



Halbjahresbericht 2006

DÜBENDORF, SCHWEIZ

INHALT:

02 Bericht an die Aktionäre

08 Halbjahresrechnung

08 Bilanz

09 Gewinn- und Verlust-Rechnung

10 Veränderungen des Eigenkapitals

11 Mittelflussrechnung

12 Ausgewählte Erläuterungen zum
Zwischenbericht

FIGURES AT A GLANCE

6 Month 2006 key figures

(USD '000)	2005	2006
Revenue	20,076	9,625
Gross profit	13,802	2,123
in % of revenue	68.75%	22.06%
OPEX*	13,307	18,048
in % of revenue	66.28%	187.51%
EBITA*	3,233	(12,288)
in % of revenue	16.10%	(127.67%)
Adjusted operating profit (loss)*	495	(15,925)
in % of sales	2.47%	(165.45%)
Operating loss	(1,390)	(34,170)
In % of sales	(6.92%)	(355.01%)
Net loss*	(87)	(16,936)
in % of sales	(0.43%)	(175.96%)

*excluding bad debt expense, restructuring costs and
impairment of intangible assets

Sehr geehrte Aktionärinnen und Aktionäre,

Mit der Ernennung von Jean-Claude Martinez zum CEO durch den Verwaltungsrat im Mai 2006 begann bei Esmertec™ ein neues Kapitel. Ausserdem konnte der Verwaltungsrat am 30. August ankündigen, dass Ruedi Noser die Nominierung als Kandidat für das Verwaltungsratspräsidium angenommen hatte. Herr Noser ist Mitbegründer und Verwaltungsratspräsident der Noser Group und verfügt über mehr als 20 Jahre Erfahrung in der Telekommunikationsindustrie. Er steht an der ausserordentlichen Generalversammlung, die am 23. November 2006 stattfinden soll, für die Wahl zum Verwaltungsratsmitglied zur Verfügung.

Das erste Halbjahr 2006 (1H2006) erwies sich für Esmertec als eine herausfordernde Phase. Lassen Sie uns einige der wichtigsten Ereignisse dieses Zeitraums zusammenfassen.

Anfang Februar 2006 übernahm Esmertec das Unternehmen Cellicium™. Dies war eine wichtige Akquisition, die Esmertec zuverlässige und bereits in den Märkten eingeführte Produkte für das geplante Mobile Operator-Geschäft bietet. Zusätzlich erwarb Esmertec eine massgebliche Beteiligung an ESLab™, dem koreanischen Service Partner des Unternehmens mit Know-how in der Integration von Software in Geräten. Des Weiteren erwarb Esmertec eine Minderheitsbeteiligung an Javaground™, einem Unternehmen, das ein Software Tool entwickelte, mit dem Inhalte, wie zum Beispiel Spiele, leicht in eine Vielzahl von Geräten integriert werden können.

In der ersten Hälfte des Jahres nahmen wir einige bedeutende Änderungen in der Geschäftsleitung vor. Wir verpflichteten Georges Bouloy, unseren Chief Product Officer, und reorganisierten die Forschungs- und Entwicklungsabteilung nach Produktlinien. Nach der Reorganisation verliess Anne-Marie Larkin, Chief Technology Officer, das Unternehmen. Mit dem Ziel, die Profitabilität der weltweit angebotenen Dienstleistungen zu verbessern, verpflichteten wir Jean-Luc Gianduzzo, Executive Vice President of Global Services. Aufgrund des Ausblicks auf das Unternehmensergebnis im 1H2006 verliessen sowohl Billy Crotty, Executive VP Sales and Services als auch der Verwaltungsratspräsident und CEO Alain Blancquart das Unternehmen.

Veränderungen im Markt für mobile Geräte hatten einen deutlichen Einfluss auf Esmertecs Umsätze. Am 3. Juli 2006 wurden organisatorische und kostensenkende Massnahmen bekannt gegeben, die Jean-Claude Martinez gemeinsam mit dem Managementteam umsetzte. Im Einzelnen bedeutet dies, dass wir unsere Geschäftstätigkeiten in Japan um mehr als 50% reduziert und unser OSVM™ Forschungs- und Entwicklungszentrum in Dänemark geschlossen haben. Unser Verkaufs- und Service-Team wurde in zwei Gruppen aufgeteilt, damit sich jede Gruppe auf ihre Kernkompetenz konzentrieren kann.

Das Management hat ausserdem den Schwerpunkt auf die Festigung der Kundenbeziehungen durch persönliche Kontakte und Besprechungen gelegt. Wir sind zufrieden, dass wir im ersten Halbjahr 2006 9,6 US\$ Umsatz erzielen konnten. Dies ist mehr als wir Ende Mai 2006 erwartet hatten.

Ein weiterer Schwerpunkt im 1H2006 war der Aufbau unseres zweiten Geschäftsbereichs - das Mobile Operator Segment. Esmertecs bisheriges Kerngeschäft war hauptsächlich auf die Jbed™ Java™ Virtual Machine sowie die dazugehörigen Produkte und Dienstleistungen ausgerichtet. Mit dem zweiten Segment rückt Esmertec in der Wertschöpfungskette der Telekommunikationsindustrie näher zu den Mobilfunkanbietern. Damit haben wir die Möglichkeit, die Bedürfnisse der Mobilfunkanbieter besser zu verstehen, welche stark mit den Software-Anforderungen der Mobiltelefonhersteller verknüpft sind.

Im Mobile and Multimedia Devices Segment haben wir zwei Produktlinien: (1) mobile Geräte wie Telefone und PDAs sowie (2) Multimediageräte für den Heimbedarf wie Set-Top Boxen, interaktive Fernseher und Blu-Ray Disc™ Geräte.

Die Produktlinie der Mobile Devices blieb im 1H2006 weiterhin der Hauptumsatzträger von Esmertec. Mit einem der führenden Mobiltelefonhersteller konnte ein Vertrag verlängert werden. Im gleichen Zeitraum wuchs die Zahl der von Kunden ausgelieferten Geräte auf mehr als 18 Millionen Einheiten, was einem Anstieg von 94% im Vergleich zum ersten Halbjahr 2005 entspricht. Damit erreicht die Gesamtzahl der mit Esmertec Software ausgelieferten Geräte mehr als 58 Millionen in mehr als 190 Modellen.

Die Java Technologie wird immer häufiger von Industrievereinigungen wie der Blu-ray Disc™ Association als den Interaktivitäts-Standard für Home-Multimedia ausgewählt. Vor diesem Hintergrund hat Esmertec im 1H2006 eine Vereinbarung mit der Pioneer Corporation unterzeichnet, um Esmertecs Jbed Software in Pioneers Blu-ray Disc Abspielgeräten, die voraussichtlich die herkömmlichen DVD Player in der Unterhaltungselektronik ersetzen werden, zu integrieren.

Im Mobile Operator Segment ist es uns im 1H2006 gelungen, fünf Neukunden zu gewinnen und somit die Zahl der Mobilfunkanbieter auf 15 erhöhen. Eine der aktuellen Herausforderungen der Mobilfunkanbieter ist es, neue Dienstleistungen zu finden, die sie von ihren Konkurrenten differenzieren. Die USSD Browsing-Lösung von Esmertec ermöglicht es den Mobilfunkanbietern Kosten zu sparen und besseren Kundendienst anzubieten. Die Zahl von Konsumenten mit Zugang zu unserer USSD Browsing-Lösung wächst stetig. Unsere Kunden haben gegenwärtig insgesamt einen Kundenstamm von über 40 Millionen.

Wir wollen Ihnen nun den Finanzbericht für die ersten sechs Monate 2006 vorstellen.

Neue Segmentberichterstattung

Wir haben die Segmentberichterstattung geändert, um so der Entwicklung der Gruppe nach der Gründung des Mobile Operator Segments zu Beginn des Jahres Rechnung zu tragen. Das Mobile Operator Segment beinhaltet hauptsächlich die Ergebnisse von Cellicium seit der Übernahme durch Esmertec im Februar 2006. Die bisherige Geschäftstätigkeit von Esmertec war überwiegend auf den Verkauf der Jbed Java Virtual Machine sowie der dazugehörigen Produkte und Dienstleistungen ausgerichtet. Dies spiegelt sich im Mobile and Multimedia Devices Segment wider und ist vom Volumen her mit dem Ergebnissen des ersten Halbjahres 2005 vergleichbar.

In US\$ millions, except unit shipments	Esmertec Group	Mobile& Multimedia Devices Segment	Mobile Operator Segment	Esmertec Group
	1H2005	1H2006	1H2006	1H2006
Revenues	20.1	6.3	3.3	9.6
Gross profit	13.8	0.0	2.1	2.1
Restructuring expense	0	(1.7)	0	(1.7)
Impairment loss on intangible assets	0	(15.6)	0	(15.6)
Bad debt expense	(1.9)	(0.9)	0	(0.9)
Other operating expenses, including amortization	(13.3)	(15.9)	(2.1)	(18.0)
Earnings before interest, taxes, amortization/ impairment (EBITA)	1.3	(15.7)	0.8	(14.9)
Operating income/(loss)	(1.4)	(34.2)	0.0	(34.2)
Net loss attributable to Esmertec AG shareholders	(1.9)			(34.2)

Alle Finanzkennzahlen werden untestiert und in Übereinstimmung mit den International Financial Reporting Standards (IFRS) veröffentlicht. Zusammengefasste und konsolidierte Finanztabellen sind am Ende dieser Veröffentlichung aufgeführt.

Umsätze

Die konsolidierten Umsätze des 1H2006 beliefen sich auf 9,6 Millionen US\$, was einem Rückgang von 52% im Vergleich zum 1H2005 entspricht. Der Halbjahresumsatz des Mobile and Multimedia Devices Segments, das mit der Esmertec Gruppe im Jahr 2005 vergleichbar ist, belief sich auf 6,3 Millionen US\$, was einem Rückgang von 69% im Vergleich zum Ergebnis der Esmertec Gruppe im 1H2005 entspricht. Dieser Rückgang im Mobile and Multimedia Devices Segment widerspiegelt: (1) eine Mischung aus markt- und kundenspezifischen Einflüssen im 1H2006, die zu Verzögerungen oder Verringerungen der verbindlichen Vertragsvolumina führten, (2) Verzögerung der Umsatzrealisierung bei Aufträgen mit kleineren Kunden und (3) dass mehrere, 2005 abgeschlossene Grossaufträge voraussichtlich nicht vor dem 2H2006 oder 2007 erneuert werden. Die Umsätze des 1H2006

des neu gegründeten Mobile Operator Segments entsprechen dem Umsatz von Cellicium seit der Übernahme im Februar 2006.

Bruttogewinnmarge

Die Bruttogewinnmarge für das konsolidierte Geschäft lag im 1H2006 bei 22,1% im Vergleich zu 68,8% im 1H2005. Die Bruttogewinnmarge für das Mobile and Multimedia Devices Segment lag im 1H2006 leicht über Break-even, bedingt durch einen 2,3 Millionen US\$ Verlust bei Dienstleistungen, der einen 2,3 Millionen US\$ (89,2%) Bruttogewinn bei Lizenzen aufgehoben hat. Die Ursache des Verlustes bei Dienstleistungen waren hauptsächlich Kostenüberschreitungen bei Kundenprojekten in Japan und eine Reihe von Leistungen im Rahmen von Kundenevaluationen die als Akquisitionsmassnahmen durchgeführt wurden. Die Bruttogewinnmarge im Mobile Operator Segment lag bei 63,6 %.

Laufende Kosten der Geschäftstätigkeit

Die gesamten Kosten des operativen Geschäftes im 1H2006 beliefen sich auf 36,3 Millionen US\$ im Vergleich zu 15,2 Millionen US\$ im 1H2005. Der Anstieg widerspiegelt (1) die Übernahme von Cellicium im Februar 2006 und (2) die volle Auswirkung der Aufnahme der Geschäfte in China, die nur teilweise schon in das 1H2005 fiel und (3) die Effekte der Kosten für uneinbringliche Forderungen, Restrukturierungskosten und Wertminderung immaterieller Vermögenswerte.

Kosten für uneinbringliche Forderungen in Höhe von 0,9 Millionen US\$ im 1H2006 (1H2005: 1,9 Millionen US\$) sind in einem neu aufgetretenen Risiko mit amerikanischen Kunden sowie einer zusätzlichen allgemeinen Rückstellung für Risiken in Asien begründet. Die endgültige Zahlung an CoreTek wurde aufgrund nicht übertragbarer Kundenverträge reduziert. Die Verminderung der Schlusszahlung von 0,5 Millionen US\$ wurde als Verminderung des Goodwills in der Bilanz erfasst und hatte keine Auswirkung auf die Konzernergebnisrechnung.

Als Folge des starken Umsatzrückgangs im 1H2006 hat Esmertec eine Reihe von Massnahmen zur Anpassung der Kostenstruktur des Unternehmens durchgeführt, um den revidierten Geschäftserwartungen gerecht zu werden. Das OSVM Forschungszentrum in Dänemark wurde geschlossen, die japanischen Verkaufs- und Support-Aktivitäten wurden drastisch reduziert und einige mittlere Managementpositionen wurden abgebaut. Die Kosten für alle durchgeführten Massnahmen beliefen sich auf 1,7 Millionen US\$. Ab Beginn des vierten Quartals 2006 wird voraussichtlich der volle Effekt der Massnahmen wirksam und zukünftig quartalsweise Einsparungen in Höhe von etwa 2 Millionen US\$ bringen, die zum Teil auch über einen Rückgang der Dienstleistungskosten erreicht werden.

Die revidierten Erwartungen der Umsätze der bestehenden Produkte im Mobile and Multimedia Devices Segment sowie die Änderungen in der Gruppenstruktur führten zudem zu einer Neubewertung der immateriellen Vermögenswerte. Diese Wertberichtigungen wurden

im 1H2006 erfasst und berücksichtigen Wertminderungen an OSVM (3,2 Millionen US\$), Japan (9,2 Millionen US\$) sowie an erworbener und selbst entwickelter Technologie (3,1 Millionen US\$).

Netto-Finanzaufwand

Der Netto-Finanzaufwand für das erste Halbjahr 2006 in Höhe von 2,5 Millionen US\$ (0,3 Millionen US\$ im 1H2005) widerspiegelt einen Zinsaufwand von 1,8 Millionen US\$ (1,5 Millionen US\$ im 1H2005) und einen Netto-Fremdwährungsverlust von 1,0 Millionen US\$ (Netto-Fremdwährungsgewinn in Höhe von 1,7 Millionen US\$ im 1H2005). Das Fremdwährungsergebnis ist hauptsächlich das Resultat der Volatilität des US Dollars gegenüber dem Schweizer Franken, der funktionalen Währung der Esmertec AG. Dagegen wird der US Dollar in den meisten unserer Verträge und zur Bewertung von Debitorenforderungen verwendet.

Ertragssteueraufwand (Gewinn)

Der Nettosteuerertrag von 1,4 Millionen US\$ im 1H2006 ist auf die Auflösung der latenten Netto-Steuerverbindlichkeiten im Zusammenhang mit den Wertminderungen auf immateriellen Vermögenswerten zurückzuführen. Der Nettosteuerertrag im 1H2005 lag bei 0,2 Millionen US\$ und beruht hauptsächlich auf Quellensteuern, die den Lizenz Erlösen zuzurechnen sind.

Nettoverlust

Der Nettoverlust, der den Aktionären der Esmertec AG zuzurechnen ist, belief sich im 1H2006 auf 34,2 Millionen US\$ (2,10 US\$ pro Aktie). Der Nettoverlust, der den Aktionären der Esmertec AG zuzurechnen ist, belief sich im 1H2005 auf 1,9 Millionen US\$ (0,18 US\$ pro Aktie).

Bilanz

Die Zahlungsmittel und kurzfristige Finanzanlagen beliefen sich am 30. Juni 2006 auf 25,3 Millionen US\$ gegenüber 55 Millionen US\$ vom 31. Dezember 2005. Diese Abnahme erklärt sich durch Zahlungen im Rahmen der Akquisition von Cellicium im Betrag von 11,8 Millionen US\$, die Schlusszahlung für die CoreTek (China) Akquisition von 2,5 Millionen US\$, Investitionen und Darlehen von 1 Million US\$ in die Firmen Javaground und ESLabs sowie Mittelabfluss aus operativer Tätigkeit. Der Mittelzufluss von Kundenzahlungen im 1H2006 betrug 13,4 US\$. Der Grund der hohen Mittelzuflüsse liegt in Umsätzen, die in Vorperioden verbucht wurden.

Die immateriellen Vermögenswerte stiegen von 31,3 Millionen US\$ am 31. Dezember 2005 auf 40,0 Millionen US\$ am 30. Juni 2006, wobei die immateriellen Vermögenswerte durch die Übernahme von Cellicium (24,1 Millionen US\$) und ESLabs (0,3 US\$) stiegen und durch die 13,7 Millionen US\$ Wertberichtigungen reduziert wurden.


Strategischer Fokus und Ausblick

Wir sehen zuversichtlich der zweiten Jahreshälfte entgegen und erwarten im Vergleich zum ersten Halbjahr einen Umsatzanstieg sowohl bei unseren Mobilfunkanbieter-, als auch bei den Java-Software-Produkten und Dienstleistungen. Das Management wird den Fokus auf die Verbesserung der operativen Effizienz richten und gleichzeitig weiterhin unsere Strategie in unseren zwei Marktbereichen implementieren.

Im Mobilfunkmarkt nimmt die Konkurrenz zu. Darum ist es für die Handyhersteller prioritär, ihre Geräte schneller und zuverlässiger zu liefern. Ebenso wichtig ist die Kostenreduktion der Mobiltelefonherstellung. Unsere Strategie ist auf die Auslieferung kompletter Softwarepakete und -anwendungen ausgerichtet, die Integrationsaufwand und -kosten unserer Kunden reduziert und ihnen gleichzeitig ausgereifte Software-Integration, Support und Kundendienstleistungen bietet. In der Produktlinie Home Multimedia liefern wir mittels Partnerschaften umfangreiche Middleware Software-Lösungen an Gerätehersteller. Als Folge unseres Fokus auf das Mobile Operator Segment wird unser Kundenstamm für das USSD Browsing Produkt weiter wachsen. Zugleich soll unser Produktportfolio mit Lösungen, wie beispielsweise Portalen auf Geräten, erweitert werden, die die Endbenutzer zu Datenkonsum motivieren und folglich die Umsätze für Mobilfunkanbieter erhöhen.

Wir möchten die Gelegenheiten nutzen, unseren Kunden und Aktionären für ihre dauerhafte Unterstützung und ihr Interesse an Esmertec zu danken.

Mit freundlichen Grüßen



Hans-Ulrich Müller
Vize-Präsident
Verwaltungsrat Esmertec AG



Jean-Claude Martinez
Chief Executive Officer

Dübendorf, Switzerland
September, 2006

FINANCIAL STATEMENTS

INTERIM CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2005 AND JUNE 30, 2006

(in US\$ 000s)	Notes	December 31, 2005	June 30, 2006 (unaudited)
ASSETS			
Current assets			
Cash and cash equivalents		35,771	25,012
Short-term investments		19,195	251
Marketable securities		0	3,808
Trade accounts receivable	5	36,434	35,717
Other receivables		639	1,398
Inventory		3,935	3,213
Prepaid expenses and accrued income		1,257	2,633
<i>Total current assets</i>		97,231	72,032
Non-current assets			
Furniture and equipment		971	1,291
Intangible assets		31,295	40,000
Financial assets ¹⁾	6	607	1,536
Deferred tax assets		3,207	0
<i>Total non-current assets</i>		36,080	42,827
Total assets		133,311	114,859
LIABILITIES AND EQUITY			
Current liabilities			
Bank overdrafts		3,176	1,958
Interest-bearing loans and borrowings		121	195
Trade accounts payable		1,587	2,936
Income and withholding tax payable		2,783	2,079
Other payables		7,190	12,699
Accrued expenses		10,723	11,615
Deferred revenue		1,824	4,142
<i>Total current liabilities</i>		27,404	35,624
Non-current liabilities			
Interest-bearing loans and borrowings		27,935	30,398
Pension liabilities		925	1,032
Other long-term liabilities		0	4,352
Deferred revenue		366	175
Deferred tax liabilities ¹⁾		3,746	3,056
<i>Total non-current liabilities</i>		32,972	39,013
Total liabilities		60,376	74,637
Shareholders' equity			
Share capital	8	1,231	1,313
Share premium		114,737	120,213
Treasury shares		(1)	0
Cumulative translation adjustment		888	(2,213)
Accumulated losses		(44,987)	(79,156)
<i>Total equity attributable to equity holders of the parent company</i>		71,868	40,157
Minority interest		1,067	65
Total equity		72,935	40,222
Total liabilities and equity		133,311	114,859

¹⁾ Restated, see Note 2 for further information

These Interim Consolidated Financial Statements should be read in conjunction with the accompanying Notes.

INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE SIX MONTHS ENDED JUNE 30, 2005 AND JUNE 30, 2006

		Six months ended	
(in US\$ 000s, except per share amounts)	Notes	June 30, 2005 ¹⁾ (unaudited)	June 30, 2006 (unaudited)
License revenue		15,009	4,037
Service revenue		5,067	5,260
Other revenue		0	328
Total revenue		20,076	9,625
Cost of license revenue		(2,061)	(283)
Cost of service revenue		(4,213)	(6,923)
Cost of other revenue		0	(296)
Total cost of revenue		(6,274)	(7,502)
Gross profit		13,802	2,123
Research and development		(2,649)	(3,867)
Sales and marketing		(3,545)	(4,724)
Bad debt expense	5	(1,885)	(903)
General and administrative		(4,375)	(5,820)
Restructuring costs	9	0	(1,707)
Amortization of intangible assets		(2,738)	(3,637)
Impairment of intangible assets	7	0	(15,635)
Loss from operations before interest and taxes		(1,390)	(34,170)
Financial income		3,018	1,827
Financial expenses		(3,364)	(4,283)
Loss before income taxes		(1,736)	(36,626)
Income tax (expense)/benefit		(236)	1,445
Net loss for the period		(1,972)	(35,181)
Attributable to:			
Equity holders of the parent company		(1,905)	(34,169)
Minority interest		(67)	(1,012)
		(1,972)	(35,181)
Basic and diluted loss per share	10	(0.18)	(2.10)

¹⁾ Restated, see Note 2 for further information

These Interim Consolidated Financial Statements should be read in conjunction with the accompanying Notes.

**INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY FOR THE
SIX MONTHS ENDED JUNE 30, 2005 AND JUNE 30, 2006 (UNAUDITED)**

Attributable to equity holders of the parent company								
(in US\$ 000s)	Share capital	Share premium	Cumulative translation adjustment	Accumulated losses	Treasury shares	Total	Minority interest	Total equity
Balance at December 31, 2004	949	54,731	(6,605)	(29,297)	0	19,778	3,613	23,391
Net loss				(1,905)		(1,905)	(67)	(1,972)
Other comprehensive income:								
Translation adjustment	(112)	(5,780)	4,471			(1,421)	(52)	(1,473)
Total recognized income and expense for the period	(112)	(5,780)	4,471	(1,905)	0	(3,326)	(119)	(3,445)
Increase of share capital	8	1,996			(1)	2,003		2,003
Cost of share capital increase		(1)				(1)		(1)
Stock option expense		723				723		723
Incorporation of Esmertec (China) Co.						0	85	85
Balance at June 30, 2005	845	51,669	(2,134)	(31,202)	(1)	19,177	3,579	22,756
Balance at December 31, 2005	1,231	114,737	888	(44,987)	(1)	71,868	1,067	72,935
Net loss				(34,169)		(34,169)	(1,012)	(35,181)
Other comprehensive income:								
Translation adjustment	70	6,288	(3,101)			3,257	10	3,267
Total recognized income and expense for the period	70	6,288	(3,101)	(34,169)	0	(30,912)	(1,002)	(31,914)
Increase of share capital	12	302				314		314
Stock option expense		311				311		311
Reversal of allocated deferred taxes on IPO expenses directly recognized in equity		(1,464)				(1,464)		(1,464)
Share transfer ESLab Inc., Korea		39			1	40		40
Balance at June 30, 2006	1,313	120,213	(2,213)	(79,156)	0	40,157	65	40,222

These Interim Consolidated Financial Statements should be read in conjunction with the accompanying Notes.

**INTERIM CONSOLIDATED CASH FLOW STATEMENTS FOR THE SIX MONTHS
ENDED JUNE 30, 2005 AND JUNE 30, 2006**

(in US\$ 000s)	Notes	Six months ended	
		June 30, 2005 (unaudited)	June 30, 2006 (unaudited)
Net loss for the period		(1,972)	(35,181)
Adjustments for:			
Depreciation and amortization		2,829	3,820
Impairment of intangible assets	7	0	15,635
Loss on sale of fixed assets		15	41
Foreign exchange (gain)/loss, net, on intercompany transactions		(167)	(199)
Cost of stock options		723	311
Increase of pension accruals		8	32
Increase of bad debt reserve, net	5	1,885	903
Interest expense		1,547	1,786
Interest income		(282)	(439)
Income taxes		237	(1,445)
		4,823	(14,736)
Decrease/(increase) in trade and other receivables, accrued income and prepaid expenses		(15,497)	3,873
Decrease/(increase) in inventories		(846)	1,094
(Decrease)/increase in trade and other payables		707	(3,659)
(Decrease)/increase in accrued expenses		3,932	(1,650)
(Decrease)/increase in deferred revenue		(298)	313
Income and withholding taxes paid		(277)	(404)
		(7,456)	(15,169)
Net cash used in operating activities			
Capital expenditure for fixed assets		(400)	(397)
Capital expenditure for intangible assets		(3,207)	(2,673)
Acquisition of businesses, net of cash acquired	4	(1,965)	(11,839)
Investment/financing of business	6	0	(844)
Decrease of short-term investments		0	19,634
Proceeds from disposal of fixed assets		2	0
Interest received		120	182
Increase in financial assets		(26)	(29)
		(5,476)	4,034
Net cash (used in)/provided by investing activities			
Proceeds from borrowings		2,965	0
Repayment of borrowings		(5,908)	(1,273)
Proceeds from minorities		85	0
Proceeds from issue of share capital		8	314
Interest paid		(91)	(113)
		(2,941)	(1,072)
Net cash used in financing activities			
Net decrease in cash and cash equivalents		(15,873)	(12,207)
Cash and cash equivalents at beginning of period		19,817	35,771
Effect of exchange rate fluctuations on cash and cash equivalents		(1,234)	1,448
Cash and cash equivalents at end of period		2,710	25,012

These Interim Consolidated Financial Statements should be read in conjunction with the accompanying Notes.

SELECTED NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

1. CORPORATE INFORMATION AND PRINCIPLES OF CONSOLIDATION

The Esmertec Group ("Esmertec" or the "Group") consists of Esmertec AG ("the Company"), incorporated on April 1, 1999, in Dübendorf, Switzerland, and its consolidated subsidiaries, which are the following controlled companies:

Company	Share capital (million)	Ownership interest June 30, 2005	Ownership interest June 30, 2006	Consolidated since
Esmertec Inc., Dana Point, USA	US\$ 0.1	100%	100%	Creation: May 2000
Esmertec Engineering Services KK (formerly eValley Inc.), Tokyo, Japan	JPY 94.63	51%	-	Acquisition: March 2004 (merged into Esmertec KK in December 2005)
Esmertec KK, Tokyo, Japan	JPY 65.7	100%	82.82% after merger with Esmertec Engineering Services KK in December 2005	Creation: September 2004
Oovm A/S, Aarhus, Denmark	DKK 0.5	100%	100%	Acquisition: July 2004
Esmertec (China) Co., Ltd., Beijing, PRC	CNY 2.0	65%	65%	Creation: April 2005
Esmertec Holding AG	CHF 1.0	-	100%	Creation: February 2006
Cellidium S.A., Bagneux, France	€ 0.08	-	100%	Acquisition: February 2006
ESLab Inc., Seoul, South Korea	KRW 60.0	-	20%, with effective operational control	Acquisition: February 2006

Esmertec is publicly traded on the Swiss Stock Exchange (SWX).

The Board of Directors authorized these Interim Consolidated Financial Statements for issuance on August 22, 2006.

2. BASIS OF PREPARATION AND ACCOUNTING POLICIES

Basis of preparation

The Interim Consolidated Financial Statements for the six months ended June 30, 2006, were prepared in accordance with IAS 34, Interim Financial Reporting.

The preparation of the Interim Consolidated Financial Statements requires management to make estimates and assumptions that affect the reported amounts of revenues, expenses, assets, liabilities and disclosure of contingent liabilities. If actual circumstances in the future deviate from such estimates and assumptions, the original estimates and assumptions will be modified as appropriate in the period in which the circumstances change. During the periods under review, there were no significant changes in estimates that should be reported under this heading except for estimates and assumptions taken in determining the value in use of the intangible assets (see Note 7).

Significant changes to accounting policies

The accounting policies used in the preparation of the Interim Consolidated Financial Statements are consistent with those used in the Annual Consolidated Financial Statements for the year ended December 31, 2005, except for the changes required by the following applicable standards which are mandatory for annual periods beginning on or after January 1, 2006:

- IAS 19 "Employee Benefits"
- IAS 39 "Financial Instruments: Recognition and Measurement"
- IAS 21 (technical correction) "The Effects of Changes in Foreign Exchange Rates"
- IFRIC 4 "Determining whether an Arrangement contains a Lease"

Such revised requirements (as well as the newly issued IFRS 6 and IFRIC 6) did not have any material effect on Esmertec's Interim Consolidated Financial Statements. For IAS 19 "Employee Benefits" the Group does not apply the alternative recognition option of posting the actuarial gains and losses directly to equity.

In addition, Esmertec has changed its segment reporting to reflect the evolution of the Group following the creation of the Mobile Operator Segment and the acquisition of Cellicium S.A. in February 2006 (see Notes 4 and 11 below). As services currently are sold only to customers who buy products, separating services into a separate segment was no longer considered meaningful by management.

Reclassification of expenses and change in balance sheet presentation

In the presentation of the Interim Consolidated Financial Statements, certain amounts in the statement of operations for the six months ended June 30, 2005, and in the balance sheet as of December 31, 2005, have been reclassified to conform to current year presentation.

The compensation and related costs for the Chief Executive Officer (CEO) and certain other senior managers previously categorized as sales and marketing expense have been reclassified as general and administrative expense, reflecting their primary roles in the current organization. This reallocation resulted in a change in the allocation of facilities expenses between these two line items. Further bad debt expenses are shown separately and other income/expenses, net, are reclassified to general and administrative expenses. The impact of the reclassifications on the Statement of Operations for the six months ended June 30, 2005, was:

Statement of operations	1H2005 before reclassification	Reclassification	1H2005 after reclassification
(in US\$ 000s)			
Cost of service revenue	(4,159)	(54)	(4,213)
Research and development	(2,504)	(145)	(2,649)
Sales and marketing	(6,788)	3,243	(3,545)
General and administrative	(3,209)	(1,166)	(4,375)
Bad debt expense	0	(1,885)	(1,885)
Other income/expense, net	(7)	7	0
Total effect on net loss		0	

During the six months ended June 30, 2006, the cost of these personnel allocated to general and administrative expenses included the cost of the settlement agreement related to the departure of the former CEO. Such settlement cost totaled US\$ 519,000, including US\$ 138,000 of non-cash expense related to modifications to vested but unexercised stock options.

In the presentation of the Interim Consolidated Balance Sheet, deferred tax assets and liabilities allocable directly to the different legal entities have been netted within that jurisdiction. While this change in presentation had no impact on the Statement of Operations, the change on the Balance Sheet as of December 31, 2005 was as following:

Balance sheet	December 31, 2005 before reclassification	Reclassification	December 31, 2005 after reclassification
(in US\$ 000s)			
Deferred tax assets	6,417	(3,210)	3,207
Deferred tax liabilities	(6,956)	3,210	(3,746)

3. SEASONALITY OF OPERATIONS

Management believes that Esmertec is not exposed to significant seasonal or cyclical variations in its operations.

4. BUSINESS COMBINATIONS

The following business combinations occurred during the six-month periods ended June 30, 2006 and 2005:

June 30, 2006

Acquisition of Cellicium S.A.

In February 2006, Esmertec acquired 100% of the shares of Cellicium S.A., a French software and services company, for a total purchase price of € 22.2 million (US\$ 27.0 million), including transaction costs. The transaction is resulting in an expected cash outflow for 2006 in the amount of € 13.7 million (US\$ 16.5 million) and will be completed by additional payments in 2007 and 2008 totaling in an estimated € 9.5 million (US\$ 11.7 million), based on 2006 and 2007 performance criteria. These performance-based components of the purchase price will be settled at least 70% in cash and up to 30% in Esmertec shares. The € 9.5 million payable has been discounted to present value at the date of the acquisition using an imputed market interest rate.

The acquisition had the following effect on the Group's assets and liabilities:

Effect of the acquisition on the half-year ended June 30, 2006 in US\$	Book value before takeover	Fair value adjustments	Fair value
Cash and cash equivalents and marketable securities	5,484		5,484
Accounts receivable	2,164		2,164
Other current assets	407		407
Non-current assets	491	9,005	9,496
Accounts payable	(722)		(722)
Deferred revenues	(1,492)		(1,492)
Other liabilities (incl. deferred tax liability)	(378)	(3,005)	(3,383)
Net assets acquired June 30, 2006	5,954		11,954
Goodwill			15,047
Total purchase price			27,001
Settled by:			
- cash payment 1H2006			(13,417)
- accrued liability			(13,219)
- paid transaction costs			(265)
- accrued transaction costs			(100)
Total purchase price			(27,001)
Paid in cash in 1H2006			(13,682)
Less cash acquired			1,846
Net cash outflow 1H2006			(11,836)

The purchase price allocation is about to be finalized. On a provisional basis the fair value adjustment of US\$ 9,005 is allocated to customer base (US\$ 6,000), intellectual property (US\$ 2,895) and trademark (US\$ 110).

The acquisition was effected by Esmertec Holding AG, a newly-created wholly owned Swiss subsidiary of Esmertec AG. Both Cellcium S.A. and Esmertec Holding AG are fully consolidated in Esmertec Group as from February 2006. While this acquisition did not have any effect on the result for the comparative period, revenues and net results were affected during the six months ended June 30, 2006, by US\$ 3.3 million and US\$ 145,000, respectively.

Acquisition of controlling interest in ESLab Inc.

In February 2006, Esmertec announced the acquisition of a controlling interest in ESLab Inc., its outsourcing partner in Korea. The purchase agreement calls for Esmertec to make an initial purchase of 20% of the outstanding shares of ESLab, combined with a number of control features which allow Esmertec AG to exercise effective control over the operations of ESLab. Consequently, ESLab is consolidated with Esmertec Group as from February 2006. The purchase price for the initial shares totaled US\$ 80,000, of which half was paid in cash and half in shares of Esmertec AG (2,623 Esmertec shares, issued out of treasury shares). The transaction is resulting in an estimated net cash outflow for 2006 of US\$ 3,000 (including transaction costs, net of cash acquired of US\$ 96,980). In early 2007, Esmertec's ownership interest will increase to 100% at a price to be determined based on 2006 financial performance criteria. The total purchase price is estimated to be a maximum of US\$ 850,000. As a result of this transaction, US\$ 289,000 in intangible assets was recognized in the Balance Sheet as of June 30, 2006. The purchase price allocation is about to be finalized.

While this acquisition did not have any effect on the result for the comparative period, revenues and net results were affected during the six months ended June 30, 2006, by US\$ 40,000 and US\$ 159,000, respectively.

June 30, 2005

CoreTek Systems Inc.

In January 2005, Esmertec entered into an agreement for the purchase of all assets of the mobile division of CoreTek Systems Inc. (CoreTek), located in China. The transferred business included the employees, IP of the CoreTek wireless software products, assignment of customer contracts and, to a minor extent, tangible assets of CoreTek's mobile division. Under the terms of the agreement, the IP assets were transferred to Esmertec AG and recognized on June 30, 2005. These IP assets are exclusively owned by Esmertec AG.

The remaining assets were transferred into a newly-formed company, Esmertec (China) Co., Ltd. (Esmertec China), of which Esmertec owns 65% of the voting rights and the remaining 35% voting rights are owned by a founding member of CoreTek.

Esmertec China was valued at US\$ 10.0 million and the consideration to be paid by Esmertec for 65% ownership was US\$ 6.5 million to be paid in cash in installments during 2005 and 2006. During 2005, a total of US\$ 3.5 million was paid. As a result of these transactions, US\$ 8.0 million in intangible assets was recognized in the Balance Sheet as of June 30, 2005.

During 1H2006, management determined that not all the expected customer contracts had been transferred from CoreTek and a claim was made under the asset purchase agreement. Consequently, an amendment to the asset purchase agreement was signed in April 2006 reducing the remaining payments due to CoreTek in 2006 from US\$ 3.0 million to US\$ 2.5 million, which amount was paid in June 2006. The US\$ 500,000 reduction in the original purchase price has been accounted for as a decrease of the value of goodwill.

Esmertec has a right to purchase 15% of the total share capital from the minority shareholder at a price of US\$ 1.5 million in 1H2007, and has the obligation to do so if certain criteria are met.

5. TRADE ACCOUNTS RECEIVABLE

On June 29, 2005, one of Esmertec's customers, Sendo Limited, UK, was placed into administration by order of the High Court in London. Consequently a bad debt expense of US\$ 1.9 million was recognized, which covered the net outstanding amount as of June 30, 2005. In the second half of 2005, the provision was increased due to the identification of several additional doubtful accounts, including primarily four Asian customers and two European customers. The Company also established a provision for risk related to the Chinese market. As of December 31, 2005, no accounts had been recovered nor written off.

During the six months ended June 30, 2006, management increased the provision related to risk in China and also provided for the net amount due from one American customer. In addition, a number of accounts provided for in 2005 were determined to be uncollectible; consequently these accounts receivable have been written off and the bad debt provision reversed. As these amounts had been fully provided for in 2005, there was no impact on the 2006 results. The net amount of bad debt expense recognized in the Statement of Operations in the six months ended June 30, 2006, is US\$ 903,000 and is net of the reversal of provisions for the cost of third-party licenses initially recorded in cost of sales and other related liabilities.

6. LONG TERM INVESTMENT IN JAVAGROUND USA INC.

In February 2006, Esmertec announced a 19.99% investment in Javaground USA Inc., a California-based company focusing on porting and testing games for mobile telephones. The investment was made for US\$ 444,000 (incl. transaction costs of US\$ 44,000). In addition, Esmertec has agreed to provide a loan of up to a total of US\$ 1.6 million to help fund Javaground's working capital requirements. The loan, which is repayable in 2008 and bears interest at 4% per annum, will be funded up to a maximum of US\$ 400,000 per quarter; the first US\$ 400,000 was funded at the same time the investment was made and is the amount outstanding as at June 30, 2006. The total amount of US\$ 892,000 (2005, US\$ 0) is included in financial assets.

Esmertec has the option to take a controlling interest in early 2007 and a further option to acquire the entire company in early 2008; the options are exercisable purely at Esmertec's discretion.

7. INTANGIBLE ASSETS

In June 2006, after a review of the latest market conditions and the internal sales pipeline, management decided to prioritize the development of products around Esmertec's core technologies, resulting in a revised product roadmap with some projects discontinued. In addition, management decided to reduce Esmertec's presence in markets where Esmertec did not have a strong position. Consequently:

- The engineering center for the OSVM product in Denmark was closed and the decision made to continue to support the existing product and customers without committing any resources to further development or commercialization of the product.
- Headcount in Esmertec KK (Japan) was reduced by more than 50%, primarily in the engineering and sales departments. Development work on acquired intellectual property was stopped.
- Intellectual property acquired from CoreTek will be used in products which will be sold primarily in the Chinese domestic market and will not have a significant penetration outside of China.

These events and decisions triggered new estimations of future cash flows from Esmertec's acquired and internally developed intangible assets. Such future cash flows, discounted to present value at a rate of 14.68%, were compared to the carrying value of the related intangible assets. Where the discounted cash flows were below the carrying value, an impairment loss was recorded.

In total an impairment loss of US\$ 15,635,000 (June 30, 2005: 0) was recorded which has been fully allocated to the Mobile & Multimedia Devices Segment (formerly: Embedded Device Segment). The impairment loss can further be analyzed as follows:

Acquired intangible assets

In the six months ended June 30, 2006, impairment charges of US\$ 12,930,000 were recorded, relating to the estimated impairment of certain intangible assets acquired with OOVM (Denmark), Esmertec KK (Japan) and CoreTek (China). The specific impairment charges were:

OOVM intellectual property	US\$ 1,895,000
OOVM goodwill	947,000
Esmertec KK intellectual property	405,000
Esmertec KK customer base	4,824,000
Esmertec KK goodwill	4,094,000
CoreTek intellectual property	765,000
Total	US\$ 12,930,000

Capitalized development costs

As a result of the decisions outlined above, and based on current estimates of future cash flows, management considered that the value of a number of projects with capitalized costs had been impaired and a loss in the amount of US\$ 2,705,000 has been recorded in 1H2006.

Development costs incurred after technical feasibility has been demonstrated are capitalized until such time as the product incorporating the technology is commercialized. The total amount of development cost capitalized during the six months ended June 30, 2006, amounted to US\$ 2,420,000 compared to US\$ 2,953,000 for the six months ended June 30, 2005. Capitalized development costs are amortized over a period of five years after the commercial release of the respective product.

8. SHARE CAPITAL

During the six month periods ended June 30, 2005 and 2006, no dividends were paid out. The movements in issued share capital for the six-month period ended June 30, 2006, are as follows:

	Number of shares	Share capital (US\$ 000s)
Issued capital at January 1, 2006	16,212,469	1,231
Shares issued through exercise of stock options	146,955	12
Translation adjustment		70
Issued capital at June 30, 2006	16,359,424	1,313
Thereof treasury shares	1,060	0
Authorized capital at June 30, 2006	805,055	65
Conditional capital at June 30, 2006	3,992,925	320

Shares issued through exercise of stock options

During the six-month period ended June 30, 2006, stock options were exercised resulting in the issuance of 146,955 shares at a nominal value of CHF 0.10 each, with net proceeds to the Company of CHF 14,696 (US\$ 12,000).

Authorized share capital

At the annual general meeting of shareholders held on May 19, 2006, the shareholders voted to increase the authorized capital by CHF 70,000 (700,000 shares of CHF 0.10 each).

Conditional share capital

The conditional share capital comprises shares which are reserved for the exercise of stock options and for the conversion of convertible bonds.

At the annual general meeting of shareholders held on May 19, 2006, the shareholders decided to increase the conditional capital by CHF 145,949.40 (1,459,494 shares of CHF 0.10 each), of which CHF 40,000 (400,000 shares of CHF 0.10 each) are reserved for stock options and CHF 105,949.40 (1,059,494 shares of CHF 0.10 each) are reserved for the convertible bonds.

Stock options

The following table details the movements in outstanding employee stock options from January 1, 2006, until June 30, 2006:

(in 000s)	For the six months ended June 30, 2006
Opening balance	1,489
Granted	396
Exercised	(147)
Cancelled and expired	(26)
Ending balance	1,712
- Thereof vested	1,048

On June 29, 2006, the Board of Directors granted a total of 400,000 stock options to employees of Esmertec Group. The options granted have an exercise price equal to the market price of the shares on the date of grant. One fourth (25%) of the options vest at the end of the first year and the remaining 75% vest straight-line on a quarterly base over the subsequent 3 years.

No stock option expense relating to the new grants was recognized in the first half 2006 due to the timing of the grant at end of June.

The amount of stock option expense related to previous grants recognized in 1H2006 was US\$ 311,000 (US\$ 723,000 in H1 2005) including the one time effect of expenses to be recorded for modifications of vested unexercised options in the amount of US\$ 144,000. In total there were 745,266 vested options affected. The modification is relating to the extension of the exercise period.

9. RESTRUCTURING

In June 2006, management decided to reorganize and restructure the Esmertec Group. This resulted in a decision to close the engineering center in Denmark which had been focused on the non-core OOVm product line, a reduction in the sales and support effort in Japan and the elimination of certain middle management roles. All of these decisions, which resulted in the eliminations of positions, were launched during the month of June 2006. The costs related to this restructuring of the organization have been recognized in the results of operations for the first six months of 2006 and total US\$ 1.7 million. These costs comprise primarily final compensation for terminated employees and to a lesser extent, consulting fees related to the process, and costs to terminate leases.

10. LOSS PER SHARE

The basic earnings per share are calculated by dividing the net loss of US\$ 34,169,000 (net loss of US\$ 1,905,000 in prior period) attributable to equity holders of the parent company by the US\$ 16,262,549 weighted average number of shares issued and outstanding during the period (US\$ 10,807,716 in prior period).

11. SEGMENT REPORTING

In February 2006, Esmertec announced the creation of a new Mobile Operator Segment, which currently reflects primarily the results of Cellicium S.A.. Esmertec's historical activity has been based primarily on the sale of the Jbed Java Virtual Machine and related products and services. This activity is now reflected in the Mobile and Multimedia Devices Segment and is comparable to the historical results for the six months ended June 30, 2005.

	Mobile & Multimedia Devices Segment		Mobile Operator Segment		Total Esmertec Group	
	Six months ended June 30		Six months ended June 30		Six months ended June 30	
(in US\$ 000s)	2005	2006	2005	2006	2005	2006
Total revenue	20,076	6,309	0	3,316	20,076	9,625
Gross profit	13,802	14	0	2,109	13,802	2,123
(Loss)/profit from operations (EBIT)	(1,390)	(34,190)	0	20	(1,390)	(34,170)

12. COMMITMENTS AND CONTINGENCIES

The Group's companies grant guarantees in the normal course of business. At December 31, 2005, there were no guarantees in favor of third parties. At June 30, 2006, performance guarantees and tender bonds had been issued to customers and prospects by the Mobile Operator Segment totaling US\$ 829,000. All such bank guarantees were secured by liens in an amount equal to the guaranteed amounts on marketable security accounts held at the issuing banks. Management is not aware of any other significant commitments or contingent liabilities which have not been disclosed in these Financial Statements.

13. RELATED PARTY TRANSACTIONS

In December 2005, Esmertec entered into a service agreement with a computer games publisher controlled by Esmertec's largest shareholder with a total contract value of US\$ 930,000. Under the terms of the service agreement, Esmertec has created a game porting and testing center in China and will operate it through March 2007. The only client of the porting and testing center is the games publisher. The service fee charged was based on arm's length negotiations.

In March 2007, the porting and testing center may be transferred to the games publisher at its option for a fee, or Esmertec may continue to operate the center and continue to charge service fees to the games publisher. On January 2006, the first installment in amount of US\$ 250,000 was paid by the customer. The remainder is being paid in quarterly installments. US\$ 330,000 was recognized in revenue during the six months ended June 30, 2006. There were no other significant transactions with related parties during the six-month periods ended June 30, 2005 and 2006.

14. POST BALANCE SHEET EVENTS

Additional loan to Javaground USA Inc.

In connection with the investment in Javaground USA Inc., Esmertec has agreed to provide a loan of up to a total of US\$ 1.6 million to help fund Javaground's working capital requirements. It will be funded up to a maximum of US\$ 400,000 per quarter. The first US\$ 400,000 was funded in February 2006. An additional installment in the amount of US\$ 400,000 was funded in July 2006.

There have been no other events between June 30, 2006, and the date of authorization of these Interim Consolidated Financial Statements that would lead to an adjustment of the carrying amounts of assets and liabilities presented as of June 30, 2006, or would otherwise have to be disclosed.

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