of the financial statements or their auditing (Chief Financial Officer and senior executives in financial management).

The Audit Committee interviews the Statutory Auditors.

The Audit Committee met 6 times over the course of the 2012 financial year with an attendance rate of 100%.

### 1.6. Compensation and Appointment Committee

At its meeting dated March 31, 2011, the Supervisory Board of the Company decided to merge two pre-existing committees (the governance committee and the compensation committee) into a single compensation and appointment committee (the "Compensation and Appointment Committee").

The main objectives of the Compensation and Appointment Committee are:

- to make recommendations to the Supervisory Board regarding the persons or entities that should be appointed as members of the Management Board or the Supervisory Board, as the case may be,
- to review the compensation policies implemented by the Group and applicable to senior executives, to make proposals regarding the compensation of members of the Management Board and, as the case may be, of members of the Supervisory Board, and to prepare all reports that the Company must disclose on these matters.

The Compensation and Appointment Committee is, in particular, responsible for the following:

- in regards to appointment matters:
    - Make recommendations to the Supervisory Board on the composition of the Management Board, the Supervisory Board and its committees;
    - Propose annually to the Supervisory Board a list of members who may be qualified as "independent members" pursuant to the standards defined in the corporate governance code of publicly traded companies published by the AFEP-MEDEF in December 2008 and revised in April 2010, which the Company uses as a reference,
    - Establish a succession plan for the executive officers of the Company and assist the Supervisory Board in the selection and evaluation of members of the Management Board;
    - Prepare a list of persons to recommend for appointment to the Management Board or the Supervisory Board; and
    - Prepare a list of members of the Supervisory Board to recommend for appointment to one of the Supervisory Board's committees.
- in regards to compensation matters:
    - Study the main objectives proposed by senior management regarding compensation of executives who are not corporate officers of the Company, including free allocation of shares and stock options,
    - Review the compensation of executives who are not corporate officers of the Company, including free share plans and stock option plans, pension schemes, welfare plans and benefits in kind;
    - Formulate recommendations and proposals to the Supervisory Board regarding:
        - compensation, pension and welfare schemes, benefits in kind and other pecuniary rights, including in the event that the terms of office of Management Board members are terminated. The Committee proposes amounts and systems of compensation and, in particular, rules for calculation of any variable compensation taking into account the strategy, objectives and results of the Company and market standards;

- free share plans, stock option plans, and any similar profit sharing mechanism and, in particular, the individual grants to the members of the Management Board,

- Review the total amount of attendance fees and their distribution among the Supervisory Board members, as well as the conditions of reimbursement of costs that may have been incurred by the members of the Supervisory Board in connection with their duties, if any;

- Prepare and present reports required under the terms of the internal charter of the Supervisory Board; and

- Prepare any other recommendation that could be requested by the Supervisory Board or the Management Board regarding compensation.

Generally speaking, the Compensation and Appointment Committee will provide any advice and formulate any appropriate recommendations regarding the matters set forth above.

If possible, the Compensation and Appointment Committee is composed of at least three members of the Supervisory Board appointed by the Supervisory Board, it being specified that no less than the majority of the members of the Audit Committee must be, insofar as possible, independent members in accordance with the criteria defined in the corporate governance code of publicly-traded companies published by the AFEP-MEDEF in December 2008 and revised in April 2010, which the Company uses as a reference.

The members of the Compensation and Appointment Committee are:

- Jean Schmitt (Chairman),
- Ronald Black (independent member),
- Alex Brabers (Chairman of the Supervisory Board), and
- Patrick Jones (independent member).

Within the context of its duties, the Compensation and Appointment Committee can submit a request to the Chairman of the Management Board regarding the need for the assistance of any management executive (*cadre dirigeant*) of the Company, the specific skills of which could facilitate the completion of one of the tasks on the agenda.

The Compensation and Appointment Committee met 5 times over the course of the 2012 financial year with an attendance rate of 95%.

### 1.7. Principles and rules that determine the compensation of corporate officers (*mandataires sociaux*)

The Company applies all of the recommendations contained in the AFEP-MEDEF Code relative to the compensation of executive corporate officers (*dirigeants mandataires sociaux*) and non-executive corporate officers (*mandataires sociaux non dirigeants*).

Detailed information on this compensation and their determination can be found in the Management Report prepared by the Management Board for the financial year ended on December 31, 2012.

Over the course of the 2012 financial year, the variable items of compensation paid to Rémy de Tonnac and Pascal Didier were determined by the Supervisory Board of the Company based on a proposal submitted by the Compensation and Appointment Committee, in accordance with the following criteria: (i) 60% based on meeting the financial objectives of the Group, and (ii) the remaining 40% based on qualitative objectives (key actions for the Company such as launching new products).

Over the course of the 2012 financial year, the variable items of compensation paid to the other members of the Management Board under their respective employment contracts were set according to the following criteria: (i) 80% based on individual qualitative objectives (key actions for the departments they are responsible for such as the certification of products), and (ii) the remaining 20% based on meeting the financial objectives of the Group.

The total amount of attendance fees allocated to the members of the Supervisory Board for the 2012 financial year was equal to EUR 100,000 (against EUR 48,000 for 2010 and none in 2011). They are distributed as follows (in Euros):

| **Members of the Supervisory Board** | **Gross amounts paid out** |
|---|---:|
| Ronald Black | € 0 |
| Alex Brabers | € 20 089 |
| Glenn Collinson | € 11 161 |
| Patrick Jones | € 20 089 |
| Jean Schmitt | € 17 857 |
| Joëlle Toledano | € 11 161 |
| Fonds Stratégique d'Investissement | € 13 393 |
| Sofinnova Partners | € 6 250 |

Over the course of the 2012 financial year, certain corporate officers of the Company were granted free shares, as detailed in the following table:

| **First and Last Name** | **Office** | **Date of Plan** | **Number of Shares Granted** | **Vesting Date** | **Duration of the Vesting Period** | **Number of shares that must be held while in office** |
|---|---|---|---|---|---|---|
| Rémy de Tonnac | Chairman of the Management Board | July 26, 2012 | 10 400 | July 26, 2014 | 2 years | 10% |
| Pascal Didier | Chief Executive Officer | July 26, 2012 | 2 950 | July 26, 2014 | 2 years | 10% |
| Pierre Garnier | Member of the Management Board | October 17, 2012 | 60 000<br>30 000<br>30 000 | October 17, 2014<br>October 17, 2015<br>October 17, 2016 | 2 years<br>2 years<br>2 years | 10% |

Within the context of a more general grant, the free shares granted to Rémy de Tonnac and Pascal Didier correspond to the substitution of, respectively, 80,400 and 17,648 stock-options that became null and void at the time of the initial public offering in February 2012.

The free shares granted to Pierre Garnier had been granted before he was appointed to serve on the Management Board of the Company.

### 1.8. Other corporate governance considerations

The provisions relative to the participation of shareholders in shareholders' meeting can be found in Article 22 of the By-Laws available at the registered headquarters of the Company. The information described in Article L. 225-100-3 of the French Commercial Code that could potentially have an impact in the event of a public offering, are detailed in the Management Board's management report.

## 2. Risk management and internal control procedures implemented by the Company

In drafting this section of its report, the Company used as its reference the AFEP-MEDEF implementation guide for the framework of reference on internal control adapted to publicly traded companies, revised in April 2010.

### 2.1. General risk management principles

#### *A) Definition*

Risk management aims to identify all of the main risks and risk factors that could affect the business activities and processes of the company and to define the means of managing these risks and maintaining them, or to bring them down to an acceptable level for the Company, in particular by setting up preventative measures and controls linked to the internal control system. This process is intended to cover all types of risks and to apply to all the business activities of the Company and the Group.

#### *B) Risk management objectives*

The Company adopted the definition of risk management published by the French *Autorité des marchés financiers*[4], according to which risk management is a leverage mechanism in the management of the Company that contributes to:

- creating and maintaining the value, assets, and reputation of the Company,
- providing added security to the decision-making and processes of the Company in order to promote the reaching of objectives,
- promote consistency between actions and the securities of the Company,
- focus employees on a shared view of the main risks the Company is exposed to.

#### *C) Components of the risk management system*

The risk controlling method used by the Company is based, on the one hand, on the assessment of the risks within the context of the definition provided in the annual business plan and, on the other, on the elaboration of plans of action aimed at handling these risks.

The main risks associated with the business activities of the Company are described in the Management Board's management report.

[4] Implementation guide for the framework of reference on internal control adapted to small and mid caps, as revised on July 22, 2010

Specific plans of action are put in place in order to respond appropriately to the main risks identified. A constant monitoring is also implemented. Financial risks and related controls in place are shared with the Statutory Auditors and the Audit Committee on a regular basis in order to adapt or modify them, as the case may be. The Company continues to elaborate its risk management system. The Company has established a risk map over the course of the second half of the 2012 financial year, which provides it with a more systematic monitoring tool.

### 2.2. Relationship between risk management and internal control

The internal control system relies in particular on risk management to identify the main risks that need to be controlled. In the past, the Company has first elaborated and developed an internal control system, whereas the elaboration of the risk management system is more recent. The Company is now involved to reconciling both systems, aiming to identify the terms of controls to which the key processes of the company that could potentially be impacted by risks regarded as "major" are subject.

### 2.3. General Internal Control Principles

#### *A) Definition*

Inside Secure uses as a guideline the definition of internal control proposed by the French *Autorité des marchés financiers*[5], according to which internal control is a system implemented by the Company intended to ensure:

- compliance with laws and regulations of its activities;
- the enforcement of instructions and guidelines set by senior management,
- the proper functioning of the internal processes of the Company,
- the reliability of its financial information,

and, generally, contribute to the monitoring of its activities, the effectiveness of its operations and the efficient use of its resources. Over the course of the financial year, the Company continued to implement an internal control system intended to "internally guarantee that the information used and distributed throughout the businesses of the Company is relevant and reliable."

However, the use of internal controls does not constitute an absolute guarantee that the objectives of the Company will be reached, or even that the risk of error or fraud will be fully controlled or eliminated.

#### *B) The components of internal control*

Standard

The procedures described below are those of the Company and its subsidiaries, the financial statements of which are consolidated by the global integration method, it being hereby specified that in the context of its development and of the initial listing of its shares on the NYSE Euronext regulated market in Paris, France, the Company intends to improve and supplement its existing system by referring to the guidelines contained in the implementation guide for the framework of reference on

[5] Implementation guide for the framework of reference on internal control adapted to small and mid caps, as revised on July 22, 2010

risk management and internal control adapted to small and mid caps published by the French *Autorité des Marchés Financiers* on July 22, 2010.

*The various actors of the internal control system*

The Group's internal control system relies on the Management Board of the Company, its Supervisory Board, its Audit Committee and its Compensation and Appointment Committee. Their composition, functions and operation are described above.

*Accounting and financial organization and steering*

In order to make its financial and accounting information more reliable, the Group has implemented a number of procedures, mainly organized around:

- a three-year business plan,
- an annual budget,
- a monthly consolidated reporting for internal use, enabling the reconciliation of accounting data and forecasts, that shall contribute to the quality and reliability of its financial information, it being specified that such reporting is also used for the financial management of the Group.

*Identification of key controls and the monitoring of their implementation*

Within the context of the drafting of its risk map in 2012, the Group identified the major risks it is exposed to as a result of the nature of its business activities. The Group identified fifteen processes used in the preparation of its financial information:

- Governance
- Reporting and budgetary procedures
- Research and development activity
- Existence and valuation of stocks
- Recognition of income and customers
- Purchase and suppliers providers
- Payroll and Human Resources
- Procedures for investment and capital expenditures
- Cash and derivatives
- Contractual and legal framework
- Tax matters
- Research tax credits and grants
- Subsidiaries
- Information systems
- Procedures for closing interim and annual financial statements

These processes are listed in an internal control matrix that included 200 key controls during its most recent review in November 2012. Some key controls have revealed internal control weaknesses, which as far as the Company is concerned, did not significantly affect the reliability of its financial information as offsetting controls were implemented. These are areas of improvement for the Group. The Audit Committee reviews the matrix of internal control on an annual basis.

*Accounting and Financial information system*

The Group has established three information systems in order to strengthen its internal control system:

- a management tool for ERP (SAP), the objective of which is to restore financial information in an automated and secure way. This tool has helped to establish a plan of accounts, to improve the traceability of information and create audit trails,

- a tool to monitor research and development projects that enables the monitoring, on a per project basis, of the time spent by researchers on each project and the costs incurred in connection with each project.

- A software package for modeling projected cash flows in order to manage cash projections in connection with accounting and budget control data.

*Resources allocated to internal control*

Given its size, the Group has not established an internal audit department. Internal control is primarily the responsibility of its financial department. During their visit to sites abroad, its teams review the analyses of the financial statements prepared by the accountants of its subsidiaries. In general, for foreign subsidiaries, the Group relies on outside auditors for the preparation of the financial statements and the annual tax returns in order to maintain an adequate segregation of duties and to ensure proper compliance with and implementation of local legal and tax provisions.

### 2.4. Scope of risk management and internal control

The internal control procedures described herein are applicable to the Company as well as to any of its subsidiaries for which the financial statements are consolidated according to the global integration method.

### 2.5. Bodies responsible for risk management and internal control

The Management Board of the Company is responsible for the identification and processing of essential challenges and defines strategic and operational objectives. It ensures that the strategy is executed and reviews the options contributing to its effective implementation, in particular in the fields of technology, security, and human and financial resources.

The framework of reference used by the Company for its internal control is focused on ensuring that the accounting and financial information is reliable and on compliance with applicable laws and regulations, in particular in the area of preparation of accounting and financial information.

The Management Board is responsible for the supervision of the internal control system of the Company. Since its does not have an internal auditing department, the Management Board entrusts the financial department with the responsibility of identifying the risks and implementing, monitoring, and evaluating the internal control system.

Within the financial department, the CFO, financial overseers, and the management control department are an integral part of the system and work in close collaboration with the various operating services in order to guarantee an acceptable level of internal control.

Lastly, acting under the authority of the members of the Supervisory Board of the Company and in order to ensure the quality of internal control procedures and of the reliability of the information provided to shareholders and to the financial markets, The Audit Committee monitors all issues associated with the establishment and auditing of accounting and financial information.

### 2.6. Limitations of risk management and internal control and areas of improvement

Risk management and internal control represent a constantly improving process. In 2013, the Company intends to test its risk management system and to improve the monitoring of identified plans of action. At the same time, the Company intends to update its internal control system by taking into account changes in its internal structure and its business. The Company also plans to ensure that the internal control system it implemented can cover the risks identified when it established its risk map.

The Supervisory Board approves the terms of this report, which will be presented at the General Shareholders' Meeting called to approve the financial statements of the 2012 financial year.

______________________________________

**The Chairman of the Supervisory Board**

**Appendix 2**

**Auditors' report on the chairman's report on corporate governance, internal control and risk management**

[TEXT INTENTIONALLY OMITTED.]

## Appendix 3

## Statements of the fee of the statutory auditors and of their affiliates

[TEXT INTENTIONALLY OMITTED.]

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