i2S Innovative Imaging Solutions

15 October 2007

A vision for the future

I2S is a state-of-the-art specialist in the digital vision, optronics and digital processing markets. The group has a client base of international companies and is organised into three branches of activity. New markets are opening up constantly and we forecast average sales growth of 25% over the next three years alongside strengthened profitability.

- I2S offers a number of advanced technologies that have achieved world firsts: the first images of the wreck of the Titanic, the world's fastest automatic scanner (which could help to resolve some of the problems surrounding the digitisation of the world's written heritage), and more recently, the "But Finish" system used by the French TV channel Canal+ for its football broadcasts.
- Positioned on niche markets, the company develops expertise in areas that enables it to enter new – mostly international – markets. It has already achieved major successes in China and the US. Rather than bringing i2S into head-on competition with the top players, who are firmly established on the mass retail market, this positioning sometimes makes it possible for the group to build partnerships with them.
- i2S's upcoming IPO is aimed at financing growth and the transition towards a more service-based offer. External growth is also on the agenda.
- Our DCF and stock market comparison point to pre-money shareholder equity of € 22.7m and € 27.1m post-money, or € 15.9 per share and € 15 on a diluted basis. Based on an IPO price of € 12, the discount is 20%, implying upside potential of 25%.
- Management's proven expertise in anticipating technological trends and coping with fast-growing activity underpins our confidence in the group's ability to achieve dynamic and profitable growth in the coming years.

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Contents

Investment case

Digital optics

Created in 1979 by its two leading shareholders, Alain Ricros and Jean-Louis Blouin, i2S (Innovative Imaging Solutions) is an internationally recognised player offering high-value-added products on the digital vision, optronics and image processing markets. The group designs, builds and sells optical, camera and software systems for industrial and media applications.

A strong track record

The group's first-class references – including the first film of the wreck of the Titanic, the Olympic Games, Ariane Espace, Canal+, Stanford and Gazprom – underline the high level of expertise in imaging technologies, which are becoming an increasingly crucial component of numerous modern markets.

Three core activities have one characteristic in common: technological excellence

The group's activity is divided into three parts:

- **i2S Vision** (remote cameras and smart vision sensors). This is the group's historical activity, which is being fuelled by new markets in the sport, media, biomedical and transport safety segments.
- **i2S Digibook** (digital scanners). This fast-growing activity has been in the spotlight since the launch of projects to create a global digital library.
- **i2S LineScan** (flat surface monitoring systems). A significant commercial success already, management now wants to further penetrate the US market.

More than 40% of sales are generated abroad from two hubs: one in China and one in the US. This proportion should grow on the back of new distribution deals and the strengthening of the group's presence outside France.

Visibility and flexibility

The cost structure is flexible and the growth of the business should enable a strengthening of margins in the coming years. Margins should also be reinforced by the group's commitment to expanding its service offer and the relative reduction in the proportion of sales from the low-value-added distribution activity.

A four-year action plan

The group has set out a strategic plan christened "Odyssée 2010", which aims to triple sales and strengthen margins. A successful execution of the plan should allow the group's three core businesses to enhance profitable growth on niche digital vision markets.

Improving profitability

Armed with a healthy balance sheet (pre-IPO gearing of 43% in 1H07) and low capex (less than 1% of sales), this strategy should enable a steady increase in ROCE.

Strengthening the offer

Today, i2S is aiming to widen its technological and international footprint, partly through external growth.

Market value of shareholder equity estimated at € 22.7m

Our DCF calculation yields a pre-money, pre-discount value of € 22.9m. A peer comparison (which is a less pertinent method in our view) gives us € 22.5m. We thus estimate the pre-money market value of shareholder equity at € 22.7m and € 27.1m post-money. This is equivalent to € 15.9 per share and € 15 on a diluted basis. Based on an IPO price of € 12, the discount stands at 20%, implying upside potential of 25%.

Shareholder structure

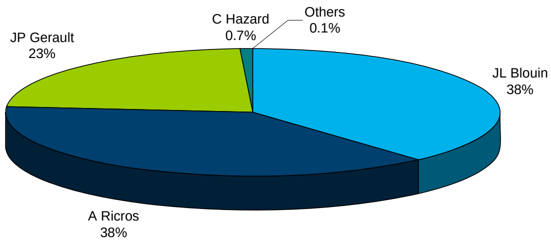
Three core shareholders

The capital of i2S is currently shared between the two founding shareholders: Jean-Louis Blouin and Alain Ricros with 41.04% each of the pre-IPO shares, and Jean-Pierre Gerault with 17.82%. Mr Gerault entered the capital in 2006 when he acquired the stake of Capital Investissement Galia Gestion in Cofintech, which was the mother holding company of i2S before being absorbed by i2S in June 2007. In early 2007, Mr Gerault and Claude Hazard were granted respectively 90,000 and 10,000 share warrants at a price of € 0.7 each and an exercise price of € 1.7 expiring on 31 December 2011.

Post-IPO freefloat estimated at 25%

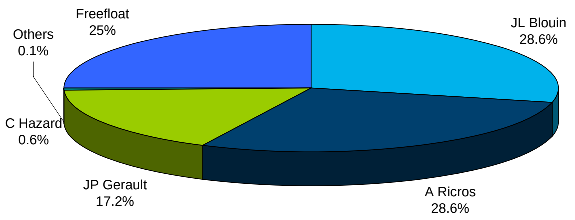
We estimate that the capital increase will raise € 4.3m by creating 361,600 new shares, or 20% of the current outstanding number of shares. At the same time, 90,400 existing shares will be sold by the current shareholders (5% of the total). Assuming 1,807,054 fully-diluted shares post-IPO, the freefloat would stand at 25%. Management has agreed to a six-month lock-up period.

Shareholder structure (pre-IPO diluted)



Source: company

Estimated shareholder structure (post IPO diluted)



Source: company, KBC Securities estimates

Use of proceeds

Financing strong organic growth

The markets where i2S is present appear to have huge potential. The funds raised by the IPO will be used to finance long-term growth, accelerate R&D capacity and strengthen the group's sales teams. In order to gain a foothold on new market segments, the company needs the financial clout to be able to work alongside its commercial and industrial partners.

An ability to seize external growth opportunities

One priority is to be able to pounce on external growth opportunities in each of the three businesses in order to fill out the offer, particularly in software and services, but also with a view to consolidating market share in Europe and the US.

With a negative pre-IPO cash position of € -1.1m and a positive € 3.3m post-IPO, the reinforced financial structure should enable the group to finance its strategy from its own cash resources.

Swot analysis

Strengths	Weaknesses
• A reputation for innovation and technological prowess • Flexible *Fabless* cost structure • Global presence with major multinationals • High-quality management	• Modest size • Niche markets contain high value-added but lack depth • Weak margins in recent years • Past acquisitions limited to minority stakes
Opportunities	**Threats**
• Markets have global potential • International breakthroughs are possible • New partnerships and alliances • Shift in business model towards services and software	• Loss of technological lead to larger rivals • Strong sales growth might be difficult to absorb • More dynamic and better-known rivals • Unfavourable dollar trends

A high-quality management team

The track record of the three main shareholders, who each take a hands-on role in the day-to-day management of the company, reveals a high level of scientific expertise combined with a solid grasp of the business challenges ahead.

Top-flight experience

Chairman since 22 December 2006, Jean-Pierre Gérault graduated from the prestigious Ecole Nationale Supérieure des ingénieurs en arts Chimiques et Technologiques. He has a Doctorate in solid physics and holds an MBA in Marketing and Finance. Over the last decade, he has held posts as Managing Director of Xerox France, Senior Vice President at Xerox Europe and then Managing director again at the Guilbert group (formerly the PPR group). He has also written books on the impact of NICTs (New Information and Communication Technologies) on the written word and the spreading of knowledge.

Close links with regional bodies dedicated to technology

Cofounder, Delegate Director General and member of the Board, Jean-Louis Blouin graduated as an engineer from the Institut National des Sciences Appliquées and holds a management diploma and an executive MBA from the CPA management school in Lyon. He is also active in several regional industrial and technological organisations such as the ALPHA (which oversees the “route des lasers” pole of excellence) and the electronics arm of the Association pour le Development de l’Electronique et de l’Informatique dans le Sud-Ouest (ADEISO). He is also Chairman of AlphaNov, the laser and optics technology centre in the Aquitaine region of France.

A global profile

Cofounder and Chair of the Supervisory Committee, Alain Ricros graduated as an engineer at the École Nationale Supérieure d'Électronique et de Radio électricité in Grenoble. He has a Masters in Economic sciences and a diploma from the Institute for Economic Applications (IAE). He began his career at EADS before founding i2S. He is also Chairman of Aquitaine Création Investissement, a regional risk capital company with a mixture of public and private capital. Mr Ricros initiated i2S’s international expansion.

The solid expertise of the top management is well suited to the company’s technological and global environment, and should enable the group to fully exploit the attractive growth opportunities that exist on the constantly-evolving markets where it is present.

Strong growth and international expansion

Technological excellence at the heart of the offer

In order to be successful, each of the three core activities must possess a strong technological expertise in digitisation. The dynamic growth of the markets where Digibook and LineScan are present mean that these two businesses are growing faster than Vision. However, Vision should benefit from the shift in the offer away from the cost/volume based logic of standard technical products towards the much-higher-value-added cameras developed by i2S.

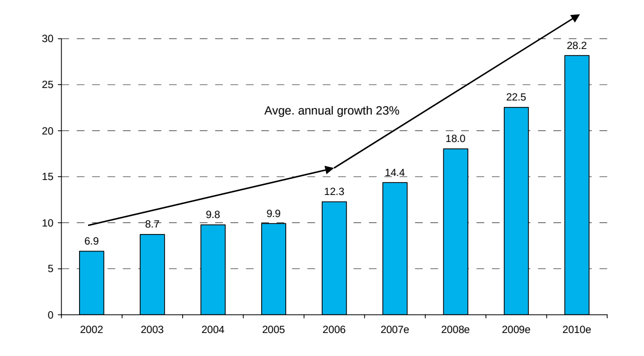
An adapted distribution model

Distribution is direct for the Vision and LineScan divisions and indirect for Digibook and the equipment supplier clients of the Vision division.

Accelerating growth

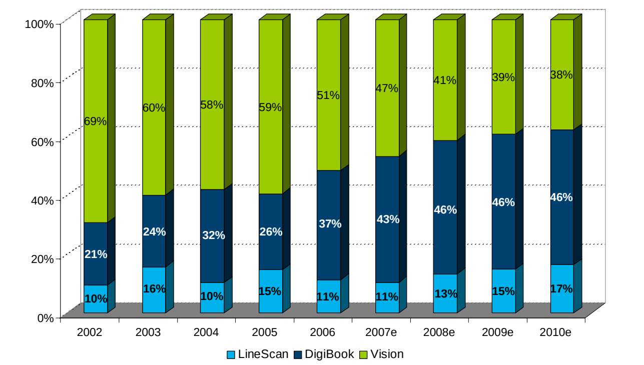
Average annual organic growth was 15.5% between 2002 and 2006. We now forecast an acceleration to 17% in 2007 and to 25% between 2008 and 2010. Sales were already up 28.5% in 1H07.

Sales (€m)



Source: company, KBC Securities estimates

Sales breakdown by activity



Source: company, KBC Securities estimates

Volatile sales likely in DigiBook and Vision

Note that because of the relatively small size of the business, the signing of new contracts or the loss of tenders can lead to significant sales volatility. While Digibook and LineScan currently have a stronger growth profile than Vision, the latter activity should see a more favourable evolution than the one we have integrated into our model.

A niche position

Although it could appear that competition from the larger specialists is fierce, we should point out that i2S is positioned on niche markets which are not targeted by the major international groups. In fact, these same groups are increasingly contacting innovative SMEs like iS2 with a view to collaborating on the development of new applications, particularly since these new products can destroy value for such groups when they replace existing offers. Finally, the company does not enter into head-to-head competition with the giants of the mass retail or the B2C markets. Rather, i2S offers made-to-measure products that generate recurrent revenues, thus creating value-added.

LINESCAN: take-off imminent

Niche market growing 25% a year

LineScan manufactures and supplies turnkey surface inspection systems used to monitor flaws in constantly-moving flat materials (high-value-added glass composites, non-woven products and plastic films). The addressable market is worth around $ 130m (a third of which is located in the US) that is growing at an annual rate of 4 to 5% in traditional materials and of 20 to 25% in new materials (source: Automated Imaging Association). Competitors on this market are scarce: the leader is the German player ISRA Vision, which is listed on the Frankfurt stock exchange (ISR). In a press release dated 26 September 2007, this company announced a steep jump in order intake in the Surface Vision division. i2S's presence on this market is still small but the number of contacts with major accounts is rising fast, usually selling standard systems that are then adapted to suit the needs of each client. Around 35% of the price is linked to raw materials and the remainder comes from the added-value components (software, quality assurance, the guarantee of an effective monitoring rate, etc). Because they are related to spare parts, maintenance and improvements to integrated software, between 10% and 12% of sales are recurring. Note that these sales generate margins that are higher than elsewhere in this division.

Selective approach to addressable markets

In order to optimise resources and the margin, management carefully selects the contracts it signs and the sectors in which it is prepared to work.

- The group has a fairly uneven profile in **the paper market**, which is stagnant and dominated by other players. Prices are in a downtrend and products contain insufficient value-added.
- So far, the group is not present on **the steel market**, although discussions are underway for a possible partnership with an Original Equipment Manufacturer (OEM).
- By contrast, the **integrated glass market** carries high value-added. Numerous visual checks are necessary, particularly for the fast-growing treated glass market (double glazing, etc). Potential clients – who include high-profile players like AFG industries and Saint Gobain – are approached by i2S's R&D arm.
- The **plastic film market** is also attractive (Celgard, GE Plastic USA), particularly the solar panel segment. These products offer very high value-added and no flaws can be tolerated.
- **Technical fabrics** is another growing market where i2S is present, particularly in the healthcare sector (Tredegar in the US and Dayuan and Yaolong in China).

Innovation makes commercial success possible

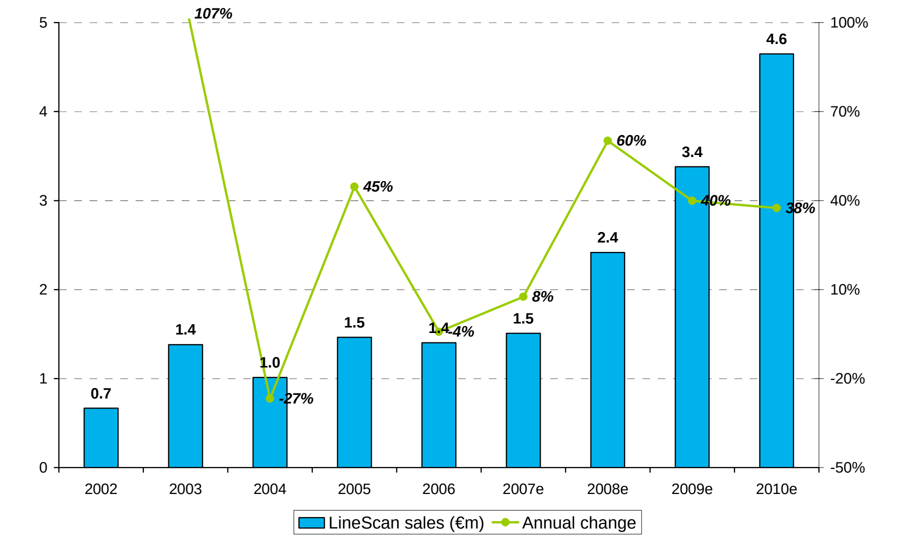
The group has built up a library of common flaws found in each type of surface. Commercial success is linked to the technical capacity of each product to respond to the client tests, geographic proximity, the lifespan of the systems, the quality of the interface with the operator and the Smart Classifier, a piece of software developed in-house that enables the user to build a personalised defect library.

Software development

The group is currently focusing its software development efforts at the area of SPC (Statistical Process Control), which has the ability to improve manufacturing procedures. The aim is to expand the offer by evolving away from quality control towards production optimisation using Artificial Intelligence (the AI covers adjustments for paper thickness, organising the fibres of a fabric, etc). Other developments are underway with 3D and multispectrum multisensors (ultraviolet, infrared, etc).

Annual average growth expected to accelerate by 35% between 2006 and 2010

Sales at LineScan division (€m, change in %)



Source: company, KBC Securities estimates

Significant potential underlined by fast-growing address book

At its inception, i2S supplied components to the vision-based quality control industry. In 2004, the company changed strategic tack and decided to address the end client directly by developing its own solutions. The first LineScan systems were installed on the premises of international clients in 2005 and proved successful. The company now has numerous contacts with major sector-leading multinationals and the number of incoming calls is increasing. In 2007, the business portfolio grew dramatically, suggesting that we can expect dynamic growth in this activity over the coming years, assisted by the group's steadily expanding knowledge base. New market share gains are significant, particularly on the glass and plastic films markets. Future business will be supported by the development of complementary products aimed at penetrating markets like solar panels (for which industry production capacity is growing fast) and technical fabrics. This widening of the offer will enhance margins because it will be based on the technological building blocks that have already been laid down for the existing activities.

An international client base

This activity is closely linked with company spending and is therefore correlated with economic cycles. However, i2S hopes to widen its geographic reach to exploit its commercial strengths in new regions, particularly Europe. The group's presence in the US over the last three years has been crucial to its commercial success so far. This is where the group's innovative offer can help clients to reach into Asian and South American markets. At the same time, the group's presence in China is a major advantage for the US clients. At the moment, i2S is still on a learning curve in China and management remains prudent about the business prospects with local clients. That said, the penetration of the Chinese market is already a reality; the group generated 4% of total sales in the region in 2006.

VISION: innovation, recurring sales and large clients

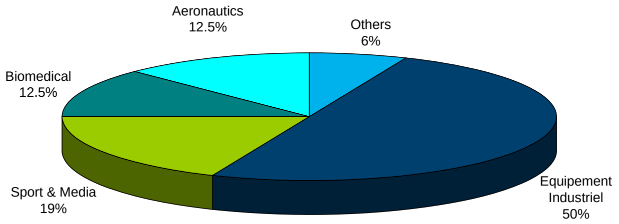
Distribution and engineering

The Vision business addresses the market for smart camera systems used to capture and analyse images in extreme conditions (sport, biomedical, aeronautics, space defence, industrial equipment, scientific organisations, etc). The activity is spread between the distribution of leading-brand components – including Sony, Matrox, Dalsa and Fujinon – and an engineering arm offering made-to-measure solutions to clients.

Expertise in each segment

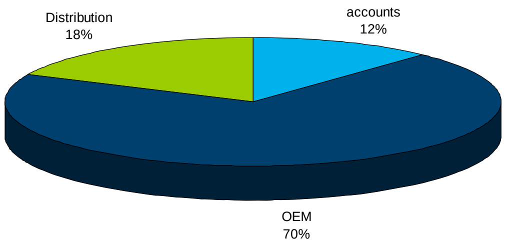
The French industrial market has been stagnating for some time and the cost-volume-based strategy does not appear to be profitable. i2S has therefore decided to steadily phase out its pure trading activity (18% of the division's sales) to focus instead on high-tech niches with marketing adjusted to suit each sector. The expertise built up with existing clients has enabled Vision to develop know-how in each segment that should enable it to pierce certain niche markets, particularly abroad. The migration is taking place some way down the value chain, with developments in software and embarked electronics.

Vision: sales breakdown by sector in 2006



Source: company

Vision: sales breakdown by client in 2006



Source: company

Biomedical

Among these growth vectors, the biomedical sector is worthy of note, particularly the biological diagnostics segment. Laboratories use imaging solutions in their analysis to ensure that repeated measurements are both rapid and accurate. In 2007, Bio-Rad, a company specialised in test design and the manufacture of diagnostics instruments took out an exclusive contract with i2S to build a new generation of reading modules for biological tests. The prototype is currently being certified and should lead to the building of 500 units a year worth around € 1.5m annually.

Aeronautics

In the aeronautics sector, i2S Vision has developed an on-board camera system for the Ariane V rocket. This solution – which offers real-time transmission and decoding of video images over extended periods in extreme conditions – has enabled the group to sign contracts for flight tests of the Airbus. These contracts do not generate recurring sales, but i2S has been making a concerted effort to concentrate on offers that *do* offer recurring effects. An example of this is the recently-signed deal with Thalès, which was already a client for the distribution of customised products. Thales is now also collaborating with i2S within the framework of the AESE pole of excellence (Aéronautique Electronique Systems Embarqués) to develop a 3D positioning system to be used in the helmets of aircraft pilots. This system should lead to series production and open up new applications and new markets (medical, video games, etc).

Industry

The automation of production lines and quality control has prompted industrial groups to install video systems allowing image analysis. i2S Vision is now supplying global equipment manufacturers with the necessary sub-assemblies. Clients in this area include MSC, a world leader in bottle inspection equipment, Lectra, a top fabric-cutting specialist, VITechnologies, an equipment supplier in the electronic cards market and more recently, the oil services leader Schlumberger. The average lifespan of this equipment is estimated at four to five years and clients tend to renew their orders. In the area of food security, i2S Vision has developed a vision system that, when linked up to an "electronic nose", can measure the freshness of fish for auction. The group is also equipping an abattoir with a tool that can classify the meat in terms of its shape, colour and weight.

Prospects

i2S's experience with large accounts and in embarked and smart vision technologies now enables it to target new, potentially lucrative markets like remote surveillance systems and transport safety. More in-depth development could prompt the company to take an interest in the morphological reconnaissance sector.

Sport and Media

Finally, i2S is present in sport and the media with a number of global projects to its credit. The group's expertise in digital vision has enabled it to perfect and commercialise solutions that have revolutionised the sporting world, the best example being photo finish imaging systems at various international events, including the Olympics. i2S has supplied its fifth generation of cameras to the Swatch subsidiary SwissTiming in a deal that is generating recurring sales. More recently, i2S has developed the "But Finish" in partnership with Canal Plus and EVS, the recording systems builder listed in Brussels. This portable system allows an accurate verification of whether a football has crossed a goal line using simultaneous real-time 2D and 3D images from four cameras capable of processing between 240 and 300 images a second. The referee has an answer in less than a minute.

Partnerships will form the basis of future activity

The But Finish project is a clear illustration of the group's strategic shift in its relationships with large-account clients. For example, the R&D for the Canal+ project was financed by the client, but i2S will be able to use the acquired expertise in other markets. If Canal+ wins the broadcasting rights for the French football league, it would aim to market the solution worldwide with i2S.

Co-engineering and co-development

In a more general sense, i2S is using these made-to-measure solutions to position itself as an indispensable partner in the client's strategy: the risk contained in the projects is thus shared, but production volumes are guaranteed, bringing in their wake recurring sales. The terms of these deals also enable i2S to use the technology on other markets, thus enabling more amortisation of R&D costs.

Different stages to achieving recurring sales

Sales visibility is based on a three-stage business model:

1- Feasibility study and prototyping

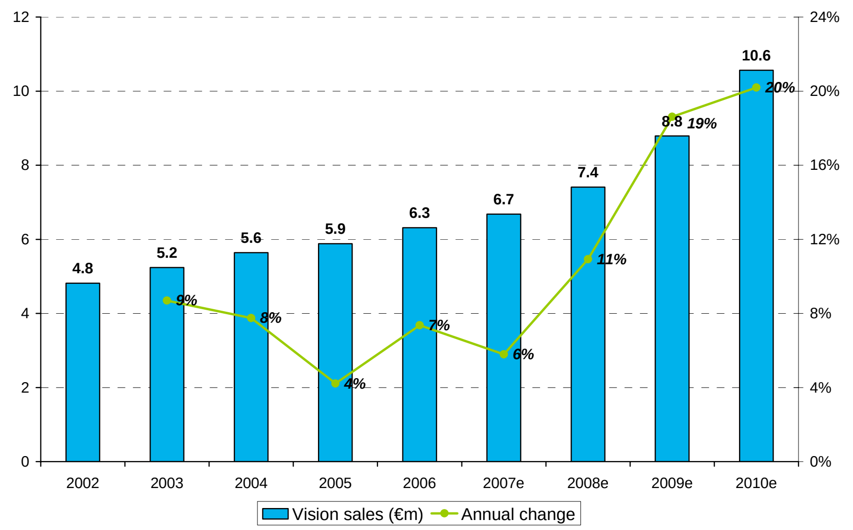
2- Launch of preproduction

3- Series production

Each stage is invoiced to the client. Any errors in the prototyping phase will become visible in preproduction or in an R&D budget overrun. In a standard contract, i2S does not charge for the initial stage, but asks clients to commit to a certain volume of orders in the following stages. The group therefore prefers not to simply sell its expertise but exploit to the full the R&D process with a view to generating recurring sales. At present, 70% of clients are OEMs with recurring sales of 36 months.

Average annual growth of 7% between 2002 and 2006 should accelerate from 2008

Vision sales (€m, change in %)



Source: company, KBC Securities estimates

A cautious scenario

Average annual sales growth for Vision was 7% between 2002 and 2006. This rate should accelerate from 2008 and in the years thereafter on the back of new projects currently in the development pipeline for new markets (on new sectors and in new geographic regions). In the interests of caution, we have not included the international commercialisation of the But Finish system in our model. We have also anticipated weak growth in pure distribution as the group focuses instead on products containing customised features developed by i2S. This could entail for example the integration of software as part of the product improvement carried out for some clients and the parallel development of a support activity. The evolution of the product mix should lift the operating margin.

i2S Vision: a mid-sized player in a fragmented market

The sheer diversity of the markets where i2S Vision is present makes it difficult to classify the group's rivals. Some players, like i2S, are present on several markets:

- Stemmer Imaging, Europe's leading specialist distributor for the vision sector with € 39.5m in sales in 2006, is active in France through Imasys. Armed with pan-European experience (Germany, Switzerland, the UK and France), the group benefits from a favourable balance of power in its relationships with manufacturers. Imasys is present in the industrial vision markets for system integrators and OEMs, in image analysis for the medical sector, in R&D and smart safety systems for road transport and in morphological reconnaissance.

- Created in 2002, Elvitec is a French distributor active in industrial vision and remote video surveillance markets. The company posted 2006 sales of € 1.8m.

- Cedip is another French player that builds and distributes infra-red cameras for industrial applications and the medical and transport sectors. The company is currently the subject of a bid from the world leader on the sector, the US player, Flir. Successful completion is dependent on approval from the competition authorities. Sales in 2006 reached € 17.5m. Market cap based on the € 19 per share offer comes to € 61m.

- Tattile is an Italian group specialised in technological vision solutions for the quality control market with sales of € 19.5m in 2006.

- Finally, Kappa opto-electronics is a German manufacturer of cameras and image processing systems. Annual sales exceed € 10m and there are subsidiaries in Toulouse and Los Angeles.

DIGIBOOK: a vast market emerges

Digitisation of bound documents

DigiBook targets the market for scanners used for the digitisation of bound and archived documents. The lion's share of the offer is for libraries and public archiving centres. The group aims to widen its focus to include project management by developing value of use for the end user.

Prestigious references

Nearly 1,000 i2S machines are now in use in 25 national libraries and in more than 300 university libraries and archiving centres across France, Europe and the US. Companies like Jouve and Safig, which are the European and US leaders in digitisation services, both use i2S equipment.

Wide product range

Around 60% of the division's business comes from Copibook products, which are mostly used by public libraries and government offices seeking to digitise their resources. With a price ranging from € 20,000 to € 30,000, CopiBook is now installed in 500 establishments. Moving higher up the product range, SupraScan generates 35% of sales from cadastral surveys, plans and large-format documents. The latter market is growing slightly. Prices range from € 30,000 to € 60,000 and there are 250 units in service. The top-of-the-range product in this division is Digitizing Line, which is built and distributed in partnership with ASSY, but only represents 5% of divisional sales. The price tag ranges from € 200,000 to € 300,000 and the product reflects the technological depth of the i2S offer.

The flagship product

In effect, the DL 3000 model can scan at record speeds of 3,000 pages an hour, making Digitizing Line a fully automated solution capable of meeting the demands of international digitisation projects. The recent unveiling of plans by global giants like Google, Yahoo and Microsoft to digitise documents and books from our global heritage have underlined the need for scanners that combine high quality with optimal productivity. Europe's largest digitisation centre, the Walck archiving centre in Alsace, is already equipped with four i2S Digitizing Line machines. This centre was set up by the French Ministry of Justice with a view to digitising cadastral registries for Alsace and Moselle in order to give on-line access for solicitors. The project was coordinated by Infotechnique, a subsidiary of Getronics and a pioneer in industrial scale digitisation.

Digitising books

Microsoft is at present the only private player to have signed a deal with a scanner manufacturer: Kirtas, a US player and a rival of i2S on this market. As for Google, it has yet to reveal the technology to be used in its project to digitise 15 million works by 2015. Numerous universities and libraries have already authorised the search giant to digitise their resources in exchange for free access to the resulting digital files. Although controversy surrounds the quality of the scanning carried out by Google, the libraries are getting unbeatable value for money. The Lausanne library, the first French language library to join the Google Book Search project, will pay virtually nothing for the digitisation of 100,000 copyright-free volumes out of two million in stock, since Google will cover transport costs, insurance and digitisation for a total cost estimated at between € 6m and € 9m. Calls for higher quality could enable i2S to gain a foothold on this market.

Digital libraries: clear potential but in what timeframe?

But i2S is pursuing other ways to penetrate this market for industrial-scale digitisation: European projects rivalling that of Google such as the French digital library or the European digital library (as part of the European Community's 7th coordinated R&D Framework Programme – aka the 7FP). However, major projects to digitise national libraries are dependent on an extremely slow political decision-making process and then an even longer wait before work actually begins in some cases. This is despite a need to scan some documents within the next 50 years, such as editions printed between 1850 and 1950 using paper containing acid. In March 2007, Jacques Chirac unveiled the plan of the European Digital Library (EDL) to digitise six million works by 2010, and two million by 2008. The French National Library (FNL) has already been granted an annual budget for this project of around € 10m. Jouve won the tender for the first 30,000 books and SAFIG won the second tender for 100,000 a year in the next three years. A digitisation facility has now been created near Paris in partnership with BancTec, a European distributor of digitisation equipment. Jouve and SAFIG will be using i2S equipment in two contracts that have so far generated € 400,000.

Although European governments are dragging their feet when it comes to allocating budgets and actually launching these projects – an example is the halting by Germany at end-2006 of the Quaero project that was destined to develop a new system for managing multimedia content – a single breakthrough could suddenly persuade other national libraries that such schemes are feasible, thus triggering a domino effect. In 2008, three national libraries (Spain, Switzerland and Germany) are expected to launch tenders and others could quickly follow in their wake (Norway, Finland, Italy, Portugal…).

A niche market

With a maximum speed of 3,000 pages an hour, Digitizing Line could digitise 90,000 works a year or 270,000 by 2010. The EDL wants to scan six million works by 2010 and needs 22 DL 3000s at € 250,000 a piece to hit the target. This implies potential sales of € 5.5m for i2S, bearing in mind that the digitisation facilities are up and running and that some of them are already using other technology. This product is therefore a niche market for i2S.

Long-term potential is not in doubt

Short-term visibility on the book digitisation market is weak, as book publishers have held back for fear that they could suffer the same problems as the music industry, which has been slow to respond to the challenges raised by digital content. In the longer term however, industrial-scale digitisation is unavoidable. In France alone, 62,527 new titles were published in 2006 and total book sales concerned 475,093 different titles.

Public and private markets: Value creation for the end-user

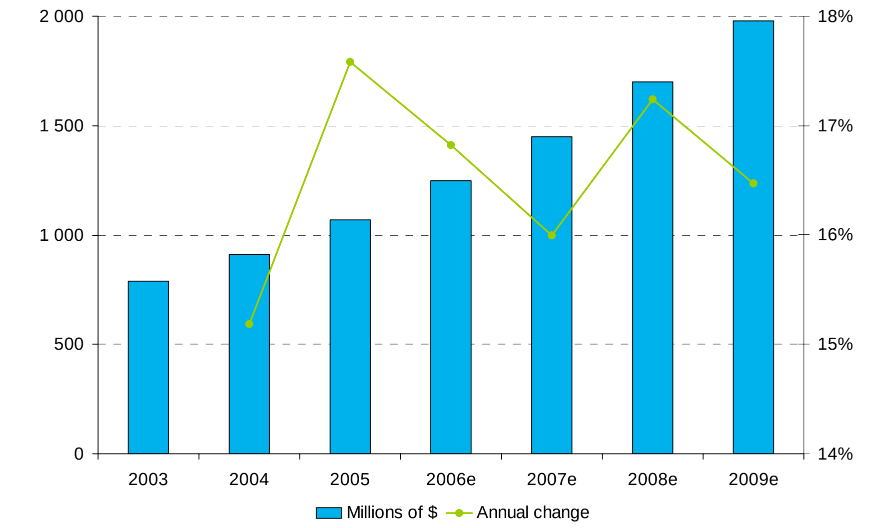
In the shorter term however, the real market is elsewhere. Digitisation facilities are sprouting up in private companies and local government. The business model appears solid since the value of use for the end user is high. The cost of digitisation is therefore justified by the value-added contained in the document (use and distribution). The group is seeking to improve the level of automation in the digitisation process in order to add value for clients, an objective that is within reach thanks to the constant enhancement of equipment and software. The increased automation – and hence the reduction in man hours – means in turn that i2S can offer very attractive prices.

The Book Restorer™

i2S has partnerships with the French publisher Pixelion, a specialist in image processing, compression and distribution and Abbyy, a Russian publisher of character recognition software (OCR) used in the DL 3000. But the group also develops software in-house to boost the value added of its equipment. Book Restorer™ is a perfect example of this search for quality and productivity gains. The software optimises the management of digital documents (consultation, saving, publication and restoration) and includes external modules that enable pre-determined or constant automation as well as control over the quality of the restoration.

Annual average growth of 16%

World market for document scanning software

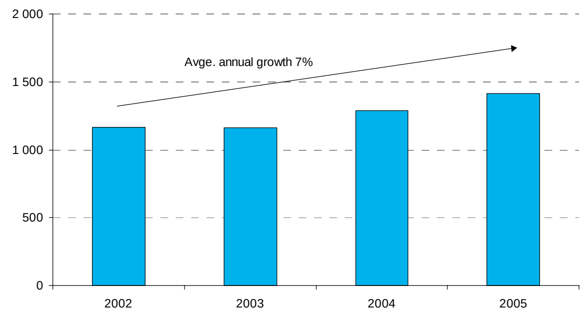


Source: Harvey Spencer Associates, 2006

Absorb value added in equipment

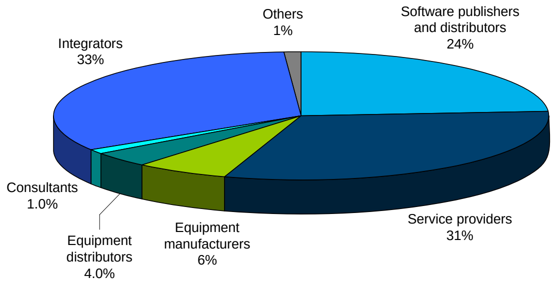
Around 20% of the budget in a digitisation facility is spent on equipment and the remainder on labour. The FNL offers a good example. With an overall budget of € 9m for the digitisation of 100,000 books, only € 600,000 was allocated to scanners. Another example is the Walck digitisation centre where the overall budget was € 45m but only € 1.2m went on i2S scanners and more than 50% was for labour. i2S hopes to integrate part of this labour cost into the equipment, enabling it to reduce the client's overall cost and thus increase its own prices. Increasing the level of automation in the digitisation process is essential if this objective is to be achieved.

Evolution of EDM in France (€m)



Source: IDP / Archimag

Breakdown of EDM market



Source: IDP / Archimag

Partnerships are necessary

These budget priorities mean that specialists in document digitisation like Jouve, Europe's leader in industrial-scale scanning, need to offer cheaper, simpler but nevertheless efficient solutions. The use of i2S products could be the answer, enabling the company to consolidate its partnership-based strategy and move away from a pure equipment supplier model.

Valorising our cultural heritage

A partnership is already in place between i2S and Arkhênum, another specialist in the digitisation of ancient works, in which i2S holds an 18% stake. A project to digitise 50,000 manuscripts in Timbuktu (Mali) is underway, representing a total of 4 million pages. The scanning is scheduled to start in November 2007. i2S hopes to strengthen the partnership with Arkhênum as part of its drive to raise its profile as a service provider.

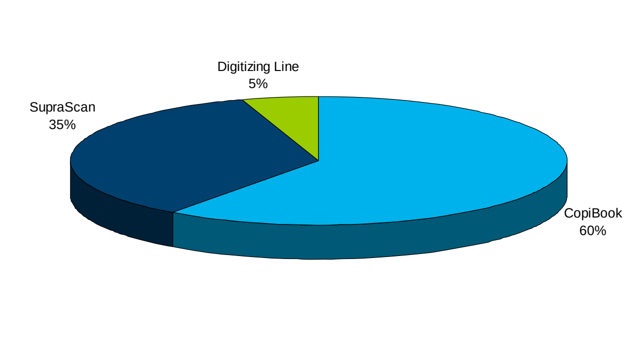
Promising trends but uncertain development pattern

Trends on the document digitisation market are not yet clearly defined. On the one hand, some companies and government bodies are internalising their digitisation procedures. Gazprom for example previously outsourced the digitisation of its archives and documents but the company has now signed a € 1.8m contract with i2S for 100 Copibooks as part of a drive to meet its digitisation needs in-house. i2S's automation software and user-friendly interface make this possible. Alongside this phenomenon, industrial scale digitisation centres are appearing in Europe. Sometimes these are for single clients (Walck for the administration and Kirtas for Microsoft in the US) but they can also be available for sub-contracting work provided volumes are high enough. A third development path is also open: that of mobile digitisation facilities, which can be temporarily set up on the client's premises, a method already used by Arkhênum. i2S is mulling a shift towards becoming a project manager, even at the risk of upsetting its relationships with intermediate partners, who currently act as middlemen between i2S and the end client (and who account for 7% of sales). It would appear however that no final decision has been made on this point.

i2S's rivals are not the global giants like Kodak and Canon, who provide scanners for the mass EDM (Electronic Document Management) market, but rather the manufacturers of scanners for professional applications. On these markets, the competitors include:

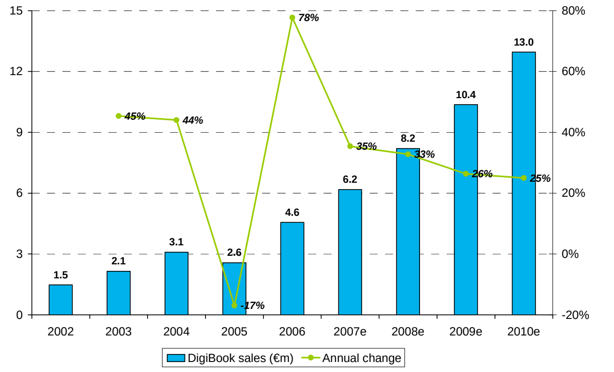
- Zeutschel, a German company active for 40 years that played a role in the development of microfilm and then adapted its offer to include digital scanners. We have no financial data.
- Image Access, created in 1993, employs 75 staff including around 30 in R&D. The company is present in the US and Germany. Its subsidiaries DLSG (Digitize Library Systems Group) and BookEye are both active on i2S's markets.
- Kirtas is an American company that competes primarily against i2S's Digitizing Line product for enabling industrial-scale digitising. The company's profile has risen since the signing of a partnership with Microsoft for its Live Book Search project, which is rivalling the Google Book Search. In Europe, Kirtas products are distributed by BancTec, which has just been strengthened by a private capital injection of $385m.
- Atiz Innovation is another US company present on the digital scanner market.

Breakdown of 2006 DigiBook sales by product



Source: company

DigiBook sales (€m, change in %)



Source: company, KBC Securities estimates

Numerous growth drivers and a conservative scenario

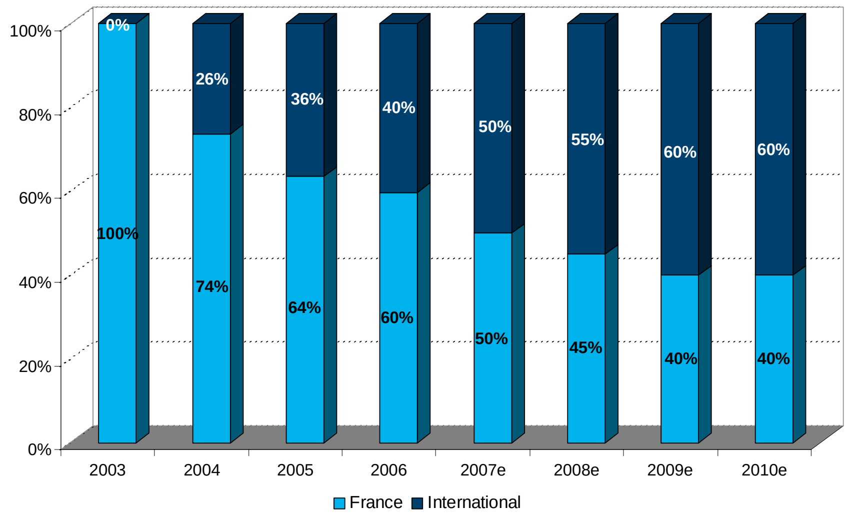
The peak in activity and the relative drop in 2005 were caused by the opening of the La Walk digitisation facility. The strong growth in 2006 was driven by the launch at the 2005 CEBIT trade fair of the new CopiBook, which is the first scanner capable of high-quality scanning in ambient light. The annual average growth between 2002 and 2006 was 32%. We expect this rate to slow from 2007 and over the coming years to a still-respectable 30%. The main growth drivers are the numerous tenders underway launched by national libraries, the strong performance of the distribution network abroad, the renewal of the SupraScan range and the growth of the service offer. Note also that an opportunity could emerge on the market for public scanners that will replace hundreds of obsolete book copiers and microfilm duplicators in libraries across France and around the world. This would generate recurring sales on a per-scan basis. Given the size of the installed base, the potential of this market is two or three times greater than that of the digitisation projects at national libraries in terms of the number of machines required, with the added advantage of being clearly identified. But in the interests of caution, we have not integrated this scenario into our forecasts.

The international activity

Present in the US and China since 2003

The proportion of sales generated outside France should continue to grow steadily thanks to the opening of the American and Chinese hubs in 2003. The development of the US subsidiary dedicated to LineScan and the company's positioning on tenders for foreign libraries is supporting this positive trend. France represented 60% of sales in 2006 against 40% for the international activity, but we expect this ratio to be reversed by 2009.

Geographic sales breakdown



Source: company, KBC Securities estimates

Development of the distribution network

In 2005, the launch of the LineScan activity in the US and China triggered an increase in the proportion of international sales. In 2006, the ramp-up of sales of the new range of CopiBook scanners explained part of this international growth, thanks in particular to a good performance by the distribution network. In 2006, DigiBook realised 75% of its sales through exports and LineScan 90%. The group plans to develop its activities not only in Europe, the US and China, where it is already present, but also in Japan and South East Asia, in South America and Eastern Europe. i2S has also recently supplied Gazprom with 100 digital scanners. Through its numerous distribution agreements, DigiBook is present in 25 countries. The distributors are rigorously selected according to their ability to integrate software into the equipment and offer value-added services.

Currency risk

In 2006, 92% of sales were invoiced in euros. The remainder is hedged against the risk of adverse €/$ fluctuations. Note also that 80% of purchasing is carried out in euros, offering a natural hedge against currency risk. According to management, a +/- 1% fluctuation in the €/$ exchange rate can have an impact of +/- €10,000 on sales and +/- € 19,000 on purchasing.

Steady margin improvement

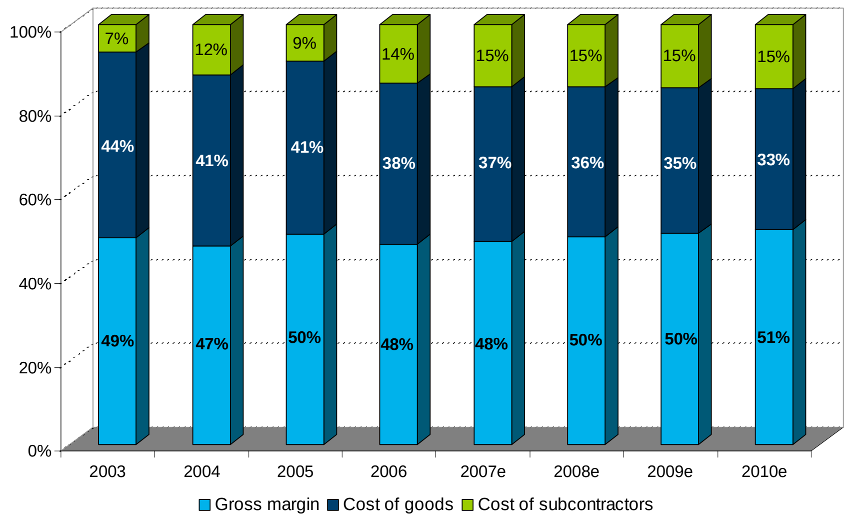
Favourable evolution of the product mix

Cost of purchasing relative to sales set to drop

Until 2002, the lion's share of i2S's business consisted of distributing standard electronic and optical components that had been enhanced to meet client needs. Since then, the group has been developing its own solutions, thus taking it closer to becoming a fully-fledged systems developer and manufacturer. Most of the margin improvement will come from the favourable shift in the product mix towards i2S's own products as the distribution activity is wound down. This change in the mix should lead to a reduction in purchasing costs relative to sales.

Component purchasing costs are safeguarded by sourcing from several different suppliers. At 30 June 2007, the group's main supplier accounted for only 8.6% of purchasing. The company is keen to spread the load in this way and reduce its dependence on suppliers. Management is currently looking into the possible gains from making certain components in the dollar zone or South East Asia. The LineScan systems are already assembled in the US.

Gross margin (% of production)



Source: company, KBC Securities estimates

Outsourcing increases flexibility

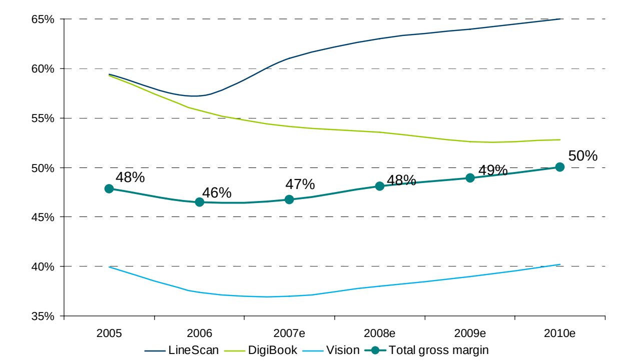
i2S uses a "fabless" economic model, meaning that non-critical parts of production are outsourced, offering the company flexibility and reactivity in the event of an unexpected order book slowdown.

A pole of excellence

The so-called "route des lasers" in the Aquitaine basin is a web of optical specialists that limits the risk of component shortages or quality issues. One of i2S's strengths is its close links with local subcontractors specialising in optical mechanics (Novalase, 7**%** of production purchasing), mechanics (IDT, 10%) and electronics (Sinergy, 5%). i2S's "industry" department oversees the entire manufacturing process from conception to delivery. The company's in-house workshop is responsible for making components that contain the group's expertise: for example the digitisation heads for the Copibook products. The outsourcing can at times lead to the creation of capitalistic partnerships, as it has with Assy, a Swiss company that developed the automatic page-turning machine used by Digitizing Line and in which i2S has a 33% stake.

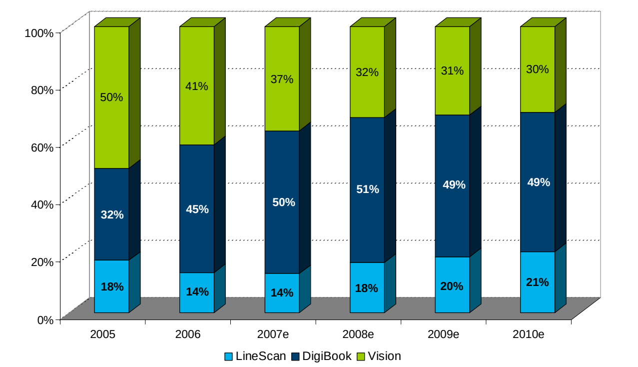
Outsourcing should either remain stable relative to sales, or increase slightly as LineScan and CopiBook expand their share of overall activity. By its flexibility, the use of subcontractors offers a safety net in the event of a slowdown in activity. However, the group's sustainable growth could make it possible to set up a structure with a higher proportion of fixed costs, which would in turn strengthen the operating margin. There are no plans to switch all assembling to Chinese service providers.

Overall gross margin by activity (% sales)



Source: company, KBC Securities estimates

Contribution to gross margin by activity



Source: company, KBC Securities estimates

On 30 June 2007, the gross margin (after purchasing and outsourcing costs) was 57% for the Digibook activity and 70% for LineScan. It reached 38% in the Vision activity, where distribution remains important, with pure trading offering a maximum margin of 40%, the reselling of standard or adapted products to OEM networks offering margins of around 25%, and a growing share for specific products with margins in excess of 50%. Note that we are predicting a downtrend in the gross margin for the DigiBook due to a negative volume effect on the average price of units sold as part of large orders.

Flexibility and visibility

Six months of visibility

Good visibility means that management usually has a fairly clear idea of where year-end sales will land by July. This makes it possible to adjust charges (thanks in particular to the use of subcontractors) and thus post at least a breakeven result. This ability to see ahead is the fruit of i2S's long experience in analysing the order book and the business portfolio.

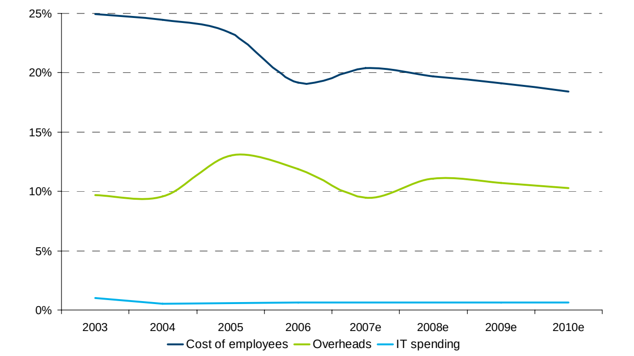
Absorbing payroll costs…

Both the size of the workforce and the average salary have risen in 2007 after the recruitment of a top-flight sales manager, an engineer and an administrative and financial director. This will increase the ratio of payroll costs to sales, but the trend should be reversed from 2008, despite higher recruitment, thanks to lower average salaries, reflecting the strengthening of the sales force. Note that experienced engineers are in high demand but the company's market listing will enable it to offer stock options (estimated at 2 to 3% of the capital) that should make it easier to attract and hold on to them.

… and overheads

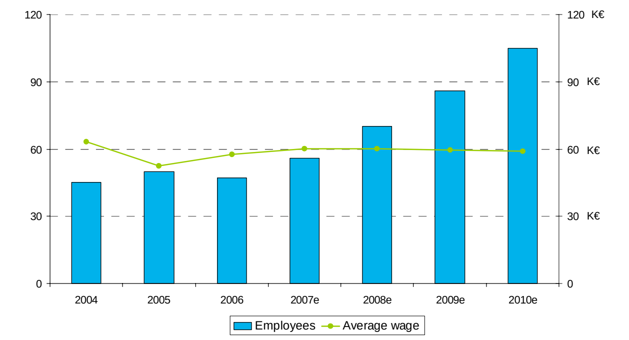
Finally, partially fixed overheads should also diminish relative to sales. In 2005, this budget increased from around 1% to 2% of sales due to a stronger effort in marketing and communication. The higher rate was maintained in 2006.

Payroll costs and overheads



Source: company, KBC Securities estimates

Workforce and average salary



Source: company, KBC Securities estimates

R&D: the backbone of the company

Technological expertise has formed the backbone of the group's growth over the last 25 years: 19 patents have been filed and five are in force today. The track record of world firsts speaks for itself:

Technological innovations

Dates	Events and description
1985	The first images of the wreck of the Titanic using an acoustic transmission
1996	First colour photo finish system at the Atlanta Olympic Games
2000	Digitisation of the Gutenberg bible
2004	Equipped Europe's first large-scale digitisation centre (La Walck)
2005	Cameras embarked on Ariane V rocket
2005	The CopiBook ambient light scanner
2006	The world's fastest scanner: the DL 3000 high-speed automatic scanner
2007	The But Finish system with Canal+

Source: company

Recognised technological expertise…

The R&D division contains about 15 highly-qualified engineers with expertise in optics, electronics, computing and mechanics. The recognition accorded to the division is illustrated by the company's presence in a number of large-scale projects both in French poles of excellence (the AESE and the "Route des Lasers"), and in Europe, with the push to develop digital libraries as part of the EU's 7th joint R&D framework programme (the FP7).
Within the framework of the "Route des Lasers", i2S was selected along with two CNRS (the French centre for scientific research) laboratories to carry out a feasibility study for the digitisation of closed books (TeraBook). i2S is also working alongside Thalès within the AESE on the PLUS project (a 3D positioning system to be integrated in the helmets of aircraft pilots). Finally, i2S is one of 40 SMEs selected by OSEO Innovation as favoured candidates for bidding in tenders flowing from the FP7. This prompted i2S to set up a European consortium and propose a project (DILBAERT) to develop technologies that can enhance scanned data with a view to making it available on-line later. This € 3.4m project is at the top of the second list (in 12th place and the top-placed SME out of 150 bids in total), with a grade of 13.5 out of 15. The company is therefore in with a chance of winning the tender.

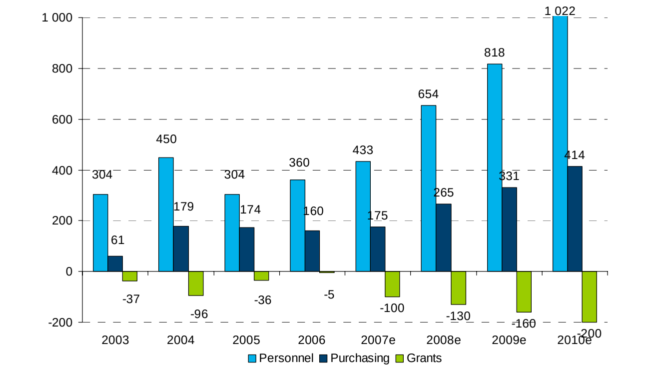
… at the service of the client

The R&D division targets areas that can enhance value for the client and that will strengthen i2S's commercial offer. This ability to add value for the client is a way of enhancing i2S's value in the longer term, which is why the R&D department works in close collaboration with the sales teams, and in particular the Business Development Manager in each of the company's three divisions.

A net R&D budget at 4.4% of sales

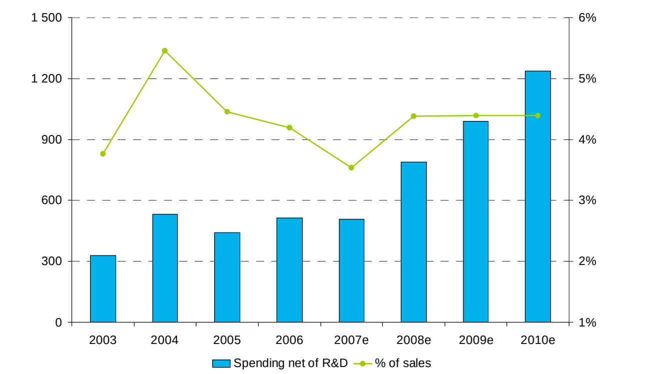
The R&D budget amounted to around 11% of sales in 2006, of which 6.8% was linked directly to and financed by contracts with clients. These contracts are bundled agreements: around 15% of i2S's R&D costs are covered by the client. In addition to tax-free grants offered to innovative companies by the government funding body OSEO (that must be reimbursed by i2S according to the level of sales), the group also benefits from so-called "dry" subsidies, which are booked as income from operations and are subject to VAT and corporate tax. These subsidies are granted by local government and are dependent on participation in large-scale projects (as part of a pole of excellence or the FP7 for example).

R&D (€ '000s)



Source: company, KBC Securities estimates

R&D spending net of subsidies (€ '000s/%sales)



Source: company, KBC Securities estimates

Simplified earnings statement

Earnings statement: KBC forecasts (€ '000s)

	2005	2006	S1 2007	2007E	2008E	2009E	2010E
Sales	9,917	12,277	7,290	14,365	18,028	22,535	28,168
Annual change	*1.4%*	*23.8%*	*28.0%*	*17.0%*	*25.5%*	*25.0%*	*25.0%*
Gross margin	**4,741**	**5,707**	**3,404**	**6,719**	**8,673**	**11,022**	**14,091**
As % of sales	***47.8%***	***46.5%***	***46.7%***	***46.8%***	***48.1%***	***48.9%***	***50.0%***
Overheads	1,291	1,460	665	1,365	2,001	2,411	2,901
As % of sales	*13.0%*	*11.9%*	*9.1%*	*9.5%*	*11.1%*	*10.7%*	*10.3%*
Payroll costs excl. R&D	2,316	2,353	1,439	2,930	3,551	4,304	5,183
As % of sales	*23.4%*	*19.2%*	*19.7%*	*20.4%*	*19.7%*	*19.1%*	*18.4%*
R&D net of grants	442	515	258	509	789	989	1,237
As % of sales	*4.5%*	*4.2%*	*3.5%*	*3.5%*	*4.4%*	*4.4%*	*4.4%*
EBITDA	**522**	**1,199**	**923**	**1,700**	**2,061**	**2,980**	**4,348**
As % of sales	***5.3%***	***9.8%***	***12.7%***	***11.8%***	***11.4%***	***13.2%***	***15.4%***
Amortisation and provisions	336	235	277	461	273	346	411
As % of sales	*3.4%*	*1.9%*	*3.8%*	*3.2%*	*1.5%*	*1.5%*	*1.5%*
EBIT	**207**	**970**	**646**	**1,273**	**1,788**	**2,634**	**3,937**
As % of sales	***2.1%***	***7.9%***	***8.9%***	***8.9%***	***9.9%***	***11.7%***	***14.0%***
Financial result	-46	-46	-35	-62	-55	-20	41
Tax	53	237	217	312	501	814	1,326
Net profit	**108**	**687**	**427**	**899**	**1,232**	**1,799**	**2,652**
As % of sales	***1.1%***	***5.6%***	***5.9%***	***6.3%***	***6.8%***	***8.0%***	***9.4%***

Source: company, KBC Securities estimates

Change in the accounting method

Amortisation and provisions will be subject to a temporary change in accounting rules in 2007, when charges relating to the US subsidiary will be booked as fixed financial assets and then immediately depreciated. In previous years they were recorded as overheads. This will lead to abnormally high provisions and an equivalent improvement in Ebitda. Our forecasts do not integrate a repeat of this phenomenon in 2008, when the charges will be recorded at the Ebitda level.

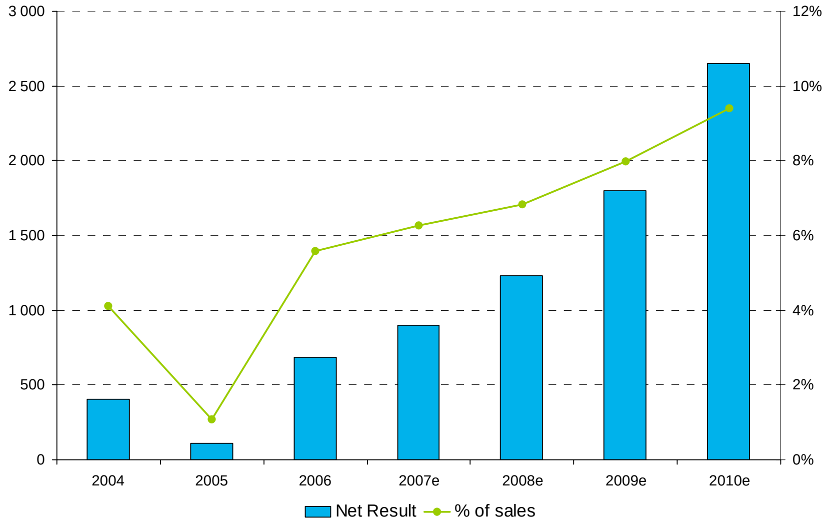
Financial assets

The financial result should improve steadily as net debt shrinks. Since we do not expect the group to resort to factoring, we have not integrated payments made to the factoring company from 2008.

Tax credit for R&D

Finally, tax rates are estimated at a normative rate of 33.6%, minus a tax credit that will gradually shrink to zero in 2010. We believe this is a very cautious hypothesis given the € 173,000 tax credit linked to R&D in 2006.

Net profit in € '000s and as % of sales



Source: company, KBC Securities estimates

The net margin should also improve steadily from 5.6% in 2006 and 5.9% in 1H07 to 9.4% in 2010.

Investment and use of proceeds

A healthy balance sheet

The balance sheet shows a positive cash position at end 1H07 of € 659,000, down € 59,000.

Balance sheet at 31 December and 30 June 2007 (€ '000s)

	2003	2004	2005	2006	1H07
Net fixed assets	332	363	344	315	377
Stocks	670	876	903	1,272	1,362
Receivables	806	865	1,451	1,445	1,843
Other receivables	1,615	1,432	1,202	1,689	1,532
Other active assets	41	68	95	172	232
Cash position	548	838	621	719	659
Total assets	**4,011**	**4,441**	**4,617**	**5,613**	**6,005**
Shareholder equity	2,062	1,741	1,838	2,524	2,187
Provisions for risk and charges	155	159	138	139	194
Financial debt and others	171	367	249	572	803
Suppliers	862	1,186	1,444	1,639	1,626
Other liabilities	762	988	948	738	1,194
Total liabilities	**4,011**	**4,441**	**4,617**	**5,613**	**6,005**

Source: company

A lease of € 1m

In order to gain an accurate appreciation of the financial structure, some adjustments were necessary. The group currently has a 15-year lease on a building in Pessac. The contract was signed on 4 November 2002 and the property is valued at € 1,579,000 with a sale price fixed at € 1. We include the net value of this asset under assets and under liabilities we integrate a financial debt of € 1,003,000 in 2006.

Less factoring in 1H07

The group also uses factoring for some of its receivables, all of which are recorded as "other receivables". A proportion of this is subject to a short-term financial debt owed to the factoring company. On 30 June 2007, i2S had access to € 1,536,000 through this facility but it had only used € 90,000 and still has outstanding liquidity of € 314,000. Almost all sales come from large account clients, so the risk of insolvency is very small. Note also that with international clients, receivables are guaranteed up to 90% with the factoring company Coface. At end-2006, we estimate that clients took 76 days to pay on average, down from 88 in 2005. We estimate 78 days in 2007 which we take to be a normative rate. We have not integrated factoring into our forecasts for next year or beyond.

A current account with Assy recorded in other receivables was fully depreciated in 2005 and 2006 for € 167,000 before being reclassified as a fixed financial asset. The arrangement might be renewed at a later date if ASSY sees business and profitability pick up, as already looks likely. Another current account established with the holding mother-company Cofintech for € 488,000 was reintegrated as part of the reverse merger which saw i2S buy Cofintech.

i2S merges with mother-company Cofintech

In order to simplify its legal structure, i2S acquired its mother company Cofintech, whose most important asset was i2S shares. This operation created no significant change in the structure of individual shareholders.

Adjusted balance sheet at 31 December and 30 June 2007 (€ '000s)

	2005	2006	1H07	2007E	2008E	2009E
Net fixed assets	1,415	1,318	1,309	1,321	1,307	1,274
Stocks	903	1,272	1,362	1,466	1,869	2,365
Receivables	2,854	3,045	3,065	3,194	4,018	5,032
Other receivables	148	524	84	418	528	663
Other active assets	95	172	232	285	358	447
Cash	621	719	659	802	1,060	1,617
Total assets	**6,036**	**7,050**	**6,712**	**7,485**	**9,140**	**11,397**
Shareholder equity	1,838	2,524	2,187	2,660	3,591	4,991
Provisions for risk and charges	138	139	194	197	217	247
Financial debt and others	1,668	2,010	1,738	1,735	1,700	1,622
Suppliers	1,444	1,639	1,626	1,867	2,344	2,929
Other liabilities	948	738	966	1,027	1,287	1,608
Total liabilities	**6,036**	**7,050**	**6,712**	**7,485**	**9,140**	**11,397**

Source: company, KBC Securities

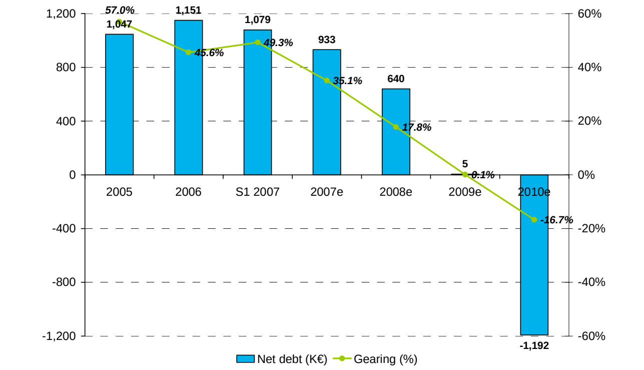
Gearing de 49.3%

After adjusting for the € 932,000 lease and the factoring, gross debt stood at € 1.74m at end-1H07 and net debt was € 1.08m, with gearing of 49.3%. The debt breaks down as € 550,000 from the banks at an average fixed rate of 5.15%, advance payments from Coface worth € 182,500 and an advance payment of € 70,000 from OSEO ANVAR. Excluding the lease, € 151,000 of this debt is due for reimbursement in less than 12 months.

Normative WCR estimated at 18.8%

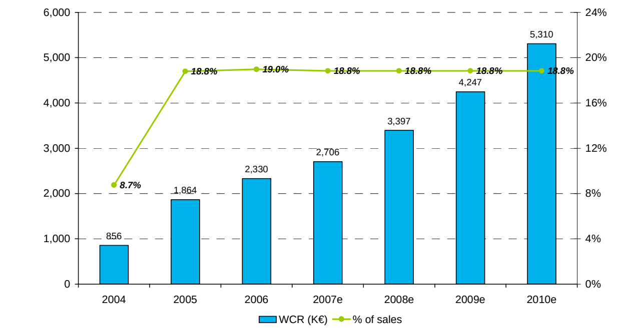
The gross WCR was 19% of sales in 2006. Assuming a seasonal peak of activity in the fourth quarter, our forecasts assume a normative WCR of 18.8%. Note that the € 488,000 receivable from Cofintech that was cancelled in 1H07 is not included in our 2006 calculation. We do however integrate in the WCR the current account liability relating to the tax integration of Cofintech.

Net debt and leverage (€ '000s /% of sales)



Source: company, KBC Securities estimates

Gross WCR (€ '000s /% of sales)



Source: company, KBC Securities estimates

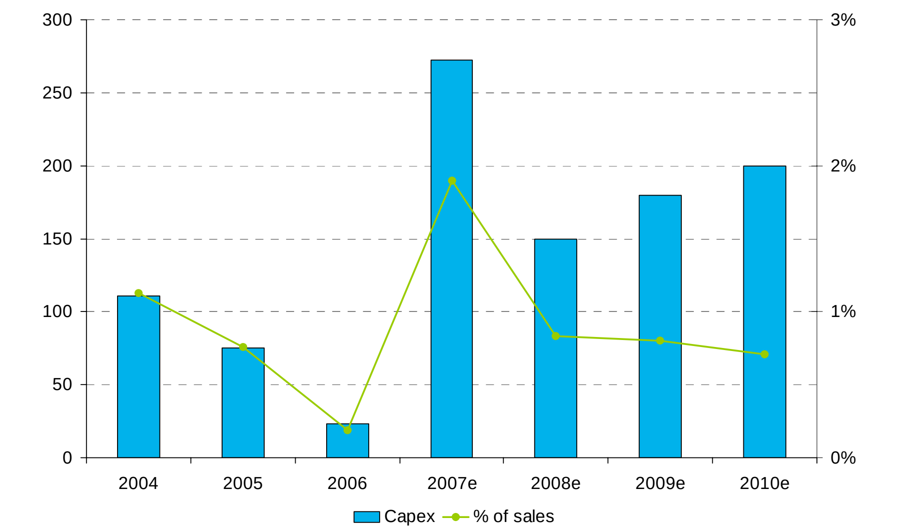
Investment and external growth

Low capital intensity

Investment since 2004 has mostly been targeted at computing equipment and the filing of patents. We estimate the spending at 0.7% of sales on average. To this, we add another € 150,000 for a one-off recapitalisation in 2007 required to revitalise the business of i2S Inc in the US. i2S Inc is not consolidated at present so this investment will be classified as a fixed financial asset. But from 2008, our forecasts will show i2S Inc as fully integrated.

The recapitalisation of the US subsidiary will allow the group to set up a demonstration platform, acquire a spare parts inventory and strengthen the existing team.

Net investment (€ '000s, % of sales)



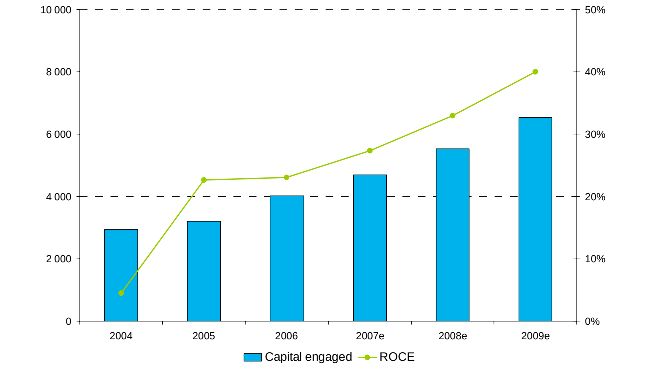
Source: company, KBC Securities estimates

Note that R&D is not booked as an asset but as a charge. Our scenario does not include financing for the setting up of JVs, even though several opportunities exist. Indeed, creating the ability to seize such opportunities is one of the justifications for the capital increase that will accompany the IPO.

Profitability set to improve

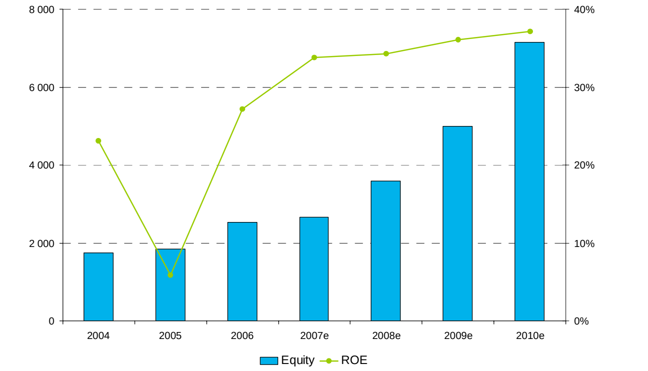
We expect a continued strengthening of ROCE and ROE.

Economic assets in € '000s and ROCE



Source: company, KBC Securities estimates

Shareholder equity in € '000s and ROE



Source: company, KBC Securities estimates

External growth

In our view, the fund-raising exercise points to probable face-value acquisitions without creating new shares, thereby avoiding the risk of dilution for the existing shareholders. Such operations could take place in any of the group's three core activities in order to fill out the offer, but we expect management to target the software and services segments as well as activities that can consolidate geographic market share in Europe and the US.

Capable of managing growth

The arrival at end-2006 as Chairman of the Board of Jean-Pierre Gerault – who has extensive management experience in global-scale companies like Xerox and Guilbert – reinforces our confidence that the company is capable of managing a steep ramp-up of activity and integrating newly-acquired companies.

Pre-money pre-discount valuation

Using the DCF method

Our detailed forecasts cover the 2007 to 2010 period. We then fix our assumptions as normative from 2010 to 2016. These calculations show a marked slowdown of growth at 5% until 2016, from when we use an infinite growth rate of 2%. The normative cash flow margin is set at 10.2% from 2010, with the WCR and investment are respectively 18.8% and 0.7% of sales.

DCF (€ '000s)

	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Sales	**14,365**	**18,028**	**22,535**	**28,168**	**32,393**	**35,633**	**37,414**	**39,285**	**41,249**	**43,312**
Annual change	*17%*	*26%*	*25%*	*25%*	*15%*	*10%*	*5%*	*5%*	*5%*	*5%*
Cash flow	**1,300**	**1,360**	**1,987**	**2,879**	**3,311**	**3,643**	**3,825**	**4,016**	**4,217**	**4,428**
As % of sales	*9.1%*	*7.5%*	*8.8%*	*10.2%*	*10.2%*	*10.2%*	*10.2%*	*10.2%*	*10.2%*	*10.2%*
Change in WCR	**810**	**691**	**850**	**1,063**	**797**	**611**	**336**	**353**	**370**	**389**
Investment	**272**	**150**	**180**	**200**	**230**	**253**	**266**	**279**	**293**	**308**
As % of sales	*1.9%*	*0.8%*	*0.8%*	*0.7%*	*0.7%*	*0.7%*	*0.7%*	*0.7%*	*0.7%*	*0.7%*
Free Cash Flow	**217**	**519**	**957**	**1,616**	**2,285**	**2,779**	**3,223**	**3,384**	**3,554**	**3,731**
Discounted cash flows	195	417	688	1,043	1,321	1,439	1,496	1,408	1,325	1,247
Discounted cash flows	**10,578**	44%								
Terminal value	**13,264**	56%								
Enterprise value	**23,843**									
Net debt 1H07	**1,079**									
Financial assets and others	**196**									
Shareholder equity	**22,960**									

Source: KBC Securities

Estimated WACC of 11.6%

Cash flows are discounted at a WACC of 11.6%. This calculation is based on a risk-free rate of 4.5%, a risk premium of 3.5% and a relatively high beta of 3. Assuming an ROE of 15% coupled with average gearing of 43%, we obtain the above-mentioned WACC of 11.6%.

Shareholder equity of € 22.96m

We obtain an EV of € 23.9m, of which 56% can be attributed to the terminal value. Adjusted for net debt at end-June 2007 of € 1.08m and the financial assets, the market value of shareholder equity comes to **€ 22.96m**.

Capitalistic holdings valued at book value

The financial assets – stakes held by i2S in other companies – are integrated according to their book value. The group holds:

- 33% in Assy, the Swiss company that developed the automatic page-turner used in the Digitizing Line
- 18% in Arkhênum, a service provider specialised in the digitisation of antique works and a client of i2S
- 25% in AIG, a group containing four companies (including i2S) based in the Aquitaine region that bids jointly for tenders launched by one of the region's leading project initiators.

The table below highlights the valuation's high sensitivity to the WACC:

Sensitivity table by DCF (infinite growth rate / WACC)

	Average weighted cost of capital						
Infinite growth rate	10.1%	10.6%	11.1%	**11.6%**	12.1%	12.6%	13.1%
0.5%	25,636	23,926	22,388	**20,997**	19,734	18,584	17,533
1.0%	26,538	24,706	23,066	**21,589**	20,255	19,043	17,938
1.5%	27,545	25,572	23,815	**22,241**	20,824	19,542	18,379
2.0%	**28,676**	**26,539**	**24,646**	**22,960**	**21,450**	**20,089**	**18,859**
2.5%	29,957	27,625	25,575	**23,759**	22,141	20,690	19,384
3.0%	31,419	28,855	26,618	**24,650**	22,908	21,354	19,962
3.5%	33,102	30,258	27,798	**25,652**	23,764	22,091	20,600

Source: KBC Securities estimates

Valuations ratios and comparables

Due to the diversity of the group's activities, it has been difficult to find sufficient comparable listed peers.

Cedip

We have however been able to make a comparison based on recent M&A activity in value-added cameras based on the takeover bid by the US company Flir for the French infra-red camera maker Cedip.

i2S valuation based on comparison with Cedip

	2007E	2008E	2009E	Valuation i2S
Capitalisation Cedip (€ '000s)	61,038			
PER Cedip	**22,7**	**19,3**	**16,9**	**24,833**
Estimated net profit growth Cedip	29%	18%	14%	
Estimated net profit growth i2S	31%	37%	46%	
Net debt Cedip (€ '000s)	-17,044	-18,611	-21,457	
Enterprise value Cedip (€ '000s)	43,994	42,427	39,581	
EV/sales Cedip	**2.2**	**1.8**	**1.6**	**32,927**
EV/EBIT Cedip	**11.8**	**9.7**	**7.9**	**17,067**
EBIT margin Cedip	18.7%	19.1%	19.8%	
EBIT margin i2S	8.6%	9.9%	11.7%	
Valuation i2S	**21,614**	**24,363**	**28,851**	**24,943**

Source: Bloomberg, KBC Securities estimates

If we apply Cedip's ratios to i2S we obtain a valuation of **€ 24,9m**. Note that i2S is posting faster profit growth than Cedip, even though its operating margins are weaker.

Sample of S&M caps with fast-growing profitability

We have also drawn up a sample of companies listed on the CAC M&S 190 who all have similar profit growth profiles to i2S. A comparison with the ratios of 19 of these companies, for which average annual EPS growth over the 2006-2009 period ranges from 25% tot 40%, yields a **valuation for i2S of € 20.2m**.

Peer valuation based a sample with similar profitability trends

	2007E	2008E	2009E	Valuation i2S
PER	**23.4**	**16.7**	**14.0**	**22,285**
Average EPS growth	44.1%	38.0%	18.8%	32.2% (avge. 2006/09E)
i2S net profit growth	31%	37%	46%	37.9% (avge. 2006/09E)
EV / sales	**1.6**	**1.2**	**1.0**	**21,735**
EV/ EBITDA	**10.4**	**7.7**	**6.3**	**16,961**
Avge. EBITDA margin of sample	14.8%	16.0%	17.0%	,
i2S EBITDA margin	11.8%	11.4%	13.2%	,
EV / EBIT	**15.2**	**10.8**	**8.6**	**19,749**
Avge. EBIT margin of sample	10.1%	11.5%	12.6%	,
i2S EBIT margin	8.6%	9.9%	11.7%	,
				,
I2S valuation	**19,393**	**18,760**	**22,395**	**20,183**

Source: Bloomberg, KBC Securities estimates

The combination of these comparisons gives an average valuation of **€ 22.5m**.

The average of all our valuation methods gives € 22.7m, or € 16.9 per share, and € 15.7 on a diluted basis, when we take into account 100,000 share warrants at an exercise price of € 1.7.

Assuming a capital increase will create 361,600 new shares, the total number of shares (including the share warrants) will increase to 1,807,054. **Based on an IPO price of € 12 per share**, the post-money valuation comes to € 27.1m, or € 15.9 per share and € 15 on a diluted basis. **The discount is 20%, implying upside potential of 25%.**

KBC Securities

Financial data

Income statement (€ m)	2005	2006	2007E	2008E	2009E	2010E
Sales	9.9	12.3	14.4	18.0	22.5	28.2
COGS	-5.2	-6.6	-7.6	-9.4	-11.5	-14.1
Gross profit	4.7	5.7	6.7	8.7	11.0	14.1
Operating costs	-4.6	-4.7	-5.5	-6.9	-8.4	-10.2
Other income & costs	0.0	0.0	0.0	0.0	0.0	0.0
EBIT	0.2	1.0	1.3	1.8	2.6	3.9
Net interest	0.0	0.0	0.0	0.0	0.0	0.1
Other non-operating	0.0	0.0	0.0	0.0	0.0	0.0
Pre-tax earnings	0.2	0.9	1.2	1.7	2.6	4.0
Taxes	-0.1	-0.2	-0.3	-0.5	-0.8	-1.3
Associates	-	-	-	-	-	-
Discontinued & other	-	-	-	-	-	-
Consolidated earnings	0.1	0.7	0.9	1.2	1.8	2.7
Minority interests	-	-	-	-	-	-
Net earnings	0.1	0.7	0.9	1.2	1.8	2.7
Depreciation and amortisation	-0.2	-0.2	-0.3	-0.3	-0.3	-0.4
Amortisation other intangibles/ Impairments	-0.2	0.0	-0.1	0.0	0.0	0.0
Non recurring elements included in EBIT	0.0	0.0	0.0	0.0	0.0	0.0
REBITDA	0.5	1.2	1.7	2.1	3.0	4.3
EBITDA	0.5	1.2	1.7	2.1	3.0	4.3
REBITA	0.4	1.0	1.4	1.8	2.6	3.9
EBITA	0.4	1.0	1.4	1.8	2.6	3.9
Net earnings from continued operations	0.1	0.7	0.9	1.2	1.8	2.7
Adjusted net earnings	0.1	0.7	0.9	1.2	1.8	2.7

Balance sheet (€ m)	2005	2006	2007E	2008E	2009E	2010E
Intangible assets	0.0	0.0	0.0	0.0	0.0	0.0
Tangible assets	1.2	1.2	1.1	1.1	1.1	1.0
Financial assets	0.2	0.2	0.2	0.2	0.2	0.2
Other assets	0.2	0.7	0.7	0.9	1.1	1.4
Inventories	0.9	1.3	1.5	1.9	2.4	3.0
Receivables	2.9	3.0	3.2	4.0	5.0	6.3
Cash & equivalents	0.6	0.7	0.8	1.1	1.6	2.7
TOTAL ASSETS	6.0	7.0	7.5	9.1	11.4	14.6
Equity	1.8	2.5	2.7	3.6	5.0	7.1
Minorities	-	-	-	-	-	-
Provisions	0.1	0.1	0.2	0.2	0.2	0.3
LT financial debt	1.2	1.4	1.7	1.6	1.6	1.5
Other liabilities	1.0	0.9	1.0	1.3	1.6	2.0
Payables	1.4	1.6	1.9	2.3	2.9	3.7
ST financial debt	0.5	0.5	0.1	0.1	0.1	0.1
TOTAL LIABILITIES	6.0	7.0	7.5	9.1	11.4	14.6
Net working capital	2.3	2.7	2.8	3.5	4.5	5.6
Capital employed	2.9	3.8	3.6	4.3	5.1	6.0
Net debt	1.0	1.2	0.9	0.6	0.0	-1.2
Net debt, incl. off-balance items	1.0	1.2	0.9	0.6	0.0	-1.2

Cash flow statement (€ m)	2005	2006	2007E	2008E	2009E	2010E
Consolidated earnings	0.1	0.7	0.9	1.2	1.8	2.7
Depreciation, amortisation & impairment	0.3	0.2	0.5	0.3	0.3	0.4
Other cash flow from operations	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2
Change in working capital	-0.4	-0.4	-0.8	-0.7	-0.9	-1.1
CASH FLOW FROM OPERATIONS	0.0	0.4	0.5	0.7	1.1	1.8
Net capital expenditure	-0.1	0.0	-0.3	-0.2	-0.2	-0.2
Acquisitions / disposals	-	-	-	-	-	-
Other cash flow from investments	-	-	-	-	-	-
CASH FLOW FROM INVESTMENTS	-0.1	0.0	-0.3	-0.2	-0.2	-0.2
Dividend payments	0.0	0.0	-0.2	-0.3	-0.4	-0.5
Shares issues	0.0	0.0	-0.5	0.0	0.0	0.0
New borrowings / reimbursements	0.0	0.2	0.4	0.0	0.0	0.0
Other cash flow from financing	-0.1	-0.5	0.3	0.0	0.0	0.0
CASH FLOW FROM FINANCING	-0.1	-0.3	-0.1	-0.3	-0.4	-0.5
Fx and changes to consolidation scope	-	-	-	-	-	-
CHANGE IN CASH & EQUIVALENTS	-0.2	0.1	0.1	0.3	0.6	1.1
Free cash-flow	-0.1	0.4	0.2	0.5	1.0	1.6
Change in net debt	1.0	0.1	-0.2	-0.3	-0.6	-1.2

Performance criteria	2005	2006	2007E	2008E	2009E	2010E
Sales growth	-	23.8%	17.0%	25.5%	25.0%	25.0%
Gross profit growth	-	20.4%	17.7%	29.1%	27.1%	27.8%
REBITDA growth	-	129.6%	41.8%	21.2%	44.6%	45.9%
EBITDA growth	-	129.6%	41.8%	21.2%	44.6%	45.9%
REBITA growth	-	164.5%	41.8%	30.8%	47.3%	49.5%
EBIT growth	-	368.0%	31.3%	40.4%	47.3%	49.5%
Pe-tax earnings growth	-	473.8%	31.1%	43.1%	50.8%	52.2%
Net earnings growth	-	537.0%	31.0%	37.0%	46.1%	47.4%
Earnings growth from continued operations	-	537.0%	31.0%	37.0%	46.1%	47.4%
Adjusted earnings growth	-	686.1%	27.1%	42.3%	46.1%	47.4%
Gross margin	47.8%	46.5%	46.8%	48.1%	48.9%	50.0%
REBITDA margin	5.3%	9.8%	11.8%	11.4%	13.2%	15.4%
EBITDA margin	5.3%	9.8%	11.8%	11.4%	13.2%	15.4%
REBITA margin	3.7%	7.9%	9.5%	9.9%	11.7%	14.0%
EBIT margin	2.1%	7.9%	8.9%	9.9%	11.7%	14.0%
Net working capital / sales	23.3%	21.8%	19.4%	19.7%	19.8%	20.0%
CAPEX/ Sales	0.8%	0.2%	1.9%	0.8%	0.8%	0.7%
FCF / Sales	-1.0%	3.3%	1.5%	2.9%	4.2%	5.7%
Depreciation / Capital Expenditure	209.9%	1019.9%	122.4%	182.1%	192.1%	205.5%
Capital expenditure / EBITDA	14.4%	1.9%	16.0%	7.3%	6.0%	4.6%
Net debt / Equity + Minorities	55.3%	45.6%	35.1%	17.8%	0.1%	-16.7%
Net debt / EBITDA	1.9	1.0	0.5	0.3	0.0	-0.3
EBITDA / net interest	14.9	26.9	49.2	185.9	-139.7	-52.9
Pay-out ratio	-	-	-	-	-	-
Net earnings margin	1.1%	5.6%	6.3%	6.8%	8.0%	9.4%
x CE turnover (Sales / avg. CE)	-	3.7	3.9	4.6	4.8	5.1
x Leverage (avg. CE / avg. equity)	-	1.5	1.4	1.3	1.1	0.9
= Return on Equity (avg)	-	31.5%	34.7%	39.4%	41.9%	43.7%
Return on Equity - adjusted (avg)	-	31.2%	33.4%	39.4%	41.9%	43.7%
Return on Capital Employed (avg)	-	21.7%	25.5%	32.3%	38.9%	47.3%
Return on Capital Employed - adjusted (avg)	-	21.5%	24.9%	32.3%	38.9%	47.3%

Disclosure & Disclaimers section

The company disclosures can also be consulted on our website http://www.kbcsecurities.be/disclosures.

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Stock rating	Definition
BUY	Expected total return (including dividends) of 10% or more over a 6-month period
ACCUMULATE	Expected total return (including dividends) between 0% and 10% over a 6-month period
REDUCE	Expected total return (including dividends) between –10% and 0% over a 6-month period
SELL	Expected total return (including dividends) of -10% or worse over a 6-month period

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