

Report by the Board of Directors

2009

Orolia SA, a French limited liability company (*société anonyme*) with share capital of €16,675,836

Registration number: R.C.S Evry 492 370 622

Registered office: 3, avenue du Canada

91974 Les Ulis, France

For the period from 1 January to 31 December 2009



OROLIA

French public limited company (*Société Anonyme*) with share capital of €9,786,000

Registered office: 3 avenue du Canada - 91974 LES ULIS, France

Registration number: 492 370 622 RCS Evry

REPORT BY THE BOARD OF DIRECTORS ON THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

Ladies and Gentlemen,

As required by law and our Company's Articles of Incorporation, we hereby submit our Directors' Report on the Group and its consolidated financial statements for the past financial year.

We will present the annual financial statements to you in detail before submitting them for your approval. These financial statements have been prepared in accordance with the rules provided for in the regulations in force governing their presentation and measurement methods.

CHANGES IN THE GROUP'S ACTIVITIES IN 2009

Changes in the Group's activities in 2009

As a result of the reorganisation of Orolia at the end of 2009 following the acquisition of Kannad and McMurdo and the merger of Spectracom and Pendulum Instruments, the Group's activities will now be reported on the basis of three Divisions:

- **Positioning** (Kannad and McMurdo): equipment and systems for the determination, transmission or monitoring of positioning information in harsh environments.
- **Navigation** (SpectraTime and T4 Science): primary generation of time and frequency signals using atomic clocks, mainly for satellite navigation systems.
- **Timing** (Spectracom and Pendulum Instruments, now merged): distribution of time and frequency signals within data networks for time-stamping or synchronisation, and measurement, referencing and analysis of time or frequency signals.

In 2009, Orolia's sales increased 10.4% to €31.1m, thanks to the acquisitions in the Positioning division, which offset the effects of the economic crisis on the two component segments of the Timing division (which saw decreases of 27% and 31% in the Test and Measurement division and the digital broadcasting segments respectively), and the Navigation division, where revenue was down 12% due to delays in the ground segment of the Galileo programme and the end of a major military programme that had made a significant contribution to 2008 revenue.

Activity by business line

Positioning

This new segment represents 14.9% of the Group's 2009 revenue, corresponding to the consolidation of Kannad as from October 2009 and McMurdo for December 2009 only. On a pro forma consolidation basis, the Positioning Division accounted for 51% of Orolia's 2009 revenue, reflecting Orolia's change of size and shape to become a major player in the PNT (Positioning, Navigation, Timing) sector.

The Positioning Division is specialised in two related areas:

- Maritime, aeronautical and land-based distress beacons connected to the international search and rescue system via the COSPAS-SARSAT satellites. Orolia ranks second worldwide in this sector, behind the Anglo-American group Cobham.
- Systems for tracking and supervising mobile objects in extreme environments, based on satellite geolocalisation techniques; applications include tracking FAD (*fish aggregation device*) rafts for the fishing industry, electronic supervision of fishing vessels and quotas, maritime beacons and electronic navigation at sea, etc.

This Division's activity has been relatively unscathed by the economic crisis, as a result of effective marketing and the attractiveness of its products. Only the aviation sector has been significantly affected by the economic slowdown, necessitating adjustments to Kannad's workforce as from the end of the summer in 2009.

The launching in 2009 of new, highly innovative products should allow the Positioning Division to maintain its growth impetus in 2010, sufficiently to attenuate the impact of the cyclical downturn expected in commercial aviation and merchant shipping:

- Launch of the smallest and least expensive personal distress beacon on the market, the **FastFind 210** Personal Locator Beacon (PLB). This won the Best Safety Product award at the MAATS trade show in the US in March 2009, was named Product of the Year by the major marine retail chain West Marine, was nominated for a DAME Award at the METs trade show in Europe in November 2009 and was designated Boating Product of the Year at the Helsinki Boat Show in March 2010.
- Launch of **SafeLink**, a new-generation distress beacon for merchant shipping and leisure marine use, with an innovative design that offers a currently unequalled combination of safety, cost and ease-of-use.

Kannad has also obtained PART-145 certification for the maintenance of its aviation market equipment. This certification allows this distress beacon manufacturer to extend its range of services in Europe and complements its EN 9100 certification and the Part 21-O approval for design and Part 21-G approval for production organisation for its aeronautical distress beacons granted by the European Aviation Safety Agency (EASA), the body charged with the continuous supervision of aeronautical equipment manufacturers.

Lastly, despite the difficult economic environment, the Positioning Division has maintained its new product development activities in all its areas of business. These products and services will be launched in stages during 2010 and should also contribute to business resilience.

Navigation

This activity accounted for 30.7% of Group revenue in 2009 (17.7% pro forma).

Clocks for space applications

2009 revenue in the embarked atomic space clock segment was slightly up, by 4%, despite the end of major programmes (the Asian Earth observation programme, the In-Orbit Validation (IOV) phase of the Galileo system and the European Space Agency's GAIA scientific project), thanks to the start of major research and development contracts, including the ACES programme. This segment, mainly linked to government programmes, is not affected by the economic crisis.

Exceptionally, atomic clocks for the ground segment of space programmes (active hydrogen masers) – a very mature market usually generating relatively stable revenue – reported activity sharply down by 40% against 2008. This was a result of major delays in the Galileo ground segment programme and the “wait-and-see attitude” of certain customers in this period of economic crisis. However, as this segment accounts for less than 3% of the Group's pro forma revenue, the impact of any fluctuations is relatively marginal.

2010 should see a return to more consistent growth. In the embarked clock business, a boost is expected from the effective launch of large-scale production of satellites for the Galileo system. In January 2010, the European Space Agency named the main contractor for the first 14 satellites for the Galileo constellation and this contractor has already authorised Orolia to commit to expenditure for the manufacture of the satellites' atomic clocks. A two-year contract of the order of €20m should be finalised shortly.

At the same time, supply of atomic clocks for the Indian navigation system, IRNSS, and for the ACES scientific experiment should continue.

In the area of hydrogen masers for ground applications, the substantial marketing work undertaken in 2009 resulted in new orders in Asia and, for the first time, in the USA, our main competitor's home market.

During the first quarter of 2010, T4 Science received an order for two masers from MIT (Massachusetts Institute of Technology), thanks to the exceptional performances of its clocks. Furthermore, the ground segment of the Galileo project now seems certain to be moving forward again and deliveries of masers for this programme will soon be able to be made. This activity should therefore return to the usual levels seen in previous years.

Clocks for defence and telecommunications

Our strong share in the atomic clocks market for telecommunications applications in Asian countries, less affected by the economic crisis, has allowed this activity to avoid the current economic difficulties and maintain its 2008 level.

Sales of products for military applications were down. This was connected with the end of a major programme for the Swiss and Israeli armies, which made a strong contribution to revenue in 2008.

Timing

This activity accounted for 54.4% of Group revenue in 2009 (31.3% pro forma).

2009 was marked by the merger of the Spectracom and Pendulum Instruments operations. Under the Spectracom brand, these two entities now share the same management team, marketing network and

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management and services infrastructure.

Time-stamping and synchronisation instruments

This segment comprises sales of rack-mount units, OEM cards and various accessories such as display units for the military, civil defence, digital broadcasting, financial services (banks, hedge funds, financial markets) and high-performance computer infrastructure (data centres, cloud computing) markets.

The beginning of the year was very difficult for this sector, because of the very sharp fall in orders in the USA in the last quarter of 2008. However, the recovery in business seen from the second quarter onwards allowed us to limit the fall in revenue to 4.5% despite the crisis in the digital broadcast market, which was as severe as it was unexpected (with revenue down 31% compared with 2008), driven by TV channels' financial difficulties and the postponing of decisions on mobile phone television and digital radio. This sector's difficulties have led us to adjust our workforce during the third quarter of 2009 and write down the related intangible asset. However, digital broadcasting now only accounts for 4% of the Group's pro forma revenue and its relative impact is today less important for our overall performance.

Despite this difficult context, development of new products has continued, particularly in the area of defence. The launch of our Secure Sync new-generation, fully modular time-frequency platform, should be a major growth factor in the US defence market as from 2010.

Time-frequency systems

In the area of synchronisation systems more particularly intended for the defence and satellite communication ground infrastructures markets, the formation of Orolia Global Services Ltd to penetrate the UK defence market has allowed us to increase our market shares in Europe and increase revenue from this activity, which promises potentially recurrent maintenance contract revenue. The French Defence Ministry has again shown its confidence in the Group in 2009 by renewing multi-year contracts for €8m for the maintenance of operational readiness of the synchronisation systems sold to it in the past by Orolia.

Orolia has also been selected by US company Globecom System to supply the synchronisation equipment for its new satellite communication system intended for a major international military organisation.

Under this \$500,000 contract, Orolia's **NetClock** secure GPS clock platforms and **Epsilon** signal distribution platforms will ensure the generation and distribution of a range of time-frequency signals for the telecommunication system's ground stations.

Test and Measurement

This activity accounted for 11.6% of Group revenue in 2009 (6.6% pro forma). Reporting a 27% decrease in pro forma revenue, this activity – with digital broadcasting – was the one that suffered the most from the economic crisis, being heavily dependent on investments in new production capacity by our customers in the electronics industry. These investments have to a great extent been frozen as a result of the strong decline in global consumption of manufactured goods. These difficulties have led us to restructure Pendulum Instruments. This included the closure of its Californian subsidiary, a reduction in its workforce and the merger of its operations with those of Spectracom. The continuing uncertainties regarding this sector's prospects have also led us to adjust the value of the intangible assets allocated to Pendulum Instruments downwards, for the sake of prudence.

The economic crisis has also created opportunities to prepare for the future. We were therefore able to increase our operating scope on good financial terms in the area of GPS signal generators. These high-

technology instruments are intended for testing and measuring electronic apparatus incorporating a GPS function (such as mobile phones, car navigation systems, personal GPS receivers for leisure activities, etc), a market seeing structural growth. This product line was acquired from Naviva, a Business Unit of Space Systems Finland (SSF).

A first GPS signal generator at a very competitive price – the GSG-L1 – is now in the catalogue and strengthens our existing instrumentation product range.

CHANGES IN THE GROUP'S RANGE OF ACTIVITIES

Acquisition of Rapco Electronics

As part of its international growth strategy, Orolia acquired the assets of the UK company Rapco Electronics in January 2009, and formed a new entity, Orolia Global Services Ltd. With more than forty years' experience in the development, manufacture and sale of time-frequency systems for defence, space (ground segment), security, and terrestrial digital television applications, Rapco Electronics was for many years one of the leaders in the UK market, before starting to suffer from a lack of investment in R&D. Inheritance problems involving this company's shareholders gave Orolia the opportunity to acquire – on very favourable financial terms – a competent technical and marketing team and attractive customer base with which to accelerate Spectracom's development in the UK market. Based at Basingstoke (near London), Orolia Global Services now forms a regional sales and customer support centre serving the Timing division. The good growth in Spectracom's activity in the UK as from the first financial year confirms the attractiveness and pertinence of this acquisition.

Acquisition of Kannad

An Extraordinary Shareholders' General Meeting held on 16 September 2009 approved the contribution by Airtek Capital Group of the 2,000,000 shares representing the share capital of Kannad, a French Simplified Limited Liability Company with share capital of €2,000,000 and registered office at Village du Hirgoat -ZI des Cinq Chemins, 56520 Guidel, France. This contribution was valued at €10,000,000 for the purposes of determining the share exchange ratio. However, under the terms of the contribution agreement dated 4 September 2009, the shares in Kannad were contributed for their carrying amount as recorded in the accounts of the contributor, Airtek Capital Group; this was €8,000,000. In consideration of this contribution, the General Meeting decided to increase the share capital by €4,324,324 to €14,110,324 by issuing 1,081,081 new shares of €4 nominal value, each being issued with a share premium of €3.40, the total of the share premium amounting to €3,675,675.40. All the new shares were allocated to Airtek Capital Group. These new shares granted rights from 16 September 2009 and are considered in the same way as the existing shares, granting the same rights and subject to the same provisions of the articles of incorporation and decisions of General Meetings. They are also freely tradable.

Kannad is a French company specialising in the design of positioning systems for harsh environments. It has been a world leader in the area of maritime, aeronautical and land-based distress positioning beacons for more than 20 years. Kannad's technical know-how and marketing has enabled it to take strong niche positions in the area of satellite tracking (tracking moving objects or people) for certain critical applications. Located at Guidel in Brittany, the company employs more than 60 people mainly involved in research & development, product marketing and customer service. Kannad has a strong international presence through a distribution and maintenance network covering more than 60 countries.

Acquisition of McMurdo

On 23 November 2009, Orolia acquired the assets of McMurdo, a division of the US group Digital

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Angel (NASDAQ: DIGA) and a specialist in the field of animal identification and emergency location solutions. Formed in 1937, McMurdo is based at Portsmouth (UK) and employs 50 people. McMurdo is present in more than 60 countries through its marketing network. McMurdo has worldwide recognised expertise in the field of distress beacons for merchant shipping and leisure marine use and is a leader in portable personal beacons. This acquisition combined with that of Kannad has enabled the Group to take second place worldwide in distress beacons, demonstrating our ability to gain market share in Positioning while benefiting from the opportunities offered by a market context favourable to consolidation.

The combination of Kannad and McMurdo within our Positioning Division will allow revenue representing nearly half the Group's total pro forma activity to be generated. In addition to strengthening our leadership position in the Search and Rescue market, the synergies between the two companies will allow us to extend our global presence through a more powerful distribution network and two strong brands. The strong complementarity of the product portfolios enhances the two entities' product offer in their core business: aviation beacons for Kannad and maritime and personal beacons for McMurdo, creating a new growth dynamic.

Financial details of the transaction:

- \$9.5 million cash consideration, including \$1 million to be held in escrow for twelve months to cover warranties and indemnities;
- Structured as a cash-free, debt-free sale of assets (trade receivables and payables were not acquired).

RESEARCH AND DEVELOPMENT

Orolia is a very R&D intensive company.

Its core activity consists in the design, development and manufacture of processes, equipment, software and high-technology systems, in which nearly one third of its employees are engaged.

Orolia's R&D work can be classified under several headings:

- Space: a large part of Orolia's activities consists in designing and developing new atomic clock technologies and applying them in manufacturing. Such projects are almost entirely financed by customers in the space industry (e.g. the Swiss Space Office, European Space Agency, satellite manufacturers).
- Military and governmental: the development of major systems and the related provision of services (maintenance, training and maintaining operational readiness) follow the same approach, under programmes financed by defence ministries and specialised military equipment manufacturers.
- Broadcasting, telecommunications, test and measurement, civil defence, distress beacons and some geolocalisation applications: products of a more standard nature are developed at the Group's own expense.

In order to stimulate growth and consolidate its market shares, the Group has, despite the economic crisis, again increased its activities in the areas of development of new products and improvement of existing products. Orolia's gross R&D expenditures increased from 9.2% of revenue in 2008 to 10.3% in 2009, to which can be added approximately 5.3 percentage points in respect of research contracts financed by certain customers, compared with 2.3% in 2008.

Moreover, Orolia's subsidiaries have taken part in various government projects and standardisation working groups and have increased their collaboration with economic excellence clusters (Pegase, System@tic, and Pôle Mer Bretagne), various universities and new innovative enterprises in order to explore technical paths at an early stage, with a view to monitoring developments and preparing for the future. Amongst the themes in question, special mention should be made of the study and research of new types of synchronisation techniques, time-frequency system architecture and test instruments for full-IP networks, the development of an active space maser, the development of a miniaturised laser-driven atomic clock, demonstration of the feasibility of distress beacons using the return channel of the future Galileo satellites and highly integrated radio architectures for distress beacons.

ANALYSIS OF THE 2009 CONSOLIDATED FINANCIAL STATEMENTS

In accordance with Article L. 233-16 of the French Commercial Code, Orolia prepares its consolidated financial statements applying the methods provided for in Article L. 233-18 of that Code. Orolia's joint statutory auditors report on their assessments regarding these consolidated financial statements in their report.

The assets of Rapco Electronics were acquired in January 2009; the consolidated financial statements include 12 months of that company's operations.

Kannad was acquired in September 2009; the consolidated financial statements therefore include 3 months of that company's operations.

Profit or loss for the period

Revenue

The Group's consolidated revenue was €31.1m, up 10.4% compared with 2008. On a pro forma basis (with Kannad and McMurdo included for 12 months instead of 3 months and 1 month respectively in 2009, and Pendulum Instruments included for 12 months instead of 9 months in 2008), the increase was 85% to €54.1m.

Excluding the Kannad and McMurdo acquisitions, revenue was down 6.0%.

At 12.1%, the decline was more marked in the Navigation division, reflecting the delays in notification of the Galileo ground segment contract and the end of a military programme for Switzerland and Israel, which made a significant contribution to the Division's activity in 2008. The Timing Division saw a more moderate decline, of 2.2%. After a very difficult first quarter in the USA, the recovery starting in the second quarter allowed the fall in revenue to be contained despite the absence of any recovery in the digital broadcast market, where revenue was down 31%, penalised by the postponing of decisions on mobile phone television and digital radio. With pro forma revenue down 27%, sales of test and measurement instruments have also suffered greatly from the crisis, being strongly dependent on production capacity investments by our customers in the electronics industry, which many have frozen while awaiting the economic recovery.

Nevertheless, the formation of Orolia Global Services to penetrate the UK market has enabled revenue to be increased in the area of defence systems and the space programme ground segment.

Operating profit

Consolidated operating profit was €1.6m, a 5.1% margin on revenue, compared with €3.2m in 2008.

This substantial fall in performance was mainly due to the decline in revenue which could not be offset completely by the cost-reduction plans carried out throughout the year. In particular, there has been no price war leading to lower gross margins. However, R&D costs have increased by €270k (excluding the effect of acquisitions) given the launch of new products for which R&D expenditure had been taken as an asset in previous years, while product sales declined with the economic crisis, resulting in lower operating margins.

The contributions of Kannad and McMurdo were small during the year, as these companies were consolidated late in the year. Furthermore, some integration actions indispensable for good profitability from 2010 onwards have had to be carried out and reduced these entities' profitability.

Financial income / (expense)

Financial expenses amounted to €136k, compared with €686k in 2008. This change was due firstly to the effects of strong fluctuation in the currencies used by the Group (USD, CHF, SEK, and GBP) which led to large changes in unrealised foreign currency gains and losses.

Interest paid amounted to €594k compared with €498k in 2008, and related to the mezzanine loan taken out in February 2008 and the €3m acquisition loan agreed with Société Générale in December 2009. As available cash remained at a high level throughout the year, financial income enabled this expense to be reduced by approximately €150k compared with €216k in 2008, reflecting the fall in short-term interest rates.

Net exceptional income / (expense)

Net exceptional expense of €902k, compared with net exceptional income of €31k in 2008, was strongly affected by the economic crisis and the measures taken to adapt to it.

Workforce reduction measures and other restructuring costs resulted in an expense of €426k for the year.

Moreover, impairment tests performed on R&D expenditure revealed insufficient profitability compared with the Group's hurdle rate for one product related to the digital broadcast market, given a very prudent approach with respect to the recovery of this market which was hit strongly in 2009. The Board of Directors has therefore decided to recognise a 100% impairment loss on this asset, amounting to €386k. Similarly, in connection with the rationalisation of the product portfolio between Kannad and McMurdo, a capitalisable R&D project was written down following abandonment of a duplicate product, an expense of €114k.

Net profit after tax and before goodwill amortisation

Net profit after tax and before goodwill amortisation was €422k, compared with €2,137k in 2008. This subtotal is close to the concept of net profit under both IFRS and US GAAP and is easier to interpret or to use as a comparative than net profit as defined under French GAAP. Despite the economic crisis, it has remained positive.

Net profit or loss

The net result for the year was a loss of €3,071k compared with a profit of €1,111k in 2008. In the light of the impacts of the economic crisis on the Test & Measurement business, corresponding to Pendulum Instruments' markets, and given the weakness of the recovery in this area in 2010, a prudent approach in connection with the impairment test performed on the goodwill in Pendulum Instruments has led to this asset being considered impaired and being written down 100%, generating an exceptional expense of €2,450k.

Furthermore, amortisation of the goodwill relating to the Group's other subsidiaries, mandatory under French GAAP even though there has been no loss of value on these shareholdings, has generated a supplementary impact of €1,043k of a technical nature on the net profit or loss for the year.

Balance Sheet

Non-current assets

Goodwill increased from €9,436k to €19,839k as a result of the acquisition of Kannad and of the assets of McMurdo and Rapco Electronics. Impairment tests had been performed and revealed a potential loss of value only on the acquisition of Pendulum Instruments, which was therefore written down by €2,450k.

Goodwill was therefore €17,389k at the balance sheet date, accounting for 66% of the Group's total non-current assets.

Intangible assets, mainly comprising Research and Development assets, increased strongly from €2.9m to €4.4m, as a result of the increase in the Group's consolidation scope and the continued high level of its R&D work.

The increase in property, plant and equipment was connected partly to the acquisition of Kannad and the assets of McMurdo and Rapco Electronics (€2,152k net) and partly to the renewal of equipment owned by the Group's already existing member companies (€609k).

This item also increased as a result of the leaseback of the Kannad site at Guidel, which resulted in a revaluation of the property on consolidation of €608k.

Current assets

Ignoring acquisitions, the decrease of €1.8m in current assets was almost entirely due to the decrease in trade receivables and invoices to issue, related in particular to the end of space programmes.

At constant consolidation scope, all the other items have remained relatively stable.

Cash amounted to €15.4m at the balance sheet date, up €4m, providing the Group with reserves allowing it to approach 2010 with confidence while at the same time continuing its external growth strategy.

Equity

Equity amounted to €33.3m at the balance sheet date, representing 51.8% of total assets or liabilities compared with 47% in 2008, as a result of two successive share capital increases carried out in connection with the acquisition of Kannad and of the assets of McMurdo. The acquisition of Kannad led to a payment in Orolia shares of 1,081,081 shares valued at €10.24 (the share price on the day of the share capital increase), resulting in a consequent increase in equity of €11,070k.

The issue of new shares for cash in December contributed €5,933k to equity.

Trade payables

In general, trade payables decreased at constant consolidation scope by €2.8m, slightly more than operating assets, resulting in higher WCR.

Financial debt excluding current bank borrowings

Financial debt increased, as a result of the €3m acquisition loan taken out in December 2009. This debt is intended to be used to continue the Group's acquisition strategy while allowing shareholders to benefit from leverage. Nevertheless the debt-to-equity ratio has remained very reasonable at 38.5%, compared with 43% in 2008. The sum of financial debt, current bank debt, factor finance less cash and cash equivalents was a net negative liability of €0.1m at the balance sheet date.

The increase in factor finance arose mainly from the change in consolidation scope as Kannad also uses this method to finance its WCR.

Net cash and cash equivalents (after deduction of current bank borrowings)

Cash net of bank overdrafts stood at €15.2m compared with €11.0m in 2008, taking account of cash flow from operations of €249k, cash flow used in investments of €2.34m, the acquisition of Kannad and the assets of Rapco Electronics and McMurdo (a cash outflow of €16.4m), and the proceeds of the acquisition loan (€3.0m) and the share capital increases (€16.7m).

MATERIAL POST-BALANCE SHEET EVENTS

There have been no material post-balance sheet events to report.

We will be pleased to provide you with any further information you may require.

The Board of Directors