

To our shareholders,

Increasingly, mobile phones and multimedia devices are flexible tools that can be used by everyone for numerous applications. It is Esmertec's software platforms and services at their core that allow mobile communications users to experience optimal performance and versatility. At its origin, it is your company that enables tomorrow's mobile communication solutions for an increasing number of people globally. Indeed, as you read this letter, we have passed the milestones of 100 million mobile units shipped with Esmertec's device middleware since the launch of this product line in 2003 and over 70 million mobile subscribers now having access to our USSD browsing solutions.

Nevertheless 2006 was a challenging year. On the operational level, the company continued to show sound progress with a continued growth of customers and shipments and the creation of a new Mobile Operator segment. However, Esmertec experienced a severe revenue decrease during the first half year, which caused strains on our organization. From a financial perspective, the past year has been a disappointing one for your company.

Esmertec faced important changes in the management team and in the Board of Directors. Key executives, including Alain Blancquart, Chairman and CEO, left the company in May 2006. In July 2006, COO and President of Mobile Operator segment Jean-Claude Martinez was appointed Chief Executive Officer and in June 2006 Jean-Luc Gianduzzo joined Esmertec as EVP Global Services to run the global service organization. His primary task is to ensure that service profitability will further improve. As from January 2007, Michel Kuntz took over the responsibility of driving the global sales organization in the role of EVP Sales. In November 2006, Ruedi Noser, co-founder and Chairman of Swissbased Noser Group, a telecommunications software provider, was elected Chairman of Esmertec, along with two additional new Board members Jean-Pascal Aubert and Hans Peter Baumgartner. These personalities add their valuable telecommunications and multimedia industry experience to our Board's know-how. At the beginning of February 2006, we acquired CellicumTM S.A., an important business development that provided Esmertec with reliable and commercially implemented products for the Mobile Operator segment. In addition, we took a minority investment in JavagroundTM, a company which has designed software that enables applications such as games to be easily ported to multiple mobile devices.

Quick actions taken

The sharp decline in revenues in the first half year of 2006 resulted from a combination of market and customer-specific factors, which led to delays or reductions in committed volume contracts in the Mobile and Multimedia Device segment. Also, several large contracts were renewed later than previously expected. Furthermore, Sun's announcing that Java software would become open source created confusion in our markets and strongly impacted Esmertec's returns during this period.

The Board and the management team quickly reacted to these operational challenges. We decided to reassess our contract terms. We decided to focus on shorter term contracts which reduced the financial risk but resulted in lower revenues. We aligned the company to be a market-driven organization. Already in July, we started to implement organizational and cost-cutting measures. In Japan, Esmertec KK's management bought a majority stake of its company from us and became an exclusive reseller of Esmertec's software. We closed the OSVM R&D center in Denmark and its IP was bought by Esmertec KK in order to keep servicing existing customers. We reduced some middle management; overall we reduced the head count by over 20% from a high of over 380 in May to 30 employees at the end of 2006.

We evaluated alternatives for the operations in the United Kingdom and we continue to challenge our cost structure going forward. The efficiency improvement measures result in an overall cost structure reduction of USD 5.5 million in the second half of 2006 compared to the first half.

In addition, we optimized the sales and services organization structuring them into two separately run and measured groups in order to support our market-driven approach. We increased the number of customers in both segments. In the second half of the year we had our sales back on track. Our activities were particularly successful in Europe and Asia with mobile devices and in Middle East and Africa with the mobile operator services. Today, we are happy to say that we strengthened our relationships with our customers and improved our position in the mobile devices segment. Consequently we increased our market share to an estimated 7.6% of the mobile phone market and achieved a cumulated subscriber base at our customers of over 70 million with access to our mobile operator solutions.

Build our strategy on fundamental trends

Esmertec's markets are experiencing a growing use of interactive and mobile communication devices as well as maintenance services globally. Java technology is increasingly being selected as the interactivity enabling requirement for handset manufacturers and home multimedia products. Esmertec is well positioned to benefit from two fundamental growth drivers:

- The telecommunication industry is facing increased competition, both on the manufacturing and on the services side resulting in tough price pressure, shorter product cycles, constant product and service innovation, increasing product complexity as well as a convergence of applications. The competitive environment offers leading specialists increasing opportunities to provide flexible low-cost solutions.
- Network operators need flexible branding and innovative applications in order to provide mobile phone end users with an increasing variety of services that can differentiate them from their competitors.

Being again on track, we now concentrate our efforts on developing our business plan to exploit our strengths, both in the Mobile and Multimedia Device segment and in the Mobile Operator segment. Our plan builds on three fundamental strategic priorities:

- Reinforce market presence and penetration
- Move up the value chain
- Develop service offering

Outlook

Our operational turnaround was substantially completed by the end of the reporting year. We are challenging our engineering team to keep our technological advantage. In the Mobile and Multimedia Device segment, we are working to continue to grow our market share. Our emphasis in the Mobile Operator segment will be growing our sales coverage worldwide and introducing new products. Focus will be on profitable growth in each segment as well as in the service business. We continue to challenge our cost structure to be more efficient and to align our company to a market-driven organization. We are confident that we are once again on the path to growth.

Thanks

The management is proud of the skilled and committed Esmertec employees around the world. The challenges of last year have demanded great efforts from all and we sincerely appreciate the whole team's commitment and exceptional performance. Their professionalism and achievements have made a difference for this company. Finally, we express gratitude to our shareholders for their continuing support and confidence in us. All employees at Esmertec work hard to merit it.



Ruedi Noser
Chairman of the Board of Directors



Jean-Claude Martinez
Chief Executive Officer

In USD millions, except as otherwise indicated	FY 2005	H1 2006*	H2 2006	FY 2006
Revenues	39.2	9.3	15.5	24.8
Gross profit	24.3	1.8	8.2	10.0
EBITA (LBITA)	(5.9)	(15.3)	(6.3)	(21.6)
Operating income (loss)	(13.8)	(34.5)	(10.8)	(45.3)
Net loss attributable to equity holders of Esmertec AG	(15.7)	(34.5)	(13.9)	(48.4)
Basic loss per share, USD	(1.22)	(2.12)	(0.85)	(2.97)
Diluted loss per share, USD	(1.22)	(2.12)	(0.85)	(2.97)
Cash collections	17.4	13.4	14.5	27.9
Cash flow from operating activities	(15.7)	(12.7)	(7.5)	(20.2)
Cash, cash equivalents, short term investments, marketable securities	55.0	29.1	13.2	13.2
Shipments in the period, millions of units	23.1	18.1	41.0	59.1
Subscribers added in the period, millions of subscribers	N/A	6.5	29.7	36.2

Esmertec's historical activity has been based primarily on the sale of the Jbed Java Virtual Machine and related products and services. This is reflected in the Mobile and Multimedia Devices Segment and is comparable in scope to the historical results for 2005. The Mobile Operator Segment reflects principally the results of Cellcium since its acquisition by Esmertec at the beginning of February 2006.