THALES

FINANCIAL REPORT

BUSINESS REVIEW

SHAREHOLDER INFORMATION

ANNUAL REPORT 2006

CONTENTS

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Overview

Traditionally described as "professional electronics", the Thales Group's businesses are primarily dedicated to **critical information systems** for **defence, aerospace** (aeronautics and space), and **security** applications, in particular for ground transportation. Information systems and infrastructures are considered critical if they provide services that are essential for people's lives and livelihoods and underpin a country's economic and political machinery.

Thales solutions span all the functions in the critical information loop, from detection and data processing to communication of information to the relevant people, decision support, response management and reporting on any action taken.

Today, effective information management is a key requirement of Thales's customers. Critical information systems and information dominance have become a major priority for the armed forces, but defence markets now only account for roughly half of Thales's revenues. The company's non-defence customers often have similar needs in that secure information management has become critical to their operations. This is the case in the **air transport** sector, traditionally the company's second largest market, and in **ground transportation,** particularly rail transportation, where Thales significantly strengthened its operations at the beginning of 2007 with the acquisition of the rail signalling businesses of Alcatel-Lucent, and in the growing markets for **civil security.** Thales provides security solutions for infrastructure, people and goods, and is experiencing rapid growth in this sector, mainly to meet demand from administrations, infrastructure and network operators, and major corporations. In civil security markets, Thales benefits from three main competitive advantages:

- an outstanding **portfolio of innovative products and technologies.** All Thales businesses draw on a common core of technologies revolving around information management and superiority, real-time distribution of information, and complex systems engineering and architecture. A network of 20,000 engineers and technical staff operating in all Thales subsidiaries around the world constantly enhances this core of technologies through the company's research and development programmes,

- **solid experience of the defence sector,** with recognised expertise in mission-critical system integration and large-scale programme management,

- a positioning as a **global player in security markets,** with an extensive international presence in more than twenty major countries. Thales refers to this international presence as "multidomestic" to emphasise the excellent relations that the company has established with local customers and the local industrial fabric in each of its countries of operation. This positioning also provides the company with a solid basis for managing its international operations.

Expanding the international dimension of the company's operations continues to be a major strategic priority.

The data and comments on individual business sectors in this report reflects the organisation introduced by the company in 2004, which was in place throughout 2006:

- the **Aerospace division** covers three major segments: equipment for civil and military aircraft, mission electronics for combat aircraft, and airborne surveillance & mission systems for armed forces and civil security authorities,

- the **Air Systems division** serves two main markets: air defence and missile systems for military customers, and civil air traffic management systems,

- the **Land & Joint Systems division** develops network-centric systems and network-enabled equipment for land forces and joint and allied commands. It also draws on its dual technology capabilities to develop tailored offerings for selected civil customers,

- the **Naval division** focuses on four key areas of expertise: warship prime contracting, systems for surface ships, underwater systems and naval services, including maritime security,

- the **Security division** leverages the company's technology expertise to provide risk management solutions for civil, government and private-sector customers,

- the **Services division** capitalises on Thales's experience in providing IT services, simulation-based training and other services to military and aerospace customers, with an extended offering tailored to major government, institutional and enterprise customers.

The major strategic operations finalised in 2007 are expected to lead to a number of organisational changes within the company.

Timeline

Origins

1968: The professional electronics businesses of Thomson-Brandt (previously CFTH) merge with the Compagnie Générale de Télégraphie Sans Fil (CSF) to form Thomson-CSF. Compagnie Française Thomson-Houston (CFTH) was formed in 1893 to operate the patents of the US Thomson-Houston Electric Corp in the emerging market for power generation and transmission. CSF was founded in 1918 and became a pioneer in broadcasting. With its subsidiary Société Française Radioélectrique (SFR), acquired in 1957, CSF was a key player in the 1930s development of broadcasting, short wave, electro-acoustics and early radar and television systems.)

1970-1980: The company receives its first major export contracts in the Middle East, after the 1973 and 1979 oil crises. It diversifies into telephone switchgear, silicon semiconductors and medical imaging (CGR).

Strategic refocusing on professional and defence electronics

1982: In February, the parent company Thomson SA is nationalised. The financial situation of Thomson-CSF is very weak, its portfolio of businesses highly diversified, and its market share in many areas too small to be profitable. Despite the inflow of revenues from the first major contracts with the Gulf States, debt remains high.

1983-1987: The financial situation is turned round by refocusing on professional and defence electronics. The company divests heavily in civil telecommunications in 1983 (agreement with CGE, which later became Alcatel) and the medical sector (sold to General Electric in 1987). The semiconductor businesses are merged with those of the Italian group IRI Finmeccanica in 1987 to form SGS-Thomson. Financial performance also benefits from the finance activities developed in-house from 1984 to manage cash flows from major export contracts. This finance business is progressively taken over by Crédit Lyonnais from 1990 to 1993, in exchange for a stake in the bank.

Building a multidomestic company: from Thomson-CSF to Thales

1987-1996: As early as 1987, Thomson-CSF anticipates the inevitable cutbacks in defence spending and, as its major ongoing export contracts draw to a close, starts to radically restructure its businesses in order to maintain margins. A proactive policy of external growth is adopted, mainly in Europe, with the acquisition of the defence electronics businesses of the Philips group in 1989. The other major operation is the acquisition of a controlling interest in Sextant Avionique (formed through the merger of the avionics businesses of Thomson-CSF and Aerospatiale). Numerous other acquisitions, large and small, significantly expand the Group's industrial base outside France, mainly in Europe. The non-French subsidiaries' share of consolidated revenues rises from 5% to 25%.

1996 and 1997: Holdings in Crédit Lyonnais and SGS Thomson (now STMicroelectronics) are divested. The capital gains are used to finance further international growth.

1998: Reduction of the French State's interest in Thomson-CSF, from 58% to 40%, resulting from a contribution of assets by Alcatel and Dassault Industries, which become shareholders in the company. The assets contributed, namely Dassault Electronique and the professional and defence electronics businesses of Alcatel, strengthen Thomson-CSF's scope of business, consolidate its market positions in defence and industrial electronics, and expand its industrial operations in Europe, particularly in Germany, Italy and Norway. The operation also results in the formation of Alcatel Space, which brings together the space businesses of Alcatel, Aerospatiale and Thomson-CSF and is jointly owned by Thomson-CSF (49%) and Alcatel (51%).

1998-2000: After privatisation, the Group's “multi-domestic” strategy in defence markets is pursued throughout the 1990s in Europe, and then extended to South Africa, Australia, South Korea and Singapore… After the friendly takeover in June 2000 of the British company Racal Electronics, the United Kingdom becomes the Group's second-largest “domestic” industrial base.

At the end of December 2000, Thomson-CSF, recently renamed Thales, forms the first transatlantic joint venture in the defence sector, and the world leader in air defence, with the American company Raytheon, Thales Raytheon Systems.

In the space of just over ten years, the number of employees based outside France increased from less than 30% of the workforce to almost half.

Thales, world leader in critical information systems

These acquisitions as well as internal growth radically alter the Group's portfolio of businesses with increasing importance of civil applications, particularly on IT markets. In line with this strategic focus, a new organisation with three business areas – defence, aerospace and information technology and services (IT&S) – is introduced in July 2000.

This organisation is intended to leverage the "dual" nature of the company's technology. In addition, with this clearer strategic focus in its civil activities, the company is ready to divest businesses that do not offer sufficient synergies with its defence and aerospace activities and in which it does not have favourable competitive positions. This divestment policy is also intended to reduce the debt contracted to finance the company's external growth operations.

As of 2001, responding to the geopolitical and economic upheavals following 11 September 2001, Thales strengthens its focus on the most technology-intensive segments of the defence market, particularly network-centric warfare and force interoperability. At the same time, it expands its role as prime contractor and service provider to meet the needs of client countries faced with the growing complexity of programmes and the increasing sophistication of defence equipment and systems.

In 2001, Thales divests its interests in Alcatel Space, whose largest market by far was, at that time, in satellites for civil telecommunications, Alcatel's core business. Thales continues to divest its non-strategic civil businesses, while at the same time consolidating and reorganising its growing civil security business.

Thales pursues its "multi-domestic" development policy, acquires full control of several defence and aerospace subsidiaries originally held through joint ventures. Thales UK, now Britain's second-largest defence contractor, is selected for a number of major Ministry of Defence programmes, including the CVF future aircraft carriers, and in 2005 the company is appointed prime contractor for the UK's *Watchkeeper* UAV system, Europe's largest tactical surveillance programme.

In 2004, with refocusing of the civil businesses almost complete, Thales announces a new organisation based on six divisions, each defined according to its respective markets, to facilitate implementation of the common technologies that underpin the company's world leadership in critical information systems for defence, aerospace and civil security.

At the end of 2005, after five years of refocusing on its core capabilities, Thales regains the room for manoeuvre needed to pursue ambitious objectives in terms of revenue growth and financial performance, with organic growth targets based on a record order book, very low net debt providing the capacity to finance external growth operations, and the prospect of improved results backed by an ongoing programme to improve its competitive performance.

A new stage in Thales's development begins in 2006: the Group materializes its external growth ambitions with two major agreements that significantly reshape the company's business portfolio, increase its focus on security in the broadest sense, for both military and civil markets, and strenghtene its leadership and capabilities in critical information systems:

- the agreement finalised at the end of March 2007 with the naval shipbuilder DCN and the French government, making Thales the main private shareholder and industry partner of one of the largest and most capable players in the worldwide naval defence sector,

- the agreement with Alcatel-Lucent, signed in December 2006 and implemented in the first half of 2007, which brings Thales a global leadership position in security systems for ground transportation, and in satellites. These new businesses represent more than 2 billion euros in annual revenues, i.e., the equivalent of 20% of Thales's consolidated revenues in 2006.

These two major agreements will bring a more equal balance to the civil and military security markets that Thales serves, with half of its business in defence and the rest fairly equally divided between aerospace and civil security, where the largest market is rail infrastructure.

Selected highlights of 2006

10 January: ThalesRaytheonSystems begins development of advanced technology improvements to its *Firefinder AN/TPQ-36* and *AN/TPQ-37* weapon locating radars to extend system service life, reduce customer life cycle costs and significantly boost reliability, maintainability and performance.

9 February: Thales completes before the deadline the upgrade of the access control and ticketing infrastructure for Line 1 of the Turin Metro. The new system goes live ahead of contract schedule and in plenty of time for the influx of visitors for the Olympic Winter Games.

16 February: The Joint Staff of the French armed forces appoints Thales as prime contractor for the *SCAPIN* operational and strategic decision-support system. For the first time, *SCAPIN* will give French commanders a comprehensive picture from across all branches of the military.

21 February: Shanghai Airlines chooses Thales to supply and support training systems for its *Boeing 737-800* airliners.

22 February: British Mediterranean Airways signs a new purchase and support agreement with Thales for in-flight entertainment systems. Thales's *TopSeries* video and audio on-demand system entered service on BMED Airbus aircraft in 2005. Under this new contract, the *TopSeries* system will be installed on *A320* and *A321* aircraft on order and scheduled to enter service in 2010.

5 April: Thales and Alcatel announce their intention to transfer Alcatel's satellite businesses and critical systems businesses for rail transport and security to Thales.

18 April: Thales is selected to provide France's Imprimerie Nationale (government printing office) with a complete secure system for the production and personalisation of the new electronic passport.

7 June: Thales wins a major contract to provide Saudi Arabia with communication infrastructure through its local subsidiary Stesa. Under the contract, Thales will design the network, install equipment and complete the necessary civil engineering tasks. Three local GSM operators will use the network: Etihad Etisalat, ITC and Bayanat.

June: At the Eurosatory 2006 land/air defence exhibition in Paris, Thales and Rockwell Collins – the leading military communication equipment suppliers with an industrial presence in Europe and the US – sign a strategic agreement for the joint development of a new line of tactical ground communication products for the international market.

11 July: Thales wins three successive secure ticketing contracts to equip the three oldest lines of the Beijing Metro, all stations of Dubai's first metro network and the new Metronorte Line in Madrid.

July: At the Farnborough International Air Show, Athens-based Aegean Airlines selects Thales to supply the *flight management system* and other key avionics equipment for its future Airbus *A380* fleet. Deliveries are scheduled to begin in Spring 2007. Also at Farnborough, Thales signed a cooperation agreement with Russian planemaker Antonov to focus on special-mission aircraft and sold training simulators to Sukhoi for the *Superjet100* and to Kingfisher Airlines for its *A320* and *ATR* aircraft.

20 July: Thales sells most of its navigation business to Shah Capital Partners. This business is the creator of the *Magellan* brand of GPS equipment for the consumer recreation and automotive navigation markets. The divestment supports the refocus of Thales's security portfolio to professional applications.

24 July: Thales Communications Inc. wins a major contract with the US Army to supply 9,000 *AN/VRC-111* vehicle adapter amplifiers. The *AN/VRC-111* will extend the range of *SINCGARS*-capable radio systems installed by Thales on US Army vehicles and will enable additional capabilities and interoperable communications.

1 September: Thales is selected to supply the transmission subsystem and security subsystem for the *FALCON* future tactical network for British land forces. In particular, the new high-speed version of the *TRC 4000* line-of-sight radio, already in service with France, Switzerland, Croatia and Austria, will form part of the transmission subsystem.

19 September: Through their alliance with SAIC and Raytheon in the United States, Thales and TRS achieve their first success in land-based ballistic missile defence for NATO.

October: At the Euronaval exhibition, Thales presents its broad-ranging capabilities in naval defence and maritime search & rescue, and its key role in support of the naval transformation process. The Group signs an agreement with Chilean naval shipyard ASMAR for the maintenance of Thales equipment on the four Chilean Navy frigates purchased from the Royal Netherlands Navy and currently being transferred.

12 October: Thales Australia is created as the Group acquires the remaining shares in ADI, a defence company previously owned jointly with Transfield Holdings. The operation was completed with the full authorisation of the Australian government. ADI thus joins the other fully owned Thales local subsidiaries – Thales Underwater Systems, Air Traffic Management and Training & Simulation – to form a single entity called Thales Australia.

10 November: Thales opens its new research centre on the campus of the *École Polytechnique* near Paris. The ceremony is attended by the French minister for higher education and research. The location at one of France's most prestigious engineering schools further illustrates the Group's commitment to promote cooperation with the university research community.

1 December: Thales and Alcatel-Lucent sign the final agreement for the transfer of Alcatel-Lucent's transport & security businesses and space businesses to Thales. The accord also provides for closer industrial cooperation between the two partners.

4 December: Thales is selected to provide communication services for the NATO International Security Assistance Force (ISAF) in Afghanistan. The Group is responsible for the provision, operation and maintenance of a secure voice and data communication network that will be progressively deployed to more than sixty ISAF points of presence in the country for a minimum of three years.

11 December: Thales makes a strategic breakthrough in the North American transport market with a first contract to supply an integrated secure ticketing system for the Toronto bus, tram and rail networks. Work will be carried out in cooperation with the Accenture Group.

12 December: The European Commission selects the consortium led by Thales to develop OSIRIS, the first integrated service of *GMES* (Global Monitoring for Environment and Security). *GMES* will create an EU-wide capability to acquire, analyse, process and distribute information in support of European environment and security directives.

22 December: Thales Nederland wins a contract with the Royal Danish Navy for the delivery of three anti-air warfare suites, each comprising one *APAR* multifunction radar, one *SMART-L* volume search radar and one fire control cluster. The suites will be installed on new patrol ships currently under construction.

Key figures

In € m	2006	2005	2004	2003	2002
Order book at year-end	20,676	20,223	17,578	18,743	19,009
Order intake	10,818	12,781	9,375	10,887	10,677
Consolidated workforce at year-end	52,160	53,047	55,705	57,439	60,662
France	29,180	29,835	30,872	32,219	33,236
United Kingdom	8,524	8,920	9,810	10,521	11,478
Other Europe	7,100	7,202	7,663	7,630	7,791
Rest of world	7,356	7,090	7,360	7,069	8,157

Financial data for 2004 to 2006 in accordance with IAS/IFRS

In € m	2006	2005	2004
Revenues (a)	10,264	10,263	10,283
France	3,064	2,995	2,982
United Kingdom	1,342	1,242	1,337
Other Europe	2,079	2,167	1,954
Rest of world	3,779	3,859	4,010
Income from operations	755	722	700
Income of operating activities	576	549	571
Net income "Group share"	388	334	326
Earnings per share *(in euros)*	2.30	2.00	2.00
Dividend per share *(in euro)*	0.87	0.83	0.80
Total R&D	(2,000)	(1,900)	(1,850)
Company-funded R&D	(534)	(512)	(444)
Operating cash flows before working capital changes	946	901	888
Capital expenditures	(373)	(352)	(273)
Net (acquisitions) disposals	304	164	99
Net debt (net cash position)	(91)	398	860
Shareholders' fund (excluding minority interests)	2,287	2,062	1,710

(a) Geographical breakdown of revenues by destination.

Financial data for 2002 to 2004 in accordance with French accounting standards

In € m	2004	2003	2002
Revenues (a)	10,288	10,569	11,105
France	2,984	2,748	2,554
United Kingdom	1,337	1,268	1,444
Other Europe	1,955	2,114	2,110
Rest of world	4,012	4,439	4,997
Operating income	729	698	597
Income of operating activities	619	497	447
Net income "Group share"	198	112	111
Earnings per share *(in euros)*	1.22	0.69	0.70
Net dividend per share *(in euro)*	0.80	0.75	0.70
Total R&D	(1,850)	(1,850)	(1,900)
Company-funded R&D (incl. Capitalised)	(436)	(419)	(460)
Operating cash flows before working capital changes	848	770	591
Capital expenditures	(321)	(350)	(357)
Proceeds from disposal of real estate assets	35	48	198
Net (acquisitions) disposals	101	124	79
Net debt (net cash position)	841	906	1,320
Shareholders' fund (excluding minority interests)	2,097	2,014	2,139

(a) Geographical breakdown of revenues by destination.

2006 Financial report

I - Directors' report

II - Consolidated financial statements

I - Directors' report

A. Management discussion and analysis of 2006 financial statements

Highlights and major trends in 2006

A new stage in Thales's development began in 2006, with two major agreements that significantly reshape the company's business portfolio, increase its focus on security in the broadest sense, for both military and civil markets, and strengthen its leadership and capabilities in critical information systems:

- the agreement with Alcatel-Lucent on 1 December 2006 to transfer certain of the telecommunications group's businesses to Thales. These businesses generated 2006 revenues totalling €2.1 billion in ground transportation, civil security and satellites. The 1 December 2006 agreement provides for a transfer in two stages: (i) a contribution of assets, approved by the 5 January 2007 general meeting, leading to an increase in Alcatel-Lucent's interest in Thales from 9.5% to 21%, and (ii) a cash transaction involving Alcatel-Lucent satellite businesses, subject to the approval of the European Commission expected in the second quarter of 2007(1),

- the agreement with DCN and the French government in December 2005 for the transfer to DCN of some of Thales's naval businesses in France and the simultaneous acquisition by Thales of 25% of DCN's share capital. The final agreement was reached on 30 January 2007 and was expected to come into effect at the end of the first quarter of 2007(2).

These two major agreements will bring a more equal balance to the civil and military security markets that Thales serves, with half of its business in defence and the rest fairly equally divided between aerospace and civil security, where the largest market is rail infrastructure.

In the summer of 2006, Thales virtually completed its divestment of non-strategic businesses, begun in 2000, selling the GPS positioning and navigation equipment businesses of its Thales Navigation subsidiary in California *("Magellan")*. These businesses, which generated revenues of €224 million in 2005 and €113 million in the first half of 2006, were deconsolidated from the second half of 2006.

In terms of business and results, 2006 was a highly positive year, marked by the following major trends:

- **Confirmed return to growth**
  > organic revenue growth of 4.3% on a like-for-like basis,
  > a further increase in the order book at the end of the year, to €20,676 million, with a book-to-bill ratio of 1.05 supported by healthy recurring and diversified orders, despite the absence of major contracts on the scale of a number of awards in 2005.

- **Marked improvement in financial performance**
  > income from operations up 5% at €755 million and a further improvement in operating margin to 7.35%, compared with 7.05% the previous year,
  > net income up 16% to €388 million from €334 million in 2005.

- **Positive net cash position at end-2006** of €91 million, compared with net debt of €398 million at end-2005, due largely to a 24% increase in operating cash flows to €754 million.

1. Revenues: confirmed return to growth

In € m	2005	2006	Overall change	Organic change
Revenues	10,263	10,264	+0%	+4%
Order intake	12,781	10,818	-15%	-13%
Order book at year-end	20,223	20,676	+2%	+3%

(1) Approved by the European Commission on 4 April 2007; effective transfer on 6 April 2007.
(2) Transaction finalised on 29 March 2007.

1.1. Consolidated revenues

In 2006, Thales Group revenues totalled **€10,264 million,** compared with €10,263 million in 2005. On a like-for-like basis, revenues grew by 4.3% (compared with organic growth of +3.8% in 2005).

- **Exchange rate** fluctuations reduced revenues by €73 million. Changes **in the scope of consolidation** further to the divestment of non-core businesses resulted in a net reduction in revenues of €345 million. The main businesses divested were Thales Broadcast & Multimedia and the High Tech Optics operations, which were deconsolidated at end-2005, and the satellite navigation business, which was deconsolidated from 30 June 2006.
- The breakdown by division shows a reduction in revenues for **Naval,** limited to 10% despite the completion of the *Sawari 2* contract, while **Security** and **Land & Joint Systems** recorded double-digit growth (+13% and +10% respectively).

a. Consolidated revenues by division

In € m	2005	2006	Overall change	Organic change
Aerospace	2,335	2,473	+6%	+6%
Air Systems	1,596	1,589	-0%	+0%
Land & Joint Systems	2,178	2,401	+10%	+10%
Naval	1,484	1,330	-10%	-10%
Security	1,186	1,205	+2%	+13%
Services	1,183	1,214	+3%	+5%
Other and divested businesses	301	52	ns	ns
Consolidated revenues	**10,263**	**10,264**	**0%**	**+4%**

- The **Aerospace** division recorded +6% organic growth, reflecting a strong performance by the division's civil businesses, which increased revenues by more than 20% over the year, particularly for in-flight entertainment systems, where sales nearly doubled compared with the previous year. Sales of avionics systems continued to rise in line with the increased pace of Airbus production, and, to a lesser extent, deliveries for Bombardier regional aircraft and billings on the Sukhoi regional aircraft programme, which is in the development phase. In military markets, 2006 revenues fell slightly overall, although increased sales of avionics systems on the *A400M* and *Rafale* France programmes and the *Watchkeeper* UAV-based surveillance programme in the United Kingdom partly offset the reduction in billings linked to the completion of a number of major export programmes.
- Revenues of the **Air Systems** division remained stable compared with the previous year on a like-for-like basis, although a strong recovery (+11%) was recorded in the last quarter. Billings on surface radars were lower because several naval radar contracts in Asia (South Korea and Singapore) reached completion and new orders in this segment only had a moderate impact on revenues by end-2006. Air defence systems business remained solid in 2006 overall as work continued on the *FSAF* (Franco-Italian cooperative programme), *KSAM* (South Korea) and *VT1* programmes for France and Finland. Revenues from the air defence businesses of the joint venture ThalesRaytheonSystems were stable over the first three quarters of 2006, before recording a marked increase in the fourth quarter. The main revenue streams from this business were the *ACCS Loc1* programme for NATO and the support services contract for the US Army's *Firefinder* radars. Revenues from air traffic management businesses were similar to the previous year, with a marked increase in sales of air traffic control radars offsetting lower revenues from major upgrade programmes that were completed in 2005 or 2006 in Brazil, New Zealand and Kenya.
- After two years of virtually flat growth, the **Land & Joint Systems** division recorded a 10% increase in revenues in 2006. The highest rates of revenue growth came from the United States, where a new complement of tactical communications equipment is being delivered to the US

military, and in France, with the deployment of the large-scale *Socrate* infrastructure network and the *Syracuse III* satellite communications programme. In the United Kingdom, the division recorded its first revenues on the *Falcon* tactical network programme in the fourth quarter. The order for this programme was booked mid-year

- As expected, **Naval** division revenues fell as a result of the completion of the *Sawari 2* frigate programme for Saudi Arabia. The overall reduction in revenues was limited (10%), however, as the division commenced billings on the *P75* submarine programme for India, the cooperative Franco-Italian *FREMM* programme, and the ongoing demonstration phase of the *CVF* aircraft carrier programme in the United Kingdom.
 The positive impact of these new programmes was reflected in the upturn in revenues recorded in the fourth quarter: sales by the division increased by 13% in the fourth quarter of 2006, compared with an average decrease of 21% over the first nine months of the year. The completion of the *Sawari 2* programme no longer impacted the division's revenues in the fourth quarter.

- Most of Thales's **Security** businesses are experiencing positive growth: sales of security systems grew as the communication infrastructure contract for *Etisalat* in Saudi Arabia ramped up, and continued brisk growth in secure transactions and components, which were driven in particular by the development of digital technology in medical imaging and the up-cycle in the satellite market.

- The **Services** division recorded 5% revenue growth for the full year, with quite significant variations between different businesses. In particular, revenues from telecom services for the rail transport sector in the United Kingdom returned to strong growth in the second half of the year. The division also sustained its growth in IT services, while training and simulation sales grew at a more moderate rate.

b. Revenues by geographic area

Destination	2005		2006		Overall change
	€m	%	€m	%	
France	2,995	29%	3,064	30%	+2%
United Kingdom	1,242	12%	1,342	13%	+8%
Other European countries	2,167	21%	2,079	20%	-4%
Total Europe	**6,404**	**61%**	**6,485**	**63%**	**+1%**
North America	1,068	10%	1,192	12%	+12%
Near & Middle East	884	9%	617	6%	-30%
Asia-Pacific	1,537	15%	1,577	15%	+3%
Africa & Latin America	370	5%	393	4%	+6%
Total outside Europe	**3,859**	**39%**	**3,779**	**37%**	**-2%**
Total	**10,263**	**100%**	**10,264**	**100%**	**0%**

The proportion of revenues billed in **Europe** rose slightly, to 63%, as a result of higher sales in the United Kingdom, driven in particular by stronger activity on the *Watchkeeper* programme, billings on the *CVF* and *Falcon* programmes and the return to growth in telecom services for the rail transport sector. The moderate growth in revenues billed in France includes a sharp increase in billings on major military network programmes and the *FSAF* air defence system, as well as civil sales of security systems and services, but lower revenues on the *Rafale* France programme. Most of the decrease in revenues billed in other European countries was the result of billing schedules on a number of ongoing defence programmes.

Despite the divestment of the navigation business in mid-2006, Thales again recorded double-digit growth (12%) in revenues billed in **North America** in 2006, particularly for defence communications and in-flight entertainment systems and support services for airlines.

The large reduction in billings in the **Middle East** is a cyclical effect attributable to the completion of several major contracts in Saudi Arabia *(Sawari 2* frigates). High order intake from this region in 2006 (€1,088 million) will lead to higher billings from the 2007 financial year.

The small progression in revenues in the Asia-Pacific region combines, on the one hand, the completion of a number of naval and airport modernisation programmes and, on the other hand, a marked increase in revenues from civil aerospace support services, satellite components, optronic systems and defence communication equipment, leading to a moderate overall increase in revenues billed in this region. Asia-Pacific still accounts for more Thales revenues by destination than any other region except Europe.

1.2. Orders

The book-to-bill ratio was greater than 1 in 2005 and the first half of 2006, and Thales recorded sustained growth in orders worth €100 million or less. The full-year figures confirm both trends, with 11% overall growth in these smaller orders and an overall book-to-bill ratio of 1.05 for 2006.

Total order intake, at €10,818 million, was 15% lower (13% lower on a like-for-like basis) than the exceptionally high order intake recorded in 2005 (€12,781 million), which included €3,260 million for three contracts each worth more than €500 million: the Franco-Italian *FREMM* frigate programme and India's *Scorpene-class P75* submarine programme for the Naval division, and the United Kingdom's *Watchkeeper* UAV-based surveillance programme for the Aerospace division. None of the new orders booked in 2006 is worth more than €200 million; eight are worth more than €100 million.

a. Order intake by division

In € m	2005	2006	Overall change
Aerospace	3,164	2,369	-25%
Air Systems	1,202	1,450	+21%
Land & Joint Systems	2,364	2,869	+21%
Naval	3,237	1,254	-61%
Security	1,421	1,525	+7%
Services	1,101	1,304	+18%
Other and divested businesses	292	47	ns
Total order bookings	**12,781**	**10,818**	**-15%**
Total of orders worth less than €100 million	8,630	9,548	+11%

- Orders booked by the **Aerospace** division in 2006 were 25% lower than in 2005, when order intake included almost €1 billion for the *Watchkeeper programme in the United Kingdom.* Excluding this major contract, the year-on-year increase in the division's order intake would have stood at 3%. Civil orders were relatively solid, driven by growth in in-flight entertainment, higher Airbus production rates and a good level of support business. In military markets, in addition to *Watchkeeper,* highlights of the year were the pursuit of the *Rafale* France programme, particularly the roadmap for the development of the active phased-array radar, the upgrade contract for Morocco's *Mirage F1* combat aircraft and the avionics contract for the British Army's *Future Lynx* helicopter.

- The sharp increase in orders booked by the **Air Systems** division (+21%) is the result of strong business in surface radars and civil radars, and good sales performance in services, both in defence markets, particularly for through-life support on Saudi Arabia's air defence systems, and in civil markets, with a new contract to upgrade air traffic control radars in Brazil.

- The **Land & Joint Systems** division again recorded a sharp rise in order intake (+21%), both in defence communications and networks in France, the United Kingdom and the United States (with order intake close to €300 million), and in optronics, particularly in France and the United Kingdom. The division significantly increased its order intake in all regions.

- After an exceptional year in 2005, when new business included orders worth €2.3 billion for the first phase of the Franco-Italian *FREMM* multi-mission frigate programme and confirmation of the Scorpene submarine contract for India, order intake by the **Naval** division fell by 61% and represented a book-to-bill ratio of 0.94. The first orders in 2006 were to equip several corvettes in partnership with Navantia as well as patrol boats for Denmark.

- The **Security** division recorded an increase in order intake of 7% (+17% on a like-for-like basis excluding the impact of the deconsolidation of the GPS navigation business in the second half of the year). This increase was mainly driven by new orders in information system security with the secure GSM network contract for *Etisalat* in Saudi Arabia, and, to a lesser extent by secure transactions and components. In the transport sector, order intake stabilised after strong growth in 2005.
- The 18% rise in order intake by the **Services** division came mainly from information systems, particularly IT outsourcing, telecom services for Network Rail and the London Underground, and defence services in Australia. Order intake by the training and simulation business was roughly at the same high level as in the previous year, thanks to strong growth in simulator orders for commercial airlines.

b. Orders by geographic area

Destination	2005		2006		Overall change
	€m	%	€m	%	
France	4,265	33%	2,528	23%	-41%
United Kingdom	2,133	17%	1,306	12%	-39%
Other European countries	2,311	18%	2,128	20%	-8%
Total Europe	**8,709**	**68%**	**5,962**	**55%**	**-32%**
"book-to-bill"	**1.36**		**0.92**		
North America	1,458	12%	1,278	12%	-12%
Near & Middle East	367	3%	1,088	10%	+197%
Asia-Pacific	1,816	14%	1,760	16%	-3%
Africa & Latin America	431	3%	730	7%	+70%
Total outside Europe	**4,072**	**32%**	**4,856**	**45%**	**+19%**
"book-to-bill"	**1.05**		**1.28**		
Total	**12,781**	**100%**	**10,818**	**100%**	**-15%**

As a proportion of total order intake for the year, orders booked from France and the United Kingdom were significantly lower than in 2005, when two major orders totalling €2.7 billion were placed by these countries *(FREMM* and *Watchkeeper).* Similarly, new orders in the rest of **Europe** were lower than in 2005, when major new contracts included the development of the avionics for Sukhoi's *RRJ* and the upgrade of the *F122 / F123* frigates for the German Navy.

The apparent reduction in order intake in **North America** was entirely the result of the divestment of, in 2005, the broadcast and multimedia activities and high-tech optics and, in 2006, GPS navigation businesses, all of which have a substantial presence in the United States. With the same scope of consolidation, order intake rose slightly, representing a book-to-bill ratio of 1.07, and this region contributed 12% to Group order intake in 2006, the same percentage as in 2005.

Order intake in **Asia** was strong, with major new orders in South Korea, a naval programme for Indonesia, several defence orders in Australia and in-flight entertainment systems for an Indian airline sustaining total order intake at almost the same level as in 2005, when new orders included the 580 million euro Indian submarine contract and orders booked by the high tech optics business in Singapore, which was divested at the end of the year. The book-to-bill ratio stood at 1.12 for 2006 compared with 1.18 for 2005.

Order intake almost tripled in the **Middle East** with a new series of through-life support contracts for air defence systems, the deployment of Etisalat's secure GSM network in Saudi Arabia, and a contract to supply electronic warfare equipment to the United Arab Emirates.

At 31 December 2006, **the order book** stood at €20,676 million, the highest level ever recorded, and was 2% higher than at end-2005 (€20,223 million). The order book represents 24.2 months of revenues compared with 23.6 months at end-2005. The largest order books by division were for Naval (43 months of revenues), Air Systems (29 months) and Aerospace (25 months), ahead of Land & Joint (20 months) and Services (19 months). The order book for the Security division, whose market cycles are shorter, represented 12 months of revenues. Note that the year-end order book for the Aerospace division, and the Group as a whole, does not include avionics equipment that will be purchased from Thales for Airbus aircraft already on firm order from airlines: Airbus only orders this equipment from Thales a few weeks before they are installed on the aircraft. End-2006, the value of these implicit orders was more than $1.5 billion.

2. Financial performance: significant improvement in 2006

The increase in net income in 2006 is due to the following favourable trends:

- a 4.5% improvement in current income from operations, from €722 to €755 million, with a further rise in operating margin to 7.35% of revenues, compared with 7.05% in 2005,

- a 5% increase in income of operating activities, from €549 to €576 million, after restructuring costs somewhat lower than the previous year, and despite significantly reduced capital gains from divestments,

- financial results improved from €(93) to €(73) million as a consequence of the reduction of net financial debt over the year and a reduction in other components of pension charge.

Thales showed a net profit, Group share, of €388 million for the 2006 financial year, €16 million higher than the previous year's figure of €344 million.

Summarised profit and loss account

In € m	2005	2006	Change
Consolidated revenues	10,263	10,264	+1
Income from operations	**722**	**755**	**+33**
Restructuring costs	(213)	(193)	+20
Gain (loss) on disposal of assets and other exceptional items	40	14	-26
Income of operating activities	**549**	**576**	**+27**
Other financial income (expense)	(93)	(73)	+20
Other components of pension charge	(34)	(19)	+15
Income tax	(87)	(101)	-14
Equity in income of unconsolidated affiliates	8	8	--
Net income (loss)	**343**	**391**	**+48**
share of minority interests	(9)	(3)	-6
Net income (loss), Group share	**334**	**388**	**+54**

2.1. Income from operations

Income from operations increased by 4.5% to €755 million and represented an operating margin on revenues of 7.35% compared with 7.05% in 2005.

Income generated by the six divisions increased by nearly €30 million (+4%) overall, to €775 compared with €746 million in 2005. This corresponds to an operating margin of 7.55%, compared with 7.26% in 2005.

These positive trends were obtained despite the negative impact of exchange rates, estimated at €46 million, and mainly caused by the dollar parity. With constant exchange rates, income from operations increased by 11%, reflecting both the first results of restructuring measures implemented under the Optimum plan and the positive effects of the portfolio refocusing policy that has been ongoing for several years.

Income from operations by division

In € m	2005	2006	Change
Aerospace	209	201	-4%
% of revenues	*8.9%*	*8.1%*	
Air systems	123	139	+13%
% of revenues	*7.7%*	*8.7%*	
Land & Joint Systems	128	186	+45%
% of revenues	*5.9%*	*7.7%*	
Naval	150	100	-33%
% of revenues	*10.1%*	*7.5%*	
Security	56	68	+22%
% of revenues	*4.7%*	*5.6%*	
Services	80	81	+1%
% of revenues	*6.8%*	*6.7%*	
Division total	**746**	**775**	**+4%**
% of revenues	*7.26%*	*7.55%*	
Other and divested businesses	(24)	(20)	Ns
Income from operations	**722**	**755**	**+5%**
% of revenues	***7.03%***	***7.35%***	

The **Aerospace** division was the most affected by exchange rate fluctuations, with slightly lower income of €201 million. However the division posted operating margin of around 8%. In its defence businesses, the division is implementing a restructuring programme to adapt to a structural decline in orders from France. In civil businesses, the division is continuing to invest heavily in R&D and marketing and sales to support the rapid development of the in-flight entertainment business.

The **Air Systems** posted income of €139 million and an operating margin of 8.7%, markedly higher than the year before, with good performance from the joint venture with Raytheon and the air defence systems business. The contribution from the air traffic management and missile electronics businesses remained the same as in 2005.

The sharp increase in income and margin for the **Land & Joint Systems** division, to €186 million and 7.7%, was driven by the growth in revenues. The greatest improvements were posted in the United States, where higher volumes led to stronger margins, and in France, with the improvement in the optronics business.

As expected, the **Naval** division's income, €100 million, was sharply down as a result of the end of the *Sawari 2* contract. However, the division maintained an operating margin of 7.5% as a result of growth in the support services and underwater electronics business, which are benefiting from the effects of the productivity plan.

The **Security** division's income from operations was €68 m despite the operating loss of €17 million booked in the first half of 2006 for the navigation businesses divested in the summer. In 2005, these businesses posted a slight profit. Income from other businesses rose more than 40% as a result of improvements in most sectors, particularly transport, secure transactions and components.

With a 5% improvement in income at constant exchange rates, the **Services** division raised its operating margin to nearly 7%, due largely to better management of indirect costs, particularly in IT services.

The "non-division" operating losses, of €(24) million in 2005 and €(20) million in 2006, include the income (loss) from businesses divested the previous year and other income (loss) from operations not managed by divisions:

- total income from operations of businesses divested in 2005, mainly Thales Broadcast & Multimedia and the high tech optics business, was €13 million in the year of their divestment,

- other "non division" operating results were a loss of €(37) million in 2005 and of €(20) million in 2006.

These operating losses are mainly attributable to costs related to real estate vacated by operating entities, whose rent is paid by the parent company pending reallocation or expiration of lease. The corresponding charge booked in 2006 was reduced by €9 million as the cost of these vacated premises fell. In 2005, this charge also included a provision of €8 million for anticipated costs of vacating a major site in the Paris area; this provision was fully used in 2006.

Analysis of the **components of income from operations** shows that the 4.5% increase from 2005 to 2006, while revenues were stable, was due to a €19 million increase in gross margin and a reduction in indirect costs of €14 million. Indirect costs fell by 1% overall, with a 1% reduction in research and development costs as well as in marketing and sales expenses partly offset by a 1% increase for general and administrative expenses.

Total **research and development expenditure** rose roughly 4% in 2006 to just over €2 billion, compared with 1.90 billion in 2005 and €1.85 billion in 2004 and 2003. Company-funded research and development, at €534 million in 2006 (4% higher than the 2005 figure of €512 million), accounted for just over one-quarter of the total. Company-funded research and development expenditure breaks down into €157 million capitalised under IAS 38 (compared with €138 million in 2005), €361 million charged as an expense (€366 million in 2005), and €16 million (compared with €8 million in 2005 and 2004) in research tax credit from the French authorities.

Most R&D work is conducted by the operating units. Advanced research ("Research and Technology") accounted for just under one-fifth of total expenditure (€360 million in 2006) and includes concept design, technology demonstrators and technological research. Development work accounts for four-fifths of the total (€1,675 million in 2006), divided fairly equally between equipment development and systems development. An estimated 20,000 Thales employees worldwide, 75% of them engineers, are involved in research and development activities: 5,200 in Aerospace, 5,400 in Land and Joint Systems, 4,000 in Air Systems, 2,500 in Security and Services, and 2,400 in Naval. The central laboratories and departments, under Thales Research & Technology, employ some 500 research staff.

Company-funded research and development includes technological research and development projects conducted by both Thales Research & Technology central laboratories on key technologies, and by the divisions on system of systems architecture.

A significant proportion of company-funded research and development supports the Group's major strategic programmes, such as those of the Aerospace division (avionics equipment, airborne systems, UAV systems, in-flight entertainment, etc.), the Land & Joint Systems division (Battlefield Transformation Centre, tactical networks, software radio, etc.), the Air Systems division (ATM software) or the new Security Solutions & Services division (e-government, major administrative portals).

Marketing and sales expenses (€856 million compared with €868 million in 2005) fell slightly: the deconsolidation of businesses with high marketing and sales expenses had a positive impact on the overall figure, but, on a like-for-like basis, bid and demonstration costs increased, particularly for defence markets, as did commercial and support services for certain civil business, such as in-flight entertainment. **General and administrative expenses** were virtually stable, at €459 million compared with €456 million.

Income of operating activities rose by 5% to €576 million, compared with €549 million in 2005. This figure includes €193 million in restructuring costs, compared with €213 million in 2005, for the Optimum plan announced in March 2005. Provisions of around €400 million were booked in 2005 and 2006 for this exceptional plan, which aims to generate approximately €300 million in full-year savings by 2008.

Income from operations also includes a €23 million gain from disposals, mainly the balance from the gain of €41 million from the divestment of Embraer shares and the loss of €(25) million booked for the divestment of the GPS navigation equipment businesses.

2.2. Other results

- **Financial results** improved by €20 million to €(73) million, reflecting a lower average debt over the year, estimated to be €736 million compared with €1,140 million in 2005, and a lower average interest rate, down from 6.6% to 6.2%. Other financial expense mainly includes the accounting impact of hedging activities, particularly the change in fair value of derivative exchange instruments and impairment of some investment securities.

- **Other components of pension charge**[1] fell to €(19) million, compared with €(34) million the previous year. This improvement results from the favourable, though non recurring, impact of curtailments and settlements of some schemes that occurred in the Netherlands, the UK and Norway. Conversely, the apparent net financial cost of pensions included in this figure, corresponding to the discounted charge less expected return on plan assets, rose by €10 million.

2.3. Net profit

Thales recorded a net profit of €388 million, a 16% increase on the previous year (€334 m), after paying tax of €(100) million, compared with €(87) million in 2005. This reflects, as in the previous year, an apparent tax rate of 21%, substantially lower than the "theoretical" average rate of some 31%, because of the fiscally positive impact of capital gains and the positive effect of the recognition in assets of tax losses not recognised in previous periods.

3. Financial position: positive net cash flows at year-end

Thales ended 2006 with a **net cash resource of €530 million,** up 22% on the previous year's figure (€435 million).

Summarised statement of cash flows

In € m	2005	2006	Change
Operating cash flows before working capital changes	**901**	**946**	**+45**
Change in working capital requirements	(134)	(24)	+110
Payment of pension benefit	(111)	(140)	-29
Income tax (paid) received	(46)	(28)	+18
Cash flows from operating activities	**610**	**754**	**+144**
Net operating investments	(352)	(373)	-21
Operating free cash flow	**258**	**381**	**+123**
Net proceeds from disposals	311	289	-22
Dividend paid	(134)	(140)	-6
Net cash flows for the year	**435**	**530**	**+95**

With a further increase in operating cash flows, to €946 million from €901 million in 2005, and a moderate increase in working capital requirements of €24 million, cash flow from operating activities was 24% up, to €754 million versus €610 million in 2005. **Operating free cash flow** after funding the year's net capital expenditure stood at €381 million, an increase of 48% over the previous year (€258 million). Net capital expenditure amounted to €373 million, including €157 million in R&D investment (€138 million in 2005).

This strongly positive figure was supplemented by **net proceeds from disposals** of €289 million, including €134 million (received in early 2006) from the divestment of Thales Broadcast & Multimedia, €119 million from the sale of Embraer shares and €87 million from the sale of the GPS navigation equipment businesses, net of €61 million in investments, including €25 million to acquire 49% of Diehl Luftfahrt Elektronik.

After payment of dividends in respect of 2005, Thales ended 2006 with a **net cash resource of €530 million.**

Thales thus cancelled out its net financial indebtedness and ended 2006 with a **positive net cash position of €91 million** on the balance sheet, compared with net debt of €398 million at end-2005.

Shareholders' equity (excluding minority interests) increased to €2,287 million at end-2006 from €2,062 million at end-2005. This €225 million improvement comes mainly from the increased net income (€388 million profit) over the dividends paid for the previous year, namely €140 million.

4. Proposed dividend

In view of the strong results for 2006, confirmation of the outlook for business growth and further improvement in financial performance, the expansion of the scope of consolidation to be finalised in 2007, and the Group's favourable financial position, the Board of Directors will propose that the General Meeting of 16 May 2007 approve a dividend of €0.87 per share, an increase of 5% compared to the previous year. If approved, the dividend will be payable on 31 May 2007.

(1) Only concerns defined-benefit schemes (see Note 20 to the Consolidated Accounts).

5. Outlook for the current year

The major agreements concluded with Alcatel-Lucent on 1 December 2006, and with the French State and DCN on 30 January 2007, should be implemented in 2007, once the remaining contingencies have been lifted.

As a result, Thales expects to generate consolidated revenues of more than €12 billion in 2007. This figure includes the impact of changes in the scope of consolidation, although these changes are only expected to become effective progressively over the course of the first half of the year, and a further increase in organic growth. Operating margin should continue to rise, exceeding 7.5% of revenues(1).

In 2008, the first full year reflecting these changes in the scope of consolidation, the Group expects to generate consolidated revenues of approximately €13 billion and is targeting an operating margin of approximately 8% of revenues(1).

These forecasts and targets do not take into account the contribution of Thales's 25% future interest in DCN, which will be carried under the equity method in the consolidated financial statements. Including this contribution (25% of DCN revenues), Thales would generate close to €13 billion in revenues in 2007 and to €14 billion in 2008.

Furthermore, in both 2007 and 2008, restructuring costs should be significantly lower than those recorded for the last two financial years, representing between 0.5% and 0.75% of revenues.

This outlook is based on the assumption that the overall economic context will not be significantly different from the economic context today.

The assumptions on which the 2007 and 2008 profit forecasts are based, as well as the "Statutory Auditors' Report on the profit forecast", are presented on pages 169 and 170 of this annual report.

Finalisation of the operation with DCN and of the acquisition of the space activities of Alcatel-Lucent

- The agreement with DCN entered into force on 29 March 2007:
  The acquisition from the French State by Thales of 25% in DCN's share capital was financed, up to €514 million, by the proceed of the sale by Thales to DCN of the surface naval business of Thales Naval France (excluding the subsidiary's equipment businesses), and up to €55 million by a complementary cash payment.

- On April 4th 2007, the European commission approved the sale to Thales of Alcatel-Lucent's space activities. This sale which concerns the interest of Alcatel Lucent in two joint-ventures with Finmeccanica, Alcatel Alenia Space (67%) and Telespazio (33%) was effective on 6 April 2007. Alcatel Alenia Space was then renamed Thales Alenia Space.

B. Risk factors

1. Financial risk

1.1. Liquidity risks

The Group's short- and long-term financial resources consist of:

- shareholders' equity, listed by heading in Note 18 to the consolidated financial statements,

- gross debt, listed by date of maturity, in Note 23 to the consolidated financial statements,

- undrawn confirmed credit facilities granted by banks as back-up for the commercial paper programme and representing, as such, a financing reserve. The characteristics of these facilities are presented in Note 23 to the consolidated financial statements.

At 31 December 2006, the cash recorded under consolidated assets was €2,333 million (compared with €1,320 million at end-2005), including:

- €1,830 million held by the parent company, most of which, approximately €1,350 million, was for the acquisition of Alcatel's satellite businesses and a stake in DCN for roughly €850 million, and redeeming of the OCEANE bond in early 2007 for €500 million, the remainder available for immediate use,

(1) Before purchase accounting on assets from Alcatel-Lucent.

- €503 million in cash that could not be immediately cleared by debt positions for technical reasons. This includes €260 million in cash invested directly by joint ventures (prorated by Thales's interest in each joint venture), since cash pooling is not applicable to joint ventures. It also includes the bank credit balances of subsidiaries outside France.

At the date of publication, Thales's credit risk ratings were as follows:

	Moody's	Standard & Poors
Medium and long-term loans	A1	A-
Outlook	outlook stable	outlook negative
Commercial paper & short-term loans	Prime-1	A2

1.2. Interest rate risk

The corporate treasury department consolidates data on the Group's exposure to interest rate and foreign exchange risk, and uses the appropriate financial instruments to hedge those risks.

Group policy is to optimise its funding and banking operations and to control exchange rate and counterparty risks by consolidating and pooling all units' cash surpluses and requirements. This makes it possible to:

- simplify cash management and match all units' cash positions to produce a single consolidated position that is easier to manage,
- gain prime access to non-bank markets through Thales SA financing programmes rated by Standard & Poor's and Moody's, as above.

This principle of centralising units' short-term surpluses and requirements (cash pooling) is applied to units in the same currency zone, with a euro zone, a sterling zone and a dollar zone, and, in some cases, in the same country, as in France.

The Group's exposure to interest rate fluctuations is covered by swaps. The breakdown of the Group's debt by type of interest rate is described in Note 23 to the consolidated financial statements

The following table summarises the Group's exposure to interest rate risk before and after hedging.

	O/N to 1 year		1 to 5 years		Longer		Total	
	fixed	variable	fixed	variable	fixed	variable	fixed	variable
Financial liabilities	-551	-228.3	-603.4	-822.1	-181.8	-1	-1,336.2	-1,051.4
Financial assets		2,478.4						2,478.4
Net position before hedging	-551	2,250.1	-603.4	-822.1	-181.8	-1	-1,336.2	1,427.0
Off-balance-sheet		-300.0	300		0		300.0	-300.0
Net position after hedging	-551	1,950.1	-303.4	-822.1	-181.8	-1	-1,036.2	1,127

A 1% rise in interest rates, applied to the financial assets and liabilities after hedging would reduce financial expense in 2006 by €11 million (€7 million in 2005).

1.3. Foreign exchange risk

a. Interest rate and exchange rate risk management for business activity

Business-related currency risk occurs when some business is billed in a currency other than that of the costs incurred, particularly when the products are intended for export. Although roughly one-half (€5 billion) of Thales's consolidated revenues is generated outside the euro zone, the actual proportion of Group revenues exposed to foreign exchange risk is much lower.

The reason is that over the last fifteen years or so, the Group has considerably expanded manufacturing operations internationally as part of its "multidomestic" development strategy. The reasoning behind this strategy is to locate operating units as close as possible to end customers, particularly in defence markets, where, given the sensitivity of sovereignty issues, it is a commercial advantage to have a local production base. This policy was first applied to European countries, some of which are now in the euro zone, and has had a sharp focus on the United Kingdom. Today it extends further afield, in particular to Australia and Asia. This expansion has reduced the Group's exposure to currency risk, since the same currency is used for billing and local costs in the countries with multidomestic operations.

However, the Group's exposure to currency risk has not disappeared altogether: most of the operating subsidiaries, wherever they are based, are likely to export to countries with different currencies. And any operating subsidiary may pay for its supplies in a foreign currency.

The Group has adopted a specific policy for hedging the consequent exchange risk:

- risk associated with future revenues, including risk on contracts due to come into effect in the future, and denominated in foreign currencies, are hedged either by reinsurance with insurance companies, in particular Coface, or through market transactions (forward exchange-rate contracts and options),

- risk associated with orders booked in foreign currencies are hedged by forward sales denominated mainly in US dollars or sterling.

The figures below give an idea of the hedging of business-related dollar risk for 2006. "Dollar risk" is the main currency risk the Group needs to hedge, either as the currency in which most export contracts are denominated whatever their destination, or as the reference currency for certain businesses such as civil aerospace.

On 31 December 2006, total hedging for firm commitments was $674 million to hedge USD/EUR and $69 million to hedge USD/GBP.

b. Management of risk relating to foreign currency-denominated assets

The Group hedges a limited part of its foreign currency-denominated assets, mainly those assets likely to be disposed of at some future date. The criteria for determining whether or not a given foreign currency-denominated asset should be hedged are as follows:

- the nature of the business involved (the Group's core business assets are excluded),

- the structure of the Group's commitment. This includes all foreign currency-denominated assets of jointly held companies in which the Group's partner has a call option.

In general, hedging is achieved by loans or currency swaps in the same currency as the assets to be hedged.

The actual application of this policy, however, also depends on:

- the objective of optimising hedges in the light of market conditions (availability of foreign currency, interest rates, cost of hedges, etc.),

- the risks inherent in the future value of the assets being hedged and the nature of the corresponding subsidiaries' business,

- specific features of the shareholders' agreement in each joint venture.

Summary of risks relating to foreign currency-denominated assets at 31 December 2006 (€m)

	GBP	USD	AUD
Net equity	786.8	401.1	258.2
Off-balance-sheet positions	-48.9	-102.5	
Net position after hedging	**737.9**	**298.6**	**258.2**

1.4. Stock market risk

After divesting its only stake in a listed company in 2006, namely Embraer, Thales is no longer exposed to any stock market risk.

The central treasury and financing department includes some thirty people specialising in interest rate & exchange rate risks and financing.

Reporting and back-office teams are in charge of all the procedures required to carry out these operations effectively. Their information systems meet the highest professional standards.

2. Litigation

Due to the nature of its business activities, the Group is exposed to the risk of technical and commercial litigation. Litigation mentioned in last year's annual report has progressed as follows:

The request for arbitration submitted by Republic of China Navy (Taiwan) for an amount of USD 599 million in damages, arising out of the execution of a contract, signed in 1991, for the supply of equipment and systems executed in conjunction with an industrial partner continued in 2006.

In June 2005 the adverse party, in the context of this procedure, increased its request to USD 1,119 million, to which interest for late payment would be added. It reduced its request to USD 882 million in April 2006 (interest for late payment excluded). If an unfavourable judgment were to be issued, Thales's share of any amounts due would be limited to approximately 30%, being a proportion corresponding to its share in the equipment supply contract. Thales, in conjunction with its industrial partner, has constantly opposed this request.

On the basis of the information at its disposal at the balance sheet date for 2006, Thales has carried out a review of the financial risks to which the Group could be exposed as a result of this procedure. In the absence of any new significant information, Thales has, in consequence, decided to maintain at 31 December 2006 a reserve for this litigation identical to that recognised in its 2005 financial statements, an amount in respect of which, in application of paragraph 92 of IAS 37, no detailed disclosure is provided.

No other significant litigation arose since the start of 2006. To the best of the Thales Group's knowledge, there is no other exceptional circumstance or dispute that has had or is likely to have a significant influence on the Group's results, financial position or prospects.

3. Environmental risk

The Thales Group's activities generally do not have any significant environmental impact.

The management of environmental risks involves:

- compliance of plants and products with applicable regulations and control of any environmental impact they may have,

- implementation of an environmental management system adapted to each site (more than 50 sites have obtained ISO 14001 certification),

- mapping of environmental risks in more than ten countries in which the Group operates. The aim of this exercise is to verify that employees and local residents are not exposed to health and environmental risks,

- management of identified risks: changes to plants, decontamination, and monitoring.

At 31 December 2006, the amount of reserves for environmental contingencies amounts to €4.8 million.

4. Insurance

Thales operates a policy of active risk management in order to achieve optimal protection of its employees, customers, professional assets and businesses, and to protect its property in the interest of shareholders.

This policy is based on the following principles:

- risk identification policy, with risk-mapping for major businesses,

- prevention and protection policy for industrial sites, to reduce the extent and frequency of the risk of accidental fire or explosion: in 2004-2006, 97% of insured assets were audited for fire safety by an outside body,

- a Group-wide risk financing policy, using both self-insured retention and transfer to insurers. For risks relating to damage to property and consequent operating loss, transport, general civil liability, assembly and testing, the Group underwrites routine incidents by means of a reinsurance captive. Its maximum liability is limited to €11.9 million. Cover relating to major disasters is transferred to insurers,

- an organisational structure and crisis management tools designed to deal as efficiently as possible with the immediate consequences of a catastrophic event and take the necessary emergency measures,

- provision of resources to ensure business continuity in the event of a major disaster.

The programme to improve information system recovery plans was pursued in 2006. The Internal Audit Department continued its IT security audit plan at major Group units.

The business continuity plans continued to be deployed throughout 2006.

The main accident risks that Group companies are exposed to – damage to property and consequent operating loss, transport, general civil liability, assembling and testing – are covered by an integrated worldwide multi-line, multi-year programme. This programme is subscribed with first-tier international insurance and reinsurance companies and was renewed in March 2007. It can only be renegotiated in the event of a catastrophic increase in accident rates.

In 2006, total premiums paid for global cover amounted to 0.41% of consolidated revenues.

The maximum guarantee for damage to property and subsequent operating losses is set at €600 million. This figure is greater than the estimated largest claim the Group might make for direct damage and operating losses caused to an industrial site.

Civil liability cover depends on the quantification of reasonable risk for the Group as identified by risk-mapping, and guarantee capacity available on the insurance market. The insurance guarantee for civil liability of its aerospace businesses, which is covered by a separate programme, stands at two billion US dollars.

The exclusions common to the market as a whole (asbestos, etc.) also apply to Thales.

The Group also subscribes specific and/or local policies where necessary to comply with local regulations or meet particular requirements of specific projects or activities.

5. Dependence

5.1. Upstream: key supplies and technologies

For more than ten years now, Thales has developed and implemented a policy to control critical technologies and outsourcing. This policy is updated each year on the basis of analyses carried out in each Unit as part of their Technical Strategic Plan (TSP). It identifies any risk related to access to critical components, particularly in the microelectronics, optics and optronics fields, and infers any necessary internal action or partnerships.

Due to the nature of its activities and the specific features of its products, Thales conducts most of its research and development work in-house (€2 billion invested in 2006, compared with €1.90 billion in 2005) and controls the patents that are of critical importance to its businesses. The specific microelectronics components used in its equipment are also developed and, in some cases, manufactured in-house. However, the Group outsources standard components and commodity products.

Risks of technological dependence have been identified and are covered by reserves for special contingencies.

Thales also identifies and analyses its risks of technological dependence on third party patents, either as part of the procedures for filing its own patents, or when launching technical studies or product developments. A dedicated department, Thales Intellectual Property (TPI), works with the legal department's litigation team, and where necessary with Group partners specialised in IP law, to handle third-party claims of infringement of intellectual property rights by a Group company.

5.2. Downstream: main customers

The defence businesses and some civil aerospace businesses have government agencies as their main customers.

The Group's policy of international development over the last fifteen years, especially in the defence sector, which generates two-thirds of its revenues, has led to broad geographical diversification of the Group's customer base and made Thales much less reliant on orders from any one country or defence budget. In 2006, the French Ministry of Defence, still the Group's largest single customer, accounted for approximately 23% of consolidated revenues (for Thales directly or as subcontractor). Thales's second-largest customer, accounting for nearly €1 billion, was the UK Ministry of Defence.

Civil aerospace customers are aircraft manufacturers, airlines and public agencies (primarily airport authorities). Direct sales to Airbus or to airlines for their Airbus fleets (avionics and power generation, simulators and pilot training) amounted to €450 million in 2006, slightly up on 2005. The other civil businesses, in security and services, serve a much wider range of customers: mainly administrations or civil authorities (particularly for transport infrastructure), industrial companies or the tertiary sector. However, some of these businesses may rely on a relatively small number of customers. This is the case, for example, with the telecom services subsidiaries, part of the Services Division, who work mainly for British Rail, and whose revenues fell significantly in 2005 following completion of a contract with this customer. To reduce the impact of this dependence, the Services Division is working to optimise synergies between these subsidiaries and other service businesses in the United Kingdom with increasing workloads.

C. Recent events

1. Finalisation of the first stage of the agreement with Alcatel-Lucent to transfer some of its businesses to Thales

The Extraordinary General Meeting of Thales shareholders on 5 January approved the first phase in the transfer of Alcatel-Lucent businesses to Thales under the terms of the cooperation agreement and master agreement signed on 1 December 2006. The companies agreed to transfer to Thales all of Alcatel-Lucent's businesses in the field of signalling systems for rail transport and urban networks, and integrated systems for critical infrastructures. In return for these businesses, 25 million new Thales shares were issued at €40 each in favour of Alcatel-Lucent and a cash payment of €40 million was made.

Through this operation, Alcatel-Lucent increased its interest in Thales from 9.46% to 20.95% while the French State's interest fell from 31.26% to 27.29%. A new shareholders' agreement has been signed between Alcatel-Lucent and the French State. This agreement is valid for a period of five years and is renewable. It replaces the previous shareholders' agreements signed in June 1998 by Alcatel, Groupe Industriel Marcel Dassault (GIMD) and the French State.

The master agreement also provides for the subsequent sale to Thales of Alcatel-Lucent's holdings in two space companies – 67% of the satellite manufacturer Alcatel Alenia Space and 33% of the satellite operator Telespazio Holding, both jointly owned with Finmeccanica – for €670 million in cash.

This second phase is contingent upon completion of the investigation launched by the European Commission on 28 November 2006 with respect to EU competition regulations, and upon approval of the operation by the Commission, which is expected in the second quarter of 2007[1].

According to data published by Alcatel-Lucent in its 2006 consolidated financial statements, total revenues of the businesses contributed to Thales on 5 January and those that are expected to be approved for transfer in the second quarter of 2007 (proportional to the holdings to be sold to Thales) stood at €2,099 million in 2006. Their income from operations was €105 million. The figure for income from operations takes into account the payment of corporate fees to Alcatel-Lucent in line with the telecom group's policy.

2. Convergence between the naval businesses of Thales and DCN

On 30 January 2007, the French State, DCN and Thales announced a final agreement on closer ties between DCN and Thales's naval businesses in France. Under the agreement, DCN will acquire all of Thales's naval businesses in France (with the exception of equipment for naval programmes) and will become the sole shareholder in the joint subsidiaries set up by the two companies (the largest being Armaris and MOPA2). At the same time, Thales will acquire 25% of DCN's share capital, with the French State retaining 75%. The difference in valuation will lead to net cash outlay by Thales of approximately €100 million. The agreement also includes provisions for additional payments contingent upon certain contract awards and levels of operational performance. Thales will have an option to increase its interest to 35% after two years. Thales's interest in DCN will be carried under the equity method in the Group's financial statements.

The agreement entered into force on 29 March 2007, following approval by the European Commission on 19 March and a favourable ruling by the French Commission des Participations et des Transferts on 23 March 2007[2]. The businesses Thales transfers to DCN will be deconsolidated as from 1 April 2007; the 25% holding in DCN will be carried by the equity method in the Group's consolidated financial accounts from that date.

The Thales businesses transferred to DCN generated revenues of €397 million in 2006 and income from operations of €37 million.

(1) The European Commission approved this operation on 4 April 2007 and the transfer of the space activities from Alcatel-Lucent to Thales was thus effective on 6 April 2007.
(2) This ruling was published in the Bulletin des Annonces Légales et Obligatoires dated 27 March 2007.

3. Creation of a new Security Solutions and Services division

The Security Solutions & Services division was formed in January 2007 by combining the transport and security businesses contributed to Thales by Alcatel-Lucent at the beginning of the year with two Thales divisions – the Security division (excluding its components and devices business) and the Services division – both of which closely complement the contributed businesses.

With close to 20,000 employees in 35 countries, this division represents total revenues of approximately €3.2 billion (based on the 2006 revenues of the entities concerned), making Thales one of the world leaders in safety and security solutions for critical infrastructure, particularly in the ground transportation sector.

II - Consolidated financial statements

A. Consolidated profit and loss account

In € m	Notes	2006	2005	2004 (a)
Revenues	note 4	10,264.3	10,263.2	10,282.8
Cost of sales		(7,833.6)	(7,851.1)	(7,938.9)
Research and development expenses		(360.8)	(366.0)	(367.9)
Marketing and selling expenses		(855.7)	(867.8)	(820.5)
General and administrative expenses		(459.6)	(456.5)	(455.5)
Income from operations	note 4	**754.6**	**721.8**	**700.0**
Restructuring costs	note 21	(193.1)	(212.5)	(109.0)
Other operating income (expense)	note 22-a	--	(84.3)	(2.6)
Impairment of non current operating assets	notes 9 & 10	(8.5)	(34.2)	(13.0)
Gain (loss) on disposal of assets	note 5	22.9	158.3	(4.5)
Income of operating activities	note 4	**575.9**	**549.1**	**570.9**
Financial interest on gross debt		(95.9)	(126.0)	(124.4)
Financial income from cash at bank and equivalents		54.1	43.2	39.8
Cost of net financial debt	note 6-a	(41.8)	(82.8)	(84.6)
Other financial income (expense)	note 6-b	(31.5)	(10.2)	(11.4)
Other components of pension charge	note 20	(19.0)	(33.6)	(17.5)
Income tax	note 7	(100.4)	(87.3)	(126.9)
Equity in income of unconsolidated affiliates	note 11	7.9	7.9	10.3
Net income (loss)		**391.1**	**343.1**	**340.8**
Of which:				
Net income, Group share		**388.0**	**333.9**	**325.5**
Minority interests		3.1	9.2	15.3
Basic earnings per share *(in euros)*	note 8	2.30	2.00	2.00
Diluted earnings per share *(in euros)*	note 8	2.26	1.97	1.93

(a) As financial instruments standards IAS 39 and IAS 32 were only applied as from 1 January 2005, financial interest for 2004 is not comparable with financial interest for 2005 and 2006. Restatement of 2004 financial interest on the OCEANE (see note 23) in accordance with IAS 32 would have increased such expenses by €14.3 million in that year.

B. Consolidated balance sheet

Assets

In € m	Notes	31 Dec. 06	31 Dec. 05	1 Jan. 05 (a)	31 Dec. 04
Goodwill, net	note 9	1,825.4	1,859.1	1,925.6	1,925.6
Other intangible assets, net	note 10	432.4	348.2	236.8	236.8
Tangible assets, net	note 10	1,007.4	1,027.9	1,077.9	1,077.9
Total non current operating assets		3,265.2	3,235.2	3,240.3	3,240.3
Equity in unconsolidated affiliates	note 11	157.9	161.8	176.5	176.5
Other investments	note 12	98.8	196.0	163.7	151.6
Other financial assets	note 12	159.3	137.5	149.1	150.8
Total non current financial assets		416.0	495.3	489.3	478.9
Fair value of derivatives: interest rate risk management	note 23	1.9	15.5	15.0	--
Fair value of put and call options between Thales and Transfield / ADI		--	31.8	22.9	--
Pension and other employee benefits	note 20	40.3	39.5	37.6	37.6
Deferred tax assets	note 7	440.8	454.1	422.4	482.0
Non current assets		**4,164.2**	**4,271.4**	**4,227.5**	**4,238.8**
Inventories and work in progress	note 13	1,737.3	1,619.5	1,545.7	1,545.7
Construction contracts: assets	note 14	2,096.7	2,042.8	2,487.8	2,487.8
Advances to suppliers		1,201.3	1,030.1	870.9	870.9
Accounts, notes and other current receivables	note 15	3,214.4	3,199.8	2,934.3	3,004.1
Fair value of derivatives: currency risk management		60.7	33.5	197.7	--
Total current operating assets		8,310.4	7,925.7	8,036.4	7,908.5
Current tax receivables		68.7	64.9	38.8	38.8
Current accounts with affiliated companies	notes 17&23	122.6	157.5	127.3	127.3
Marketable securities	note 23	22.7	14.4	6.0	6.0
Receivable on disposal of Broadcast & Multimedia to Thomson	note 23	--	133.6	--	--
Cash at bank and equivalents	note 23	2,333.1	1,319.9	1,181.6	1,181.6
Total current financial assets		2,478.4	1,625.4	1,314.9	1,314.9
Current assets		**10,857.5**	**9,616.0**	**9,390.1**	**9,262.2**
Total assets		**15,021.7**	**13,887.4**	**13,617.6**	**13,501.0**

Liabilities and shareholders' equity

In € m	Notes	31 Dec. 06	31 Dec. 05	1 Jan. 05 (a)	31 Dec. 04
Capital, paid-in surplus and other reserves		2,407.5	2,150.6	2,028.3	1,867.5
Cumulative translation adjustment		19.6	53.5	(26.0)	(26.0)
Treasury shares		(140.4)	(142.3)	(292.4)	(292.4)
Shareholders' equity	note 18	**2,286.7**	**2,061.8**	**1,709.9**	**1,549.1**
Minority interests	note 19	7.5	41.0	30.6	52.2
Total shareholders' equity and minority interests		**2,294.2**	**2,102.8**	**1,740.5**	**1,601.3**
Financial debt – long term	note 23	1,610.2	1,449.4	1,430.5	1,431.6
Pension and other employee benefits	note 20	1,070.5	1,103.5	1,109.0	1,109.0
Deferred tax liabilities	note 7	39.1	30.1	15.3	12.8
Non-current liabilities		**2,719.8**	**2,583.0**	**2,554.8**	**2,553.4**
Advances received from customers on contracts		2,918.8	2,755.8	3,047.6	3,047.6
Refundable grants		171.1	174.0	171.0	171.0
Construction contracts: liabilities	note 14	359.4	341.5	357.7	357.7
Reserves for contingencies	note 21	834.3	787.2	585.5	586.3
Accounts, notes and other current payables	note 15	4,866.0	4,601.4	4,294.4	4,420.6
Fair value of derivatives: currency risk management		34.8	60.0	76.9	--
Total current operating liabilities		9,184.4	8,719.9	8,533.1	8,583.2
Current tax payables		44.0	26.2	30.0	30.0
Financial debt – short term	note 23	638.5	299.3	609.4	583.3
Current accounts with affiliated companies	notes 17&23	140.8	156.2	149.8	149.8
Total current financial liabilities		779.3	455.5	759.2	733.1
Current liabilities		**10,007.7**	**9,201.6**	**9,322.3**	**9,346.3**
Total liabilities and shareholders' equity		**15,021.7**	**13,887.4**	**13,617.6**	**13,501.0**

(a) After application of financial instruments standards.

C. Consolidated statement of cash flows

In € m	Notes	2006	2005	2004
Net income (loss)		391.1	343.1	340.8
Add (deduct):				
Income tax expense (gain)		100.4	87.3	126.9
Equity in income of unconsolidated affiliates (net of dividends received)		4.1	6.7	0.1
Depreciation and amortisation of tangible and intangible assets	note 10	295.1	274.0	273.1
Provisions for pensions and other employee benefits	note 20	113.8	117.1	93.0
Impairment of non current operating assets	notes 9 & 10	8.5	34.2	13.0
Loss (gain) on disposals of assets	note 5	(22.9)	(158.3)	4.5
Net allowances to restructuring provisions	note 21	22.8	94.9	4.6
Other items		33.6	101.7	31.9
Operating cash flows before working capital changes		**946.5**	**900.7**	**887.9**
Change in working capital requirements and in reserves for contingencies (a)		(24.0)	(133.7)	(440.1)
Payment of pension benefits (defined benefit plans)	note 20	(140.2)	(110.9)	(106.4)
Income tax (paid) received		(28.7)	(46.5)	17.2
Net cash flows from operating activities	**- I -**	**753.6**	**609.6**	**358.6**
Capital expenditure	note 24-a	(412.1)	(390.8)	(310.6)
Proceeds from disposal of tangible and intangible assets		39.3	38.5	37.9
Net operating investments		**(372.8)**	**(352.3)**	**(272.7)**
Acquisitions	note 24-b	(61.5)	(84.3)	(12.3)
Disposals	note 24-b	345.0	276.6	86.3
Change in loans		(0.4)	2.9	9.4
Change in current accounts with affiliated companies		29.5	(23.0)	17.7
Decrease (increase) in marketable securities		(8.2)	(7.8)	(2.3)
Net financial investment		**304.4**	**164.4**	**98.8**
Net cash flows from investing activities	**- II -**	**(68.4)**	**(187.9)**	**(173.9)**
Dividends paid		(140.4)	(133.7)	(121.7)
Increase (decrease) in shareholders' equity and minority interests	note 24-c	5.2	118.6	29.3
Increase in debt		738.5	278.6	633.9
Repayment of debt		(268.4)	(584.5)	(588.4)
Net cash flows from financing activities	**- III -**	**334.9**	**(321.0)**	**(46.9)**
Effect of exchange rate variations	- IV -	(6.9)	37.6	(2.4)
Total increase (decrease) in cash at banks and equivalents	**- I+II+III+IV -**	**1,013.2**	**138.3**	**135.4**
Cash at banks and equivalents at beginning of period		1,319.9	1,181.6	1,046.2
Cash at banks and equivalents at end of period		**2,333.1**	**1,319.9**	**1,181.6**

(a) Including changes in proceeds from non-recourse sale of government receivables (€(106.6) million in 2006, €(19.1) million in 2005 and €0.3 million in 2004). At 31 December 2006, receivables transferred without recourse, including notably amounts which have reached their due date for payment and which bear interest on arrears, amounted to €232.4 million against €339.0 million at 31 December 2005 and €358.1 million at 31 December 2004 (note 1-t).

Financial interest paid was €83.1 million in 2006, €118.0 million in 2005 and €109.3 million in 2004. Financial interest received was €48.8 million in 2006, €50.6 million in 2005 and €29.5 million in 2004.

D. Consolidated statement of changes in shareholders' equity and minority interests

In € m	Number of shares outstanding (thousands)	Share capital	Paid-in surplus	Retained earnings	Changes in fair values	Cumulative translation adjustment	Treasury shares	Share-holders' equity	Minority interests	Total
At 1 January 2004	**162,264**	**515.6**	**2,673.0**	**(1,430.4)**	**--**	**--**	**(421.5)**	**1,336.7**	**39.8**	**1,376.5**
Capital increase	4	--	0.1	--	--	--	--	0.1	--	0.1
Dividends (including €(53.3) million of taxes) (a)	--	--	--	(175.0)	--	--	--	(175.0)	(1.1)	(176.1)
Share-based payments (note 18-c)	--	--	--	14.9	--	--	--	14.9	--	14.9
Change in treasury shares	3,102	--	--	(54.4)	--	--	129.1	74.7	--	74.7
Total transactions with shareholders	3,106	--	0.1	(214.5)	--	--	129.1	(85.3)	(1.1)	(86.4)
Translation adjustment	--	--	--	--	--	(26.0)	--	(26.0)	(1.4)	(27.4)
Other	--	--	--	(1.8)	--	--	--	(1.8)	(0.3)	(2.1)
Total income and expense recognized directly through shareholders' equity in the year	--	--	--	(1.8)	--	(26.0)	--	(27.8)	(1.7)	(29.5)
Net income 2004	--	--	--	325.5	--	--	--	325.5	15.3	340.8
Changes in scope of consolidation	--	--	--	--	--	--	--	--	(0.1)	(0.1)
At 31 December 2004	**165,370**	**515.6**	**2,673.1**	**(1,321.2)**	**--**	**(26.0)**	**(292.4)**	**1,549.1**	**52.2**	**1,601.3**
First-time application of financial instruments standards	--	--	--	37.6	123.2	--	--	160.8	(21.6)	139.2
At 1 January 2005	**165,370**	**515.6**	**2,673.1**	**(1,283.6)**	**123.2**	**(26.0)**	**(292.4)**	**1,709.9**	**30.6**	**1,740.5**
Capital increase (note 24-c)	41	0.1	0.9	--	--	--	--	1.0	--	1.0
Dividends (a)	--	--	--	(133.7)	--	--	--	(133.7)	(0.9)	(134.6)
Share-based payments (note 18-c)	--	--	--	18.9	--	--	--	18.9	--	18.9
Change in treasury shares	3,335	--	--	(37.5)	--	--	150.1	112.6	--	112.6
Total transactions with shareholders	3,376	0.1	0.9	(152.3)	--	--	150.1	(1.2)	(0.9)	(2.1)
Translation adjustment	--	--	--	--	--	79.5	--	79.5	2.3	81.8
Financial instruments (note 18-d)	--	--	--	--	(64.1)	--	--	(64.1)	(0.6)	(64.7)
Other	--	--	--	3.8	--	--	--	3.8	--	3.8
Total income and expense recognized directly through shareholders' equity in the year	--	--	--	3.8	(64.1)	79.5	--	19.2	1.7	20.9
Net income 2005	--	--	--	333.9	--	--	--	333.9	9.2	343.1
Changes in scope of consolidation	--	--	--	--	--	--	--	--	0.4	0.4
At 31 December 2005	**168,746**	**515.7**	**2,674.0**	**(1,098.2)**	**59.1**	**53.5**	**(142.3)**	**2,061.8**	**41.0**	**2,102.8**
Capital increase (note 24-c)	97	0.3	2.3	--	--	--	--	2.6	--	2.6
Dividends (a)	--	--	--	(140.0)	--	--	--	(140.0)	(0.4)	(140.4)
Share-based payments (note 18-c)	--	--	--	16.8	--	--	--	16.8	--	16.8
Change in treasury shares	29	--	--	(0.1)	--	--	1.9	1.8	--	1.8
Total transactions with shareholders	126	0.3	2.3	(123.3)	--	--	1.9	(118.8)	(0.4)	(119.2)
Translation adjustment	--	--	--	--	--	(33.9)	--	(33.9)	(2.6)	(36.5)
Financial instruments (note 18-d)	--	--	--	--	(9.9)	--	--	(9.9)	--	(9.9)
Other	--	--	--	(0.5)	--	--	--	(0.5)	--	(0.5)
Total income and expense recognized directly through shareholders' equity in the year	--	--	--	(0.5)	(9.9)	(33.9)	--	(44.3)	(2.6)	(46.9)
Net income 2006	**--**	**--**	**--**	**388.0**	**--**	**--**	**--**	**388.0**	**3.1**	**391.1**
Changes in scope of consolidation	--	--	--	--	--	--	--	--	(33.6)	(33.6)
At 31 December 2006	**168,872**	**516.0**	**2,676.3**	**(834.0)**	**49.2**	**19.6**	**(140.4)**	**2,286.7**	**7.5**	**2,294.2**

(a) Dividends per share amounted to €0.83 in 2006, €0.80 in 2005 and €0.75 in 2004.
The Board of Directors will propose that the Annual General Meeting of 16 May 2007 approve a dividend of €0.87 per share.

E. Notes to the consolidated financial statements

All amounts included in these notes are expressed in € million except for per share data.

On 8 March 2007, the Board of Directors approved, and authorised for issue, Thales' consolidated financial statements for the year ended December 31, 2006. In accordance with French legislation, the financial statements will be considered to be definitive when approved by the shareholders of Thales S.A. at the annual general meeting convened for 16 May 2007.

Thales S.A. is a listed French société anonyme, registered with the Nanterre registrar of companies *(Registre du Commerce et des Sociétés de Nanterre)* under the number 552 059 024.

1. Accounting policies

In application of European regulation N° 1606/2002 pertaining to international standards, issued on 19 July 2002, the consolidated financial statements of the Thales Group are prepared, since January 1, 2005, in accordance with IAS/IFRS standards (International Financial Reporting Standards) as approved by the European Union.

The Group previously applied French accounting standards, as defined notably in regulation 99-02 of the French accounting rules and regulations committee *(Comité de Réglementation Comptable* or C.R.C.).

As a first time adopter of IFRS for the financial year ended 31 December 2005, Thales applied the specific rules for first time adoption defined in IFRS 1. Any specific options retained are set out in the following notes.

The accounting policies described hereafter have been applied consistently for all of the periods presented, with the exception of standards IAS 32 and IAS 39 pertaining to financial instruments which have only been applied as from 1 January 2005.

New accounting standards, amendments to existing accounting standards and interpretations published by the IASB in 2005 and 2006 and approved by the European Union that are not obligatorily effective as from 1 January 2006 have not been adopted early:

- IFRS 7 (Financial instruments: disclosures),
- amendment to IAS 1 (Presentation of financial statements),
- IFRIC 6 (Liabilities arising from participating in a specific market – waste electrical and electronic equipment), IFRIC 7 (Financial reporting in hyperinflationary economies), IFRIC 8 (Scope of IFRS 2) and IFRIC 9 (Reassessment of embedded derivatives).

Although the Group has not yet prepared a precise estimate of the amounts in question, it does not expect a material impact on the financial statements. IFRS 7, pertaining to disclosures regarding financial assets and liabilities has no impact on the recognition and measurement of transactions.

a. Consolidation

The financial statements of significant subsidiaries directly or indirectly controlled by Thales have been fully consolidated. Companies in which Thales does not have a controlling interest but over which it exercises significant influence, directly or indirectly, are accounted for under the equity method. Companies under joint control are accounted for under the proportionate method.

Financial statements of consolidated companies, prepared in accordance with accounting standards applicable in the countries in which the companies are incorporated, have been restated for the purposes of the consolidation in order to comply with IFRS.

All transactions between fully consolidated or proportionately consolidated companies are eliminated, as are all internal gains and losses related to consolidated companies.

Transactions between a fully consolidated company and a proportionately consolidated company, whether or not they affect consolidated profit and loss, are eliminated to the extent of the Group's ownership interest in the proportionately consolidated company.

As an exception to this principle, transactions between a fully consolidated company and a proportionately consolidated company are fully eliminated when the jointly controlled company acts simply as an intermediary or performs profit-neutral services on behalf of, or as a direct extension of the activities of, its different shareholders.

b. Business combinations

Business combinations are accounted using the purchase accounting method. Under this method, the identifiable assets, liabilities and contingent liabilities acquired are measured at their fair value at the date at which control is obtained. The difference between the cost of acquisition of the shares and the Group's share in the fair value of net assets constitutes goodwill.

Goodwill can be adjusted in the twelve months following the acquisition date to take account of definitive estimates of the acquired assets and liabilities recognised. After this period, adjustments to fair value are recognised through profit and loss.

Negative goodwill is immediately recognised in "other operating income (expense)".

Goodwill related to controlled enterprises is recognised in balance sheet assets under the "intangible assets" caption. Goodwill related to companies accounted for under the equity method is recognised under the "equity in unconsolidated affiliates" caption.

Goodwill is not amortised but is subject, each year, to impairment tests in accordance with IAS 36. These tests consist of ensuring that the recoverable amount of each of the Group's cash generating units is at least equivalent to its corresponding net assets (including related goodwill). The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use. Value in use is determined on the basis of discounted projections of future operating cash flows over a three-year period and a terminal value. This calculation is based on data from the strategic plans prepared in accordance with Group procedures. The discount rate used is calculated on the basis of the Group's weighted average cost of capital (8.0% in 2006, 7.9% in 2005) adjusted if necessary for the specific risks attributable to each business sector. Assumptions used concerning growth in revenues and terminal values are based on a reasonable approach in line with specific data available for each business sector.

Goodwill impairment is recognised as an expense in "income of operating activities", except for impairment of goodwill related to equity in unconsolidated affiliates, which is accounted for in "equity in income of unconsolidated affiliates". Goodwill impairment cannot be reversed.

Reminder of policy applied on first time adoption of IFRS
The Group decided not to restate business combinations that occurred before 1 January 2004.

c. Translation of the financial statements of foreign subsidiaries

The financial statements of companies whose functional currency is different from the Group's functional currency are translated using the following methods:

- balance sheet items are translated at the exchange rates prevailing at balance sheet dates,
- profit and loss items and the statement of cash flows are translated at the average exchange rates for the year,
- translation adjustments are directly recognised in shareholders' equity within the "cumulative translation adjustment" account.

The main closing and average exchange rates used for translation purposes in recent years are summarised below:

	31 Dec. 06		31 Dec. 05		31 Dec. 04	
Euros	**Closing rate**	**Average rate**	**Closing rate**	**Average rate**	**Closing rate**	**Average rate**
Australian Dollar	1.6691	1.6685	1.6109	1.6269	1.7459	1.6928
Pound Sterling	0.6715	0.6819	0.6853	0.6830	0.7051	0.6793
U.S. Dollar	1.3170	1.2630	1.1797	1.2380	1.3621	1.2462

Reminder of policy applied on first time adoption of IFRS
The Group took the option, provided by IFRS 1, of not retrospectively reconstituting cumulative translation adjustments in shareholders' equity at 1 January 2004. Translation adjustments that arose prior to the IFRS transition date will therefore not be taken into account in calculating gains or losses on future disposals of consolidated subsidiaries or equity affiliates.

d. Accounting for foreign currency transactions

Transactions in foreign currencies are translated at the rate of exchange prevailing at the transaction date. Foreign currency denominated assets and liabilities are translated into euros at closing exchange rates. Translation gains and losses are recorded in profit and loss as "Foreign exchange gains (losses)".

Foreign currency exposure is managed by the finance department of Thales which uses foreign currency derivatives to protect against changes in the value of future cash flows related to commercial flows in foreign currencies.

In order for a derivative to be eligible for hedge accounting, it is necessary to define and document the hedging relationship and to demonstrate its effectiveness as from origination and throughout its duration.

When a hedge is shown to be effective, hedge accounting is applied in the following manner:

- the change in the fair value of the hedging instrument is recognised directly in shareholders' equity for the effective portion of the hedge until such time as the hedged flows affect profit and loss. The ineffective portion is recognised in profit and loss,
- the amount of the foreign currency denominated transaction is subsequently translated at the exchange rate prevailing at the date of the hedge.

Changes in the fair value of premiums or discounts related to forward foreign currency contracts, as well as the time value of foreign currency options, are recognised in "other financial income (expense)" as they are excluded from the hedging relationship.

In addition, the Group puts in place hedges of its net investment in foreign subsidiaries. Foreign exchange gains or losses on foreign currency denominated financial instruments corresponding to such hedges are recognised through equity under the "cumulative translation adjustment" caption until the date of disposal of these investments. At this date, these foreign exchange gains or losses are recognised in profit and loss.

e. Tangible and intangible fixed assets

Property, plant and equipment are carried at their acquisition cost, as reduced by accumulated depreciation and impairment losses recognised.

Depreciation of tangible fixed assets is generally calculated on the basis of the following typical useful lives:

- 20 years for buildings,
- 1 to 10 years for plant and equipment,
- 5 to 10 years for other tangible fixed assets (vehicles, fixtures, etc.).

The depreciable amount takes account of the residual value of the asset. The different components of tangible fixed assets are recognised separately when their estimated useful lives or patterns of use, and thus the period over which they are depreciated or the depreciation methods applicable to them, are materially different.

When events or changes in the market environment indicate a risk of impairment of fixed assets, an impairment test is performed, in accordance with IAS 36 and as described in note 1-b. If the net book value is greater than the recoverable amount of the fixed asset (market value or value in use if the latter amount is greater), an impairment loss is recognised.

Assets financed under finance leases that transfer substantially all the risks and rewards related to ownership of the asset are recognised in the balance sheet at their fair value or, if lower, at the present value of the minimum lease payments. Such assets are depreciated in accordance with the methodology described above. The corresponding debt is recognised in liabilities.

The Group's intangible assets are principally comprised of goodwill (note 1-b) and capitalised development costs (note 1-j).

f. Investment securities / financial loans and receivables

Investment securities (designated as "available-for-sale" assets in accordance with IAS 39) are measured at fair value. For listed securities, this value corresponds to their stock market price at the balance sheet date. For unlisted securities, valuation models are used. If fair value cannot be reliably determined, such securities are recognised at cost. Changes in fair value are recognised directly in shareholders' equity. If an impairment indicator of long-term loss of value is identified, a provision for impairment is recognised in "other financial income (expense)". Such provisions for impairment are only written back to profit and loss at the date of disposal of the security in question.

Financial loans and receivables are recognised at amortised cost. They are subject to provisions for impairment if an impairment indicator of long-term loss of value is identified. Such provisions for impairment, recognised in the "other financial income (expense)" caption, can subsequently be reversed through profit and loss if the conditions, which led to the impairment loss being recognised, cease to exist.

g. Inventories and work-in-progress

Inventories and work-in-progress are carried at the lower of their production cost (determined using the FIFO or weighted-average cost method) or their net realisable value. Work-in-progress, semi-finished and finished goods are stated at direct cost of raw materials, production labour and subcontract costs incurred during production, plus an appropriate portion of production overhead costs and of any other costs that can be directly allocated to contracts.

In the consolidated balance sheet, work-in-progress related to construction contracts is included in the "Construction contracts: assets" caption or the "Construction contracts: liabilities" caption (note 1-i).

h. Revenues

Revenues relate to the sale of goods and services and to royalty and licence income.

Revenue is recognised when it is probable that the future economic benefits will flow to the Group and when the amount of revenue can be measured reliably. The following specific criteria must also be satisfied in order for revenue to be recognised:

- revenues from the sale of goods are recognised when the enterprise has transferred the principal risks and rewards inherent to ownership of the goods to the purchaser,
- revenues related to the rendering of services are recognised on the basis of the percentage-of-completion of the transaction,
- accounting policies relating to construction contracts are set out in note 1-i.

Revenues are measured at the fair value of the consideration received or receivable. In the case where the deferral of payment has a material effect on the determination of such fair value, the amount at which revenues are recognised is adjusted to take discounting of future payments into account.

i. Construction contracts

A construction contract is a contract specifically negotiated for the construction of an asset or of a group of assets which are interrelated in terms of their design, technology, function, purpose or use.

Income and expenses on construction contracts are recognised in accordance with the technical percentage of completion method. However, where there is no significant timing difference between technical percentage of completion and contractual dates of transfer of ownership, the percentage of completion is determined according to the contractual transfer of ownership.

Penalties for late payment or relating to improper performance of a contract are recognised as a deduction from revenues. In the balance sheet, provisions for penalties are deducted from assets related to the contract.

Probable losses on contracts in progress or on the order book are fully recognised as soon as they are identified.

Selling, administrative and interest expenses are directly charged to the financial year in which they are incurred.

Estimates of work remaining to be completed on loss-making contracts do not include revenues from claims made by the Group, except when it is highly probable that such claims will be accepted by the customer.

Progress payments received on construction contracts are deducted from contract assets as the contract is completed. Progress payments received before the corresponding work has been performed are presented in "Advances received from customers on contracts" in balance sheet liabilities.

The cumulative amount of costs incurred and profit recognised, reduced by recognised losses and advance invoices issued, is determined on a contract-by-contract basis. If this amount is positive it is recognised in assets under the "Construction contracts: assets" caption in assets. If it is negative it is shown in "Construction contracts: liabilities" caption in liabilities.

j. Research and development expenses

A significant portion of research and development expenses is funded by customers and government agencies. Internally funded research and development expenses are charged to the profit and loss account as incurred as "Research and development expenses", except for project development costs that meet the following criteria:

- the product or process is clearly defined, and costs are separately identified and measured reliably,
- the product has been shown to be technically feasible,
- the product or process will be sold or used in-house,
- a potential market exists for the product, or its usefulness for in-house purposes has been demonstrated,
- adequate resources are available to complete the project successfully.

Development costs are capitalised once the above criteria are met. They are then amortised over the economic life of the product. The method of amortisation is determined by reference to expected future quantities or revenues over the period in which future economic benefits will be earned. The period of amortisation depends on the nature of the activity. If the asset becomes impaired, an impairment loss is recognised.

The Group receives public financing, in the form of reimbursable advances, for the development of certain projects. Reimbursement of these advances is generally based on the expected future revenues to be generated by the development. The Group recognises such advances in liabilities taking account of the likelihood that they will be reimbursed. Costs incurred in respect of these projects are recognised in the work-in progress-caption.

The Group benefits from tax credits related to research carried out by its subsidiaries. Such tax credits are deemed to be equivalent to operating grants and are thus included in income from operations.

k. Deferred taxation

Thales recognises deferred taxes when the tax value of an asset or liability differs from its book value.

The effects of changes in the corporation tax rate are recorded in the profit and loss account for the financial year in which the change was decided, unless the underlying transactions were recognised directly through shareholders' equity.

Deferred tax assets and liabilities are not discounted.

Deferred tax assets are not recognised in the balance sheet if the company concerned does not reasonably expect to recover the tax asset. To assess its ability to recover deferred tax assets, the Group takes into account forecasts of future taxable results of the tax entities concerned, non-recurring past events and tax strategies specific to each country.

l. Restructuring

Provisions for restructuring costs are made when restructuring programs have been finalised and approved by Group management and have been announced before the balance sheet date, resulting in an obligating event of the Group to the third parties in question, as long as the Group does not expect consideration for these costs.

Such costs primarily relate to severance payments, costs for notice periods not worked and other costs linked to the closure of facilities such as write-offs of fixed assets.

These costs and the costs directly linked to restructuring measures (removal costs, training costs of transferred employees, etc.), are recognised under the "restructuring costs" caption in the profit and loss account.

m. Pension and other employee benefits

In accordance with local legislation and practice in the countries in which it operates, the Group grants its employees post-employment benefits (pensions, retirement awards, medical care, etc.) and other long-term benefits (long-service benefits, long-service awards on departure, etc.).

The Group measures and recognises pension and similar benefits in accordance with IAS 19 (Employee benefits).

- For defined contribution schemes and state plans, contributions paid by the Group are expensed in the financial year.
- For defined benefit schemes, the actuarial method used is the "Projected Unit Credit method" on the basis of estimated salaries at the date of retirement.

For post-employment benefits, actuarial gains and losses are recognised in income or expense when cumulative unrecognized actuarial gains and losses for the scheme at the end of the previous financial year exceed the greater of 10% of the defined benefit obligation or of the fair value of plan assets at that date. These gains and losses are amortised over the expected average remaining working life of employees benefiting from the scheme (being the "corridor" method).

The expense representing the change in net commitments is recognised in income from operations for the current service cost component and in the "other components of pension charge" caption for other components.

Reminder of policy applied on first time adoption of IFRS
The Group decided to take the option, provided by IFRS 1, of recording its unamortised actuarial gains and losses at 1 January 2004 in shareholders' equity at that date. As from 1 January 2004, the corridor method has been applied. The new option provided by IAS 19, as revised, of recognising actuarial gains and losses directly in shareholders' equity has not been taken.

n. Share based payments

Share options granted by the Group to its employees are accounted for in accordance with the requirements of IFRS 2.

The Group uses a binomial model to measure the amount of the benefit to employees receiving the option granted. The fair value of such options is determined at the grant date. The amounts thus obtained are taken to profit and loss over the vesting period of the rights. Recognition in profit and loss is not linear but, rather, is based on the specific conditions under which rights vest under each scheme.

This expense is included in income from operations and a corresponding credit is recognised increasing retained earnings. It thus has no effect on the overall amount of shareholders' equity.

Reminder of policy applied on first time adoption of IFRS
The Group took the option, provided by IFRS 1, of not restating share option plans whose grant date was prior to 7 November 2002.

o. Earnings per share

Basic earnings per share is calculated by dividing profit attributable to shareholders by the weighted average number of shares outstanding during the financial year, excluding treasury shares.

Diluted earnings per share (DEPS) take into account instruments that have a dilutive effect on earnings per share. No account is taken of anti-dilutive instruments. Diluted earnings per share is calculated on the basis of the weighted average number of shares and equity-equivalent bonds outstanding during the financial year, less treasury shares. Net income is adjusted for the after-tax interest expense of related convertible bonds. The dilutive effect of share options is calculated using the treasury stock method, taking into account the average market price for the share in the period in question.

p. Financial debt – compound instruments

Financial debt is initially recognised at the fair value of the amount received, less directly attributable transaction costs. Financial debt is subsequently measured at amortised cost, in accordance with the effective interest method.

Certain financial instruments include both a financial debt component and a shareholders' equity component. The OCEANE issued by the Group in 2001 falls into this category.

In accordance with IAS 32 "Financial instruments: disclosure and presentation" these two components are separately recognised and have been determined as follows:

- the "debt component" corresponds to the value of future contractual cash-flows (including both interest coupons and capital repayments) discounted at the market rate (taking account of credit risk at date of issue) for a similar instrument with the same conditions (maturity, cash flows) but without a conversion option,
- the "shareholders" equity component" represents the value of the option to convert the bonds into shares. Its value is equal to the difference between the amount of the proceeds of issue of the bond and the amount of the debt component calculated in the manner described above.

q. Borrowing costs

Borrowing costs incurred during the construction of a qualifying asset are treated as part of the cost of that asset. The interest rate used is that of the specific loan related to the asset or, if no specific financing exists, the Group's marginal financing rate.

r. Cash at bank and equivalents

Cash at bank and equivalents includes cash on hand, demand deposits and cash equivalents (short-term, liquid investments which can easily be converted into a known amount of cash and which are subject to an insignificant risk of change in value).

It excludes bank overdrafts which are considered to be financing.

s. Derivatives

The Group uses financial instruments to manage and reduce its exposure to risks of changes in interest rates and foreign exchange rates.

In accordance with the requirements of IAS 39 "Financial instruments: recognition and measurement", derivatives are stated at their fair value in the balance sheet.

In order to be eligible for hedge accounting, financial instruments must have the following characteristics:

- at the date of origination of the financial instrument, the existence of a hedging relationship must be formal and documented,
- and the hedge must be expected to be effective. Effectiveness must be capable of being measured in a reliable manner, and must be able to be demonstrated, over the entire period of the hedge relationship as initially determined.

Accounting policies in respect of foreign exchange derivatives are presented above in note 1-d.

Financial instruments relating to interest rate hedges are hedge-accounted as either fair value hedges or cash flow hedges:

- a fair value hedge is a hedge of the exposure to changes in the value of assets and liabilities,
- a cash flow hedge is a hedge of the exposure to changes in the value of future cash flows (unknown future interest flows payable on existing variable rate borrowings or on highly probable future borrowing issues, for example).

In the case of fair value hedge relationships, the financial liabilities hedged by the interest rate derivatives are remeasured to the extend of hedged risk. Changes in value of hedged liability are recognised in profit and loss of the period and are offset by symmetrical changes of the interest rate derivatives.

In the case of cash flow hedge relationships, changes in fair value of interest rate derivatives shown in the balance sheet are recognised directly through shareholders' equity, for the effective portion thereof, until such time as the hedged flows affect profit and loss.

t. Derecognition of trade receivables

The Group transfers trade receivables from the French *Direction Générale de l'Armement* (Directorate General of Armaments), notably overdue amounts which bear financial interest on arrears.

As these transfers, which are without recourse in case of payment default by the debtor, are analysed as a transfer of substantially all risks and rewards of ownership, the corresponding receivables are derecognised in accordance with IAS 39.

u. Assets held for sale

Non current assets or disposal groups are classified as "held for sale" if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. In that case, the assets or disposal groups must be available for immediate sale and their sale must be highly probable.

Non current assets or disposal groups classified as "held for sale" are measured at the lower of carrying amount and fair value, less costs to sell. Any reduction in the value of the assets or disposal groups to fair value less costs to sell is recognised in profit and loss.

Assets or disposal groups held for sale are presented on the face of the balance sheet in specific captions.

v. Main sources of estimates

Preparation of the Group's consolidated financial statements involves making estimates and assumptions which have an impact on the valuation of income, expenses, assets and liabilities. These estimates could need to be revised if the circumstances on which they were based were to change or if new information or additional experience were to be obtained.

The main financial statement captions subject to material accounting estimates are as follows:

Construction contracts

Recognition of income and expenses relating to construction contracts is based on estimates of overall profit or loss on completion of such contracts (see note 1-i). These estimates are performed by project managers in accordance with Group procedures.

Goodwill

Goodwill, in accordance with IAS 36, is subject to impairment tests (see note 1 b). The recoverable amount of goodwill by cash generating unit is assessed on the basis of forecast data from the strategic plans prepared, in accordance with Group procedures, for each of the Group's businesses or divisions.

Pension and other employee benefits

Benefit obligations in respect of pensions and other employee benefits are estimated on statistical and actuarial bases in accordance with the policies outlined in note 1-m. Actuarial assumptions made by the Group (discount rates, expected return on plan assets, future compensation increases, rates of employee turnover, mortality tables, etc.) are reviewed each year with the Group's actuaries.

Deferred taxes

Deferred tax assets result from the existence of tax loss carry forwards and of deductible temporary differences between the book value and the tax value of assets and liabilities. Recovery of these assets is assessed on the basis of forecast data contained in the strategic plans of each of the tax groups in question.

Risks and litigation

The Group regularly identifies and reviews litigation in progress and recognizes, depending on the circumstances, accounting provisions that it considers to be reasonable. Any uncertainties concerning litigation in progress are described in note 22.

2. Changes in scope of consolidation

a. In 2006

The main changes in the scope of consolidation in 2006 were as follows:

- in October 2006, acquisition of the remaining 50% share of ADI, previously owned jointly with Transfield Holdings, following the exercise of existing options. As stipulated in the agreements, the Group paid AUD 5.8 million. As the fair value of existing options had been recognised in the Group's financial statements for 2005, no goodwill was booked in respect of this transaction in 2006,
- at the end of August 2006, disposal of navigation systems activities to an investment fund for $170 million (including a $60 million loan repayable in 2011 and 2012),
- in May 2006, acquisition from Diehl VA Systeme Siftung & Co. KG of a 49% stake in Diehl Luftfahrt Elektronik GmbH for €24.5 million. This company is consolidated under the proportionate method.

Transactions in progress at year end:

Transfer of Alcatel-Lucent's transportation, security and space assets to Thales

On 1 December 2006, Alcatel-Lucent and Thales signed a final agreement on the transfer of Alcatel-Lucent's transportation, security and space assets to Thales, and on the future industrial cooperation of the two groups.

On 5 January 2007, an extraordinary general shareholders' meeting approved the transfer of Alcatel-Lucent's transportation and security assets. The related consideration consisted in the issuance of 25 million new Thales shares in favour of Alcatel-Lucent, which received in addition, a cash payment of €40 million.

Following the extraordinary general shareholders' meeting on 5 January 2007, Alcatel-Lucent's interest in Thales increased from 9.46% to 20.95%, whereas the French State's stake decreased from 31.26% to 27.29%. Alcatel-Lucent and the French State entered into a new shareholders' agreement for a period of 5 years renewable, replacing the former shareholder agreement signed in June 1998 between Alcatel, GIMD and the French State.

In a second phase, the agreement stipulates that Alcatel Participations will sell to Thales its shares in two companies which operate in space activities, representing 67% of Alcatel Alenia Space (a satellite constructor), and 33% of Telespazio Holding (a satellite operator), both companies being jointly owned with Finmeccanica. According to this agreement, Alcatel-Lucent will receive a cash payment of €670 million[1].

(1) The acquisition price of the shares in Alcatel Alenia Space will be reappraised by an independent expert at the beginning of 2009, which could lead to an upward revision of the initially agreed amount.

The finalisation of this disposal will not take place until the end of the in-depth inquiry phase entered into on 28 November by the European Commission, in application of EU competition regulations. Finalisation is subject to European Commission approval, which is expected during the second quarter of 2007. A compensation mechanism, which would come into operation if the disposal could not be finalised, has been put in place in favour of Alcatel-Lucent.

The cost of the business combination can be analysed as follows:

Number of ordinary shares issued by Thales on 5 January 2007	25,000,000
Price per share at issuing date (in euros)	40
Total Shares issued by Thales (in million of euros)	1,000
Cash paid on 5 January 2007 (in million of euros)	40
Cash to be paid (in million of euros) (a)	670
Cost of the business combination (in million of euros) (b)	**1,710**

(a) Subject to European Commission. approval.
(b) Before transaction costs.

Assets and liabilities acquired (or to be acquired) from Alcatel-Lucent are as follows (as disclosed by Alcatel-Lucent at 31 December 2006):

In € m	
Assets	1,186
Cash	121
Advances received	(639)
Other liabilities	(967)
Net	**(299)**

Resulting goodwill would amount to €2,009 million, before purchase accounting.

In 2006, as disclosed by Alcatel-Lucent, these activities contributed €2,099 million to revenues and €105 million to income from operations.

Combination of French naval activities of Thales and DCN

On 30 January 2007, the French State, DCN and Thales announced the signature of the final agreement concerning the combination of the French naval activities of Thales and DCN. Under this agreement, DCN will acquire all of Thales' French naval activities (excluding equipment to be used in naval programmes) and will become the sole shareholder of joint ventures between the two groups, being mainly Armaris and MOPA2. Simultaneously, Thales will take a 25% stake in DCN with the remaining 75% continuing to be held by the French State. The difference in valuation will lead to net cash outlay by Thales of approximately €100 million. The agreement also contains a contingent remuneration clause related to certain contracts being obtained. At the end a two-year period, Thales will have the option to increase its interest to 35%. The new entity will be accounted for under the equity method in Thales' consolidated financial statements.

At the signature date of this final agreement, the combination of these activities was expected to come into force by the end of the first quarter of 2007, following completion of the European Commission approval procedures, and subject to the approval of the French Commission for Investments and Transfers *(Commission des Participations et des Transferts).*

In 2006, revenues and income from operations relating to activities transferred by Thales to DCN amounted respectively to €397 million and €37 million.

b. In 2005

The main changes in the scope of consolidation in 2005 were as follows:

- at the beginning of May 2005, Thales sold its 22% shareholding in Satellite Information Services Ltd to an investment fund for £18 million Sterling. As from that date, this company is no longer accounted for under the equity method,
- as from the last quarter of 2005, TDA Armements has been fully consolidated, following the acquisition for €51.5 million of shares previously owned by EADS (50%),
- as from December 2005, Thales high tech optics activities were deconsolidated following their disposal for €205.8 million to an investment fund,
- as from December 2005, Thales Broadcast & Multimedia activities were deconsolidated following their disposal for €133.6 million to Thomson.

c. In 2004

As from January 2004, Stesa has been consolidated under the proportionate method. The company was previously consolidated under the equity method.

As from January 2004, the following entities have been deconsolidated:

- the Thales Nixdorf Systèmes Bancaires SAS joint-venture, which has been sold to Wincor Nixdorf International GmbH,
- the seismic activities of Thales Underwater System Pty Ltd, sold to Sercel Australia Pty Ltd; Thales Acoustics, sold in April 2004 to J.F. Lehman & Company.

At the end of November 2004, Thales sold its Thales Electronic Solutions (TES) subsidiary to a group of investors. It has been deconsolidated as from 1 December 2004.

3. Information on the basis of comparable consolidation scope and foreign exchange rates

a. Effect of changes in both scope of consolidation and foreign exchange rates on consolidated income from operations

	2006 published	Less companies acquired (a)	2006 restated	2005 published	Less companies sold (b)	Foreign currency adjustment (c)	2005 restated
Revenues	**10,264.3**	**(53.0)**	**10,211.3**	**10,263.2**	**(397.9)**	**(15.1)**	**9,850.2**
Cost of sales	(7,833.6)	30.5	(7,803.1)	(7,851.1)	284.3	10.5	(7,556.3)
Research and development expenses	(360.8)	5.3	(355.5)	(366.0)	14.7	0.4	(350.9)
Marketing and selling expenses	(855.7)	5.2	(850.5)	(867.8)	57.9	2.0	(807.9)
General and administrative expenses	(459.6)	2.7	(456.9)	(456.5)	28.0	1.4	(427.1)
Income from operations	**754.6**	**(9.3)**	**745.3**	**721.8**	**(13.0)**	**(0.8)**	**708.0**

(a) Companies acquired in 2006 are excluded from the restated 2006 profit and loss account and the accounts of companies acquired during 2005 have been restated in order to affect 2006 profit or loss over an identical period to that over which such companies were consolidated in 2005.
(b) Companies sold in 2005 are excluded from 2005 restated results. The accounts of companies sold during 2006 have been restated in order to impact profit and loss for an identical period in 2005 and in 2006.
(c) 2005 results are translated at 2006 average exchange rates.

b. Effect of changes in both scope of consolidation and foreign exchange rates on the consolidated balance sheet

The schedule below presents a reconciliation between the balance sheet at 31 December 2004 and the balance sheet at 31 December 2006, disclosing the effects of changes in scope of consolidation, changes in foreign exchange rates, reclassifications between balance sheet line items and the effect of cash flows.

	Share-holders' equity	Pensions and other employee benefits	Current and deferred taxes	Non current operating assets	Non current financial assets	Net current operating liabilities/ assets	Gross financial debt	Current financial assets (excluding cash)	Cash at banks and equivalents
At 31 Dec. 2004	**1,601.3**	**1,071.4**	**(478.0)**	**(3,240.3)**	**(478.9)**	**674.7**	**2,164.7**	**(133.3)**	**1,181.6**
First-time application of IAS 39	139.2	--	62.1	--	(10.4)	(200.9)	10.0	--	--
At 1 Jan. 2005	**1,740.5**	**1,071.4**	**(415.9)**	**(3,240.3)**	**(489.3)**	**473.8**	**2,174.7**	**(133.3)**	**1,181.6**
Financial flows									
Cash flows from operating activities	203.7	6.2	6.1	308.2	(4.1)	89.5	--	--	609.6
Cash flows from investing activities	158.3	--	--	(358.6)	43.2	--	--	(30.8)	(187.9)
Cash flows from financing activities	(15.1)	--	--	--	--	--	(305.9)	--	(321.0)
Non-financial flows									
Changes in scope of consolidation	0.4	(16.6)	0.4	101.9	(45.6)	120.4	(23.5)	(137.4)	--
Changes in foreign exchange rates	81.8	14.3	(14.6)	(57.4)	(11.1)	(0.4)	29.0	(4.0)	37.6
Financial instruments	(64.7)	--	(38.8)	--	(24.9)	113.3	15.1	--	--
Reclassifications and other	(2.1)	(11.3)	0.1	11.0	36.5	(34.2)	--	--	--
At 31 Dec. 2005	**2,102.8**	**1,064.0**	**(462.7)**	**(3,235.2)**	**(495.3)**	**762.4**	**1,889.4**	**(305.5)**	**1,319.9**
Financial flows									
Cash flows from operating activities	385.0	(26.4)	(20.7)	303.6	(3.3)	115.4	--	--	753.6
Cash flows from investing activities	22.9	--	--	(378.9)	132.7	--	--	154.9	(68.4)
Cash flows from financing activities	(135.2)	--	--	--	--	--	470.1	--	334.9
Non-financial flows									
Changes in scope of consolidation	(33.6)	0.7	36.9	17.8	(122.1)	81.3	17.5	1.5	--
Changes in foreign exchange rates	(36.5)	4.5	5.1	18.4	16.8	(9.4)	(9.6)	3.8	(6.9)
Financial instruments	(9.9)	--	15.0	--	34.8	(60.1)	20.2	--	--
Reclassifications and other	(1.3)	(12.6)	--	9.1	20.4	(15.6)	--	--	--
At 31 Dec. 2006	**2,294.2**	**1,030.2**	**(426.4)**	**(3,265.2)**	**(416.0)**	**874.0**	**2,387.6**	**(145.3)**	**2,333.1**

4. Information by segment

a. Information by business segment

Thales is an electronics group principally serving professional equipment, systems and related services markets. Its businesses use and implement advanced technologies such as signal processing, complex system management and information system integration.

The group is organised around six divisions: Aerospace, Air Systems, Land and Joint Systems, Naval, Security and Services. The table below sets out segmented information under this structure.

31 December 2006	Aerospace	Air Systems	Land & Joint Systems	Naval	Security	Services	Other and eliminations (a)	Total Thales
Consolidated order backlog at 31/12	5,052.9	3,824.3	3,973.1	4,714.6	1,178.2	1,918.8	14.4	20,676.3
Consolidated new orders	2,368.5	1,449.5	2,869.5	1,253.8	1,524.6	1,304.2	47.5	10,817.6
Consolidated revenues	2,473.5	1,588.6	2,401.4	1,330.0	1,204.7	1,213.9	52.2	10,264.3
Inter-segment revenues	61.6	94.7	178.6	63.6	54.9	402.9	(856.3)	--
Total revenues	**2,535.1**	**1,683.3**	**2,580.0**	**1,393.6**	**1,259.6**	**1,616.8**	**(804.1)**	**10,264.3**
Income from operations	201.0	138.4	185.8	100.4	67.6	81.2	(19.8)	754.6
Income of operating activities	158.8	105.1	166.6	98.7	58.3	41.6	(53.2)	575.9
Current operating assets	2,326.1	791.9	1,170.1	1,541.0	695.0	930.7	855.6	8,310.4
Current operating liabilities	(2,080.2)	(1,121.6)	(1,497.4)	(1,957.6)	(532.4)	(872.3)	(1,122.9)	(9,184.4)
Net	**245.9**	**(329.7)**	**(327.3)**	**(416.6)**	**162.6**	**58.4**	**(267.3)**	**(874.0)**
Non current operating assets	865.0	215.3	678.7	470.9	330.2	341.2	363.9	3,265.2
Capital expenditure	190.8	21.6	46.3	9.6	45.6	54.4	43.8	412.1
Depreciation and amortisation of tangible and intangible assets	78.3	13.8	45.1	18.7	28.0	50.1	61.1	295.1
Consolidated number of employees (end of period) (b)	**12,673**	**5,878**	**11,654**	**4,415**	**5,248**	**10,172**	**2,120**	**52,160**

31 December 2005	Aerospace	Air Systems	Land & Joint Systems	Naval	Security	Services	Other and eliminations (a)	Total Thales
Consolidated order backlog at 31/12	5,173.1	3,977.9	3,543.9	4,795.9	874.2	1,845.2	12.6	20,222.8
Consolidated new orders	3,164.4	1,202.3	2,364.4	3,236.8	1,421.1	1,100.6	291.8	12,781.4
Consolidated revenues	2,335.2	1,596.1	2,178.0	1,483.8	1,186.2	1,183.2	300.7	10,263.2
Inter-segment revenues	83.1	141.6	190.5	15.6	51.5	305.2	(787.5)	--
Total revenues	**2,418.3**	**1,737.7**	**2,368.5**	**1,499.4**	**1,237.7**	**1,488.4**	**(486.8)**	**10,263.2**
Income from operations	208.7	122.7	127.9	149.7	55.5	80.4	(23.1)	721.8
Income of operating activities	130.8	103.5	88.5	112.6	31.8	54.7	27.2	549.1
Current operating assets	2,136.9	840.4	1,198.6	1,492.5	774.7	830.3	652.3	7,925.7
Current operating liabilities	(2,018.9)	(1,064.3)	(1,402.7)	(1,969.9)	(546.4)	(781.5)	(936.2)	(8,719.9)
Net	**118.0**	**(223.9)**	**(204.1)**	**(477.4)**	**228.3**	**48.8**	**(283.9)**	**(794.2)**
Non current operating assets	731.8	197.6	688.3	513.6	378.4	364.5	361.0	3,235.2
Capital expenditure	149.8	15.7	42.9	24.4	51.2	47.6	59.2	390.8
Depreciation and amortisation of tangible and intangible assets	81.6	16.2	45.3	15.1	29.8	38.1	47.9	274.0
Consolidated number of employees (end of period) (b)	**12,483**	**6,134**	**11,748**	**4,764**	**5,516**	**10,296**	**2,106**	**53,047**

(a) The "Other and eliminations" column corresponds to the elimination of transactions between the six divisions and includes figures relating to corporate activities: Group R&D centres, facilities management, holding companies and activities sold. Corporate income from operations, with the exceptions of facilities management income from operations corresponding to the cost of vacant premises (respectively €19.8 million, €36.7 million and €17.9 million in 2006, 2005 and 2004) and of income from operations relating to activities sold in 2005 (optics activities and Broadcast & Multimedia), has been allocated to the business segments.

(b) Data concerning the consolidated number of employees at 31 December include all employees of fully consolidated companies and the proportionate share of employees of companies consolidated under the proportionate method. It does do not include the employees of companies accounted for under the equity method or unconsolidated companies. Corresponding personnel expenses amount to €3,717.7 million, €3,703.2 million and €3,659.1 million respectively in 2006, 2005 and 2004. Business sold in 2006 (Navigation), which are included in the Security Systems business segment, contribute €112.6 million to revenues and €(17.5) million to income from operations.

31 December 2004	Aerospace	Air Systems	Land & Joint Systems	Naval	Security	Services	Other and eliminations (a)	Total Thales
Consolidated order backlog at 31/12	4,333.9	4,249.5	3,211.1	2,989.7	676.0	1,909.3	208.5	17,578.0
Consolidated new orders	2,367.3	1,445.9	1,820.0	1,162.2	1,098.0	1,142.2	339.0	9,374.6
Consolidated revenues	2,137.1	1,482.5	2,182.1	1,900.1	1,114.8	1,136.2	330.0	10,282.8
Inter-segment revenues	67.2	160.9	149.7	13.6	50.4	218.2	(660.0)	0.0
Total revenues	**2,204.3**	**1,643.4**	**2,331.8**	**1,913.7**	**1,165.2**	**1,354.4**	**(330.0)**	**10,282.8**
Income from operations	183.1	113.2	171.3	147.8	56.9	65.8	(38.1)	700.0
Income of operating activities	165.6	78.1	160.7	127.8	52.3	39.2	(52.8)	570.9
Current operating assets	2,074.1	850.2	1,197.3	1,503.8	730.7	789.3	763.1	7,908.5
Current operating liabilities	(1,940.2)	(1,021.5)	(1,388.7)	(1,950.3)	(563.5)	(764.9)	(954.1)	(8,583.2)
Net	**133.9**	**(171.3)**	**(191.4)**	**(446.5)**	**167.2**	**24.4**	**(191.0)**	**(674.7)**
Non current operating assets	667.4	191.8	745.4	546.3	376.1	342.1	371.2	3,240.3
Capital expenditure	95.4	16.3	53.8	33.1	37.8	22.4	51.8	310.6
Depreciation and amortisation of tangible and intangible assets	88.3	16.5	42.4	16.5	29.9	38.0	41.5	273.1
Consolidated number of employees (end of period) (b)	**12,475**	**6,338**	**12,040**	**5,679**	**5,375**	**9,715**	**4,083**	**55,705**

(a) The "Other and eliminations" column corresponds to the elimination of transactions between the six divisions and includes figures relating to corporate activities: Group R&D centres, facilities management, holding companies and activities sold. Corporate income from operations, with the exceptions of facilities management income from operations corresponding to the cost of vacant premises (respectively €19.8 million, €36.7 million and €17.9 million in 2006, 2005 and 2004) and of income from operations relating to activities sold in 2005 (optics activities and Broadcast & Multimedia), has been allocated to the business segments.

(b) Data concerning the consolidated number of employees at 31 December include all employees of fully consolidated companies and the proportionate share of employees of companies consolidated under the proportionate method. It does do not include the employees of companies accounted for under the equity method or unconsolidated companies. Corresponding personnel expenses amount to €3,717.7 million, €3,703.2 million and €3,659.1 million respectively in 2006, 2005 and 2004. Business sold in 2006 (Navigation), which are included in the Security Systems business segment, contribute €112.6 million to revenues and €(17.5) million to income from operations.

b. Information by geographic area

By country / region of destination

Revenues (direct and indirect)	2006	2005	2004
France	3,064.1	2,994.9	2,958.1
United Kingdom	1,341.5	1,241.8	1,337.7
Rest of Europe	2,079.4	2,167.1	2,129.3
North America	1,192.4	1,067.5	896.0
Middle East	616.8	884.2	1,183.2
Asia and Pacific	1,576.8	1,537.2	1,392.0
Africa and Latin America	393.3	370.5	386.5
Total	**10,264.3**	**10,263.2**	**10,282.8**

By country / region of origin

Revenues	2006	2005	2004
France	5,365.0	5,540.9	5,744.3
United Kingdom	1,619.8	1,567.4	1,640.1
Other European countries	1,231.3	1,238.5	1,244.6
Rest of the world	2,048.2	1,916.5	1,653.7
Total	**10,264.3**	**10,263.2**	**10,282.8**

Operating assets (current and non current) by original location	2006	2005	2004
France	7,458.1	7,214.0	7,264.9
United Kingdom	1,305.2	1,264.1	1,438.4
Other European countries	1,250.4	1,202.4	1,203.2
Rest of the world	1,561.9	1,480.4	1,242.3
Total	**11,575.6**	**11,160.9**	**11,148.8**

Capital expenditure by original location	2006	2005	2004
France	210.9	219.7	201.8
United Kingdom	64.9	54.2	37.8
Other European countries	36.8	38.1	33.4
Rest of the world	99.5	78.8	37.6
Total	**412.1**	**390.8**	**310.6**

5. Gain (Loss) on disposal of assets

	2006	2005	2004
Disposal of investments	**16.7**	**152.0**	**0.2**
Embraer	41.1	--	--
Thales Navigation	(24.7)	--	--
Thales Broadcast & Multimedia	--	94.3	--
High Tech Optics activities (HTO)	(4.7)	27.9	--
Satellite Information Services	--	8.3	--
Seismic activities of Thales Underwater Systems	0.2	1.6	9.9
Thales Electronic Solutions	3.0	(0.5)	(27.7)
Nice Systems shares	--	25.5	12.0
Other	1.8	(5.1)	6.0
Disposal of other assets	**6.2**	**6.3**	**(4.7)**
Real estate assets	12.2	7.1	(0.5)
Equipment	(6.0)	(0.8)	(4.2)
Total	**22.9**	**158.3**	**(4.5)**

6. Financial income (expense)

a. Cost of net financial debt

	2006	2005	2004
Interest expense:			
- on gross debt	(99.1)	(127.5)	(119.9)
- on interest rate swaps	3.2	1.5	(4.5)
	(95.9)	**(126.0)**	**(124.4)**
Interest income / cash and equivalents	54.1	43.2	39.8
Total	**(41.8)**	**(82.8)**	**(84.6)**

b. Other financial income (expense)

	2006	2005	2004
Foreign exchange gains (losses)	(3.3)	(4.3)	--
Change in fair value of derivative exchange instruments	(14.8)	(6.9)	--
Net foreign exchange gain (loss)	(18.1)	(11.2)	--
Net interest income (expense) on non-financial receivables and payables	3.5	3.5	5.0
Dividends received	2.6	1.0	2.0
Impairment of investment securities (Available-for-sale)	(7.8)	(9.3)	(12.4)
Change in fair value of put and call options between Thales and Transfield	(2.1)	8.9	--
Other	(9.6)	(3.1)	(6.0)
Total	**(31.5)**	**(10.2)**	**(11.4)**

7. Income tax

Determination of the income tax expense takes into account the specific local rules applied by Thales, including the tax consolidation system in France, Group Relief in the United Kingdom, tax consolidation in the USA, and the "Organschaft" rules in Germany.

a. Analysis of tax charge

	2006	2005	2004
Current tax	(101.8)	(55.0)	(50.6)
Deferred tax	1.4	(32.3)	(76.3)
Total	**(100.4)**	**(87.3)**	**(126.9)**

b. Effective tax rate

	2006	2005	2004
Net income (loss)	391.1	343.1	340.8
Less: income tax	100.4	87.3	126.9
Less: equity in income of unconsolidated affiliates	(7.9)	(7.9)	(10.3)
Profit before tax	**483.6**	**422.5**	**457.4**
Average tax rate	31.1%	31.3%	31.2%
Theoretical tax profit (expense)	**(150.6)**	**(132.6)**	**(142.7)**
Reconciliation:			
- permanent differences and transactions subject to lower tax rates	44.9	41.4	24.0
- creation of tax loss carry-forwards not recorded in assets	(2.7)	(18.7)	(5.7)
- recognition in assets of tax losses not recognised in previous periods	27.5	17.3	15.3
- adjustments on prior years	(7.0)	7.4	(3.4)
- other (a)	(12.5)	(2.1)	(14.4)
Actual net tax charge	**(100.4)**	**(87.3)**	**(126.9)**
Effective tax rate	**20.8%**	**20.7%**	**27.7%**

(a) Primarily specific foreign taxation and the effect of enacted future tax rate changes.
The decrease in tax rates voted at the closing date in the Netherlands and France (in 2004) leads to a loss amounted to €2.5 million in 2006, €1.0 million in 2005 and €7.2 million in 2004.

c. Deferred tax assets and liabilities

	31 Dec. 06	31 Dec. 05	01 Jan. 05	31 Dec. 04
Deferred tax assets	440.8	454.1	422.4	482.0
Deferred tax liabilities	(39.1)	(30.1)	(15.3)	(12.8)
Deferred tax assets, net	**401.7**	**424.0**	**407.1**	**469.2**

d. Changes in net deferred tax assets

	01 Jan. 06	(Expense) income in period	Recognised through shareholders' equity	Exchange rate variations, changes in scope of consolidation and other	31 Dec. 06
Temporary differences:	348.3	(3.9)	(14.0)	(2.5)	327.9
- pensions and other employee benefits	267.2	(16.8)	--	1.2	251.6
- other	81.1	12.9	(14.0)	(3.7)	76.3
Tax loss carry-forwards	373.4	(40.6)	--	(12.0)	320.8
Total	**721.7**	**(44.5)**	**(14.0)**	**(14.5)**	**648.7**
Of which non recognised in the balance sheet:	**(297.7)**	**45.9**	**(1.0)**	**5.8**	**(247.0)**
Total net deferred tax assets	**424.0**	**1.4**	**(15.0)**	**(8.7)**	**401.7**

	01 Jan. 05	(Expense) income in period	Recognised through shareholders' equity	Exchange rate variations, changes in scope of consolidation and other	31 Dec. 05
Temporary differences:	325.8	(16.6)	38.9	0.2	348.3
- pensions and other employee benefits	281.6	(14.7)	--	0.3	267.2
- other	44.2	(1.9)	38.9	(0.1)	81.1
Tax loss carry-forwards	398.3	(1.0)	--	(23.9)	373.4
Total	**724.1**	**(17.6)**	**38.9**	**(23.7)**	**721.7**
Of which non recognised in the balance sheet:	**(317.0)**	**(14.7)**	**(5.3)**	**39.3**	**(297.7)**
Total net deferred tax assets	**407.1**	**(32.3)**	**33.6**	**15.6**	**424.0**

e. Tax loss carry-forwards

Total tax loss carry-forwards represent a potential tax saving of €320.8 million at 31 December 2006. Corresponding expiry dates are:

	31 Dec. 06
2007	2.5
2008-2011	45.3
> 2011 (a)	273.0
Total	**320.8**

(a) Of which: €217.4 million without any time limit.

8. Earnings per share

		2006	2005	2004
Numerator (in millions of euros)				
Income (loss), Group share	(1)	388.0	333.9	325.5
Less interest expense, net of tax, on OCEANE bonds		18.6	17.9	8.0
Diluted income (loss), Group share	(2)	406.6	351.8	333.5
Denominator (in thousands)				
Average number of shares outstanding	(3)	168,772	167,246	162,434
OCEANE bonds	note 18-b	10,261	10,261	10,261
Share options	note 18-c	1,065	991	267
Diluted average number of shares outstanding	(4)	180,098	178,498	172,962
Earnings per share (in euros)	**(1)/(3)**	**2.30**	**2.00**	**2.00**
Diluted earnings per share (in euros)	**(2)/(4)**	**2.26**	**1.97**	**1.93**

9. Goodwill

Goodwill by division:

	31 Dec. 06			31 Dec. 05	31 Dec. 04
	Gross	Impairment	Net	Net	Net
Aerospace	387.2	--	387.2	365.6	362.4
Air systems	125.8	--	125.8	126.5	123.4
Land & Joint systems	517.6	(7.4)	510.2	514.6	576.8
Naval	441.5	--	441.5	443.6	437.7
Security	249.0	(19.2)	229.8	266.1	284.3
Services	149.5	(21.0)	128.5	140.3	138.6
Other	2.4	--	2.4	2.4	2.4
Total	**1,873.0**	**(47.6)**	**1,825.4**	**1,859.1**	**1,925.6**

Changes in net goodwill:

	2006	2005	2004
Net book value at 1 January	**1,859.1**	**1,925.6**	**2,009.4**
Acquisitions	**29.4**	**28.3**	**6.2**
- acquisition of Diehl Luftfart Elektronik GmbH	23.7	--	--
- additional acquisition (60%) of Wynid Technologies	5.7	--	--
- additional acquisition (50%) of TDA Armements	--	28.3	--
- additional price / Aérospatiale calculators activities	--	--	6.2
Disposals	**(44.8)**	**(92.8)**	**(18.5)**
- Thales Navigation	(41.0)	--	--
- High Tech Optics activities (HTO)	--	(92.8)	--
- Thales Acoustics	--	--	(10.3)
- Seismic activities of Thales Underwater Systems	--	--	(7.1)
- Other	(3.8)	--	(1.1)
Impairment (a)	**(8.5)**	**(26.1)**	**(13.0)**
Reclassification, exchange and other	**(9.8)**	**24.1**	**(58.5)**
- UK tax reimbursement recognized as a deduction from goodwill	--	--	(53.4)
- Exchange rate variations and other	(9.8)	24.1	(5.1)
Net book value at 31 December	**1,825.4**	**1,859.1**	**1,925.6**

(a) Includes:
- *in 2006, (€7.5 million) in the Services division and (€1.0 million) in the Security division,*
- *in 2005, (€18.2 million) in the Security division, (€7.4 million) in the Land and Joint Systems division and (€0.5 million) in the Services division,*
- *in 2004, (€13.0 million) in the Services division.*

10. Tangible and intangible assets

	31 Dec. 06				31 Dec. 05	31 Dec. 04
	Gross	Depreciation and amortisation	Impairment	Net	Net	Net
Other intangible assets						
Development costs	469.9	(130.3)	(1.5)	338.1	253.3	152.4
Other	377.8	(278.9)	(4.6)	94.3	94.9	84.4
Total	**847.7**	**(409.2)**	**(6.1)**	**432.4**	**348.2**	**236.8**
Tangible assets						
Land	41.5	--	--	41.5	44.4	54.5
Buildings	630.4	(343.5)	(2.0)	284.9	303.1	310.7
Plant and equipment	1,725.8	(1,243.3)	--	482.5	477.7	506.5
Other	528.9	(330.4)	--	198.5	202.7	206.2
Total	**2,926.6**	**(1,917.2)**	**(2.0)**	**1,007.4**	**1,027.9**	**1,077.9**
Items held under capital leases agreements included above						
Land	2.1	--	--	2.1	2.2	2.2
Buildings	43.9	(18.7)	--	25.2	29.2	31.8
Plant and equipment	23.0	(9.5)	--	13.5	15.0	0.4
Other	0.5	(0.4)	--	0.1	0.2	0.5
Total	**69.5**	**(28.6)**	**--**	**40.9**	**46.6**	**34.9**
Of which assets under construction	**28.1**	**--**	**--**	**28.1**	**31.3**	**40.4**

Changes in net tangible and intangible assets:

	Development costs	Other intangible assets	Tangible assets	Total
Net value at 1 January 2004	**102.9**	**102.6**	**1,157.2**	**1,362.7**
Acquisitions/capitalisations	68.5	25.1	217.0	310.6
Disposals	--	(1.5)	(36.4)	(37.9)
Depreciation and amortisation	(21.6)	(30.2)	(221.3)	(273.1)
Scope of consolidation, foreign exchange rates and other	2.6	(11.6)	(38.6)	(47.6)
Net value at 31 December 2004	**152.4**	**84.4**	**1,077.9**	**1,314.7**
Acquisitions/capitalisations	137.6	26.4	226.8	390.8
Disposals	--	--	(38.5)	(38.5)
Depreciation and amortisation	(37.9)	(30.2)	(205.9)	(274.0)
Impairment	(1.5)	(4.6)	(2.0)	(8.1)
Scope of consolidation, foreign exchange rates and other	2.7	18.9	(30.4)	(8.8)
Net value at 31 December 2005	**253.3**	**94.9**	**1,027.9**	**1,376.1**
Acquisitions/capitalisations	156.2	28.4	227.5	412.1
Disposals	--	--	(39.3)	(39.3)
Depreciation and amortisation	(49.3)	(37.6)	(208.2)	(295.1)
Impairment	--	--	--	--
Scope of consolidation, foreign exchange rates and other	(22.1)	8.6	(0.5)	(14.0)
Net value at 31 December 2006	**338.1**	**94.3**	**1,007.4**	**1,439.8**

11. Equity in unconsolidated affiliates

Group share in the equity and net income of unconsidated affiliates

	Ownership %			Net equity			Income (loss)		
	31 Dec. 2006	31 Dec. 2005	31 Dec. 2004	31 Dec. 2006	31 Dec. 2005	31 Dec. 2004	2006	2005	2004
Camelot Plc	**20**	20	20	**49.8**	58.2	68.7	**--**	--	(0.2)
Elettronica	**33**	33	33	**22.4**	21.7	20.9	**2.0**	2.2	1.7
NICE Systems (a)	**--**	--	--	**--**	--	--	**--**	--	1.5
Satellite Information Systems Ltd (a)	**--**	--	22	**--**	--	16.3	**--**	1.2	3.9
Aviation Communications & Surveillance Systems	**30**	30	30	**60.6**	64.8	54.8	**2.8**	1.4	0.1
DpiX	**20**	--	--	**7.2**	--	--	**(0.3)**	--	--
Other	**--**	--	--	**17.9**	17.1	15.8	**3.4**	3.1	3.3
Total				**157.9**	**161.8**	**176.5**	**7.9**	**7.9**	**10.3**

(a) Sold in 2005.

Goodwill in respect of entities accounted for under the equity method is included in the value of the related investments. Impairment of goodwill in respect of those entities is accounted for in "equity in income of unconsolidated affiliates".

Changes in "Equity in unconsolidated affiliates"

	2006	2005	2004
Equity in unconsolidated affiliates at 1 January	**161.8**	**176.5**	**199.1**
Income (loss) of unconsolidated affiliates	7.9	7.9	10.3
Dividends paid	(12.0)	(14.6)	(10.4)
Effect of changes in scope of consolidation (Nice Systems in 2004, Satellite Information Services Ltd in 2005, DpiX in 2006)	7.8	(17.7)	(18.4)
Effect of changes in exchange rates and other	(7.6)	9.7	(4.1)
Equity in unconsolidated affiliates at 31 December	**157.9**	**161.8**	**176.5**

12. Other non-current financial assets

a. Other investments

	31 Dec. 06	31 Dec. 05	01 Jan. 05	31 Dec. 04
Embraer (a)	--	106.6	72.1	75.6
Nice Systems (a)	--	--	25.1	11.4
Investments held by Thales Corporate Ventures (b)	25.4	24.3	21.3	21.3
Investments held by Thales International Offsets (c)	20.9	2.8	2.8	1.7
Other	52.5	62.3	42.4	41.6
Total	**98.8**	**196.0**	**163.7**	**151.6**

(a) Valued on the basis of stock market price as from 1 January 2005, in application of IAS 39. These investments have been sold since (Embraer in 2006, Nice Systems in 2005).
(b) The Group's venture capital vehicle.
(c) The Group's offset vehicle.

b. Other financial assets

	31 Dec. 06	31 Dec. 05	01 Jan. 05	31 Dec. 04
Loans to partners	52.6	48.7	41.8	41.8
Receivables relating to disposals (a)	56.0	30.3	46.9	46.9
Other	63.5	82.5	86.5	88.2
Other financial assets, gross	172.1	161.5	175.2	176.9
Provisions for impairment	(12.8)	(24.0)	(26.1)	(26.1)
Other financial assets, net	**159.3**	**137.5**	**149.1**	**150.8**

(a) Among of which €45.6 million at 31 December 2006 relating to disposal of Thales Navigation.

13. Inventories and work-in-progress

	31 Dec. 06	31 Dec. 05	31 Dec. 04
Raw materials	387.5	432.9	438.4
Work-in-progress (excluding construction contracts – note 14)	978.5	878.5	856.2
Semi-finished and finished products	675.5	622.9	613.8
Finished goods for resale	127.5	131.0	114.6
Total, gross	2,169.0	2,065.3	2,023.0
Provisions	(431.7)	(445.8)	(477.3)
Total, net	**1,737.3**	**1,619.5**	**1,545.7**

14. Construction contracts

Revenues related to construction contracts amounted to €4,569.6 million in 2006 (€4,995.1 million in 2005 and €4,970.3 million in 2004) and represented 44.5% of Group revenues (48.7% in 2005 and 48.3% in 2004). The share of revenues related to sales of goods and rendering of services amounted respectively to 33.0% and 22.5% in 2006 (31.9% and 19.3% in 2005 and 31.6% and 20.1% in 2004).

The amounts shown in the balance sheet correspond, for each construction contract, to the aggregate amount of costs incurred plus recognised profits (less recognised losses), less progress billings.

	31 Dec. 06	31 Dec. 05	31 Dec. 04
Construction contracts: assets (a)	2,096.7	2,042.8	2,487.8
Construction contracts: liabilities	359.4	341.5	357.7
Construction contracts, net assets	1,737.3	1,701.3	2,130.1
This amount corresponds to:			
Aggregate amount of costs incurred plus recognised profits (less recognised losses)	26,969.5	29,868.0	29,547.1
Less, progress billings	(25,232.2)	(28,166.7)	(27,417.0)

(a) Includes work-in-progress for an amount of €873.2 million at 31 December 2006, €1,067.1 million at 31 December 2005 and €1,540.9 million at 31 December 2004.

Advances received from customers on construction contracts related to work not yet performed amount to €2,050.5 million at 31 December 2006 (€2,255.4 million at 31 December 2005 and €2,530.5 million at 31 December 2004). They partly cover work-in-progress relating to certain contracts.

Retentions on construction contracts amount to €21.9 million at 31 December 2006 (€18.2 million at 31 December 2005 and €16.1 million at 31 December 2004).

15. Current receivables and payables

	31 Dec. 06			31 Dec. 05	31 Dec. 04
	Total	< 1 year	> 1 year		
Accounts and notes receivable, gross	2,512.9	2,406.5	106.4	2,615.8	2,379.0
Provisions on accounts & notes receivable	(109.2)	(61.7)	(47.5)	(127.9)	(171.3)
Accounts and notes receivable, net	2,403.7	2,344.8	58.9	2,487.9	2,207.7
Other tax receivables (excluding income tax)	532.6	497.6	35.0	466.9	437.4
Other debtors and prepaid expenses, gross	321.2	282.2	39.0	287.8	380.3
Related provisions	(43.1)	(43.1)	--	(42.8)	(21.3)
Other debtors and prepaid expenses, net	810.7	736.7	74.0	711.9	796.4
Accounts, notes and other current receivables	**3,214.4**	**3,081.5**	**132.9**	**3,199.8**	**3,004.1**
Accounts and notes payable	2,591.8	2,275.5	316.3	2,179.1	1,941.7
Accrued holiday pay and social security contributions	860.6	854.3	6.3	840.0	822.5
Other tax payables (excluding income tax)	651.3	623.4	27.9	575.3	477.2
Other creditors and accrued liabilities	762.3	682.4	79.9	1,007.0	1,179.2
Accounts, notes and other current payables	**4,866.0**	**4,435.6**	**430.4**	**4,601.4**	**4,420.6**

16. Companies under joint control

The contribution to Thales consolidated financial statements of companies accounted under the proportionate method is presented below:

Profit and loss account	2006	2005	2004
Revenues	1,293.0	1,145.1	1,003.4
Income of operating activities	96.9	81.7	48.4
Net income	65.8	52.7	34.6

Balance sheet	31 Dec. 06	31 Dec. 05	31 Dec. 04
Current assets	2,350.2	2,178.9	1,843.2
Non current assets	210.4	210.8	193.4
Total assets	**2,560.6**	**2,389.7**	**2,036.6**
Shareholders' equity	66.4	143.2	95.4
Non current liabilities	309.0	318.6	237.8
Current liabilities	2,185.2	1,927.9	1,703.4
Total liabilities and shareholders' equity	**2,560.6**	**2,389.7**	**2,036.6**

Cash flow statement	2006	2005	2004
Cash-flow from operating activities	44.0	125.7	43.9
Cash-flow from investing activities	(11.4)	(51.2)	5.5
Cash-flow from financing activities	(22.3)	(24.5)	(29.3)
Exchange rate variations	0.1	0.7	1.3
Increase in cash at banks and equivalents	**10.4**	**50.7**	**21.4**

17. Related party transactions

In accordance with IAS 24, the Group has identified the following related parties:

- shareholders of Thales S.A. (including the French state),
- companies controlled by these same shareholders,
- share of transactions of joint-ventures attributable to venturers,
- companies under significant influence,
- directors and senior corporate officers.

a. Revenues and purchases from and to related parties

	2006	2005	2004
Revenues			
Non controlled share of joint-ventures	138.5	125.2	128.5
Shareholders and companies controlled by shareholders (a)	3,376.9	3,013.1	2,807.7
Other	42.4	50.7	123.6
Purchases			
Non controlled share of joint-ventures	265.9	210.1	198.1
Shareholders and companies controlled by shareholders	262.7	334.7	480.4
Other	2.9	146.7	19.9

(a) Including sales to the French ministry of Defence.

b. Receivables and payables with related parties

	31 Dec. 06	31 Dec. 05	31 Dec. 04
Current operating assets			
Non controlled share of joint-ventures	99.2	100.2	83.7
Shareholders and companies controlled by shareholders	1,330.8	1,275.8	823.7
Other	105.3	206.0	93.4
Financial current accounts receivable			
Joint-ventures	113.7	146.1	117.4
Other	8.9	11.4	9.9
Current operating liabilities			
Non controlled share of joint-ventures	127.2	84.4	97.3
Shareholders and companies controlled by shareholders	1,154.4	1,137.3	876.8
Other	8.7	94.0	13.6
Financial current accounts payable			
Joint-ventures	118.6	134.8	127.5
Other	22.2	21.4	22.3

c. Agreements signed at the end of 2006 with Thales' shareholders

On 1 December 2006, a Master Agreement was signed by Alcatel-Lucent, Alcatel Participations and Thales. This agreement defines the conditions and the manner of completion of the contribution and disposal transactions described in note 2. This agreement organises the transition period for the subsidiaries acquired, as they will continue to benefit from services provided by Alcatel-Lucent (computer services, property leases) in 2007.

In addition to this Master Agreement, a certain number of contracts were signed to:

- create a new "Space Alliance" between Finmeccanica and Thales (Agreement with Finmeccanica),
- strengthen cooperation between Alcatel-Lucent and Thales. This latter agreement, replacing the former cooperation agreement signed on 18 November 1999 between Alcatel, Thales, TSA and GIMD, aims at strengthening cooperation between Alcatel-Lucent and Thales by using the synergies that result from the complementary nature of their respective areas of expertise in technologies and systems, as well as of their industrial and commercial locations worldwide,
- governs the rights of the French State and/or Alcatel-Lucent within Thales (Shareholders Agreement and Specific Agreement).

d. Commitments received

In January 1999, Thales acquired Sogelerg Ingenierie, a subsidiary of Alcatel, and obtained a maximum liability warranty of €19 million, it being understood that if the actual loss incurred by Thales exceeded this amount the companies would negotiate additional compensation in good faith.

e. Compensation of directors and senior corporate officers

Expenses recognised in respect of compensation, benefits and social security contributions attributable to Directors and members of the Executive Committee are as follows.

Expenses	2006	2005	2004
Short-term benefits			
- Fixed compensation	5.0	5.5	5.4
- Variable compensation	3.3	3.3	3.2
- Employer's social security contribution	2.4	2.5	2.6
- Termination benefits and retirement indemnities	--	0.9	--
- Compensation for attendance at Board meetings	0.4	0.4	0.4
Other benefits			
- Post employment benefits	0.7	0.7	0.5
- Share-based payments (IFRS 2) (a)	2.5	2.6	2.1

(a) In accordance with IFRS 2, the Group measures the amount of the benefit granted to employees receiving options. The fair value of such options is determined at the grant date. The amounts thus obtained are taken to profit and loss over the vesting period of the rights.

18. Shareholders' equity

a. Share capital

The share capital of Thales amounts to €516 020 424 and is comprised of 172 006 808 shares with a par value of €3.0 (compared to 171,909,863 shares with a par value of €3.0 at 31 December 2005 and 171,868,968 shares with a par value of €3.0 at 31 December 2004).

b. Debt securities entitling holders to equity in the parent company at a future date

In December 2001, the parent company issued 9,809,691 notes redeemable into new or existing Thales shares (OCEANE – see note 23). These notes matured on 1 January 2007 and were redeemed at par at this date, for a total amount of €500 million.

c. Share options

Options outstanding at 31 December 2006

At 31 December 2006, there were:

- 1,292,417 purchase options with a weighted average exercise price of €35.09,
- 15,777,283 subscription options with a weighted average exercise price of €35.21.

Purchase options

Date of Board decision	13 Nov. 2001	02 Apr. 2001	10 May 2000	14 Sep. 1999
Discount	none	none	none	none
Exercise period	from 13 Nov. 2005 to 12 Nov. 2011 (a)	from 2 April 2005 to 1 April 2011 (b)	from 10 May 2004 to 9 May 2010 (b)	from 14 Sept 2004 to 13 Sept. 2009
Exercise price (c)	€42.18	€42.37	€37.72	€32.59
Number of options exercised since grant date	none	none	6,366	391,906
Number of options outstanding at 31 Dec. 2004	226,880	111,358	252,920	1,359,030
Options exercised in 2005	--	--	4,243	271,086
Options cancelled in 2005	8,965	31,814	9,409	140,710
Number of options outstanding at 31 Dec. 2005	217,915	79,544	239,268	947,234
Options exercised in 2006	--	--	2,123	95,789
Options cancelled in 2006	65,079	21,212	5,306	2,035
Number of options outstanding at 31 Dec. 2006 (c), less options cancelled (d) and exercised	**152,836**	**58,332**	**231,839**	**849,410**
Of which exercisable options at 31 Dec. 2006	152,836	58,332	231,839	849,410
Of which outstanding options at 31 Dec. 2006 held by:				
- chairman	--	--	--	63,629
- the other members of Comex (Executive Committee)	20,930	néant	21,210	189,837
Number of grantees of outstanding options	**399**	**5**	**73**	**120**
Including members of Comex (except the Chairman) at 31 Dec. 2006	none	none	1	10
Total top ten grantees (at plan date)	20,000	70,000	101,500	290,000

(a) In France. Details in "Conditions of exercise" below.
(b) At the Board Meeting of 12 July 2001, the starting date of the exercise period was brought forward from the fifth to the fourth anniversary of the grant date.
(c) Exercise price and numbers have been adjusted according to the conditions provided for in the applicable regulations (Articles D. 174-12 and 174-13), as a result of the distribution of dividends by charging reserves after the option grant date.
(d) Notably due to termination of the contract between the grantee and the Group since the grant date.

Subscription options

Date of Board decision	09 Nov. 2006	30 June 2005	01 July 2004	01 July 2003	02 July 2002	12 July 2001
Discount	none	none	none	none	none	none
Exercise period (a)	from 9 November 2010 to 8 November 2016	from 30 June 2009 to 29 June 2015	from 1 July 2008 to 30 June 2014	from 1 July 2007 to 30 June 2013	from 2 July 2006 to 1 July 2012	from 12 July 2005 to 11 July 2011
Exercise price	€36.47	€34.01	€29.50	€25.70	€40.97 (b)	€42.18 (b)
Number of options exercised since grant date	none	1,500	24,780	115,671	none	none
Number of options outstanding at 31 Dec. 2004	--	--	2,600,100	2,910,500	3,299,704	3,494,420
Options granted	--	2,201,500	--	--	--	--
Options exercised in 2005	--	--	--	40,523	--	--
Options cancelled in 2005	--	10,700	63,750	40,130	35,242	3,866
Number of options outstanding at 31 Dec. 2005	--	2,190,800	2,536,350	2,829,847	3,264,462	3,490,554
Options granted	2,223,950	--	--	--	--	--
Options exercised in 2006	--	1,500	24,780	70,648	--	--
Options cancelled in 2006	--	43,900	47,816	40,566	252,105	277,365
Number of options outstanding at 31 Dec. 2006, less options cancelled (c) and exercised	**2,223,950**	**2,145,400**	**2,463,754**	**2,718,633**	**3,012,357 (b)**	**3,213,189 (b)**
Of which exercisable options at 31 Dec. 2006	--	192,140	338,823	555,090	3,012,357	3,213,189
of which outstanding options at 31 Dec. 2006 held by:						
- chairman	80,000	80,000	100,000	100,000	102,954	83,718
- the other members of Comex (Executive Committee)	265,000	240,000	249,500	257,938	248,124	226,044
Number of grantees of outstanding options	**1,998**	**1,990 (d)**	**3,234**	**3,643**	**5,077**	**4,947**
Including members of Comex (except the Chairman) at 31 Dec. 2006	12	12	11	11	10	11
Total top ten grantees (at plan date)	235,000	275,000	285,000	280,000	263,000	329,500

(a) In France. Details in "Conditions of exercise" below.
(2) At the Board Meeting of 12 July 2001, the starting date of the exercise period was brought forward from the fifth to the fourth anniversary of the grant date.
(3) Exercise price and numbers have been adjusted according to the conditions provided for in the applicable regulations (Articles D. 174-12 and 174-13), as a result of the distribution of dividends by charging reserves after the option grant date.
(4) Notably due to termination of the contract between the grantee and the Group since the grant date.

Conditions of exercise

All options are granted for a ten-year period, at no discount to the market price.

Stock purchase and subscription stock options granted on 14 September 1999, 10 May 2000, 2 April 2001, 13 November 2001, 12 July 2001 and 2 July 2002 can be exercised.

Options are progressively vested over four years and may be exercised as follows:

Subscription options granted on 1 July 2003 and 2004
In all countries except the Netherlands and France, up to 37.5% of the number granted eighteen months after the grant date, then up to 6.25% of the number granted at the end of each subsequent quarter, reaching a total of 100% four years after the grant date.

In the Netherlands, up to 75% of the number granted three years after the grant date, reaching a total of 100% after four years.

Subscription options granted on 30 June 2005 and 9 November 2006
In all countries except France, up to 37.5% of the number granted eighteen months after the grant date, then up to 6.25% of the number granted at the end of each subsequent quarter, reaching a total of 100% four years after the grant date.

In France, in application of specific legislative requirements, employees benefiting from stock options who are French tax residents and / or subject to French social security cannot exercise any option before the 4th anniversary of the date of grant.

Options granted and exercised in 2006

1 – Directors	Number of options granted / of shares subscribed or purchased	Exercise price	Maturity date	Grant date
Options granted in 2006				
- Denis Ranque	80,000	€36.47	08/11/2016	09/11/2006
- Pierre Lafourcade	1,800	€36.47	08/11/2016	09/11/2006
Options exercised in 2006	**none**	--	--	--
2 – Ten (a) largest grants to employees (b)				
Options granted in 2006	235,000	€36.47	08/11/2016	09/11/2006
3 – Ten largest exercises by employees (b)				
Options exercised in 2006	53,344	€32.59	--	14/09/1999
	15,375	€25.70	--	01/07/2003
	9,375	€29.50	--	01/07/2004

(a) During the 2006 financial year, the ten largest individual grants to employees of the Company or the Company's subsidiaries were between 40,000 and 15,000 options each: one grantee received 40,000, two grantees received 30,000, six grantees received 20,000 and five grantees received 15,000 options.
(b) All Group companies taken together.

Fair value of share options issued

In accordance with IFRS 2, the Group measures the amount of the benefit granted to employees receiving options. The fair value of such options is determined at the grant date. The amounts thus obtained are taken to profit and loss over the vesting period of the rights.

Changes in fair value of share options issued after 7 November 2002 (date of first application of the standard) are presented below:

Grant date	Initial number of options	Fair value at grant date	Value at 01/01/04	Grants under 2004 plan	Expense in 2004	Value at 31/12/04	Grants under 2005 plan	Expense in 2005	Value at 31/12/05	Grants under 2006 plan	Expense in 2006	Value at 31/12/06
01/07/03	3,034,200	(21.3)	(15.9)	--	9.8	(6.1)	--	4.0	(2.1)	--	1.8	(0.3)
01/07/04	2,638,750	(21.4)	--	(21.4)	5.1	(16.3)	--	10.2	(6.1)	--	4.0	(2.1)
30/06/05	2,201,500	(19.5)	--	--	--	--	(19.5)	4.7	(14.8)	--	9.4	(5.4)
09/11/06	2,223,950	(23.5)	--	--	--	--	--	--	--	(23.5)	1.6	(21.9)
Total	**10,098,400**	**(85.7)**	**(15.9)**	**(21.4)**	**14.9**	**(22.4)**	**(19.5)**	**18.9**	**(23.0)**	**(23.5)**	**16.8**	**(29.7)**

The fair value of plans are measured using a binomial model. The measurement hypotheses are presented below:

Grant date	Share price at grant date	Expected volatility	Risk-free rate	Distribution rate on future income	Forfeiture rate pre-vesting	Forfeiture rate post-vesting	Early exercise multiple
01/07/03	€25.85	34%	3.8%	3.5%	2%	3%	1.50
01/07/04	€30.07	32%	4.4%	3.5%	2%	3%	1.50
30/06/05	€33.90	30%	3.0%	2.5%	2%	3%	1.50
09/11/06	€37.32	30%	3.8%	2.5%	2%	3%	1.50

d. Changes in fair value

Foreign currency and interest rate derivatives eligible to be accounted for as cash flow hedges are recognised at fair value in the balance sheet, with variations in fair value being recognised directly through shareholders' equity until such time as the hedged flows impact profit and loss.

Non-consolidated investments, termed "available-for-sale", are measured at fair value, with variations in fair value being recognised directly through shareholders' equity until the time of disposal.

Changes in the fair values of these items are presented below:

	Cash flow hedges		Available-for-sale assets	Deferred tax	Total
	Foreign currency	Interest rate			
At 1 January 2005	169.6	(4.9)	12.1	(53.6)	**123.2**
- changes in fair value	(64.9)	--	39.7	19.7	**(5.5)**
- taken to profit and loss	(67.8)	4.9	--	19.1	**(43.8)**
- disposals (Nice Systems)	--	--	(14.8)	--	**(14.8)**
Change in the period	(132.7)	4.9	24.9	38.8	**(64.1)**
At 31 December 2005	36.9	--	37.0	(14.8)	**59.1**
- changes in fair value	57.7	(0.1)	(0.1)	(21.5)	**35.8**
- taken to profit and loss	(17.5)	--	--	6.5	**(11.0)**
- entry into scope of consolidation (Wynid tech.)	--	--	(3.7)	--	**(3.7)**
- disposals (Embraer)	--	--	(31.0)	--	**(31.0)**
Change in the period	40.0	(0.1)	(34.8)	(15.0)	**(9.9)**
At 31 December 2006	76.9	(0.1)	2.2	(29.8)	**49.2**

e. Cumulative translation adjustment

This line item reflects differences arising from the translation of the financial statements of foreign subsidiaries on the basis of both closing and average exchange rates. The principal rates used are summarised in note 1-c.

f. Treasury shares

Thales held 3,134,701 of its own shares at 31 December 2006. In the consolidated financial statements, treasury shares are subtracted from consolidated shareholder's equity for an amount of €(140.4) million at 31 December 2006.

19. Minority interests

	31 Dec. 06	31 Dec. 05	01 Jan. 05	31 Dec. 04
Australian Defence Industries (a)	--	34.6	25.3	47.0
Other	7.5	6.4	5.3	5.2
Total	**7.5**	**41.0**	**30.6**	**52.2**

(a) Following the purchase by Thales of Transfield holding's shares in October 2006 (note 2).

20. Pensions and other employee benefits

The Group grants its employees post-employment benefits (pensions, retirement awards, medical care, etc.) and other long-term benefits (long-service benefits, long-service awards on departure, etc.). Apart from state plans, the plans that are set up to cover these benefits are either defined contribution plans or defined benefit plans.

a. State plans

In certain countries, and particularly in France, the Group subscribes to state plans (Social Security State plans, compulsory additional plans such as ARRCO, AGIRC, etc.) for which the pension expense for the financial year is equal to the contributions called by, and thus payable to, such plans.

b. Defined contribution plans

These plans guarantee employees benefits that are directly related to aggregate contributions paid, as increased by the yield on investments made. The enterprise's pension expense is thus limited to contributions paid. In 2006, the corresponding pension expense was €14.9 million (€12.4 million in 2005 and €8.9 million in 2004).

c. Defined benefit plans

There are two categories of country within the Thales Group:

- countries in which retirement and other benefits are mainly funded externally: the UK and the Netherlands,

- countries in which the funding of retirement is mainly based on defined contribution plans and where certain other benefits (retirement awards, long service awards) are of a defined benefit nature and for which external funding is not systematically put in place. France and Germany are notably included in this category.

Provisions recognised in the balance sheet are broken down as follows:

	31 December 06			31 December 05			31 December 04		
	Externally funded countries	Internally funded countries	Total	Externally funded countries	Internally funded countries	Total	Externally funded countries	Internally funded countries	Total
Defined benefit obligations	(3,783.9)	(744.3)		(3,595.6)	(730.0)		(2,883.5)	(674.7)	
Plan assets	3,078.2	134.5		2,725.0	142.7		2,244.8	126.5	
Unfunded status	(705.7)	(609.8)		(870.6)	(587.3)		(638.7)	(548.2)	
Unrecognised actuarial (gain) / loss	207.3	11.7		334.9	18.2		114.3	19.1	
Unrecognised past service cost	41.8	24.5		42.5	(1.7)		3.9	(21.8)	
Net provisions	**(456.6)**	**(573.6)**	**(1,030.2)**	**(493.2)**	**(570.8)**	**(1,064.0)**	**(520.5)**	**(550.9)**	**(1,071.4)**
Of which:									
Shown in assets	39.3	1.0	**40.3**	39.5	--	**39.5**	37.6	--	**37.6**
Shown in liabilities	(495.9)	(574.6)	**(1,070.5)**	(532.7)	(570.8)	**(1,103.5)**	(558.1)	(550.9)	**(1,109.0)**
Of which:									
Post employment benefits	(453.1)	(435.2)	**(888.3)**	(489.2)	(433.0)	**(922.2)**	(516.4)	(424.7)	**(941.1)**
Other long-term benefits	(3.5)	(138.4)	**(141.9)**	(4.0)	(137.8)	**(141.8)**	(4.1)	(126.2)	**(130.3)**

By category of country, changes in defined benefit obligations and plan assets, if any, are analysed below:

Externally funded countries

	2006			2005			2004		
	United Kingdom	Netherlands	Total	United Kingdom	Netherlands	Total	United Kingdom	Netherlands	Total
Obligations at 1 January	**(2,751.6)**	**(844.0)**	**(3,595.6)**	**(2,185.0)**	**(698.5)**	**(2,883.5)**	**(1,942.8)**	**(620.7)**	**(2,563.5)**
Current service cost	(45.3)	(17.6)	**(62.9)**	(35.6)	(17.6)	**(53.2)**	(30.7)	(17.3)	**(48.0)**
Interest cost	(139.2)	(37.5)	**(176.7)**	(122.4)	(34.0)	**(156.4)**	(116.7)	(31.8)	**(148.5)**
Plan participants' contributions	(14.7)	(6.2)	**(20.9)**	(16.4)	(5.8)	**(22.2)**	(17.1)	(4.4)	**(21.5)**
Scheme amendments	(3.5)	--	**(3.5)**	(0.1)	(32.9)	**(33.0)**	9.8	(14.7)	**(4.9)**
Curtailment / settlements	1.9	7.4	**9.3**	3.7	--	**3.7**	(0.6)	--	**(0.6)**
New actuarial gains / losses (d)	(100.9)	122.3	**21.4**	(421.6)	(69.7)	**(491.3)**	(173.7)	(22.8)	**(196.5)**
Benefit paid by employer (a)	--	0.4	**0.4**	--	--	**--**	--	--	**--**
Benefits paid	96.6	16.1	**112.7**	84.6	14.5	**99.1**	77.4	13.2	**90.6**
Exchange rate variations and other	(68.4)	0.3	**(68.1)**	(58.8)	--	**(58.8)**	9.4	--	**9.4**
Obligations at 31 December	**(3,025.1)**	**(758.8)**	**(3,783.9)**	**(2,751.6)**	**(844.0)**	**(3,595.6)**	**(2,185.0)**	**(698.5)**	**(2,883.5)**
Plan assets at 1 January	**2,088.1**	**636.9**	**2,725.0**	**1,704.9**	**539.9**	**2,244.8**	**1,530.8**	**475.9**	**2,006.7**
Expected return on plan assets	129.6	33.6	**163.2**	115.9	35.2	**151.1**	118.3	34.4	**152.7**
Employer's contribution (a)	101.5	13.8	**115.3**	75.4	13.9	**89.3**	72.0	11.6	**83.6**
Plan participants' contributions	14.7	6.2	**20.9**	16.4	5.8	**22.2**	17.1	4.4	**21.5**
Benefits paid by plan assets	(96.6)	(16.1)	**(112.7)**	(84.6)	(14.5)	**(99.1)**	(77.4)	(13.2)	**(90.6)**
New actuarial gains / losses (d)	103.5	16.3	**119.8**	211.8	56.6	**268.4**	51.2	26.8	**78.0**
Exchange rate variations and other	46.7	--	**46.7**	48.3	--	**48.3**	(7.1)	--	**(7.1)**
Plan assets at 31 December (c)	**2,387.5**	**690.7**	**3,078.2**	**2,088.1**	**636.9**	**2,725.0**	**1,704.9**	**539.9**	**2,244.8**
Unfunded status at 31 December	**(637.6)**	**(68.1)**	**(705.7) (b)**	**(663.5)**	**(207.1)**	**(870.6)**	**(480.1)**	**(158.6)**	**(638.7)**
Unrecognised actuarial (gain) / loss	335.8	(128.5)	**207.3**	325.8	9.1	**334.9**	118.3	(4.0)	**114.3**
Unrecognised past service cost	--	41.8	**41.8**	(3.5)	46.0	**42.5**	(10.3)	14.2	**3.9**
Net provisions at 31 December	**(301.8)**	**(154.8)**	**(456.6)**	**(341.2)**	**(152.0)**	**(493.2)**	**(372.1)**	**(148.4)**	**(520.5)**

(a) Employer's contribution and benefits paid by employer amounted to €140.2 million in 2006, €110.9 million in 2005 and €106.4 million in 2004. In 2007, these contributions should be similar in that of 2006.
(b) In cases of external funding, solvency requirements can lead to a disbursement in order to cover funding shortfalls caused by developments in financial markets. The estimated funding shortfall as of 31 December 2006 would require, if it became payable, a cash outlay estimated at €497.0 million after tax.
(c) At 31 December 2006, 55% of plan assets are invested in equities, 41% in bonds, 3% in property and 1% in other assets. Actual return on plan assets in 2006 is 9.3%.
(d) Net experience adjustments created in 2006 on obligations amounts to €61.0 million. Net experience adjustments created in 2006 on plan assets amounts to €125.0 million.

Countries mainly internally funded

	2006			2005			2004		
	France	Other	Total	France	Other	Total	France	Other	Total
Obligations at 1 January	**(504.7)**	**(225.3)**	**(730.0)**	**(469.2)**	**(205.5)**	**(674.7)**	**(435.9)**	**(199.8)**	**(635.7)**
Current service cost	(26.0)	(5.9)	**(31.9)**	(23.7)	(6.6)	**(30.3)**	(21.5)	(6.0)	**(27.5)**
Interest cost	(21.1)	(9.3)	**(30.4)**	(20.1)	(8.6)	**(28.7)**	(20.7)	(9.4)	**(30.1)**
Scheme amendments	(32.9)	(0.3)	**(33.2)**	(5.9)	0.3	**(5.6)**	0.8	(0.3)	**0.5**
Curtailment / settlements	7.2	22.3	**29.5**	1.6	5.4	**7.0**	10.7	4.4	**15.1**
New actuarial gains / losses (d)	22.2	(6.7)	**15.5**	(7.8)	(9.7)	**(17.5)**	(15.3)	(1.9)	**(17.2)**
Benefits paid by employer (a)	13.5	5.2	**18.7**	11.4	4.5	**15.9**	13.6	3.8	**17.4**
Benefits paid by plan assets	0.9	2.9	**3.8**	0.5	2.5	**3.0**	0.5	2.5	**3.0**
Exchange rate variations and other	10.6	3.1	**13.7**	8.5	(7.6)	**0.9**	(1.4)	1.2	**(0.2)**
Obligations at 31 December	**(530.3)**	**(214.0)**	**(744.3)**	**(504.7)**	**(225.3)**	**(730.0)**	**(469.2)**	**(205.5)**	**(674.7)**
Plan assets at 1 January	**82.8**	**59.9**	**142.7**	**78.0**	**48.5**	**126.5**	**70.1**	**51.1**	**121.2**
Expected return on plan assets	4.0	3.6	**7.6**	3.9	4.1	**8.0**	3.6	3.2	**6.8**
Employer's contribution (a)	1.9	3.9	**5.8**	1.2	4.5	**5.7**	1.0	4.4	**5.4**
Benefits paid by plan assets	(0.9)	(2.9)	**(3.8)**	(0.5)	(2.5)	**(3.0)**	(0.5)	(2.5)	**(3.0)**
New actuarial gains / losses (d)	4.1	1.1	**5.2**	0.3	(0.7)	**(0.4)**	3.1	(0.2)	**2.9**
Exchange rate variations and other	(1.5)	(21.5)	**(23.0)**	(0.1)	6.0	**5.9**	0.7	(7.5)	**(6.8)**
Plan assets at 31 December (c)	**90.4**	**44.1**	**134.5**	**82.8**	**59.9**	**142.7**	**78.0**	**48.5**	**126.5**
Unfunded status at 31 December	**(439.9)**	**(169.9)**	**(609.8) (b)**	**(421.9)**	**(165.4)**	**(587.3)**	**(391.2)**	**(157.0)**	**(548.2)**
Unrecognised actuarial (gain) / loss	(6.1)	17.8	**11.7**	12.9	5.3	**18.2**	17.6	1.5	**19.1**
Unrecognised past service cost	24.8	(0.3)	**24.5**	(6.4)	4.7	**(1.7)**	(21.8)	--	**(21.8)**
Net provisions at 31 December	**(421.2)**	**(152.4)**	**(573.6)**	**(415.4)**	**(155.4)**	**(570.8)**	**(395.4)**	**(155.5)**	**(550.9)**

(a) Employer's contribution and benefits paid by employer amounted to €140.2 million in 2006, €110.9 million in 2005 and €106.4 million in 2004. In 2007, these contributions should be similar in that of 2006.

(b) In cases of internal funding, disbursements occur at the rate at which staff retire and receive awards. There is no requirement to cover, through a supplementary outlay of funds, the net value of the obligation. The level of provision varies annually according to the employee population covered by these schemes.

(c) At 31 December 2006, 55% of plan assets are invested in equities, 41% in bonds, 3% in property and 1% in other assets. Actual return on plan assets in 2006 is 9.3%.

(d) Net experience adjustments created in 2006 on obligations amounts to €61.0 million. Net experience adjustments created in 2006 on plan assets amounts to €125.0 million.

Actuarial assumptions used are determined by actuaries in accordance with the specific circumstances of each country and each scheme:

2006	United Kingdom	Netherlands	France	Rest of the world
Inflation rate	3.00%	2.00%	1.80%	2.25% to 4.00%
Discount rate	5.30%	4.70%	4.50%	4.35% to 5.66%
Expected long term return on plan assets	6.30%	5.10%	4.50%	3.75% to 8.25%
Future compensation increase	4.00%	3.00%	3.00%	2.50% to 4.50%
Expected average residual service life (years)	10	13.3	16.9	9 to 14 years

2005	United Kingdom	Netherlands	France	Rest of the world
Inflation rate	2.80%	2.00%	1.80%	1.75% to 4.00%
Discount rate	5.10%	4.30%	4.10%	4.50% to 5.75%
Expected long term return on plan assets	6.20%	5.25%	5.00%	6.00% to 8.25%
Future compensation increase	3.80%	3.00%	3.00%	3.00% to 4.00%
Expected average residual service life (years)	10	12	17.5	9.6 to 14 years

2004	United Kingdom	Netherlands	France	Rest of the world
Inflation rate	2.80%	2.00%	1.80%	1.50% to 4.00%
Discount rate	5.50%	4.75%	4.30%	5.25% to 6.50%
Expected long term return on plan assets	6.60%	6.50%	5.00%	4.50% to 8.25%
Future compensation increase	3.80%	3.00%	3.00%	1.50% to 4.00%
Expected average residual service life (years)	10	13.4	16.7	8.5 to 15.4 years

The discount rates are obtained by reference to market yields on high quality bonds in each country having maturity dates equivalent to those of the plans.

The returns on plan assets are determined plan by plan and depend upon the asset allocation of the investment portfolio and the expected future performance.

Periodic cost for defined benefit schemes is analysed below:

	2006	2005	2004
Current service cost	**(94.8)**	**(83.5)**	**(75.5)**
Interest cost	(207.1)	(185.1)	(178.5)
Expected return on plan assets	170.8	159.1	159.5
Amortisation of schemes amendments	(2.7)	(2.9)	1.4
Amortisation of actuarial gains / losses	(3.9)	(2.8)	0.8
Curtailment / settlements	23.9	(1.9)	(0.7)
Total financial component of pension charge	**(19.0)**	**(33.6)**	**(17.5)**
Defined benefit: total periodic cost	**(113.8)**	**(117.1)**	**(93.0)**

21. Reserves for contingencies

31/12/06	Opening	Changes in scope of consolidation, exchange rate and reclassification	Increase (a)	Reversal (b)	Closing
Restructuring	**232.2**	**(0.7)**	**151.6**	**(128.8)**	**254.3**
Provisions on contracts	**386.8**	**40.0**	**111.5**	**(126.9)**	**411.4**
- guarantees	154.1	(2.7)	33.5	(32.6)	152.3
- litigation	133.3	41.8	15.9	(14.8)	176.2
- estimated losses on long-term contracts	69.8	(15.6)	40.4	(45.4)	49.2
- other	29.6	16.5	21.7	(34.1)	33.7
Other reserves for contingencies	**168.2**	**22.7**	**36.0**	**(58.3)**	**168.6**
Total	**787.2**	**62.0**	**299.1**	**(314.0)**	**834.3**

31/12/05	Opening	Changes in scope of consolidation, exchange rate and reclassification	Increase (a)	Reversal (b)	Closing
Restructuring	**134.1**	**3.2**	**197.0**	**(102.1)**	**232.2**
Provisions on contracts	**285.4**	**(2.2)**	**212.5**	**(108.9)**	**386.8**
- guarantees	138.7	(0.6)	56.9	(40.9)	154.1
- litigation	65.2	(0.1)	95.5	(27.3)	133.3
- estimated losses on long-term contracts	51.2	3.2	42.4	(27.0)	69.8
- other	30.3	(4.7)	17.7	(13.7)	29.6
Other reserves for contingencies	**166.0**	**1.4**	**75.5**	**(74.7)**	**168.2**
Total	**585.5**	**2.4**	**485.0**	**(285.7)**	**787.2**

(a) In 2006, increase in reserves for contingencies includes €131.7 million recognised in income from operations, €151.6 million recognised in gain (loss) on disposal of assets, €13.4 million recognised in other income (expense) from operations (note 22-a) and €2.4 million recognised in other financial income (expense).
(b) In 2006, reversals of unused provisions amount to €(26.8) million (of which €(6.5) million included in "Income from operations" and €(20.3) million included in "Restructuring costs").

Restructuring costs can be analysed as follows:

	2006	2005	2004
Increase in reserve	(151.6)	(197.0)	(89.1)
Reversal in reserve	128.8	102.1	84.5
Expenses	(170.3)	(117.6)	(104.4)
Restructuring costs	**(193.1)**	**(212.5)**	**(109.0)**

22. Litigation and environment

a. Litigation

Due to the nature of its business activities, the Group is exposed to the risk of technical and commercial litigation. Litigation mentioned in last year's annual report has progressed as follows:

The request for arbitration submitted by Republic of China Navy (Taiwan) for an amount of USD 599 million in damages, arising out of the execution of a contract, signed in 1991, for the supply of equipment and systems executed in conjunction with an industrial partner continued in 2006.

In June 2005 the adverse party, in the context of this procedure, increased its request to USD 1,119 million, to which interest for late payment would be added. It reduced its request to USD 882 million in April 2006 (interest for late payment excluded). If an unfavourable judgment were to be issued, Thales' share of any amounts due would be limited to approximately 30%, being a proportion corresponding to its share in the equipment supply contract. Thales, in conjunction with its industrial partner, has constantly opposed this request.

On the basis of the information at its disposal at the balance sheet date for 2006, Thales has carried out a review of the financial risks to which the Group could be exposed as a result of this procedure. In the absence of any new significant information, Thales has, in consequence, decided to maintain at 31 December 2006 a reserve for this litigation identical to that recognized in its 2005 financial statements, an amount in respect of which, in application of paragraph 92 of IAS 37, no detailed disclosure is provided.

No other significant litigation arose since the start of 2006. To the best of the Thales Group's knowledge, there is no other exceptional circumstance or dispute that has had or is likely to have a significant influence on the Group's results, financial position or prospects.

b. Environment

The Thales Group's activities generally do not have any significant environmental impact.

The management of environmental risks involves:

- compliance of plants and products with applicable regulations and control of any environmental impact they may have,
- implementation of an environmental management system adapted to each site (more than 50 sites obtained ISO 14001 certification),
- mapping of environmental risks in more than ten countries in which the Group operates. The aim of this exercise is to verify that employees and local residents are not exposed to health and environmental risks,
- management of identified risks: changes to plants, decontamination, and monitoring.

At 31 December 2006, the amount of reserves for environmental contingencies amounts to €4.8 million.

23. Net financial debt

The Group's net financial debt is presented below:

	31 Dec. 06	31 Dec. 05	01 Jan. 05 (a)	31 Dec. 04
Long-term financial debt	1,610.2	1,449.4	1,430.5	1,431.6
Short-term financial debt	638.5	299.3	609.4	583.3
Current accounts payable with affiliated companies	140.8	156.2	149.8	149.8
Fair value of derivatives: interest rate risk management	(1.9)	(15.5)	(15.0)	--
Total gross financial debt (I)	2,387.6	1,889.4	2,174.7	2,164.7
Current accounts receivable with affiliated companies	122.6	157.5	127.3	127.3
Marketable securities	22.7	14.4	6.0	6.0
Cash at bank and equivalents (b)	2,333.1	1,319.9	1,181.6	1,181.6
Cash and other short-term financial assets (II)	2,478.4	1,491.8	1,314.9	1,314.9
Net financial debt (I – II)	**(90.8)**	**397.6 (c)**	**859.8**	**849.8**

(a) After application of financial instruments standards.
(b) Includes tradable debt securities and unit trusts with maturities of less than 3 months of €1,507.9 million in 2006, €646.4 million in 2005 and €427.7 million in 2004.
(c) This amount does not include the receivable arising on the disposal of Broadcast & Multimedia (€133.6 million) on 31 December 2005. This receivable was settled on 3 January 2006.

Breakdown of gross financial debt

		31 Dec. 06	31 Dec. 05	01 Jan. 05	31 Dec. 04
Borrowings from financial institutions	(a)	100.0	100.0	100.0	100.0
Other borrowings from financial institutions		23.5	30.0	30.1	30.1
Convertible notes (OCEANE)	(b)	484.0	468.9	454.6	500.0
Bonds issued in November 2000	(c)	--	--	440.8	440.4
Bonds issued in July 2004	(d)	499.9	512.6	511.3	500.0
Euro Medium Term Notes (E.M.T.N) – tradable	(e)	--	--	30.0	30.0
Euro Medium Term Notes (E.M.T.N) – tradable	(f)	--	17.5	17.0	17.0
Euro Medium Term Notes (E.M.T.N) – tradable	(g)	698.7	--	--	--
Commercial paper		--	160.7	--	--
Capital lease obligations		37.7	46.5	65.6	65.6
Project financing debt	(h)	284.8	301.0	254.2	254.2
Other borrowings		24.4	49.5	74.5	52.5
Current accounts with affiliated companies		140.8	156.2	149.8	149.8
Bank overdrafts		57.4	27.6	25.1	25.1
Accrued interest	(i)	38.3	34.4	36.7	--
Fair value of derivatives: interest rate risk management	(j)	(1.9)	(15.5)	(15.0)	--
Gross financial debt		**2,387.6**	**1,889.4**	**2,174.7**	**2,164.7**

(a) Floating rate loan with a €100 million par value maturing in June 2008.
(b) Notes redeemable into new or existing shares (OCEANE), issued at a 2.5% fixed rate with a par value of €500 million maturing in January 2007. This bond is accounted for as a hybrid financial instrument as from 1 January 2005, with the "debt component" being calculated on the basis of a 5.877% effective interest rate.
(c) Bond with a par value of €440.4 million, maturing in November 2005, issued at a 6.125% fixed rate. Includes €200 million swapped to floating rate using interest rate swaps. As from 1 January 2005, the bond is valued at amortised cost at an effective rate of 6.183% excluding the effect of hedging. The value of the bond is then adjusted to take into account changes in the fair value of the interest rate hedge.
(d) Bond with a par value of €500 million, maturing in July 2011, issued at a 4.375% fixed rate. Includes €300 million swapped to floating rate using interest rate swaps. As from 1 January 2005, the bond is valued at amortised cost at an effective rate of 4.4776% excluding the effect of hedging. The value of the bond is then adjusted to take into account changes in the fair value of the interest rate hedge.
(e) Floating rate notes, matured in March 2005.
(f) Floating rate notes, maturing in February 2006.
(g) Bond with a par value of €700 million floating rate (Euribor 3 months +0.125%), issued in December 2006, maturing in December 2009. The notes are valued at amortised cost at an effective rate of Euribor 3 months +0.1864%.
(h) Non-recourse, or limited recourse, debt whose interest costs and repayment is covered by the share of project revenues which is guaranteed contractually by customers. The debt is comprised of fixed rate loans maturing in years up to 2017.
(i) Up until 31 December 2004, accrued interest was shown under "Other creditors and accrued liabilities".
(j) In accordance with IAS 39, the value of borrowings takes into account changes in the fair value of hedged risk. This change in value of the debt is offset by changes in the value of swaps used as hedges, which are recognised on the "fair value of derivatives: interest rate risk management" line.

Breakdown of gross financial debt by currency

The breakdown by currency includes related hedging instruments. At the end of December 2006, financial instruments were used to hedge net investments in foreign companies.

	31 Dec. 06	31 Dec. 05	01 Jan. 05	31 Dec. 04
Euro	1,812.5	1,347.8	1,545.7	1,554.5
Pound Sterling	269.1	276.4	283.7	283.7
US Dollar	110.9	123.4	106.2	106.2
Singapore Dollar	102.0	--	54.0	54.0
Australian Dollar	81.4	114.9	146.7	124.7
Other	11.7	26.9	38.4	41.6
Total	**2,387.6**	**1,889.4**	**2,174.7**	**2,164.7**

Breakdown of gross financial debt by type of rate

The breakdown presented hereafter includes the effect of interest rate swaps.

	31 Dec. 06	31 Dec. 05	01 Jan. 05	31 Dec. 04
Fixed rate	1,036.2	1,069.0	1,252.0	1,242.3
Floating rate	1,351.4	820.4	922.7	922.4
Total	**2,387.6**	**1,889.4**	**2,174.7**	**2,164.7**

Breakdown of gross financial debt by maturity

	31 Dec. 06	31 Dec. 05	01 Jan. 05	31 Dec. 04
2005			758.5	733.1
2006		455.5	56.3	34.0
2007	779.3	514.7	495.2	526.2
2008	127.1	135.8	123.7	123.7
2009	727.3	28.1	24.0	24.0
2010	39.8	28.0	717.0 (a)	723.7 (a)
2011	531.3	727.3 (b)	--	--
2012 and beyond	182.8	--	--	--
Total at more than one year	1,608.3	1,433.9	1,416.2	1,431.6
Total	**2,387.6**	**1,889.4**	**2,174.7**	**2,164.7**

(a) 2010 and beyond.
(b) 2011 and beyond.

At 31 December 2006, no financing of material amount used by the Group is subject to clauses requiring accelerated repayment based on the Group's rating or on financial ratios.

At 31 December 2006, undrawn confirmed credit facilities granted by banks amounted to €1,500 million, maturing in 2011. These credit facilities are used to back commercial paper and as a financial reserve. Pursuant to the credit facility documents, in the event that the State no longer held its golden share and, simultaneously, the ratio of consolidated net financial debt to EBITDA(1) were to exceed 3, clauses providing for accelerated repayment would apply.

Fair value of debt

The fair value of Thales's debt is determined for each loan by discounting the future cash flows using a discount rate Euribor corresponding to bond yields at the end of the year, adjusted by the Group's credit risk. The fair value of debt and bank overdrafts at floating interest rates approximates their net carrying amounts.

At 31 December 2006, the fair value of debt amounted to €2,405.3 million (€1,965.2 million at 31 December 2005 and €2,241.8 million at 31 December 2004).

(1) L'EBITDA: income of operating activities plus all depreciation, amortisation and impairment of tangible and intangible assets. This item is determined by reference to French accounting principles.

24. Statement of cash flows

a. Capital expenditure

Only purchases financed by a cash flow are presented in the statement of cash flows. Capitalisation of development costs are included for €156.2 million in 2006, €137.6 million in 2005 and €68.5 million in 2004. Fixed assets acquired under financial lease arrangements (nil in 2006, nil in 2005 and €2.9 million in 2004) are not included.

b. Net financial investment

Acquisitions

	2006	2005	2004
Acquisition of Diehl Luftfahrt Elektronik GmbH	(24.5)	--	--
Investments of Thales International Offsets	(18.2)	--	--
Subscription to the capital of DpiX	(6.7)	--	--
Purchase of ADI minority interests	(3.4)	--	--
Acquisition of additional interest (50%) in TDA Armements	--	(51.5)	--
Acquisition of additional interest (60%) in Wynid Technologies	--	(11.1)	--
Investments of Thales Corporate Ventures	(3.6)	(4.1)	(4.2)
Partial payment of earn-out / EOS-IT Vizion	--	--	(1.4)
Partial payment of earn-out / HFBC	--	--	(1.8)
Other	(12.8)	(20.9)	(4.9)
Acquisitions	**(69.2)**	**(87.6)**	**(12.3)**
Cash position of companies acquired	7.7	3.3	--
Acquisitions, net	**(61.5)**	**(84.3)**	**(12.3)**

Disposals

	2006	2005	2004
Thales Navigation (a)	86.9	--	--
Embraer	119.4	--	--
Broadcast and Multimedia (b)	133.6	--	--
Optics activities (HTO)	(1.9)	205.8	--
Satellite Information Services	--	26.4	--
Thales Geosolutions (additional price)	--	9.0	--
Banking activities of CGA	--	3.2	--
Thales Acoustics	--	--	21.5
Seismic activities of Thales Underwater Systems	1.3	--	21.1
Nice Systems shares	--	36.9	18.3
Thales Nixdorf Systèmes Bancaires SAS (50%)	--	--	10.0
Thales Electronic Solutions	3.0	1.0	8.0
Others	2.7	7.5	8.6
Disposals	**345.0**	**289.8**	**87.5**
Cash position of companies sold	--	(13.2)	(1.2)
Disposals, net	**345.0**	**276.6**	**86.3**

(a) This amount excluded the $60 million loan payable in 2011 and 2012.
(b)The proceeds on sale of Broadcast & Multimedia activities (€133.6 million) were received on 3 January 2006 and are thus not shown in the 2005 statement of cash flows.

c. Increase (decrease) in shareholders' equity and minority interests

	2006	2005	2004
Increase in capital / exercise of stock options	2.4	1.0	0.1
Income tax on dividend payments	--	--	(53.3)
Proceeds from sale of treasury shares	2.8	117.6	82.5
Total	**5.2**	**118.6**	**29.3**

25. Commitments and contingencies

a. Bonds and warranties linked to commercial contracts

Within the context of its activity, the Group regularly responds to invitations to bid. When requested by the customer, bid bonds are delivered in order to demonstrate the definitive nature of the bid and to provide for indemnification to the customer if the Group fails to meet its commitments. At 31 December 2006, bid bonds issued amounted to €52.2 million (€31.0 million at 31 December 2005 and €20.2 million at 31 December 2004).

From the signature of a contract up until its completion, the Group may deliver performance bonds to its customers, using a bank as an intermediary, in order to guarantee the due and proper completion of the contract (and if not, to provide for payment of damages to the customer). At 31 December 2006, performance bonds amounted to €935.0 million (€1,015.8 million at 31 December 2005 and €1,021.0 million at 31 December 2004).

Technical, operational and financial costs incurred by the Group in order to meet its obligations are valued, on a contract-by-contract basis, and are included in the cost to completion of the contract. Otherwise, any potential risk is estimated, on a contract-by-contract basis, and provided for in the Group financial statements if necessary.

In order to finance contract completion, the Group receives advances from its customers, based on contractual terms that are booked as a liability in the balance sheet. In order to guarantee reimbursement of these advance payments if the contractual obligations are not met, the Group may deliver, at the customer's request, an advance payment bond. At 31 December 2006, advance payment bonds amounted to €1,837.9 million (€1,781.5 million at 31 December 2005 and €1,582.9 million at 31 December 2004).

During the contractual warranty period, the Group evaluates and accrues for warranty costs in order to guarantee the conformity of goods sold to the customer. In most cases, the provisional retention of payment contractually applied during this period can be replaced by setting up, using a bank as intermediary, a warranty retention bond. At 31 December 2006, warranty retention bonds amounted to €99.8 million (€100.8 million at 31 December 2005 and €94.9 million at 31 December 2004).

The maturity dates of these commitments are:

	< 1 year	1 to 5 years	> 5 years	Total
Bid bonds	43.7	7.0	1.5	52.2
Performance bonds	378.9	412.1	144.0	935.0
Advance payment bonds	812.2	643.3	382.4	1,837.9
Warranty retention bonds	33.1	48.4	18.3	99.8
Other bank bonds	59.3	44.2	146.5	250.0
Total	**1,327.2**	**1,155.0**	**692.7**	**3,174.9**

b. Other commitments

At the end of 2002, a group of French manufacturers, including Thales and one of its subsidiaries, collectively received a request for arbitration relating to the execution of old contracts.

In proportion to each industrial partner's involved, Thales would have been liable for around 20% of the total claim of $260 million.

Under an agreement signed in 2003, the client withdrew its request for arbitration. In return Thales and the other groups agreed not to have recourse to statute of limitations provisions which could have been invoked against the client.

c. Lease commitments and firm commitments to purchase tangible fixed assets

Lease contracts

Thales Group companies lease land, buildings, plant and equipment. The rents payable under these leases are subject to renegotiation at various intervals specified in the lease contracts. Binding lease and rental commitments at 31 December 2006 are analysed below:

	Rent payable			
	Total	< 1 Year	1 to 5 Years	> 5 Years
Finance leases (a)	**38.9**	7.2	12.3	19.4
Operating leases	**863.4**	137.1	414.9	311.4

(a) Including interest (€1.2 million). The corresponding debt is recognised in the consolidated balance sheet for an amount excluding interest (note 23).

Purchase of tangible fixed assets

At 31 December 2006, firm commitments to purchase tangible fixed assets amounted to €17.0 million (€18.7 million at 31 December 2005 and €16.1 million at 31 December 2004).

d. Guarantees given / received related to disposals / acquisitions of companies

The contracts governing acquisitions (disposals) of companies by Thales may contain clauses committing the seller to indemnify the buyer for liabilities in excess of those recorded in the books of the companies sold. These guarantees are generally limited in terms of value and duration. They notably cover environmental risks.

Certain contracts concerning the acquisition (disposal) of companies may include earn-out or price adjustment clauses, which are generally related to performance criteria for the entity in question. At the acquisition / disposal date, the Group records in payables or receivables its best estimate of the expected price adjustment.

e. Social commitments

French statutory training entitlement

In accordance with the requirements of the French Act of 4 May 2004 relating to professional training, French companies in the Group grant their employees a training entitlement of at least 20 hours per calendar year, which can be accumulated over a maximum period of six years. At the end of this period, if the training entitlement has not been used, each employee's total training rights will be subject to a ceiling of 120 hours.

Thales has signed an agreement regarding anticipation of changes in employment, professional development and training that is applicable to all its French subsidiaries. This agreement stipulates the manner in which the statutory training entitlement can be exercised within the enterprise. It recalls that this entitlement guarantees employees access to training for their maintenance in employment or changes therein or for the development of their skills. In this respect, training initiatives contributing to the professional development of employees envisaged in the training programme are counted as part of the statutory training entitlement. In consequence, as the costs incurred benefit the enterprise, no provision has been recognised.

The current number of training hours not used amounts to 1.7 million hours at the balance sheet date.

Employee benefits agreement

At the end of 2006, Thales signed a number of agreements with the objective, in particular, of updating the employee benefits agreement applicable to French employees. The impact of these agreements has not been taken into account in the consolidated financial statements at 31 December 2006, as those agreements have not yet been cascaded down to take effect in each of the Group's subsidiaries.

26. Financial instruments

Thales uses various financial instruments for the purpose of reducing currency and interest rate risks.

a. Currency risk management

Thales hedges currency risks arising in connection with the negotiation of contracts denominated in currencies other than the main production currency, currency risks generated by normal commercial operations, and risks relating to its net investments in foreign currencies.

Thales mainly held forward foreign exchange contracts at 31 December 2006, 2005 and 2004.

Nominal forward buy and sell contract amounts, converted into euros at closing rates, are detailed below by currency. Where options are concerned, the amounts indicated correspond to nominal values for underlying currency transactions and are mentioned in the "buy / lend" or "sell / borrow" columns depending on the nature of the operation at maturity.

	2006		2005		2004	
	Buy / Lend	Sell / Borrow	Buy / Lend	Sell / Borrow	Buy / Lend	Sell / Borrow
Forward exchange contracts						
USD	285.2	700.5	300.8	851.2	294.5	679.1
GBP	195.1	240.7	291.5	224.8	263.0	205.3
CHF	121.4	105.6	54.9	45.2	57.4	33.8
Other	160.7	204.2	127.7	142.5	204.8	91.2
	762.4	1,251.0	774.9	1,263.7	819.7	1,009.4
Foreign exchange swaps						
To hedge investments						
USD	--	102.5	--	114.4	--	99.1
GBP	--	48.9	--	47.9	--	57.5
CHF	--	--	--	12.9	--	24.0
SGD	--	102.0	--	--	--	--
Other	--	0.6	--	0.7	--	90.7
	--	254.0	--	175.9	--	271.3
To hedge commercial commitments						
USD	780.6	1,063.1	502.7	731.4	426.5	555.9
GBP	575.7	106.6	492.6	98.4	319.1	150.2
CHF	34.9	29.7	20.6	26.2	40.1	37.3
Other	279.9	180.2	178.5	149.1	157.7	103.5
	1,671.1	1,379.6	1,194.4	1,005.1	943.4	846.9
Total	**2,433.5**	**2,884.6**	**1,969.3**	**2,444.7**	**1,763.1**	**2,127.6**
Foreign exchange options						
PUT	**8.0**	**39.7**	**59.1**	**323.3**	**--**	**88.1**
USD	--	38.0	9.1	279.7	--	88.1
GBP	8.0	--	15.8	--	--	--
AUD	--	--	32.4	1.8	--	--
COP	--	1.7	--	--	--	--
HKD	--	--	1.8	--	--	--
TWD	--	--	--	41.8	--	--
CALL	**4.7**	**28.5**	**4.9**	**177.9**	**5.9**	**65.4**
GBP	--	20.3	--	--	--	--
CAD	--	--	--	--	3.6	--
DKK	--	--	--	--	--	65.4
AUD	4.7	3.5	--	1.4	--	--
COP	--	--	--	0.8	--	--
HKD	--	--	3.5	--	--	--
NOK	--	--	--	2.6	--	--
USD	--	4.7	1.4	173.1	2.3	--
	12.7	68.2	64.0	501.2	5.9	153.5

Corresponding market values are analysed as follows:

	2006		2005		2004	
	Buy / Lend	Sell / Borrow	Buy / Lend	Sell / Borrow	Buy / Lend	Sell / Borrow
Forward exchange contracts	**(9.6)**	**26.5**	**4.9**	**(15.6)**	**(38.8)**	**88.9**
Foreign exchange swaps						
- to hedge investments	--	(2.0)	--	(1.6)	--	16.0
- to hedge commercial commitments	6.1	3.1	(3.4)	(3.2)	(2.6)	12.8
Foreign exchange options						
- PUT	--	1.3	--	(13.0)	--	2.3
- CALL	--	(0.1)	--	--	--	--

Maturity dates are as follows:

	2006						2005						2004					
	< 1 year		1 to 5 years		> 5 years		< 1 year		1 to 5 years		> 5 years		< 1 year		1 to 5 years		> 5 years	
	lend	borrow	lend	borrow	lend	borrow	lend	borrow	lend	borrow	lend	borrow	lend	borrow	lend	borrow	lend	borrow
Forward exchange contracts	**568.8**	**925.8**	**191.5**	**322.9**	**2.1**	**2.3**	**571.1**	**908.8**	**199.1**	**350.5**	**4.7**	**4.4**	**648.5**	**785.2**	**171.2**	**224.2**	**--**	**--**
Foreign exchange swaps:																		
- to hedge investments	--	254.0	--	--	--	--	--	175.9	--	--	--	--	--	271.3	--	--	--	--
- to hedge commercial commitments	1,627.7	1,343.0	43.4	35.0	--	1.6	1,191.0	991.1	3.4	14.0	--	--	914.5	812.3	28.9	34.6	--	--
Foreign exchange options																		
- PUT	8.0	39.7	--	--	--	--	59.1	323.3	--	--	--	--	--	88.1	--	--	--	--
- CALL	4.7	28.5	--	--	--	--	4.9	177.9	--	--	--	--	--	--	3.6	65.4	2.3	--

b. Interest rate risk management

Most of the interest rate swap contracts held by Thales at year-end 2006, 2005 and 2004 were intended to reduce the Group's sensitivity to interest rate movements. These financial instruments serve to hedge the net cash (debt) position of the Group as well as net cash flows generated on certain large contracts, either already signed or under negotiation; foreign exchange risks on those contracts are also hedged as mentioned above. Current nominal values, by type of interest rate instrument, and corresponding to the fixed part of the swaps, are analysed below:

	2006		2005		2004	
	Buy / Lend	Sell / Borrow	Buy / Lend	Sell / Borrow	Buy / Lend	Sell / Borrow
Interest rate swaps	520.0	135.0	940.7	164.7	1,390.0	446.3
Currency swap	--	--	17.5	--	19.0	--

Corresponding market values are analysed as follows:

	2006			2005			2004		
	Buy / Lend	Sell / Borrow	Closed positions	Buy / Lend	Sell / Borrow	Closed positions	Buy / Lend	Sell / Borrow	Closed positions
Interest rate Swaps	2.3	0.4	0.3	19.8	(3.6)	0.5	14.3	(9.6)	(5.3)
Currency Swaps	--	--	--	(1.5)	--	--	(2.1)	--	--

Maturity dates range as follows:

	2006						2005						2004					
	< 1 year		1 to 5 years		> 5 years		< 1 year		1 to 5 years		> 5 years		< 1 year		1 to 5 years		> 5 years	
	lend	borrow	lend	borrow	lend	borrow	lend	borrow	lend	borrow	lend	borrow	lend	borrow	lend	borrow	lend	borrow
Interest rate Swaps	10	17	510	110	--	8	420.7	27.7	220	128	300	9	870	300	220	137.3	300	9
Currency Swaps	--	--	--	--	--	--	--	--	17.5	--	--	--	--	--	19.0	--	--	--

c. Counterpart risk management

Trading operations are conducted exclusively with banks or top-rated institutions, and within the authorisation limits set by General Management for each counterpart.

Interest rate swap transactions matched with the same counterpart:

	2006	2005	2004
Total nominal amount (a)	120.0	120.0	420.0
Including matched transactions with the same counterpart	120.0	120.0	420.0

(a) Nominal amount corresponding to fix branch of swaps.

F. List of main consolidated companies (not including Thales S.A., the Parent Company)

	% Control 31/12/2006	% Control 31/12/2005	% Stake 31/12/2006	% Stake 31/12/2005
1. CONSOLIDATED SUBSIDIARIES				
African Defence Systems (South Africa)	80%	80%	60%	60%
Australian Defence Industries (Australia)	100%	100%	100%	50%
Avimo (UK, Singapore, USA) (a)	100%	100%	100%	100%
TDA Armements SAS (France)	100%	100%	100%	100%
Thales Air Defence (France, UK)	100%	100%	100%	100%
Thales Angénieux SA (France)	100%	100%	100%	100%
Thales ATM (Europe, USA, Australia)	100%	100%	100%	100%
Thales Avionics (France, USA, Singapore, UK)	100%	100%	100%	100%
Thales Avionics Electrical Systems SA (France)	100%	100%	100%	100%
Thales Canada Inc (Canada)	100%	100%	100%	100%
Thales Communication (Europe, USA)	100%	100%	100%	100%
Thales Computers (France, USA)	100%	100%	100%	100%
Thales Defence Deutschland (Germany)	100%	100%	99%	99%
Thales Defence Ltd (UK)	100%	100%	100%	100%
Thales Electron Devices (France, Germany)	100%	100%	100%	100%
Thales Engineering and Consulting SA (France)	100%	100%	100%	100%
Thales e-Security (UK, USA, China)	100%	100%	100%	100%
Thales e-Transactions (Europe, USA, Mexico)	100%	100%	100%	100%
Thales Information Systems (Europe, Russia, Singapore)	100%	100%	100%	100%
Thales International (France)	100%	100%	100%	100%
Thales International Saudi Arabia (Saudi Arabia)	100%	100%	100%	100%
Thales Italy (Italy)	100%	100%	100%	100%
Thales MESL Ltd (UK)	100%	100%	100%	100%
Thales Missile Electronics Ltd (UK)	100%	100%	100%	100%
Thales Naval (France, UK)	100%	100%	100%	100%
Thales Navigation (France, USA)	--	100%	--	100%
Thales Nederland B.V. (Netherlands)	99%	99%	99%	99%
Thales Optronics (France, UK, Netherlands)	100%	100%	100%	100%
Thales Security Systems SAS (France)	100%	100%	100%	100%
Thales Services SAS (France)	100%	100%	100%	100%
Thales Suisse SA (Switzerland)	100%	100%	100%	100%
Thales Systèmes Aéroportés SA (France)	100%	100%	100%	100%
Thales Telecommunication Services Ltd (UK)	100%	100%	100%	100%
Thales Telematics (France, UK, South Africa)	100%	100%	100%	100%
Thales Training & Simulation (France, UK, USA, Australia)	100%	100%	100%	100%
Thales Underwater Systems (France, UK, Netherlands, Australia)	100%	100%	100%	100%
Thomson Components Tubes (USA)	100%	100%	100%	100%

(a) Excluding High Tech Optics activities (HTO) sold at the end of December 2005.

	% Control 31/12/2006	% Control 31/12/2005	% Stake 31/12/2006	% Stake 31/12/2005
2. ACCOUNTED FOR UNDER THE PROPORTIONATE METHOD				
Aircommand Systems International SAS (ACSI) (France)	50%	50%	50%	50%
Amper Programas SA (Spain)	49%	49%	49%	49%
Armaris (France)	50%	50%	50%	50%
Citylink Ltd (UK)	33%	33%	33%	33%
Diehl Avionik Systeme GmbH (Germany)	49%	49%	49%	49%
Faceo (France, UK, Spain, Italy, Belgium)	50%	50%	50%	50%
Samsung Thales Company (Korea)	50%	50%	50%	50%
Stesa (Saudi Arabia)	49%	49%	49%	49%
Navigation Solutions (USA)	22%	35%	22%	35%
Thales Raytheon Systems (France, Ireland, USA)	50%	50%	50%	50%
United Monolithic Semiconductors (France, Germany)	50%	50%	50%	50%
3. ACCOUNTED FOR UNDER THE EQUITY METHOD				
Arab International Optronics (Egypt)	49%	49%	49%	49%
Aviation Communications & Surveillance Systems (USA)	30%	30%	30%	30%
Camelot (UK)	20%	20%	20%	20%
Elettronica S.p.A. (Italy)	33%	33%	33%	33%
ESG (Germany)	30%	30%	30%	30%
Dpix (USA)	20%	--	20%	--

This is a free translation into English of the statutory auditors' report issued in the French language and is provided solely for the convenience of English speaking readers. This report includes information specifically required by French law in all audit reports, whether qualified or not, and this is presented below the opinion on the financial statements. This information includes explanatory paragraphs discussing the auditors' assessments of certain significant accounting matters. These assessments were made for the purpose of issuing an opinion on the financial statements taken as a whole and not to provide separate assurance on individual account captions or on information taken outside of the consolidated financial statements. The report also includes information relating to the specific verification of information in the group management report.

This report [together with the statutory auditors' report addressing financial and accounting information in the Chairman's report on internal control], should be read in conjunction with, and is construed in accordance with French law and professional auditing standards applicable in France.

G. Statutory Auditors' Report on the consolidated financial statements

(Free translation of a French language original)

Year ended December 31, 2006

To the shareholders of Thales,

In compliance with the assignment entrusted to us by your annual general meeting, we have audited the accompanying consolidated financial statements of Thales for the year ended December 31, 2006.

These consolidated financial statements have been approved by the Board of Directors. Our role is to express an opinion on these financial statements based on our audit.

1. Opinion on the financial statements

We conducted our audit in accordance with the professional standards applicable in France; those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements give a true and fair view of the assets, liabilities, financial position and results of the consolidated group in accordance with IFRS standards, as adopted in the European Union.

Without qualifying our opinion, we draw your attention to the matter discussed in note 22 to the financial statements relating to legal and environmental risks, which details the provision relating to the arbitration request submitted by a client of the Group.

2. Justification of assessments

In accordance with the requirements of article L. 823-9 of French Company Law *(Code de commerce)* relating to the justification of our assessments, we bring to your attention the following matters:

As stated in note 1.v to the financial statements, Thales' management is required to make estimates and assumptions that affect certain amounts included in the financial statements of the Group and the accompanying notes to these financial statements. These assumptions are by nature uncertain and the actual figures may vary from these estimates under the circumstances anticipated in note 1.v to the financial statements.

We consider that the items that have been subject to significant accounting estimates, and which are likely to require justification of our assessments, include long-term contracts, acquisition goodwill, research and development costs, restructuring costs, deferred tax assets, provisions for pension plans and related contingency and loss provisions, as follows:

Long-term contracts

Thales recognizes income on long-term contracts in accordance with the methods set out in note 1.i to the financial statements. Such income is based on estimates of income on completion made by the project managers, according to the Group's procedures and under the control of the Management.

Based on the information provided to us at the time of our audit, our work consisted in assessing the data and assumptions used to estimate the income on completion for these contracts, reviewing the calculations made by the company, comparing the amounts of income on completion from previous financial periods with the corresponding actual figures, and examining the procedures used by the Management to approve such estimates.

Acquisition goodwill

Acquisition goodwill, which appears in the balance sheet as at December 31, 2006 for a net amount of EUR 1,825.4 million, was subject to impairment tests in accordance with the methods set out in note 1.b to the financial statements. We reviewed the methods for carrying out these tests, based on discounted cash flows of the business activities and divisions, and verified the consistency of the assumptions used with the forecast data taken from the strategic plans drawn up for each of the business activities and divisions under the Group's control.

Research and development costs

As stated in note 1.j to the financial statements, research and development costs are accounted for as intangible assets when they meet the criteria of IFRS standards, as adopted in the European Union (net amount capitalized of EUR 338.1 million as at December 31, 2006). We reviewed the sales and profitability forecasts underlying the appropriate nature of this accounting treatment, as well as the consistency of the assumptions used for their amortization and impairment tests.

Restructuring costs

Restructuring costs amounted to EUR 193.1 as at December 31, 2006, as stated in note 21 to the financial statements, and have been accounted according to the terms described in note 1.l to the financial statements.

Our work consisted in assessing the data and assumptions used for the valuation of these restructuring costs, as well as the overall consistency of these assumptions, considering in particular Thales' experience and the recognition and measurement rules of IFRS standards, as adopted in the European Union.

Deferred tax assets

Net deferred tax assets in the balance sheet as at December 31, 2006 amounted to EUR 440.8 million. As stated in notes 1.k and 1.v to the financial statements, the recoverability of these amounts was assessed by Thales on the basis of forecast data taken from the strategic plans drawn up for each of the consolidated tax groups concerned, under the Group's control. As for acquisition goodwill, we reviewed the recoverability tests performed on these deferred tax assets by Thales.

Provisions for pension plans and related commitments

Certain headings in both the assets and liabilities sides of the balance sheet drawn up for consolidated financial statements, as well as off-balance sheet commitments, are estimated on a statistical and actuarial basis, in particular, the provisions for pension plans and related commitments. The methods for calculating these headings are set out in note 20 to the financial statements.

Our work consisted in assessing the data and assumptions used in the models for valuing these headings, as well as the overall consistency of these assumptions, with due regard, in particular, to Thales' experience, its regulatory and economic environment.

Loss and contingency provisions

As regards loss and contingency provisions, we ensured that the procedures in force in your Group made it possible to identify, evaluate and recognize such provisions from an accounting standpoint in satisfactory conditions.

We also ensured that the disputes identified during the implementation of these procedures were described in appropriate terms in the notes to the financial statements, and, in particular, in notes 22 and 25.

Within the scope of our assessments of said estimates, we verified their reasonable nature.

The assessments were thus made in the context of the performance of our audit of the consolidated financial statements taken as a whole and therefore contributed to the formation of our audit opinion expressed in the first part of this report.

3. Specific verification

In accordance with professional standards applicable in France, we have also verified the information given in the group management report. We have no matters to report regarding its fair presentation and conformity with the consolidated financial statements.

Paris-La Défense, April 20, 2007

The Statutory Auditors

ERNST & YOUNG AUDIT	MAZARS & GUÉRARD	
Christian Chiarasini	Thierry Blanchetier	Jean-Louis Simon

Business review

I - Business description

II - International presence

III - Research & innovation

I – Business description

A. Business in figures

In € m		Aerospace	Air Systems	Land & Joint Systems	Naval	Security	Services	Other	Total
2006	Order Book at 31 December	5,053	3,824	3,973	4,715	1,178	1,919	14	20,676
	Order intake	2,368	1,449	2,870	1,254	1,525	1,304	48	10,818
	Consolidated revenues	2,473	1,589	2,401	1,330	1,205	1,214	52	10,264
	Income from operations	201	138	186	100	68	81	(20)	755
	Consolidated workforce at 31 December	12,673	5,878	11,654	4,415	5,248	10,172	2,120	52,160
2005	Order Book at 31 December	5,173	3,978	3,544	4,796	874	1,845	13	20,223
	Order intake	3,164	1,202	2,364	3,237	1,421	1,101	292	12,781
	Consolidated revenues	2,335	1,596	2,178	1,484	1,186	1,183	301	10,263
	Income from operations	209	123	128	150	55	80	(23)	722
	Consolidated workforce at 31 December	12,483	6,134	11,748	4,764	5,516	10,296	2,106	53,047

Order intake and order book: In defence markets, an order is generally booked when the Group has received a down payment from the customer. When contract financing requires parliamentary approval, the order book only records that fraction included in the government's budget, typically the proportion corresponding to the following year (especially in Europe and North America). Multi-year orders are still relatively rare, but are becoming more common.

Consolidated workforce: the consolidated number of employees includes all employees of fully consolidated companies and the proportionate share of employees of companies consolidated under the proportionate method. It does not include the employees of companies accounted for under the equity method or of unconsolidated companies.

Total workforce: a total of 56,847 people were working under management at the end of December 2006, compared with 57,810 people at end-2005. This figure is higher than the consolidated workforce because it includes all employees of joint ventures and of companies that are controlled but below consolidation thresholds. The breakdown by division at end-2005 and end-2006 is given below:

Employees under Thales management at 31 Décember	Aerospace	Air Systems	Land & Joint Systems	Naval	Security	Services	Other	Total
2006	13,588	6,315	12,607	4,798	6,273	10,956	2,310	56,847
2005	13,222	6,868	12,796	5,494	6,232	11,064	2,134	57,810
2004	12,808	7,273	14,986	6,093	5,696	10,521	2,465	59,842

Main contracts in order book at 31 December 2006

Programmes	Country of destination	Amount in order book at 31 December 2006 (in € m)
Multi-mission frigates *(FREMM)*	France/Italy	1,711
FSAF Phase 3 *(Missile systems)*	France/Italy	903
Rafale	France	823
Watchkeeper *(UAV-based tactical surveillance system)*	United Kingdom	761
Scorpene submarines	India	540
Syracuse III *(Satellite communications)*	France	287
Meltem *(Maritime patrol)*	Turkey	260
NH90 helicopter *(Avionics & simulation)*	France/Germany	241
Corvettes & offshore patrol vessels	Navantia	204
A400M *(Avionics)*	Europe	200
Shola 2 *(Support for air defence systems)*	Saudi Arabia	197
Tiger helicopter *(Avionics & simulation)*	France/Germany	190
Scorpene submarines	Malaysia	187
Sonar support	United Kingdom	187
Starstreak *(Missile systems)*	United Kingdom	187
Horizon Frigates	France/Italy	177
Patrol vessels	Denmark	165

B. Aerospace

Key figures

In € m	2006	2005
Order book at year-end	5,053	5,173
Order intake	2,369	3,164
Consolidated revenues	2,474	2,335
Income from operations	201	209
Consolidated workforce at year-end	12,673	12,483

Overview

The Aerospace division is an equipment supplier in three major business segments:

- onboard equipment for civil and military aircraft,
- mission electronics for combat aircraft,
- airborne surveillance and mission systems for armed forces and civil security authorities.

In each segment, Thales is the European leader and ranks third or fourth worldwide.

The civil aerospace market offers strong long-term growth prospects, although the development of the sector is cyclical. After the major crisis that began in 2001, air traffic volumes returned to a satisfactory rate of growth in 2004, translating into a sharp rise in orders from aircraft manufacturers in 2005, which was sustained in 2006.

The military aerospace market is less cyclical overall, with growth driven primarily by the steady increase in electronics as a proportion of total platform value. Today, electronic equipment and systems typically account for as much as 25% of the total value of a combat aircraft. The need for surveillance, one of the major roles of governments, is also contributing to a growing reliance on airborne electronics. Overall demand for airborne surveillance systems is rising steadily, whereas combat aircraft programmes offer more modest growth prospects at world level.

The financial models that apply to these two markets are also quite different. In civil markets, suppliers share some of the risk but are assured of a regular return on investment over several decades. By contrast, military programmes tend to be funded one phase at a time in line with government defence spending plans.

The Aerospace division's involvement in both civil and military markets therefore offers benefits on at least three fronts: technical and operational synergies, balance between different economic cycles and complementary financial models.

Business review

1. Aeronautical equipment

The Aerospace division supplies flight-critical onboard electronic equipment and systems for civil and military aircraft. For commercial aircraft, the division also equips passenger cabins with in-flight entertainment (IFE) systems.

In this segment, Thales has a strong industrial base in Europe (France, the United Kingdom and Germany, through Diehl Aerospace GmbH, a joint company with the Diehl group) and now also in North America, particularly through its IFE business in the United States. The Aerospace division also has a robust global support services network to meet the needs of airlines on a local basis. In addition to these industrial and commercial operations, the division is leveraging the Thales group's multi-domestic presence to develop its aerospace equipment business in other countries.

Thales's capabilities in this area cover:

- avionics equipment and systems (cockpit, flight control and navigation),
- in-flight entertainment systems,
- electrical power generation and conversion systems,
- other electronic equipment, such as brake control units and door and slide management systems.

Thales equips all types of aircraft: commercial airliners, business aircraft, regional aircraft, military aircraft, helicopters and unmanned air vehicles (UAVs), acting as an equipment provider, or assuming responsibility for complete aircraft functions or systems (avionics suites, flight controls, cabin systems).

Thales also provides through-life support for its onboard equipment and systems, generally working directly with the airlines and armed forces that operate the aircraft.

The division is also a prime contractor for aircraft upgrade programmes, mainly for military customers.

The aerospace equipment market is characterised by the dual civil-military nature of the technologies and products required. Civil aerospace is a global market enjoying sustained overall growth. By contrast, the military market, although stable overall, is more fragmented, with growth dependent on the sovereignty policies of individual client nations. In 2006, the civil market remained particularly buoyant, with aircraft manufacturers enjoying high order books. Going forward, the civil market is liable to be larger for Thales than the military market.

Equipment maintenance represents a substantial and growing proportion of revenues, particularly in the civil market, where the rising number of aircraft in service and their increasingly intensive use drives growth.

Growth in commercial air traffic is now strong and sustained, with high levels of new aircraft orders and deliveries, particularly in the low-cost segment and in Asia. The need for airlines to reduce their operating costs is also having a favourable impact on the market for new, more fuel-efficient, lower-maintenance aircraft.

Next-generation and future aircraft, including the Airbus A380, Boeing 787 and Airbus A350 – and, in a few years, single-aisle aircraft – will speed up this process, offering a wealth of growth opportunities for Thales. The A380 successfully completed its qualification programme in 2006, with the Thales equipment on the aircraft performing faultlessly. Other major programmes, in which Thales continued to play a part in 2006, included the B787 and the A400M military transport aircraft.

Development strategy

The Aerospace division's development strategy hinges on:

- consolidating and strengthening its market positions, notably by building on its leadership in Europe and developing business in the United States and in emerging markets,
- rounding out its product ranges by implementing new technologies and leveraging the Thales group's technological potential to offer innovative system solutions,
- extending its industrial and commercial operations worldwide to boost competitiveness and work more closely with customers.

In line with these strategic goals, in 2006 Thales and its German partner Diehl merged the Diehl Group's cabin lighting business Diehl Luftfahrt Elektronik (DLE) with the jointly-owned company Diehl Avionik Systeme, now renamed Diehl Aerospace GmbH. The acquisition makes Thales the leading supplier of cabin lighting systems for Airbus and Boeing, with an offering that encompasses sophisticated ambient lighting solutions with capability for continuous adjustment of light intensity and colour across the entire colour range.

At the same time, Thales is actively involved in preparing for major forthcoming programmes at Boeing and Airbus, which offer potential business worth tens of billions of dollars over the coming decades.

The key challenge facing companies in the air transport sector going forward is to develop less polluting, quieter and more economic aircraft while at the same time delivering improvements in safety, punctuality and comfort, against a backdrop of strong growth in air traffic. To meet these challenges, Thales has signed a Memorandum of Understanding (MOU) with eight leading European aerospace companies to establish the European Clean Sky initiative. With a total budget estimated at €1.6 billion, jointly funded by industry and the European Commission, Clean Sky will be the largest ever European aerospace research project.

a. Avionics

Thales is the European leader in avionics and ranks third worldwide, behind Honeywell and Rockwell Collins of the United States. Thales is Airbus's main avionics supplier and also counts most of the other major manufacturers of civil aircraft among its customers, including Boeing, Bombardier, Dassault Aviation, Embraer and Sukhoi. The Group is also supplying avionics for the Mirage and Rafale combat aircraft, as well as for Sukhoi and MiG Russian combat aircraft, and is present in both the civil and military segments of the helicopter avionics market.

In 2006, as a key supplier to Airbus, Thales benefited from record aircraft sales, in spite of A380 programme delays which ultimately had little impact on Thales revenues. Building on its successes on the A380 programme, Thales has also been selected to equip the A400M future military transport aircraft: the company will supply the new-generation Flight Management System (FMS), screen and head-up display systems, the modular avionics suite (developed in partnership with Diehl Aerospace GmbH) and the aircraft's passenger/cargo door control system.

Thales will also equip the new Boeing 787 Dreamliner with integrated standby flight displays. In the regional aircraft market, Thales has been selected to supply avionics systems to Sukhoi for its new Superjet100.

In 2006, Thales was selected for the first time by Gulfstream to supply flight control computers for flight testing. The first flight test with Thales equipment on board was successfully completed in September 2006. The contract with Gulfstream, a new customer for the Group, consolidates Thales's presence in the North American market.

As the main supplier of avionics systems for Eurocopter's civil helicopters, Thales is playing a major role on the

Tiger and NH90 military helicopter programmes (the latter as part of the NHI consortium). In 2006, Thales was selected by AugustaWestland to supply avionics systems for the 70 Future Lynx helicopters purchased by the British Ministry of Defence. Also during the year, Thales continued deliveries of the TopOwl helmet-mounted sight for the Cobra combat helicopter in the United States. The Group is also providing AugustaWestland with avionics solutions for its A109 helicopter, as well as developing the TopDeck avionics suite for US manufacturer Sikorsky's future S-76D helicopter. In the same market, meanwhile, Thales is continuing to develop its cooperation with Russian manufacturers.

b. In-Flight Entertainment (IFE)

In-flight entertainment systems allow passengers to enjoy a huge choice of films, music, games and live TV programmes during flights. IFE systems now also offer full internet and telephone connectivity via satellite links. Thales's IFE systems equip Boeing and Airbus airliners and Embraer and Bombardier regional aircraft.

With its comprehensive product range tailored to airlines' specific needs and different aircraft types, and rounded out by additional functions (games, etc.) developed in cooperation with leading specialists, Thales continues to enjoy strong growth in the IFE segment. Now the world's second-largest provider of in-flight entertainment systems, behind Panasonic Avionics of Japan, Thales is leading the way in highly promising segments like the Boeing B787, as well as in the Chinese and Indian markets. The Group has emerged as the preferred supplier of IFE systems for Chinese B787s, for example, winning contracts with Air China, China Eastern, Shanghai Airlines and Hainan Airlines. In India, Thales has also been selected to equip aircraft operated by Air India, Indian Airlines and Kingfisher.

Thales's in-flight entertainment systems demonstrated the full range of their capabilities in a slew of demanding in-flight tests during 2006, performing with faultless reliability to the full satisfaction of both passengers and crew in the A380 early-long flight (ELF) programme with a full passenger load, the round-the-world flight of the Embraer ERJ 190 regional aircraft, and the longest flight made by a commercial aircraft, the Boeing B777-200LR. These successful tests further consolidated the confidence that aircraft manufacturers and airlines place in Thales.

Thales is also continuing to develop related services such as content management solutions that enable airlines to securely select and upload films, music, etc. to aircraft directly from production studios.

Finally, Thales is preparing for potential new developments in cabin systems and equipment. The aim is to utilise Thales's IFE product line, and cabin lighting systems supplied by Diehl Aerospace GmbH, as a platform for offering planemakers more integrated cabin systems solutions that meet their need to enhance competitiveness and rationalise architecture systems architectures.

c. Electrical power

Thales's expertise and experience in electrical power generation and conversion systems encompasses airliners as well as regional, business and military aircraft. The Group ranks third worldwide in this market, which is dominated by Hamilton Sundstrand (UTC group) of America, with Goodrich ranking second in the power generation segment.

Numerous technological breakthroughs and commercial successes in recent years have put Thales in a strong position to benefit from growth opportunities in the particularly attractive Airbus and Boeing airliner market. Building on its experience on the A380, the Group has been selected by Airbus to develop the electrical power generation system for the A400M, in partnership with Goodrich. It has also been chosen by Boeing to supply the electrical power conversion system for the new B787 Dreamliner, for which intensive development work is ongoing.

Thales is also engaged in both in-house and European R&D programmes for the next-generation electrical power systems that will equip the "More Electric Aircraft" of the future. This work provides a strong platform for further growth in the segment in the future, particularly on upcoming major aircraft programmes at Airbus and Boeing.

d. Other ancillary equipment

Thales supplies the onboard computers used in various types of ancillary equipment – including brake control, fuel management, oxygen and air-conditioning systems – either to specialist equipment suppliers or directly to aircraft manufacturers. Thales is also active in this segment through Diehl Aerospace GmbH, which has been chosen by Airbus to supply the complete all-electric door and slide management system for the A380 and A400M (the latter in 2006).

e. Through-life support and related services

Through-life support business volumes are directly proportional to the number of aircraft in service. Thales's main market segment is commercial airliners, so its share of through-life support business currently depends largely on the number of Airbus aircraft in operation worldwide. With the steady increase in Airbus sales, through-life support is one of the main long-term growth drivers for Thales's aircraft equipment business.

In late 2004, in preparation for the A380's entry into commercial service, Thales formed a joint venture called OEMServices with Diehl Avionik Systeme, Liebherr and Zodiac. OEMServices provides airlines with a single logistics interface shared by the four partners.

In the defence sector, Thales offers a comprehensive approach to services and support. In 2006, the Group teamed up with Selex and Smiths in a Total Support Services (TSS) alliance to provide the UK Ministry of Defence with flexible integrated through-life support services for avionics and electrical systems installed on the different platforms operated by its armed forces.

2. Mission electronics for combat aircraft

A combat aircraft's electronic mission system comprises target and threat detection capabilities, offensive and defensive weapon control systems and the computerised navigation and attack system, which ties together the weapon functions under the control of the crew. The onboard mission system communicates with other aircraft and ground-based control centres over secure radio links. This mission system is an integral part of the combat aircraft and is critical to its operational performance.

Thales supplies complete electronic mission systems for combat aircraft:

- nose-mounted radars for surveillance and fire control,
- electronic warfare subsystems for threat detection and self-protection,
- computers for navigation and attack systems.

Other Thales divisions also supply onboard optronic equipment (OSF forward-sector optronic suite, reconnaissance pods, laser designation pods, etc.) and radio systems.

For new aircraft programmes, Thales acts as an equipment provider, partnering with the aircraft manufacturer for the electronic mission system and working closely with both the manufacturer and the end-customer.

For upgrades to older aircraft, Thales acts as an equipment provider, but also as a prime contractor, supplying the systems and coordinating installation and qualification on board the aircraft.

Combat aircraft typically account for a significant proportion of a country's defence budget. The combat aircraft market – which includes both the aircraft and the equipment they deploy – functions largely on an individual nation basis and is dependent on the sovereignty policies of the governments concerned.

In Europe, two major programmes are in progress: the French Rafale (built by Dassault Aviation, with Thales as one of the main suppliers) and the European Typhoon. In 2006, the Rafale entered operational service with the French Air Force. In the United States, the main combat aircraft programmes are the F18E/F, the F22 – which recently entered operational service – and the F35 JSF (Joint Strike Fighter), currently in development.

Development strategy

In electronic mission systems for combat aircraft, Thales's objective is to consolidate its position as a supplier of the best-performing and most competitive systems in the world.

In Europe, Thales is set to play a key role in the cooperative programmes that should take shape as needs continue to converge, at the same time as meeting the national sovereignty requirements of each partner country.

The Group is also seeking to strengthen its position as an equipment provider, working in close partnership with manufacturers to develop new combat aircraft and UCAV(1) programmes, and to increase its involvement in the market for upgrades to previous-generation aircraft.

Competition

In mission electronics for combat aircraft, Thales is the European market leader and ranks third worldwide, behind the American companies Raytheon and Northrop Grumman. The Group's position is largely based on its involvement in the Mirage and Rafale programmes in France and on export, particularly the recent Mirage export programmes for Greece and the United Arab Emirates.

The strength of this position should not be assessed solely in terms of market share, but also in terms of the excep-

(1) UCAV: Unmanned Combat Air Vehicle.

tional quality of the Group's technologies and products, which is the key to future success. On both scores, Thales has a clear lead in Europe and is on a par with its American competitors.

- In radars, for the Rafale, Thales has delivered the RBE2, the first operational electronically scanned onboard radar on the market, which offers important new operational functions. In 2006, the French defence procurement agency (DGA) awarded Thales the key "Rafale roadmap" contract for the industrial development of the next-generation active phased array antenna, which offers exceptional operational performance. Initial flight tests with prototypes have proven highly conclusive.

- In electronic warfare systems, Thales has developed the SPECTRA(1) countermeasures suite equipping Mirage and Rafale aircraft in service with the French Air Force and export customers. Advanced studies are already underway to develop future generations of electronic warfare systems.

Drawing on its experience and expertise in electronic warfare and radar technology, the Group has become one of the leading players in radar electronic warfare systems for land and naval forces. Major orders won by the division in 2006 include electronic warfare systems for the Franco-Italian FREMM frigates as well as for UK frigates, and, in the export market, electronic warfare systems for land forces.

In 2006, the Moroccan defence ministry selected Astrac, a joint venture between Thales and Sagem Défense Sécurité, to upgrade its fleet of twenty-seven Mirage F1 aircraft. The contract includes radars and electronic warfare equipment from Thales.

3. Airborne surveillance and mission systems

Airborne surveillance and mission systems meet a broad spectrum of operational requirements, both for armed forces and civil security agencies.

The availability of various platform types (fixed-wing, helicopters, UAVs) with different range, precision and payload capacities calls for optimised solutions to meet numerous operational needs.

Different types of missions – strategic, tactical, airland, maritime, local or projected – call for different types of systems. A distinction is also made between airspace surveillance, ground surveillance and maritime surveillance missions, although multimission platforms can perform two or more if required.

This broad range of requirements and operational concepts has led to an equally diverse array of possible architectures and solutions. For example, a given requirement might be met with a manned aircraft carrying surveillance equipment or with several UAVs linked to a ground-based control centre. In either case, onboard mission equipment forms part of the "passenger" payload of the aircraft, as opposed to combat aircraft electronics, which is an integral part of the platform itself.

Drawing on its capabilities as a system architect and provider of sensors and control systems, Thales acts as prime contractor and supplies complete system solutions to meet the needs of government and military customers. For other programmes, it supplies electronic mission systems and related equipment to the programme prime contractor.

The overall surveillance systems market is expanding, driven by large-scale national and international programmes.

Key innovations in the field concern sensor, communications and data processing technologies as well as higher-level system integration. Demand is increasing for complete, integrated system architectures that are largely platform-independent and attain the new levels of flexibility and responsiveness required by forces for their systems.

Some customers are looking to the contractor community to propose operational concepts and architectures that meet these new requirements.

Two examples of this new approach are the Watchkeeper UAV-based tactical surveillance capability for the British Army – for which Thales signed a contract with the UK Ministry of Defence in 2005 – and NATO's Alliance Ground Surveillance (AGS) programme.

Development strategy

Thales intends to strengthen its European and worldwide leadership as a prime contractor, systems architect and equipment and system supplier with responsibility for mission electronics.

The Battlespace Transformation Centre (BTC), a new collaborative environment to support the design and validation of system architectures and operational procedures, is the largest-ever implementation of this collaborative approach applied to concept design and development. The BTC, which uses simulated environments to evaluate potential architecture solutions with great precision and in real operational contexts, played a key role in the design of the Watchkeeper system, helping Thales to win this major contract.

(1) SPECTRA: Système de Protection et d'Evitement des Conduites de Tir du Rafale (Rafale's electronic warfare systems).

Competition

Thales enjoys established leadership positions in airborne systems for electronic warfare and maritime surveillance and patrol missions in France and the United Kingdom, as well in export markets. In addition, the Group is now recognised by customers and industry observers alike as leading the way in ISTAR (Intelligence, Surveillance, Target Acquisition and Reconnaissance) systems, winning the 2006 Market Penetration Leadership award from the business consulting firm Frost & Sullivan for its success in securing the Watchkeeper contract.

Thales is now looking beyond Watchkeeper – which is proceeding on schedule – to new major challenges on the horizon. In 2006, the Group won contracts for technical and operational studies in the United Kingdom and France, and was also selected by the Canadian Defence Ministry to supply a mini-UAV system, following successful trials in Canada and the United States.

With its know-how and experience in radars, electronic warfare and systems, Thales is a key partner in the Euro-American TIPS(1) consortium, which has been selected by NATO to develop the future Alliance Ground Surveillance (AGS) system based on a combination of manned aircraft and UAVs. The Group's contribution involves the overall system architecture as well as the powerful TCAR(2) observation radar. In 2005, NATO and the member states involved in the programme continued studies ahead of the award of the development contract, now expected for 2007.

In maritime surveillance, in addition to export orders awarded during 2006, Thales is currently developing solutions to meet European and national needs, particularly in the Mediterranean region as part of efforts to combat trafficking and illegal immigration, as well as in other regions of the world.

C. Air Systems

Key figures

In € m	2006	2005
Order book at year-end	3,824	3,978
Order intake	1,449	1,202
Consolidated revenues	1,589	1,596
Income from operations	138	123
Consolidated workforce at year-end	5,878	6,134

Overview

Thales develops systems and equipment to support airspace safety and security. In the defence sector, the company contributes to the protection of deployed forces and sensitive sites by delivering airspace surveillance systems, command and control centres and complete threat assessment and engagement solutions. In the civil aviation sector, Thales provides tailored responses at all phases of air traffic management as well as satellite navigation systems and airport security solutions.

Business review

1. Detection and surveillance

In 2005, Thales embarked on a policy of product renewal with the objective of rapidly developing a complete new range based on a common technological foundation and standard components. By implementing product platforms tailored to market needs, the company will now be much better positioned to meet customer requirements in terms

(1) TIPS: Transatlantic Industrial Proposed Solution.
(2) TCAR: Transatlantic Cooperative AGS Radar.

of price, quality and timely delivery. In 2006, Thales launched the development of the Homeland Alerter 100 demonstrator for the detection of low-altitude stealth threats. This policy will be pursued in 2007 so that qualified equipment can begin to be delivered to customers from 2008. In civil radars, Thales has adopted a proactive policy of industrial rationalisation, in particular by forming local partnerships to complement its existing operations. Examples include the company's equity investment in Omnisys in Brazil and the agreements with ITT and DRS in the United States. Thales is further reinforcing this industrial policy in countries with significant domestic markets.

2. Air defence and missile systems

Thales's comprehensive air defence offering includes:

- integrated air command and control systems,
- detection and identification systems,
- very short, short and medium-range air defence systems,
- missile electronics and propulsion.

Thales is a major player in the market for integrated air defence systems to counter conventional threats, tactical ballistic missiles and cruise missiles. Dedicated to the protection of airspace and high-value assets, these systems actively contribute to mission planning and tasking, force engagement and threat neutralisation in the event of an attack.

Thales is therefore the only company in Europe capable of providing armed forces with complete solutions from early warning to threat neutralisation.

Air defence requirements have changed dramatically in response to the new geopolitical landscape, with its asymmetric threats and disappearing borders. Today, conventional forces must counter the threat of international terrorist networks and conduct operations in close proximity to civilian populations.

Faced with this new paradigm, mission success partly depends on the speed and agility with which forces can reconfigure their assets and resources. To provide effective protection for forces in the field and defend sensitive sites, air defence systems must incorporate all the components in the capability chain – sensors and early warning systems, launchers and other effectors – as part of an extended real-time network. In this context, individual nations and international military alliances including France and NATO are preparing to expand their capabilities, particularly in anti-missile defence.

Irrespective of the type of theatre or intervention (joint, allied, coalition or international), air defence systems must be fully interoperable and able to share all types of information in real time. These operational requirements have given rise to the concept of "plug and fight", where systems are designed as part of a single network-enabled capability and provide specific services for clearly identified air defence missions.

a. Air defence systems

ThalesRaytheonSystems (TRS), a joint venture equally owned by Thales and Raytheon, is a major player in integrated air command and control systems and battlefield surveillance and coordination systems. TRS acts as prime contractor for large-scale NATO programmes and offers integrated solutions to meet the requirements of network-centric environments. The company is playing an active role in studies to define future tactical ballistic missile defence systems and develop Active Layered Tactical Ballistic Missile Defence (ALTBMD) architectures. It also supplies air defence, battlefield surveillance and counter-battery (weapon locating) radars.

In air command and control systems, TRS has world-class references with the BCS-F programme (Battle Control System-Fixed) for the United States, ACCS LOC1 (Air Command & Control System, Level of Capability 1) for NATO and SCCOA(1) (Système de Commandement et de Conduite des Opérations Aériennes) for France. The SCCOA programme is coordinated by MOSS (a joint venture set up by Thales and EADS) with TRS performing the majority of the work. Each of these large-scale programmes calls for the development of interoperable systems for the planning, tasking and execution of offensive and defensive air missions.

In command and control (C2), the Battle Control System-Fixed (BCS-F) became operational on three North American sites: Alaska, Hawaii and Canada. The New York and Washington State sites will reach operational capability in early 2007.

In the United States, TRS was also selected by the consortium led by Lockheed Martin (and including Raytheon and SAIC) for the AOC WSI programme for the upgrade of air command and control centres to support US Air Force operations.

In France, TRS won the Martha system (SCCOA-tactical) production contract for fifty three command and coordination centres. The company was also awarded the Martha-SCCOA synergy contract to develop and produce an air defence weapon system command and coordination centre for joint forces, in accordance with requirements expressed by the joint staff of the French armed forces (EMA). This centre will be deployed by French Army and/or Air Force operators.

(1) SCCOA: France's air operations command and control system.

TRS reached an important milestone on the ACCS LOC1 programme with delivery of the Initial Baseline (IB) software to NACMA(1) within the agreed timeframe.

With regard to air surveillance systems, TRS won a contract with the Mexican Navy and Mexico's state-owned petroleum company PEMEX to supply a system to protect national territory and petroleum facilities in the Gulf of Mexico.

In weapon locating and air defence radars, TRS took advantage of its installed base and signed various major contracts, mainly in the United States for the firefinder TPQ-36 and TPQ-37 and in France with SIMMAD (the French defence ministry's integrated aeronautical equipment support structure). This extended its contract for the through-life support of ninety eight air defence radars in service with the French Army for a further five years.

b. Surface-to-air weapon systems and missile systems

Thales is a world leader in land-based and naval air defence systems, with core competencies spanning the design, development and integration of very short, short and medium-range systems.

Very short range: The demonstrator for the new multi-platform, multi-missile, multi-role launcher turret was presented to numerous customers in 2006. The turret offers enhanced detection and fire coordination capabilities and is designed to significantly shorten the sensor-to-effector loop and provide armed forces with more mobile and effective firepower against time-critical targets.

Alongside its continued investment in fire control systems, Thales has also developed a new alerting system that is capable of detecting, classifying and tracking low-observable, stealthy and concealed targets. It is designed to complement conventional radars and to readily integrate with existing operational infrastructure.

Short range: Thales has developed the Crotale Mk3 system to defend civil and military installations against airborne threats and protect forces on the move. The VT1 hypervelocity missile that equips the Crotale Mk3 system is now available with an extended range of more than fifteen kilometres. This reinforces its operational capabilities making it the highest-performance system on the market.

The Flycatcher Mk2 fire control systems ordered by the Venezuelan Army are now in operational service. Flycatcher is an autonomous hybrid system equipped with a 3D surveillance radar and dedicated to short-range air defence. It is designed to control a large variety of missile types and anti-air guns.

Medium range: as a member of the Eurosam consortium with MBDA, Thales is contributing to the major European anti-missile missile system programmes SAMP/T(2) and PAAMS(3). These large-scale programmes are the backbone of the air defence capabilities of the participating countries and will use the same equipment for key point, strategic site and wide area defence. Thales is developing the fire control system software, Arabel radar and missile seekers in both land and naval versions. In 2006, the exceptional performance of the SAMP/T system was confirmed with excellent results: demonstration of MRI module(4) air-transportability, as well as a successful test campaign and qualification firings. Operational assessment by French and Italian forces is now in progress.

To protect deployed forces against ballistic missiles with ranges of 600 kilometres and beyond, France has also selected the SAMP/T system, combined with the M3R early warning radar and the deployable component of the SCCOA air command and control system. These developments are a first decisive step towards France's future anti-ballistic missile capability, scheduled to be operational from 2015.

At the same time, NATO pursued the ALTBMD(5) programme, which will combine the anti-theatre ballistic missile assets of several European nations, including France and the Netherlands, to form a single coherent capability. In 2006, NATO awarded the ALTBMD SE&I(6) contract to the consortium led by SAIC and including Thales and TRS.

Thales is a key player in the air defence sector and won several major contracts in 2006, including the NLAW(7) export contract with Saab Bofors Dynamics for missile assembly. In addition, the FRES(8) contract award established Thales's leadership in survivability solutions for the UK's future military vehicles. Finally, Thales won a major contract with the UK Defence Logistics Organisation (DLO) for a further batch of 810 Starstreak test missiles by 2013.

c. Missile electronics and propulsion

Thales is Europe's leading supplier of electronic subsystems for missiles and precision-guided munitions and provides equipment and services to customers across the world. The company's core competencies include the design, development and production of high-performance seekers and proximity fuzes. The advanced technologies involved have applications in every segment of the market, from air defence to medium-range missile systems, and are suited to all types of missiles, including air-to-air, air-to-surface, cruise and anti-ship.

Thales is continuing to leverage its multidomestic operations in France and the United Kingdom to pursue cutting-

(1) NACMA: The NATO Air Command & Control System Management Agency.
(2) SAMP/T: Sol-Air Moyenne Portée Terrestre (land-based medium-range air defence system) (France, Italy).
(3) PAAMS: Principal Anti-Air Missile System (cooperation between France, Italy and the UK).
(4) MRI module: radar with identification friend or foe.
(5) ALTBMD: Active Layered Tactical Ballistic Missile Defence.
(6) SE&I: system engineering and integration.
(7) NLAW: the UK's Next-Generation Light Anti-Armour Weapon programme.
(8) FRES: Future Rapid Effect System.

edge research and develop world-class technologies. Examples include development of the semi-active laser (SAL) seeker for multiple applications (precision-guided rockets, mortars, artillery shells, smart bombs, missiles) and the diversification of its IFF activities (identification friend or foe). Thales also launched the initial phases of the AUDACE study to develop the anti-air seeker of the future.

In 2006, Thales further consolidated its leadership in the United Kingdom with its selection by the Ministry of Defence to join Team Complex Weapons (Team CW), established to foster closer partnership between key members of the CW supply chain.

Other highlights include an order for 100 seekers for the Exocet missile and 130 proximity fuzes for the Mica missile. In addition, the contract for 190 Exocet missiles signed in late 2006 is expected to result in a further order for seekers in the coming months.

Competition

The major players in the detection market are Lockheed Martin and Northrop Grumman in the United States, the Elta group in Israel and EADS, Indra, Saab and Selex in Europe. In command and control systems, the market leaders are Lockheed Martin and Northrop Grumman in the United States and EADS in Europe. In surface-to-air missile systems, the leaders are Raytheon in the United States, Almaz-Antey and KBM in Russia and Diehl, MBDA and SAAB in Europe.

3. Air traffic management

Thales is a global leader in ATM and one of the only companies in the world with the know-how and experience to provide complete turnkey solutions. The company designs, integrates, installs and maintains a full range of equipment and systems including air traffic control centres, control tower and surveillance systems, conventional and satellite navigational aids, landing systems and Communication, Navigation and Surveillance (CNS) systems.

Today, Thales systems are recognised as the industry standard. The EUROCAT air traffic management system is one such example, with more than 260 centres in service throughout the world, equivalent to 4,000 controller positions.

To build the systems of the future, Thales is involved in various consortiums. The company is playing an active role in the definition of new standards and is helping to draft and validate new operational procedures. These particulary relate to the integration of ground-based and onboard systems, and to satellite navigation through the SESAR programme (launched at the initiative of the Air Traffic Alliance) and the NexGen research programmes in the United States.

Competition

Alongside Thales, the other main players are Raytheon, Lockheed Martin and Indra for air traffic management and control centres, and Selex and Lockheed Martin for radars.

a. Surveillance and control centres

Thales's capabilities span the entire surveillance and security chain, from departure gate through en-route control to the arrival gate, in complex and saturated environments. Thales is one of the few companies in the world with the know-how and experience to provide complete and effective support for air traffic controllers. The EUROCAT air traffic control system has achieved commercial success in every region of the world.

In response to increasing air traffic volumes at high-density airports, Thales has developed an integrated air-to-gate solution to ensure efficient control of aircraft and maximum security from the descent phase to the parking bay, as well as during takeoff manoeuvres. This new concept was implemented for the first time as part of the SATCONS programme in Thailand (Suvarnabhumi Airport Air Traffic Control System), operational since September 2006.

In Europe, the COOPANS agreement (COOPeration between Air Navigation Service providers) will enable three ATM customers that acquired EUROCAT systems under separate contracts – the Irish Aviation Authority, the LFV Group of Sweden and Naviair of Denmark – to set common specifications and acquire joint upgrades as they work towards a single unified air traffic management system.

In Denmark, Naviair announced final acceptance of Phase 1 of the DATMAS contract to supply the country's new ATM system. This phase was completed three months ahead of schedule. Also in Europe, the initial conditional phase of the CoFlight programme in partnership with DGAC/DSNA, Skyguide, ENAV and Selex was launched in 2006. This innovative system will play a central role in managing Europe's growing air traffic volumes.

Thales also achieved notable successes in the Asia-Pacific region, confirming its leadership through major contracts with Taiwan for the supply of an integrated nationwide air traffic management system and with China for the supply of two air traffic control systems for the cities of Hefei and Tianjin. In South Korea, Thales won a contract to supply air traffic control systems and navaids for Incheon International Airport. And in Vietnam, the company will provide a EUROCAT system for Ho Chi Minh City's new airport.

Thales will also provide Mexico with six fully integrated EUROCAT air traffic management systems: an area control centre located in Mexico City and five approach control centres at Guadalajara, Puerto Vallarta, El Bajio, Acapulco and Toluca. The contract is part of a nationwide programme to upgrade air traffic control systems.

b. Navaids and satellite navigation

Thales offers a complete range of navaids for takeoff and landing, en-route and tactical navigation systems and satellite navigation systems.

In 2006, Thales confirmed its global leadership with major contracts for approach and landing aid systems in China, Italy, the Czech Republic, Angola, Nigeria, South Korea and the United Kingdom. Today, the company equips more than 180 countries and has captured over sixty percent of the world market, including ninety percent of the ILS(1) and DVOR(2) market in the United States.

In the promising ADS-B market (Automatic Dependent System-Broadcast), Thales signed a contract with France to supply ten ADS-B stations and with South Korea for two ground stations. These latest wins follow the key contracts with Australia and EUROCONTROL. In the United States, Thales is a member of the ITT-led consortium that is bidding to supply a continent-wide ADS-B system. The programme is currently in preparation with contract award expected in 2007.

In airport solutions, Thales was selected to supply a STREAMS surveillance and security system (Surface TRaffic Enhancement & AutoMation Support) for Astana International Airport, Kazakhstan. The STREAMS system is already in operation at more than ten airports in Europe, Asia and North America.

c. Galileo

Galileo is Europe's first global satellite navigation system and will provide a wide range of high-growth services, from personal location (emergency calls, isolated workers, etc.) and vehicle location (stolen vehicles, tracking of hazardous loads, etc.) to motorway toll collection, air navigation and civil security.

As a key player in Europe's satellite navigation industry, Thales was appointed last year as prime contractor for the security segment of the In Orbit Validation (IOV) programme and the Test User Service. In this capacity, Thales is responsible for signal quality and integrity and overall security for the system development phase. The company is also part of the eight-member consortium being set up to negotiate the concession contract to deploy and operate the satellite constellation and ground infrastructure.

d. Air Traffic Alliance

In Europe, air traffic volumes are expected to double by 2020. To manage this growth, developing and harmonising air traffic management systems is a top priority for the next few years.

To support this goal, Thales, Airbus and EADS launched the Air Traffic Alliance in 2002 to pool their respective know-how and experience.

The Single European Sky directive, approved by the European Parliament in 2004, provides a political framework for EU-wide action to increase the capacity, efficiency and security of the system and ensure interoperability with other regions of the world. The SESAR programme launched at the initiative of the Air Traffic Alliance with the backing of the European Commission and EUROCONTROL is the operational implementation of this directive. In March 2006, the ATA launched the definition phase of the SESAR programme. This phase is set to conclude in late 2007 with the drafting of a master plan to address the issue of air traffic management in Europe for 2020 and beyond on the basis of the initial results established by the consortium, published in July and December 2006. Responsible for conducting this two-year study, the fifty-partner SESAR consortium brings together all the major players in the air transport industry, including airports, air navigation service providers, airlines, manufacturers (aircraft, ground systems, etc.), pilot and air traffic controller associations and the defence community.

The ATA is managing this first programme phase, which will be followed by the development phase from 2008 to 2013. Thales is making a vital contribution in key areas of the programme, including the drafting and validation of new operational procedures governing the integration of ground and aircraft systems, as well as implementation of new communication and satellite navigation technologies.

(1) ILS: instrument landing system.
(2) DVOR: Doppler very high frequency omni range.

4. Customer service

Thales's global support network provides a range of integrated logistic support solutions, as well as maintenance and services to guarantee the operational availability and reliability that customers expect from their equipment and systems. Through its multidomestic operations, Thales has the capability to provide customers with timely, tailored through-life support all over the world. Capitalising on its vast installed base around the globe, Thales signed service and support contracts with customers in more than eighty countries in 2006.

In the defence sector, Thales achieved significant successes in the Middle East with the renewal of contracts to support Saudi Arabia's Crotale and Shahine weapon systems (for three and five years respectively). Responsibilities include technical assistance, repairs, supply of replacement parts and upgrade of support facilities. In addition, the French Air Force extended its contract with Thales for the through-life support of air defence radars for a further five years, while Finland signed a contract for the upgrade of Crotale weapon systems.

In civil aviation, Thales was selected to upgrade the transmit/receive elements of twenty-six civil radars for Brazil. The company also awarded a major sixteen-year contract with Australia to support ten new co-mounted primary and secondary radars. Numerous successes in Europe include the four-year extension to the through-life support contract for civil aviation radars in France, migration of AIRCAT control centre applications to Linux servers in Belgium and extension of the STAMP contract (Strategic Airport Mount Pleasant) in the United Kingdom to 2015.

D. Land & Joint Systems

Key figures

In € m	2006	2005
Order book at year-end	3,973	3,544
Order intake	2,870	2,364
Consolidated revenues	2,401	2,178
Income from operations	186	128
Consolidated workforce at year-end	11,654	11,748

Overview

Fast-evolving information and communication technologies and the emergence of new threats have had a huge impact on military procedures. More than ever, the ability to gather, process and distribute information effectively is the key to gaining and maintaining operational superiority.

These changes have driven the development of C4ISR(1) systems, which interconnect ISR systems (intelligence, surveillance, reconnaissance) with C2 (command and control), communication, decision support and weapon systems in real time. Information can thus be shared on a routine basis to facilitate collaborative engagements under joint or allied command. Indeed, this is the principle underpinning network-centric warfare and network-enabled capabilities.

Thales's Land & Joint Systems division delivers modular, secure and interoperable solutions to meet emerging operational requirements in two main areas:

- **for land forces,** the division offers a complete range of solutions and services to support the transformation of air-land combat: large-scale cooperative fighting systems and area control systems; dedicated systems for surveillance, reconnaissance, command, control and combat missions; vehicle and soldier systems; and key equipment for the air-land battlespace,

- **in C4ISR,** the division provides air, land and naval forces, joint structures, special forces and security services with the capabilities they need to achieve information superiority through high-level expertise spanning the entire intelligence and command chains, as well as secure end-to-end communication systems.

(1) C4ISR: command, control, communications, computers, intelligence, surveillance, reconnaissance.

The division draws on unique strengths that have made it a world leader in these two areas:

- **Thales is involved throughout the entire value chain** and offers unmatched capabilities as a prime contractor, system architect and integrator, equipment supplier and service provider. The company has the right people, skills and technologies to develop modular, scalable, high-performance and cost-effective solutions at minimum risk,

- Thales has the **experience** and **overall vision of operational requirements** to meet the challenges of interoperability, availability, security and flexibility in the joint forces environment. The company continues to adapt to evolving procurement practices and the shift from system / equipment-based approaches to comprehensive capabilities. The Battlespace Transformation Centre (BTC) provides a unique forum for **dialogue with customers** and a powerful tool to help them express their requirements. Teamwork with customers in this type of collaborative environment is the key to Thales's approach to solution development,

- **at the forefront of technological innovation,** the division develops system architectures based on open standards, incorporating the most advanced commercial technologies while guaranteeing the highest levels of security. Thales is a global leader **in communications and optronics** with high-level expertise in critical technologies including radio waveforms, lasers, software-defined radio and encryption. The division filed more than seventy patent applications in 2006 and takes an active part in the main European research programmes, such as Information Technology for European Advancement (ITEA) for example,

- the division has **industrial operations in over twenty countries.** This local presence is the guarantee of its ability to factor in local constraints and propose tailored solutions. Thales remains on hand to provide **high-quality** and **responsive services** to support the systems and equipment delivered. These local subsidiaries benefit from access to the division's broad-ranging expertise and from industrial transfers, usually through joint ventures with local partners.

Competition

Today, the competitive environment is becoming more dynamic than ever as traditional competitors in the United States, Europe and Israel are joined by new entrants, particularly in the emerging growth markets. The **increasing use of commercial technologies** for military applications is enabling civil-sector companies to bid for defence contracts. Thales continues to adapt to this environment through a strategy of partnerships, dual technologies and open standards.

Thales is Europe's leading supplier of C4ISR solutions and is also well positioned in **communications** and **optronics.**

Development strategy

The division's development strategy focuses on four main objectives: strengthen its capabilities in land systems and extended services, gain broader access to international markets and step up innovation:

- to serve land forces more effectively, Thales continues to **climb the value chain** by extending its mission systems portfolio to include force protection solutions. The company has also developed a range of value-adding solutions in cross-functional architectures and integration of future combat systems with multiple platform types,

- the division is also pursuing development of **innovative service and support solutions** as a major area of focus. Its capabilities in communication system architectures and integration was a decisive factor in the selection of Thales for NATO's first major **outsourcing contract** to implement and manage communication networks for the International Security Assistance Force (ISAF) stationed in Afghanistan,

- the division's **multidomestic strategy** proved extremely successful in 2006, leading to major contract wins in Norway (Link 16 tactical datalinks) and Switzerland (command system for land forces). Thales is also developing **international partnerships** to penetrate strategic markets. In the United States for example, the company entered alliances with Rockwell Collins in software-defined radio for vehicles and with Data Link Systems for MIDS-JTRS tactical datalink terminals. In India, Thales set up a new **joint venture** with Rolta India Ltd in C4ISR,

- and lastly, the ability to **innovate** is a key growth driver. In 2006, the division devoted some thirty percent of revenues to research and development. The agreement concluded by Thales and Alcatel-Lucent in late 2006 and implemented in the first half of 2007 provides further scope for cross-pollination between civil and military technologies as the division continues to develop its range of products and solutions.

Business review

1. Land systems to support the transformation of airland warfare

a. Large-scale cooperative fighting systems

To speed up the tempo of operations, boost efficiency, improve troop protection and enable commanders to retain the initiative in all circumstances, the ability to connect and coordinate all assets in the battlespace has become a top priority for land forces.

In 2006, Thales reached an important milestone in the BOA(1) cooperative fighting system programme in France with delivery of the first version of the LTO(2) integrated defence battlelab in partnership with Nexter and Sagem Sécurité Défense.

b. Mission systems and vehicle and soldier systems

Thales offers a complete range of mission solutions from reconnaissance, surveillance and target acquisition (RSTA) to command and control, combat and logistic support systems for integration with all types of platforms.

In 2006, Thales achieved further successes in integrated vehicle mission systems, most notably the Armoured Infantry Vehicle (AIV) programme in Belgium, for which the company is supplying the common electronic architecture for the seven vehicle configurations envisaged.

In vehicle systems, Thales won contracts in Australia and the Netherlands to supply more than 150 Bushmaster infantry mobility vehicles. The company also continued to consolidate its position in soldier modernisation systems. In the UK, Thales successfully completed the FIST(3) system assessment phase. In the Netherlands, the company delivered communication information modules for operational trials as part of the D2S2(4) programme. And in Germany, it signed a contract to supply communication systems for the new IdZ(5)-Enhanced programme.

c. Key equipment for the battlefield

Thales develops critical ground-based equipment for the battlefield, including communications, IFF (identification friend/foe), sensors and effectors for intelligence, surveillance and reconnaissance (ISR) missions, combat and force protection.

In 2006, Thales announced a series of product innovations including the launch of the new FlexNet vehicle software radio range developed with Rockwell Collins, and launch of the Satcom Xotm active antenna for mobile satellite communications. Thales also expanded its capabilities in smart munitions and munitronics through the Junghans Microtec GmbH joint venture with Diehl. On export markets, the company signed new tactical communication contracts with Angola, Austria, Malaysia, Poland, Switzerland, the United Arab Emirates and the United Kingdom. In 2006, the number of Catherine infrared cameras installed on combat vehicles doubled following numerous contracts in Asia, North Africa and the Middle East.

d. High-value customer services

Thales provides its customers with broad-ranging expertise in system engineering and architectures combined with a complete set of simulation and integration tools coordinated within the Battlespace Transformation Centre to support the definition of future systems. The company also ensures the availability of ground-based systems and equipment to offer optimal performance. In the United Kingdom for example, the BGTI(6) programme calls for guaranteed increased reliability through a fifteen-year integrated support agreement for vehicle optronics equipment for the British Army.

In user services, Thales unveiled a new operational command training solution called SCOPE(7). Rather than acquiring simulation systems, customers use this innovative service to access personalised training exercises.

(1) BOA: Bulle Opérationnelle Aéroterrestre.
(2) LTO: Laboratoire Technico-Opérationnel.
(3) FIST: Future Integrated Soldier Technology.
(4) D2S2: Dutch Digitised Soldier System.
(5) IdZ: Infanterist der Zukunft.
(6) BGTI: Battle Group Thermal Imaging.
(7) SCOPE: Solution for COmmand Post Exercises.

2. C4ISR solutions for joint operations

C4ISR systems manage the entire intelligence and operational command chain, from data acquisition and processing to transmission of data to command centres, operational decision support, command communications and monitoring.

a. Secure end-to-end communications

Present in all segments from tactical- to strategic-level communication systems, Thales is positioned as an architect and integrator of comprehensive solutions, providing armed forces with the interoperability they need for secure end-to-end communications. The company offers modular solutions based on recognised standards, open architectures and dual technologies.

Infrastructure networks, military satellite communications and network security

Under the Socrate Stage 2 programme, Thales successfully delivered the BOP(1) Paris area optical loop, the first major contract milestone. This phase will ensure a smooth transition to IP technologies and broadband capabilities with no break in service.

In satellite communications, the NATO Consultation, Command & Control Agency (NC3A) selected Thales to supply jam-resistant modems. The Syracuse 3 milsatcom programme reached two key milestones in 2006 with successful completion of the system design phase and launch of the second satellite. Thales is prime contractor for the ground segment.

Terrestrial tactical communications

In tactical radios, Thales strengthened its international presence with notable successes including VHF radio contracts in Malaysia, HF radios for the Swiss Army and a contract to supply 9,000 V/UHF radios for US Army vehicles. Under the JTRS programme in the United States, Thales Communications Inc. delivered the world's first JTRS radio certified for compliance with the SCA standard (Software Communications Architecture). Deliveries of PR4G F@stnet radios continued apace in France and more than twenty other countries worldwide.

In tactical networks, Thales is pioneering the transition to IP technologies. In 2006, the French Army adopted and deployed the new IP version of the RITA network in various theatres of operations. German land forces selected Thales to develop secure intranet solutions for their tactical command posts. The new high-speed version of the TRC 4000 line-of-sight radio, already in service with France, Switzerland, Croatia and Austria, was selected to equip the Falcon future tactical network for British land forces. To protect this network, Thales will deliver a highly secure infrastructure comprising transmission systems and encryption to "secret" level. Falcon will use the new-generation Datacryptor system developed by Thales's Security division and scheduled for launch in 2007.

Air and naval communication, navigation and identification

As a global supplier of air and naval communication, navigation and identification (CNI) solutions, Thales equips and networks command centres and all types of platforms in the battlespace: combat and special mission aircraft, helicopters, UAVs and surface vessels.

In 2006, Thales launched a series of innovative products including the NextW@ve high-speed V/UHF airborne radio. Also in the airborne segment, Thales won new contracts with Morocco to retrofit CNI suites on Mirage F1 aircraft and with Norway, Denmark and the Netherlands for Link 16 tactical datalink programmes. In naval communications, the company won a new contract to supply the integrated communication system for the second batch of the UK Royal Navy's Type 45 destroyer as well as the SEA 1442 IP-based fleet intranet programme for the Royal Australian Navy.

Information system security

In 2006, Thales achieved numerous successes in this segment, including the CNG(2) new-generation voice encryption competition in France. Under this contract, the company will equip France's senior government authorities with fixed and mobile telephones offering a very high level of security. Thales was also selected for the ESA-led Galileo programme and is responsible for security architecture at all levels (system, segments, components). Also in 2006, Thales won contracts for three innovative studies in France and a NATO contract for next-generation IP encryption in Norway. These contracts are expected to lead to significant advances in multi-layer security, future-generation encryption components and IP security.

(1) BOP: Boucle Optique Parisienne.
(2) CNG: Cryptophonie de Nouvelle Génération.

b. Intelligence, surveillance and reconnaissance (ISR) systems

There is growing demand from military customers for ISR systems, which are used to acquire and process data in the upstream phases of the information chain. The division offers optronic acquisition, electronic warfare and communication systems, intelligence processing systems and secure, interoperable end-to-end systems.

Sensors: electronic warfare, communications and optronics

In electronic warfare, Thales delivers technologies for the integration and operation of ESM payloads (communication interception and direction finding) and ECM payloads (jamming, deception, intrusion).

In airborne optronics, Thales was selected in the United Kingdom to supply 200 *Pirate* infrared sighting systems as part of the second tranche of the *Eurofighter Typhoon* programme. In France, the *Reco NG* programme reached a new phase with the successful completion of key qualification tests. The first aerial reconnaissance images from the pod were transmitted and processed on the ground in real time.

For naval forces, Thales launched the Artemis infrared surveillance range for surface ships. Artemis has already been selected to equip the *FREMM* multi-mission frigates for the French Navy.

Information and intelligence processing systems

In 2006, the European Commission selected the consortium led by Thales to develop *Osiris,* the first integrated service of the *GMES* programme (Global Monitoring for Environment and Security). *GMES* will create an EU-wide capability to acquire, analyse, process and distribute information in support of European environment and security directives.

In South Africa, Thales was selected to supply an ISR capability for a complete battalion as part of the *Cytoon* programme.

c. Command and control

ISR systems pass information to command and control systems, which in turn use this data to support the planning and execution of operations at all levels of the command chain. Thales develops modular, interoperable and secure solutions based on common architectures and service platforms for land, air, naval and joint forces.

Strategic command and control

In 2006, Thales and EADS were appointed as prime contractors for the overall upgrade of the information and communication systems operated by the command centre in Paris. This joint forces information system will be used by 2,000 personnel in the French armed forces command chain and will enable France to supply a strategic-level allied staff headquarters to meet the aims of the European Union.

Theatre and tactical command and control

To support the move towards battlefield digitisation, Thales developed the Comm@nder range of command and control solutions. For land forces, Thales delivered Comm@nder solutions as part of programmes in Belgium, Canada, Spain and the United Kingdom, as well as for the *SICF*(1) programme in France. The French Army regularly uses the *SICF* system on international exercises. In 2006, Thales contributed to the success of two of these exercises: *Steadfast Jaguar* and *Citadel Readiness.*

For French naval forces, Thales is conducting the *SIC 21* programme to provide the French Navy with a next-generation command information system that will allow seamless integration with the C4ISR networks of other national and coalition forces.

d. Mission support and services

Thales provides through-life support for the C4ISR equipment and solutions it delivers. In France for example, the company is supporting the French Navy's *Dupuy de Lôme* intelligence vessel for electromagnetic surveillance operations and the French Air Force through the Transal Gabriel upgrade programme. Thales is also developing a range of high value-adding services including support for forces deployed in remote theatres.

(1) SICF: Système d'Information et de Commandement des Forces (command information system).

E. Naval

Key figures

In € m	2006	2005
Order book at year-end	4,715	4,796
Order intake	1,254	3,237
Consolidated revenues	1,330	1,484
Income from operations	100	150
Consolidated staff at year-end	4,415	4,764

Overview

With capabilities spanning the entire naval defence value chain – from sensors (radars, sonars and optronic equipment), communications and electronic warfare systems to combat system design and development and warship prime contracting – Thales is one of the world's leading naval contractors. The Group is also active in maritime safety & security (MSS) and naval services.

Since the end of the Cold War and the rise of asymmetric threats, the roles assigned to naval forces have been transformed. The focus has shifted from blue-water combat to force projection, deployment and support in remote littoral waters (recent examples include the Gulf, Afghanistan, Côte d'Ivoire and Lebanon) and coastal surveillance (including harbours, coastal and offshore areas).

Missions are, moreover, increasingly multilateral thus increasing the emphasis on the interoperability of both players and systems. The value of a warship's electronic systems as a proportion of total cost has risen steadily to the point where, for some warships, electronic systems now cost more than the platform and propulsion system combined.

The changing needs of client navies plus ever-tighter defence budgets are giving rise to new contracting arrangements. Increasingly, contractors must offer guaranteed levels of availability for their equipment and systems. They also have to expand international cooperation to achieve economies of scale by spreading development costs over more ships.

A number of key decisions taken in recent months will shape forthcoming cooperation programmes in Europe. These include:

- the launch in late 2005 of the first tranche of the Franco-Italian FREMM programme (firm orders placed for eight frigates for France and one for Italy). The programme – continental Europe's largest ever – calls for 27 multimission frigates (17 for France and 10 for Italy),
- increased cooperation between the French and British aircraft carrier projects following the 2006 agreement between the respective defence ministries to proceed with a joint study to tailor the British design to French needs. Thales is contributing to both projects. In France, it has a partnership with DCN[1] through joint venture MOPA2; in the United Kingdom, it is a member of the CVF Alliance comprising BAE Systems, KBR and shipbuilder VT, known as the ACA (Aircraft Carrier Alliance).

To date, these cooperation programmes have only given rise to project-specific alliances. Meanwhile, the continuation of concurrent national programmes has intensified the competition between European players on export markets. Beyond the national regroupings mentioned below, a process of Europe-wide restructuring that transcends national boundaries has yet to begin.

Competition

After a series of mergers and acquisitions in the United States, the front-runners in naval contracting are Lockheed Martin, predominantly an electronic systems provider, followed by Northrop Grumman and General Dynamics, both active in electronic systems and shipbuilding, and sonar specialist L3COM.

In Europe, the naval defence industry remains essentially national with each domestic industry highly dependent on orders placed by government entities.

As in the United States, European naval contractors include combined shipbuilder-integrators like DCN in France, Fincantieri in Italy, Navantia in Spain and the VT Group in the UK (also a service provider to the Royal Navy) and electronic system integrators like Thales and Finmeccanica. The UK-based BAE Systems group is vertically integrated and spans both shipbuilding and electronic systems while in Germany, shipbuilder TKMS took over submarine electronics specialist Atlas Elektronik in 2006. With the exception of BAE Systems, DCN and Thales, most are also active in commercial shipbuilding.

(1) See pages 26 and 96 the evolution, at the end of March 2007, of the Partnership between DCN and Thales.

Polish shipyards should also be mentioned. After many years of contracting exclusively for countries of the former Commonwealth of Independent States, these companies are now playing a growing role in European naval shipbuilding as prime contractors award more subcontracts for warship blocks and sections.

Other key players on the world market for naval contracting include Russian shipbuilders dealing through defence export agency Rosoboronexport. Yet other players include Chinese shipbuilders as well as Korean, Singaporean and Australian industrial and shipbuilding groups.

Against a backdrop of continuing budgetary constraints, the sheer number of naval shipbuilders in Europe is a strong argument in favour of consolidation. Several restructuring initiatives were completed or launched in 2006 and early 2007, including:

- in Germany, TKMS continued its vertical integration by taking over, in partnership with EADS, the submarine electronics businesses of Atlas Elektronik,
- in France, the Convergence agreement to combine French naval shipbuilder DCN and Thales France's surface naval activities, excluding equipment, was finalised in late March 2007. This agreement also gives Thales a 25% stake in DCN,
- in the United Kingdom, BAE Systems and VT announced in late 2006 that they were planning to merge their surface shipbuilding activities.

Development strategy

In geographical terms, Thales aims to further consolidate its position on European markets where demand remains strong while at the same time pursuing growth on key international markets, notably with the support of its large local subsidiary in Australia and in the United States where the Group plans to set up a joint subsidiary with an American partner specialising in sonars. The Thales-DCN alliance should further strengthen both partners' prospects on export markets.

In terms of products and capabilities and in response to growing customer needs in Maritime Safety & Security (MSS), the Group is investing in the development of small platforms, which are more agile and less expensive, and in advanced new-generation detection and effector equipment and systems (coastal radars, unmanned surface or underwater vehicles, also known as USVs or UUVs, and optronic, sonar and IFF systems). Thales is also keen to develop sophisticated decision-support systems to help different administrations to coordinate real-time operations through improved information sharing and analysis and tactical situation displays. With a view to further enhancing long-term interoperability, Thales is also developing open-architecture systems that simplify both new equipment integration and system-level upgrades.

Business review

Thales's naval capabilities cover the following four strategic areas:

- **warship prime contracting** covers A-to-Z programme development and management for all types of warships,

- **above-water systems include:**
  > information systems, command systems and combat systems plus the integration of a wide range of equipment (radars, sonars, optronic equipment, communications and electronic warfare systems), not least equipment supplied by other Thales units;
  > maritime security, including maritime traffic control, security solutions for restricted areas and the like, maritime surveillance and operations coordination;
  > simulators and network-enabled capabilities;

- **underwater systems** include sonar systems for submarines, surface combatants and aircraft, whether for surveillance, underwater warfare, mine countermeasures or civil defence and security,

- **naval services** include fleet and through-life support.

1. Warship prime contracting

The transfer of programme responsibilities from procurement agencies to defence contractors with proven expertise in prime contracting and systems integration – a clear trend in naval procurement in recent years – was further confirmed in 2006. In their efforts to reconcile budgetary constraints and operational requirements, customers also expect industry partners to commit to operational performance, delivery dates and programme costs. One approach adopted by procurement agencies is to appoint a Lead System Integrator for all shipboard system integration.

Thales is one of the world's leading players in warship prime contracting and naval system and equipment integration with a proven track record in A-to-Z programme management and the associated contractor logistic support.

In 2006, the Group continued to make good progress on the modernisation of four *Adelaide*-class frigates in Australia. Thales also continued to provide guarantee follow-up services for the three frigates delivered under the *Sawari 2* programme and now operational in Saudi Arabia.

Subsequent to the completion of the *MINREM*[(1)] contract and the commissioning of the *Dupuy de Lôme* in June 2006, the Group signed a five-year through-life support contract.

Following the award of the first tranche of the *FREMM* programme in late 2005 for the delivery of eight frigates to the French Navy and one to the Italian Navy, Thales moved into the launch phase of this large-scale programme in 2006. In addition to its contributions, in close partnership with DCN, to warship and combat system prime contracting, Thales will supply a range of electronic equipment.

Turning to the French *PA2* and British *CVF* aircraft carrier programmes, Thales was awarded several study contracts, including one to identify areas of potential cooperation between the two programmes.

In France, Thales and partner DCN submitted a bid for the construction of the *PA2* carrier in late 2006. The main contracts are expected to be awarded in 2007.

2. Above-water systems and equipment

Demand for above-water systems and equipment for operational missions remains strong.

Thales above-water combat systems meet the full range of operational requirements and are designed to support the ongoing process of battlespace digitisation. These powerful, highly optimised, open-architecture "systems solutions" perform surveillance, command and combat functions while deploying weapon systems by US and European manufacturers.

In naval sensors, Thales is focusing on the *Smart-S Mk 2* E/F-band volume search radar specially redesigned for littoral environments, the *APAR* multifunction active phased-array radar, the new Herakles multifunction radar developed largely for the *FREMM* frigate programme and the new-generation *MRR (Multi-Role Radar)* 3D NG medium-range radar for missile system fire control, among other applications. Another important activity is the *LRR (Long Range Radar)* family selected for all new-generation European air defence frigates with a first-layer Tactical Ballistic Missile Defence (TBMD) capability. Thales contributed to the success of the first live anti-missile test, conducted by the US in late 2006, by providing the *Smart-L* early warning radar. The Thales product portfolio also includes airborne and joint forces equipment and competitive naval communications, optronic and electronic warfare systems. New orders for these products were received in 2006 with installation continuing on numerous ship types.

In 2006, Thales won a contract with Spanish shipbuilder Navantia to supply combat systems for four new corvettes and four patrol boats for an export customer. Thales is responsible for combat system integration and performance and for navigation and communications equipment. The Group also won contracts to install anti-air combat systems aboard three flexible patrol ships for Denmark and to supply combat systems for three corvettes for Oman.

In 2006, Thales expanded its range of comprehensive solutions for the fast-growing maritime surveillance sector with solutions for coastal and offshore areas and harbours. The Group also signed a partnership with Finmeccanica of Italy as part of the European *Seasame* project.

3. Underwater systems and equipment

Demand for underwater systems and equipment remains strong, not only for the FREMM and other surface fleet programmes mentioned here, but also for the Barracuda new-generation nuclear-powered attack submarine programme for the French Navy and the Scorpene conventional submarines sold to international customers by joint Thales-DCN subsidiary Armaris.

There is also strong demand for underwater systems and equipment for aircraft, particularly anti-submarine warfare (ASW) helicopters for North American and European customers.

Mine warfare, sonars and mine countermeasures (MCM) continue to make greater use of robotics. First-generation unmanned underwater vehicles (UUVs) are already available. These are typically carried to the target area by boat or helicopter, launched, remotely controlled during the mission, then recovered. Mission data is analysed either on board the host vessel or by a shore centre.

The aim now is to deploy fully autonomous underwater vehicles (AUVs) within ten years. AUVs will carry expert systems to conduct complete missions and respond to situations as they arise. Without putting human lives at risk, these force multipliers will use a single platform to deploy networked sonars, whether towed, remotely controlled or autonomous, thereby significantly increasing mine count-

(1) MINREM: Moyen Interarmées Naval de Recherche Electromagnétique (Strategic information vessel).

er-measures efficiency, speed and safety. Smart new-generation of UUVs and AUVs will rely on standardised platforms offering cost-effective multimission capabilities.

For the underwater battlespace, Thales offers a range of sonars for conventional and nuclear-powered submarines, surface combatants, MCM vessels and torpedoes as well as dipping sonars for ASW aircraft. One highly effective ASW combination uses the type *2087* towed sonar in tandem with the *Flash* dipping sonar.

Thales is also a major supplier of submarine periscopes and the non-penetrating optronic masts that are beginning to replace them. In particular, Thales developed and now produces the visual system for the UK's new *Astute* class.

Thales is further developing its capabilities in the emerging UUV segment in partnership with several European platform manufacturers.

In 2006, French authorities awarded Thales an advanced UUV study contract and the sonar contract for the *FREMM* frigate programme. In the UK, the Group won a contract to upgrade undersea warfare equipment on Royal Navy vessels. This contract will give Thales its first opportunity to deliver an open system architecture for sonar systems. In the United States, following the preproduction contract for *ALFS*(1) dipping sonars for US Navy's *MH60R* multimission helicopters, Thales put the system into production. The Group was also selected by Lockheed Martin to upgrade the acoustic systems of 30 *Merlin* helicopters. In France, Thales completed the factory acceptance testing of the SYCOBS combat system for SSBN *Le Terrible* six months ahead of schedule.

In torpedoes, EuroTorp successfully completed a number of test firings of the *MU90* lightweight torpedo. EuroTorp is a joint venture (EEIG, or European Economic Interest Grouping) set up by Thales, DCN and Finmeccanica subsidiary Wass.

4. Naval services

In recent years, demand for services has grown as navies, following the example of other branches of the armed forces, have begun to optimise spending by outsourcing certain tasks.

Two main types of outsourcing arrangements are emerging: maintenance of a complete family of equipment or subsystems (radars, sonars, etc.) or maintenance of all the equipment on a given platform type (aircraft carrier, frigate, SIGINT vessel, etc.). In either case, the contractor guarantees a given level of equipment or platform availability.

After focusing on the maintenance of electronic equipment, contractor support now extends to through-life support for systems, complete platforms and even entire fleets. Thales acts as prime contractor for fleet support contracts, working with specialised partners.

In 2006, Thales signed a contract with French shipbuilder CMN for through-life support services for the French Navy's MINREM signals intelligence vessel *(Dupuy de Lôme)*. In 2006, Thales also refitted, in just three and a half months, French Navy frigates *Nivôse* and *Floréal* in partnership with co-contractors based on Réunion island and elsewhere in the Indian Ocean.

Thales also joined forces with Chilean shipyard Asmar to support electronic systems and equipment carried by the Chilean Navy's *Type L* and *Type M* frigates as well as its *Type 22* class vessels.

The SIGLE logistic information and management system developed by Thales was installed on a number of French Navy ships in 2006. This system is proposed to export customers under the *OASIS*(2) name.

In 2006, Thales signed a contract through local subsidiary Thales Australia to provide support services for Royal Australian Navy's minehunters. The Group's Naval Services business now has a truly international dimension that draws on the combined expertise of various subsidiaries to exploit new commercial opportunities and optimise synergies.

In 2006, Thales also won a contract in partnership with DCN to provide guaranteed-availability through-life support for the French Navy's 13 Éridan-class tripartite minehunters.

In the UK, the Contractor Logistic Support (CLS) contracts already in place for sonar systems were extended to communication masts.

(1) ALFS: Airborne Low-Frequency Sonar.
(2) OASIS: Onboard Ashore Support Information System.

F. Security

Key figures

In € m	2006	2005
Order book at year-end	1,178	874
Order intake	1,525	1,421
Consolidated revenues	1,205	1,186
Income from operations	68	55
Consolidated workforce at year-end	5,248	5,516

Overview

Thales has leveraged its long-standing involvement in defence markets to become one of the major specialised security players in Europe for civil, government and business customers.

To address growing demand for safety and security solutions, Thales has developed a comprehensive range of civil and homeland security systems, together with critical infrastructure control and protection systems. The Group's offering includes security products such as payment terminals and cryptographic devices. The Security division also manufactures professional electronic tubes and devices and is the world's leading supplier in this field.

The division's scope of business underwent a major change in 2006 following the disposal of Thales Navigation, which provides GPS equipment for consumer leisure and automotive applications under the Magellan brand name(1). The Security division has now withdrawn from almost all non-strategic sectors, enabling it to focus on professional electronic applications.

Thales security solutions protect governments, citizens, critical infrastructure and information systems from terrorist acts and organised crime, and guard against infrastructure incidents and natural disasters. Their main applications are:

- critical infrastructure control, supervision and protection:
  - > energy sector (oil &gas, electricity);
  - > ground transportation;
  - > airports;
  - > banking & Finance;

- large event protection.

The division also acts as prime contractor for security and safety operations centres for the fire, police and ambulance services and crisis management centres.

This comprehensive offering for government and enterprise customers is marketed under the Thales SHIELD™ name.

Business review

1. Security systems

Leveraging its extensive experience as a systems integration and security specialist, Thales has developed a complete portfolio of safety and security solutions for civil administrations and the protection of sensitive sites and mission-critical infrastructure.

In these markets, Thales provides comprehensive services ranging from global security consulting, architecture definition and complex systems integration to turnkey solutions including the design, installation, operation and maintenance of complete security systems.

In 2006, Thales strengthened its position in the security systems market with the acquisition of SVS, a company formed from the Security division of the Enertec Group and specialising in turnkey in-vehicle videosurveillance solutions.

In the secure identification market, Thales was part of the consortium led by Imprimerie Nationale to launch France's first e-passports, providing the graphic and electronic data

(1) Revenues from the Navigation business, which amounted to €224 million at 31/12/05 and €113 million in the first half of 2006, are included in the Security Division's key figures.

personalisation system for the new passport. Thales's availability and responsive approach to this large-scale national project was a significant factor in helping to manage production peaks in the first few months.

In the sensitive site protection market, Thales was awarded a contract in 2006 to modernise the security systems at Fleury-Mérogis men's prison, Europe's largest penal establishment.

In addition, Thales delivered a computerised system to aid decision making and manage emergency situations to the Val d'Oise district fire and emergency services. With the new system, firefighting and emergency crews are able to provide a faster and more effective response.

For airports, Thales launched a new safety and security offering in 2006 and notched up its first significant success with a major contract from a large international airport in the Middle East for the supply of critical systems integration spanning networks and security. Thales will install dedicated safety, security and telecommunications infrastructure in both the terminal and the airport's main buildings.

In site protection in the energy sector, Thales was awarded a contract in 2006 from a major energy supply company to install security solutions on its gas pipelines. The contract covers protection of numerous sites, including the company's head office, compressor stations and terminals.

Under the French government's Biotox/Piratox CBRN response programme, Thales won a contract to develop a mobile laboratory vehicle for deployment in areas contaminated by biological or chemical agents. The vehicle allows operators to gather data on the actual and potential hazards encountered. The vehicle was handed over to the national CBRN unit of the French Gendarmerie Nationale in 2006.

In the communication infrastructure market, Thales' security subsidiary in Saudi Arabia won a major contract for the design and deployment of a fibre-optic backbone network for the Etihad Etisalat group, which operates the country's second largest GSM network. Other contracts were also awarded by ITC and Bayanat, two service providers for Kingdom of Saudi Arabia.

2. Transport & Energy

Thales specialises in the deployment of intelligent, high value-added solutions for the public transport and road transport markets. The Group provides a comprehensive range of solutions for the transportation of people and goods integrating shared technologies. Activities include ticketing, supervision and control, communication and security systems, traffic management, fleet management and passenger information systems, electronic road toll collection, urban traffic management and public car park management.

In 2006, Thales consolidated its global leadership in integrated ticketing based on contactless technology and multimodal, interoperable solutions with contract wins in regions around the world.

As part of the metro refurbishment programme in the Chinese capital Beijing, Thales was awarded a contract to supply secure integrated ticketing for lines 1, 2 and 8, which are scheduled to enter service in time for the Summer Olympic Games in 2008.

In Canada, Thales was named the subcontractor to supply a secure integrated ticketing system for the Greater Toronto Area as part of a ten-year contract awarded to Accenture by the Ontario Ministry of Transportation. Representing a strategic breakthrough for Thales in the North American transport market, the contract includes the design, production, installation, support and administration of the system that will involve nine municipalities, with a total of 2,000 vehicles on the city's bus, metro and train networks.

In Dubai, Thales was awarded a contract to supply a secure ticketing system for the city's new metro system being built to meet growing transport demand. The system includes the installation of access gates, ticket vending machines, computer workstations and a central control system at the 45 stations across the network.

In the Netherlands, within the scope of the consortium led by Vialis and Accenture the Group continued deployment of the extensive integrated ticketing system as part of the programme launched in 2005. Once deployment is completed, the Netherlands will be the first country in the world to offer an integrated nationwide system that allows passengers to use a single contactless ticket to travel across urban and regional transport networks run by several different operators.

Leveraging the same technology, Thales is also delivering Europe's second secure nationwide e-ticketing scheme for Danish transport operators.

In Italy, Thales completed the refurbishment of access gates and ticketing systems for line 1 of the Turin metro ahead of schedule and in time for the 2006 Winter Olympic Games.

In 2006, the Siemens-Thales consortium was awarded a contract by the Dominican Republic's transportation department to supply electro-mechanical equipment for Santo Domingo's first metro line. Thales will provide the supervision systems comprising the station control and operations control centre, telecommunications and SCADA (Supervisory Control and Data Acquisition). The contract also covers the supply of access control and contactless fare collection systems.

Another strategic areas of development is electronic road toll collection solutions. Thales is actively contributing to current thinking in this area. In 2006, the Group was awarded the contract to act as prime contactor for the deployment of Next-Generation Motorway Toll Lanes by French motorway operator Autoroutes du Sud de la France.

In the energy sector, governments and pipeline operators are under more pressure than ever before to ensure security of supply. Thales offers a range of fully integrated supervision solutions to protect energy transportation networks against theft and terrorist attacks as well as routine operating risks. In 2006, Thales won a new contract from Gazprom for the refurbishment of gas pipeline supervision and network control systems in the Saratov region of Russia, which is crossed by one of the main gas pipeline networks supplying western Russia and Moscow in particular.

3. E-Transactions

Thales e-Transactions delivers user-friendly solutions that secure electronic card transactions. As one of Europe's leading providers of secure electronic payment solutions, Thales provides fixed, portable and mobile payment terminals, integrated payment solutions, unattended payment devices, secure PIN pads for ATMs and terminal management systems.

Orders for these solutions increased significantly in 2006 with a large number of contracts awarded worldwide, especially in Europe.

In 2006, Thales consolidated its position as the exclusive, long-term supplier of secure EPP pads (Encrypting PIN Pads) to Wincor Nixdorf International, an IT solutions provider for banks and retail outlets. Under the agreement, Thales will continue to deliver EPP PIN pads, including a new generation of products, to Wincor Nixdorf through to 2010.

Also in 2006, Thales delivered its 250,000th Artema Compact payment terminal, barely two years after its launch. Artema Compact is used by banks, retail groups and other operators in Europe, the Middle East and Latin America.

Thales bolstered its presence in the Middle East in 2006, spurred by growing demand as the region enters the era of electronic payment. The Group's successes include three major contracts to supply Artema terminals to customers in Kuwait, Yemen and the United Arab Emirates.

In 2006, Thales acquired the remaining equity stake in its Swedish joint venture Thales-Manison e-Transactions in order to grow its electronic card payment market in Sweden and other Nordic countries, especially in the Baltic region.

4. E-Security

Thales is a world leader in the provision of cryptographic security products and solutions for all critical infrastructures, supplying businesses, governments and the finance industry. The Group's portfolio spans authentication security, card payment security and network security.

Thales has 40 years of unrivalled track record with governments and defence customers in providing cryptographic products and solutions approved up to "top secret". Thales offers customised, robust intrusion-prevention solutions to ensure complete data security, along with a comprehensive range of ready-to-use, fully scaleable products.

In the financial sector, Thales has over 30 years of expertise in data security solutions for high-value electronic funds transfer. Over half of the world's banks, together with the majority of the busiest exchanges, currently use Thales technology.

Thales is also a leading provider of strong authentication solutions and a key contributor to the development and implementation of these solutions for all applications. In recognition of Thales' contribution to the fight against cyber crime relating to commercial and bank transactions, the Group won The Banker 2006 Technology Award for its *SafeSign* solution deployed as part of Sweden's BankID service. BankID enables Swedish bank customers to authenticate and electronically sign their transactions in total security via the internet.

Following its launch of a number of products for high-speed broadband applications, in 2006 the Group notched up several successes in the United States including a major contract awarded by the Joint Hawaii Information Transfer Service, a data transmission system serving over 60 U.S. military bases in Hawaii, for its Datacryptor SONET high-speed encryptor.

In Europe, Thales was awarded a series of major contracts for Europe's Galileo global satellite navigation programme covering authentication, access control and data confidentiality to ward off all types of attack.

Thales also expanded its presence in secure authentication markets in Asia-Pacific with contracts from local banks for high-security solutions to improve online banking services.

5. Components and subsystems

Thales provides two main categories of products:

- x-ray detectors, for integration into state-of-the-art medical imaging equipment, designed to deliver excellent image quality and ensure accurate diagnoses,

- electronic tubes and transmitters, which amplify radiofrequency and hyperfrequency power for advanced applications in such areas as space, telecommunications, defence, radio and TV broadcasting, scientific research and industrial processes.

In 2006, the Group consolidated its leadership in these segments in the Asian markets and maintained solid positions in the American and European markets, despite competition from US and Japanese manufacturers, which benefited from weaker currencies.

Thales merged its high-power transmitters, components and subsystems activities in 2006, giving the Group a strong worldwide base for marketing travelling wave tube components and subsystems, which are deployed extensively in radar, countermeasure and telecommunication applications.

In the space sector, Thales achieved an excellent order intake in 2006. The Group is involved in several major programmes and actively contributes to the development of telecom, television broadcasting, broadband internet and scientific solutions. Thales solutions are deployed on both commercial and military satellites covering all regions of the globe.

The Group also contributes directly to scientific developments and in 2006 was selected to supply power amplification solutions in such advanced areas of scientific research as thermonuclear fusion and particle accelerators.

Thales medical radiology solutions experienced strong growth in 2006. Sales increased and production capacity was significantly expanded to meet demand in international markets.

Trixell, a joint venture between Thales Electron Devices (51%), Philips (24.5%) and Siemens (24.5%), also performed well in 2006. The company has set the standard for new-generation digital radiological detectors, which convert x-ray signals into digital images. Trixell sold its 10,000th digital detector, ranking it number one in this segment. Frost & Sullivan, whose awards are considered global benchmarks, selected Trixell as the recipient of the 2006 Frost & Sullivan Award for Global Excellence of the Year in digital radiography detector technology.

Thales' sales to radiology equipment manufacturers advanced significantly in 2006 following the development of software solutions which provide ready-to-integrate medical imaging functionalities.

The Group's joint venture in China established in 1996 with Shanghai Medical Instruments continued to develop. The company is now the leading manufacturer of x-ray imaging components in the fast-expanding Chinese market.

G. Services

Key figures

In € m	2006	2005
Order book at year-end	1,919	1,845
Order intake	1,304	1,101
Consolidated revenues	1,214	1,184
Income from operations	81	80
Consolidated workforce at year-end	10,172	10,296

Overview

The Services division offers four main types of expertise:

- **training and simulation:** supply of pilot training simulators (for military, civil, transport and combat aircraft and helicopters) and associated services including comprehensive training and equipment maintenance,
- **consulting and engineering:** upstream organisational consulting, change management, process and project management, and engineering consulting and assistance-to-owner services,
- **facility management and maintenance:** management of operations related to administrative buildings and production facilities,
- **IT outsourcing and services:** responsibility for customers' information systems, including consulting, integration and operation (management of both infrastructures and applications).

The division leverages the Group's traditional core businesses to provide through-life support services for the equipment and systems it supplies. It is also developing a services offering in other sectors to address the emerging needs of Group customers.

Facing tight budgets and staff reductions, the division's customers, both governmental and major institutions in the private sector, are seeking to optimise their resources. As a result, they are outsourcing an increasing number of tasks and introducing new technologies to increase productivity.

Thales's services offering is designed to help them meet these challenges, through both consulting and the supply of innovative technologies, methods and products. In addition, the Services division offers integrated services solutions including everything from needs assessment to service delivery, and manages every link in the chain to guarantee performance.

This integrated approach to service provision offers customers a single point of contact and has been well received by the civil administrations, armed forces, public and private enterprises, and banking organisations that make up the division's traditional customer base. With its experience on long-term projects, Thales has also gained recognition as a dependable partner, strengthening its positioning in this new and growing market.

With operations in more than ten countries, the Services division generates more than half its revenue outside France. Through this multidomestic presence, a distinctive characteristic of the Thales group as a whole, the Services division has a clear vision of industry best practices in each of its countries of operation and can provide its international customers with a unified offering and tailored local support.

The organisation of the Services division is aligned with its customers' businesses:

- Defence and Aerospace,
- Civil administration,
- Enterprise and Finance.

Business review

1. Defence and aerospace

Defence and aerospace customers benefit from all the Services division's areas of expertise. A large proportion of the division's business in this sector involves simulation and training services for civil and military aircraft, as well as civil and military land vehicles. A new European directive advocating continuing training for European truck and bus drivers has boosted demand for simulation-based training for land vehicle operators. Thales has developed an offering aimed specifically at meeting this demand and has already booked a number of major contracts in this emerging market.

The rebound of air traffic brought a strong increase in demand for commercial pilot training, making 2006 a record year for the division's civil simulator sales.

In particular, Thales was selected by Alteon, Boeing's pilot training arm, to train the crews of the future B787 Dreamliner. In addition, Boeing and Thales have signed a long-term cooperation agreement for the future development of simulation and training systems. And, with the sale of two new full-flight simulators for the Boeing 737NG, Thales confirmed its position as a key supplier for this type of aircraft in the Chinese market: in four years, Thales has won six full-flight simulator contracts with customers such as Shangai Airlines, Hainan Airlines, Shenzen Airlines and Sichuan Airlines.

Thales is also establishing itself as a supplier of simulators to regional airlines, achieving two major successes with aircraft manufacturer Sukhoi, for its Russian Regional Jet, and with India's Kingfisher Airlines.

The Spanish defence ministry has selected Thales to implement the future secure unified messaging system for its armed forces, called SIMENFAS. Developed in partnership with Spanish telecoms operator Telefónica, this new military messaging system will provide the three armed forces with a high-performance digital communication system that is fast and reliable, easy to access by all personnel, easy to deploy in remote theatres and interoperable with NATO systems.

Lastly, in Australia, Thales secured the renewal of its contract to manage the munitions supply chain for the Australian Army's main military bases.

2. Civil administration

Demand is growing in most of the Services division's countries of operation. For example, in France improving efficiency in public services administration is a major element of efforts to reform government. The public sector is engaged in a far-reaching modernisation programme with the dual aim of simplifying the relationship between government and its citizens through appropriate use of new technologies, and optimising service delivery as budgets shrink. Thales aims to provide civil administrations with consulting services and customised solutions to help them achieve these transformations.

Thales brings government customers key competencies, a solid background and an offering built on excellence in IT outsourcing, security, networks and secure architectures.

Thales is a founding member of NESSI (Networked European Software and Services Initiative), an association of major European IT companies launched in September 2005 and backed by the European Union. NESSI intends to drive future European research in software- and service-oriented architectures. By developing innovative technologies around recognised standards and open-source software, the project aims to enhance the safety, security and well-being of European citizens.

Today, under the leadership of Thales, 22 major industrial contractors, SMEs and universities are working together within NESSI to pool their research efforts toward this objective.

The division's major contract awards in 2006 included:

- In France, a new contract under the programme to upgrade the tax authority's Copernic information system. This programme will provide taxpayers with a complete set of online tools for managing their tax accounts aimed at securing, simplifying and radically overhauling their relationship with the tax authority. Thales previously developed the *www.impots.gouv.fr* French tax portal.

  The new contract awarded to Thales in 2006 includes the definition and application of a general security policy for the Copernic programme, with specific modules dedicated to digital document security and the servers that manage electronic certificate validity. It is one of the biggest IT security consulting and assistance-to-owner contracts ever awarded in France.

- In the United Kingdom, a new contract with Network Rail to maintain the entire operational telecommunications infrastructure of the UK railway system.

- In France, a contract as a member of one of the six consortia selected for the test phase of the DMP personal medical record project, in partnership with Cegedim. Records will be accessible over the Internet and contain data that all health professionals will be able to share. The prototyping phase, led by Thales-Cegedim, involves 5,000 records in two regions of France.

  To meet the stringent security and confidentiality requirements of this project, the consortium is implementing a security solution embedding high-level authentication, optimised Web security and digital signatures.

3. Entreprise and finance

One of the major components of the Thales offering is mission-critical IT outsourcing, which involves taking charge of information systems that are essential to a customer's business. This high-end service calls for 100% reliability, because the customer's ability to do business depends on it. Customers view Thales's experience with the necessary technologies and processes as a valuable safeguard and a basis for sustainable trust-based relationships.

In Germany, the Services division won an outsourcing contract in 2006 to provide full IT infrastructure management to Gossen, including the provision of a service desk and hosting, network and desktop services.

In France, the national space agency CNES decided to outsource its IT infrastructure, networks and telecommunications to Thales, which has partnered with Steria to take on this ambitious outsourcing project. The partners will assume responsibility for the agency's IT infrastructure, reprographics, telecommunications and help desk, as well as supporting risk management.

In the United Kingdom, as part of a strategic alliance, Thales signed a major IT outsourcing contract with EWS (English Welsh and Scottish Railway Ltd.), the largest rail freight operator in Britain, to supply a 24/7 help desk and network, server and desktop computing services to all EWS companies.

Lastly, the Services division also continued to develop its supply chain management and product data management offerings, which will be a major area of focus for the years ahead.

II – International presence

Exports have historically played a major role in the business of Thales. With the expansion of its **"multidomestic" operations** since the 1990s, however, the Group has taken its international dimension to a new level, as the statistics below illustrate.

France remains the largest country of operation, French subsidiaries generate worth more than 50% of 2006 revenues (52% in 2006) and employ about 55% of the consolidated staff (56% in 2006). France is also the largest country of destination: between 25% and 30% of revenues have been invoiced to France-based customers during the last five years. Today, international subsidiaries account for close to half of all Group sales. Thales UK, one of the largest of these subsidiaries, generated 16% of the total in 2006. Thales North America Inc. and Thales Australia, accounted for 9% and 5% of 2006 consolidated revenues, respectively.

The developments of 2007 will contribute to this expansion of the company's international dimension: the transport and security businesses contributed by Alcatel-Lucent employ close to 3,500 people, all of them based outside France. About 2,700 (78%) of these employees are based in continental Europe, mainly Germany (1,400) and Spain (520), while 780 (22%) are based in North America, mainly in Canada. Roughly half of the workforce of the satellite businesses acquired in 2007 (Thales Alenia Space and Telespazio, which are 67% and 33% owned by Thales, respectively) is based outside France.

A. International presence in figures

In € m		France	United Kingdom	Netherlands	Other Europe	United States	Australia	Rest of world	Total
2006	Revenues by destination	3,064	1,342	274	1,805	952	459	2,368	10,264
	Revenues by origin	5,365	1,620	401	830	934	500	614	10,264
	Consolidated staff	*29,180*	*8,524*	*2,020*	*5,080*	*2,241*	*3,335*	*1,780*	*52,160*
2005	Revenues by destination	2,995	1,242	230	1,937	934	486	2,439	10,263
	Revenues by origin	5,541	1,567	384	855	824	512	580	10,263
	Effectifs consolidés	*29,835*	*8,921*	*2,294*	*4,908*	*2,228*	*3,226*	*1,636*	*53,047*
2004	Revenues by destination	2,958	1,338	236	1,730	788	486	2,746	10,282
	Revenues by origin	5,744	1,640	402	834	619	530	513	10,282
	Consolidated staff	*30,872*	*9,810*	*2,396*	*5,267*	*1,946*	*3,178*	*2,236*	*55,705*
2003	Revenues by destination	2,774	1,242	314	1,754	822	479	3,184	10,569
	Revenues by origin	5,841	1,725	413	826	606	568	590	10,569
	Consolidated staff	*32,219*	*10,521*	*2,415*	*5,214*	*1,884*	*3,243*	*1,943*	*57,439*
2002	Revenues by destination	2,602	1,461	197	1,852	1,029	499	3,465	11,105
	Revenues by origin	5,904	1,919	433	802	853	578	616	11,105
	Consolidated staff	*33,236*	*11,478*	*2,608*	*5,183*	*2,269*	*3,206*	*2,682*	*60,662*

Note. Revenues for 2002 and 2003 are reported according to French accounting standards. The figures for 2004,2005 and 2006 are reported according to IFRS standards.

Consolidated staff figures include all employees of fully consolidated companies and prorated figures for companies carried under the proportionate method (52,160 at end-2006 for the whole Group). This does not include staff working for companies carried under the equity method or for non-consolidated companies.

Employees **working under Group management were 56,847 people** at the end of 2006 (57,810 at end-2005). This figure is higher than the consolidated workforce because it includes all employees of joint ventures and of companies that are controlled but not consolidated for reasons related to consolidation criteria.

1. Breakdown of revenues by country or region of destination

In € m	2004	%	2005	%	2006	%
France	2,958	*29%*	2,995	*29%*	3,064	*30%*
United Kingdom	1,338	*13%*	1,242	*12%*	1,342	*13%*
Other Europe	2,129	*20%*	2,167	*21%*	2,079	*20%*
Total Europe	**6,425**	***62%***	**6,404**	***62%***	**6,485**	***63%***
North America	896	*9%*	1,067	*10%*	1,192	*12%*
Near & Middle East	1,183	*11%*	884	*9%*	617	*6%*
Asia-Pacific	1,392	*14%*	1,537	*15%*	1,577	*15%*
Africa and Latin America	386	*4%*	371	*4%*	393	*4%*
Total international	**3,867**	***38%***	**3,859**	***38%***	**3,779**	***37%***
Total	**10,282**	***100%***	**10,263**	***100%***	**10,264**	***100%***

2. Major operational subsidiaries

The companies listed below are wholly owned subsidiaries of Thales Parent Company.
Revenue figures correspond to each subsidiary's contribution to consolidated revenues (excluding intra-company sales).
Data as at 31 December 2006.

Thales Air Systems SA

Air traffic management systems, ground-based detection systems and missile control systems.

Registered head office	7-9 rue des Mathurins – 92220 Bagneux – France
Sites	Bagneux (Rungis as for April 2007), Fleury-les-Aubrais, Limours, Rouen Ymare
2006 revenues	€547 m
Employees at end-2006	2,379
Shareholdings (selected)	50% of Cosyde, 77.5% of Thales Systems Ireland Ltd, 50% of MOSS SAS, 33.33% of Eurosam

Thales Avionics SA

Flight electronics

Registered head office	45 rue de Villiers – 92200 Neuilly-sur-Seine – France
Sites	Bordeaux-Le Haillan, Châtellerault, Chatou, Méru, Conflans, Meudon, Moirans, Toulouse, Valence, Vendôme
2006 revenues	€757 m
Employees at end-2006	4,095
Shareholdings (selected)	100% of Thales Avionics Asia Pte Ltd, 100% of Thales Aerospace (Beijing) Co., 99.99% of Thales Avionics LCD SA, 49% of Diehl Avionik Systeme GmbH, 34.64% of Thales Canada Inc., 25% of OEM Services SAS

Thales Communications SA

Communications & Command information systems

Registered head office	160 boulevard de Valmy – 92700 Colombes – France
Sites	Colombes, Massy, Cholet, Laval, Brive, Lille-Lambersart
2006 revenues	€924 m
Employees at end-2006	4,688
Shareholdings (selected)	100% of Arisem, 50% of Sapura Thales Electronics (Malaysia), 33.28% of TAC ONE, 25% of Euromids

Thales Systèmes Aéroportés SA

Mission airborne systems; airborne radar, electronic warfare and missile electronics equipment and systems

Registered head office	Centre Charles Nungesser 2 avenue Gay-Lussac – 78990 Elancourt – France
Sites	Elancourt, Brest, Pessac
2006 revenues	€891 m
Employees at end-2006	4,082
Shareholdings (selected)	50% of Ericsson-Thales-AEW-System, 50% of Consorzio Sigen, 50% of Astrac, 49% of Cert Thales Institute, 16% of TCAR Industries GmbH, 6.86% of 6Wind

ADI Ltd

Defence systems

Registered head office	Potts Point – NSW2011 Garden Island – Australia
Site	Garden Island
2006 revenues	€396 m
Employees at end-2006	2,651
Shareholdings (selected)	100% of ADI Munitions Pty Ltd, ADI Engineering & Vehicles Pty Ltd

Thales UK Ltd

Defence systems

Registered head office	2 Dashwood Lang Road – KT15 2NX NR Weybridge – United Kingdom
Sites	Crawley, Wells, Reading
2006 revenues	€406 m
Employees at end-2006	2,039
Shareholdings (selected)	100% of Thales Telecom. Services Ltd, Thales Optronics Ltd, Thales Underwater Systems Ltd, Thales Air Defence Ltd, Thales Avionics Ltd, Quintec Associates Ltd, 49% of UAV Tactical Systems

Thales Nederland BV

Defence systems

Registered head office	Zuidelijke Havenweg 40 – 7554RR Hengelo – Netherlands
Sites	Hengelo, Delft
2006 revenues	€397 m
Employees at end-2006	1,967
Shareholdings (selected)	50% of ET Marine & Systems GmbH, 100% of Thales Cryogenics BV, NCSS (Malaysia)

3. Major manufacturing sites

The following workforce figures refer to employees under Group management and include all employees of proportionately consolidated companies.

At 31 December 2006, 58% of employees in France worked at sites in the Île-de-France (Paris) region[1], well ahead of the Southwest (13% of the total) and Rhône-Alpes, Centre and Brittany (about 6% each) and Provence-Alpes-Côte d'Azur and Pays de Loire (between 4% and 5% each).

Fourteen sites (including neighbouring sites in the same area) with more than 1,000 employees at end-2006 accounted for 47% of total managed staff throughout the world:

At 31 December 2006	Employees	Subsidiaries
In France	**17,686 (57.5% of workforce in France)**	
Colombes	3,050	Thales Communications SA
Elancourt	2,411	Thales Systèmes Aéroportés SA Thales Services SA
Bagneux	1,568	Thales Air Defence SA Thales Naval France SA Thales Services SA
Bordeaux	2,080	Thales Systèmes Aéroportés SA Thales Avionics SA
Brest	1,444	Thales Systèmes Aéroportés SA Thales Underwater Systems SA
Massy	1,194	ThalesRaytheonSystems Thales Communications SA ACSI Thales Avionics SA
Malakoff / Montrouge	2,606	Thales Services SA Facéo
Meudon la Forêt / Vélizy	1,940	Thales Avionics SA Thales Electron Devices SA Thales Security Systems SA
Toulouse	1,393	Thales Avionics SA Thales Services SA
In the United Kingdom	**2,980 (34% of workforce in the UK)**	
Crawley	1,608	Thales Defence Ldt Thales Training & Simulation Ltd
Reading	1,372	Thales Telecom Services Ltd Thales Research Ltd
In Australia		
Garden Island	2,651	ADI Ltd
In the Netherlands		
Hengelo	2,020	Thales Nederland BV
In Spain		
Barcelona	1,175	Thales Information Systems
Total employees at named sites	**26,512 (47% of employees under Group management)**	

(1) The regions mentioned below correspond to the French legal definition of an "employment area".

B. International operations

The Group expanded only marginally outside France before 1990, when it acquired the Dutch company Hollandse Signaalapparaten (Signaal, now Thales Nederland), a world leader in naval combat systems, from Philips. Since then the Group has extended its presence in Europe, mainly in defence and aerospace, through acquisitions and equity investments primarily in the United Kingdom. In the late 1990s, the Group also expanded operations outside Europe, in Australia, South Korea, United States, South Korea, South Africa and Singapore.

In just over a decade, the Group's international footprint has expanded considerably: the proportion of staff employed at international subsidiaries rose from less than 20% at end-1993 to 44% at end-2006. The United Kingdom confirmed its position as the Group's second-largest country of operation and has accounted for worth more than 15% of the consolidated workforce since the acquisition of Racal Electronics in 2000 and the formation of Thales UK. The Asia-Pacific workforce is growing and now accounts for 8% of total employees: Australia alone accounts for 6% of the workforce and is the Group's third-largest country of operation in terms of number of employees, followed by Germany, the Netherlands and the United States.

As at 5 January 2007, in the broader scope of business including the transport and security assets contributed by Alcatel-Lucent, Thales's international subsidiaries accounted for 50% of the total consolidated workforce.

Employees at 31 December	2003	%	2004	%	2005	%	2006	%
France	32,219	56%	30,872	55%	29,835	56%	29,180	56%
United Kingdom	10,521	18%	9,810	18%	8,921	17%	8,524	16%
Other Europe	7,630	13%	7,663	14%	7,201	14%	7,100	14%
Asia-Pacific	4,537	8%	4,639	8%	4,099	8%	4,261	8%
North America	2,128	4%	2,199	4%	2,492	5%	2,503	5%
Africa	357	1%	332	1%	295	1%	299	1%
Near & Middle East	30	0%	186	0%	196	0%	285	1%
Rest of world	17	0%	6	0%	8	0%	8	0%
Total consolidated workforce	**57,439**	**100%**	**55,705**	**100%**	**53,047**	**100%**	**52,160**	**100%**

In many cases, the Group has expanded into new defence markets through partnerships with local industrial groups. Most of these partnerships have later been dissolved, with Thales taking control or full ownership of the local subsidiary once local customers have recognised its legitimacy and capabilities.

The most recent example involves the Australian defence subsidiary ADI, which had been a 50-50 joint venture with the Australian infrastructure group Transfield since its acquisition from the Australian State in 1999. In October 2006, Thales acquired Transfield's interests in ADI after gaining the approval of the Australian authorities. Since then, ADI has been renamed Thales Australia and has assumed responsibility for all of Thales's operations in Australia in its three business areas of defence, aerospace and civil security.

Some companies in which Thales has taken an interest are highly specialised (e.g. naval systems in the Netherlands, military communications and air defence in South Korea). Although Thales aims to consolidate each new subsidiary's position in its original field, corporate policy is that each company should expand its field of competence to include most of the Group's areas of expertise.

The United Kingdom is a special case in that Thales UK was formed by bringing together companies acquired over nearly ten years in a variety of segments of the professional and defence electronics market, and can therefore build on these companies' extensive portfolio of competencies.

Thales has also developed research and technology centres outside France, within the national security constraints of each country, and has organised these centres of excellence into a global network.

1. Main international acquisitions and equity investments since 1990

Year	Company	Field of business	Countries	Seller
1990	Signaal (Hollandse Signaalapparaten BV)	Naval systems	Netherlands	Philips
	MBLE Défense	Military telecommunications	Belgium	Philips
	TRT Défense	Radionavigation and communication equipment	Netherlands	Philips
	Ferranti Thomson Sonar Systems Ltd	Underwater detection	United Kingdom	Ferranti
	Link-Miles Ltd	Simulation	United Kingdom	Bicoastal Corp.
1991	MEL	Communications	United Kingdom	Thorn-EMI
	Joint venture with Pilkington	Optronics	United Kingdom	Pilkington
	Atherton Technology	Software engineering	USA	
	Kyat	Information systems	Spain	
1993	Thomcast AG	Transmitters	Switzerland	ABB
	Thomcast GmbH	Antennas	Germany	ABB
	Thomson Elektronenröhren	Electron tubes	Switzerland	ABB
	50% of Short Missile Systems Ltd	Very short-range surface-to-air missile systems	United Kingdom	Bombardier
	Hughes Rediffusion Simulation Ltd	Flight simulators	United Kingdom	Hughes Aircraft
1994	Redifon	Naval communications and civil and military microwave communications	United Kingdom	Redifon
	Ferranti Syseca Ltd.	Supervision systems for energy transmission and distribution	United Kingdom	Ferranti
1995	Thomson Thorn Missile Electronics Ltd.	Missile electronics	United Kingdom	Thorn-EMI
	Pilkington Thorn Optronics Ltd.	Optronics	United Kingdom	Thorn-EMI
1996	Comwave	TV transmitters	USA	
	AEG electron tubes	Electron tubes	Germany	AEG contribution
	Software Union Syseca	Information systems	Germany	Aachener und Münchner
	Joint venture Thomson Marconi Sonars	Anti-submarine warfare	United Kingdom, Australia	50% of GEC Marconi
	27% of Elettronica (33% in 1998)	Airborne electronic warfare	Italy	73% Finmeccanica and founders (67% in 1998)
1997	Signaal GmbH	Defence electronics	Germany	Deutsche System Technik
	51% of Trixell	Components for medical imaging	Germany	49% Siemens & Philips
1998	Additional 40% of Pilkington Optronics (remainder acquired in 2000)	Optronics	United Kingdom	Pilkington
	50% of African Defence Systems (ADS)	Defence electronics	South Africa	South African government
	Alcatel's defence subsidiaries	Military communications	Germany, Norway Switzerland	Alcatel (contributor)
1999	Thales Nortech	Military communications	Norway	Siemens
	Additional 30% of ADS	Defence electronics	South Africa	
	25% of Avimo (remainder acquired in 2000 and 2001)	Optronics	Singapore, United Kingdom	Alvis (and financial market)
	50% of Australian Defence Industries (ADI)	Defence electronics	Australia	Australian government 50% Transfield
	Thales In-Flight Systems	In-flight entertainment (IFE)	USA	BE Aerospace
	Samsung Thales Electronics	Defence electronics	Korea	
2000	Racal Electronics Plc.	Defence and professional electronics	United Kingdom	Takeover
	Remaining 50% of Short Missiles (to 100%)	Very short-range surface-to-air missile systems	United Kingdom	Bombardier
	Joint venture ThalesRaytheonSystems (creation)	Air defence	France / USA	Raytheon
2001	Magellan Corp. (a)	GPS products	USA	Orbital Science
	Remaining 50% of Thales Marconi Sonar	Anti-submarine warfare	United Kingdom	BAE
2006	Acquisition of Diehl Luftfart Elektronik GmbH	Avionics	Germany	Diehl Luftfart Elektronik GmbH
	50% remaning in ADI	Multi domains	Australia	Transfield

(a) Activity disposed in mid 2006.

2. Major countries of operation

Thales in the United Kingdom

Revenues generated in the United Kingdom in 2006: €1,620 m
Sales to the United Kingdom in 2006: €1,342 m
Consolidated workforce in the United Kingdom at end-2006: 8,524(1)

The United Kingdom is the Group's second-largest country of operation. Over the years, Thales has become a major player in the UK domestic market and one of the main local suppliers to the Ministry of Defence. The first Thales (Thomson-CSF) marketing operation in the United Kingdom dates back to the early 1970s. Since then, the Group has expanded its operations in the country through a series of external growth operations, the largest of which was the acquisition of Racal in 2000. Before the Racal operation, Thales acquired Shorts Missile Systems, simulation companies Link Miles and Rediffusion, Thorn Missile Electronics, Redifon MEL, Avimo, the sonar businesses of Ferranti and GEC Marconi, Pilkington Optronics, and other businesses.

Thales's operations in the United Kingdom include the whole range of the Group businesses: Land & Joint Systems, Naval, Aerospace, Air Systems and Security Solutions and Services. Thales delivers mission critical solutions and services to address aerospace, defence and civil markets ranging from flight simulation and training provision to secure transactions and integrated communications for railways.

The company has consolidated its role as a major defence contractor in the United Kingdom through continued success on major programmes:

- Thales is prime contractor for the large-scale *Watchkeeper* tactical UAV-based surveillance system, awarded in 2005. The system is being developed in partnership with the MoD to provide the British armed forces with enhanced ISTAR capabilities (Intelligence, Surveillance, Target Acquisition and Reconnaissance), one of the keys to network-centric operations. In 2006, Thales expanded U-TacS, a joint venture with Elbit of Israel, to prepare for the next phase of this programme,
- Thales is a major partner in the AirTanker consortium, alongside EADS, Cobham and Rolls Royce. In February 2005, AirTanker was selected as a "preferred bidder" for the FSTA[2] air-refuelling programme. FSTA is a 27-year PFI (Private Finance Initiative) contract to provide air refuelling and air transport services to the Royal Air Force,
- since 2003, Thales has also been engaged as prime contractor on the assessment phase of the FIST[3] programme to modernise UK infantry systems,
- Thales is involved in the Royal Navy's Carrier Vessel of the Future (CVF) programme as a key member of the Aircraft Carrier Alliance alongside BAE Systems and the MoD.

In addition to these flagship programmes, Thales is contributing to numerous other UK procurement programmes. Recent contracts include:

- a contract awarded by BAE Systems to supply three Radar Electronic Support Measures (RESM) systems for the second batch of the Royal Navy's Type 45 destroyers. Thales earlier secured the contract for the first batch of destroyers in this class,
- a contract to equip the Future Lynx helicopter, including communication and navigation systems featuring TopSIS and CDNU technologies,
- in land systems, in addition to FIST, Thales was chosen to be a key partner in the Falcon programme to provide British armed forces with a highly secure information system. Thales has also been awarded two technology demonstrator contracts for FRES[4], which will equip the Army with new network-enabled armoured vehicles and will be one of the UK's flagship defence programmes in the coming years.

Thales is also a member of the Total Support Services alliance with Smiths Aerospace and SELEX S&AS, which announced a strategic partnering agreement with the Defence Aviation Repair Agency for onboard electronic equipment. The aim is to establish the principles that will underpin subsequent long-term service contracts across aircraft platforms on both rotary and fixed-wing programmes for the UK MoD. The company also provides active support to British forces deployed in the theatre of operations.

(1) Employees under Thales management at end-2006: 8,713 people.
(2) FSTA: Future Strategic Tanker Aircraft.
(3) FIST: Future Integrated Soldier System.
(4) FRES: Future Rapid Effect System.

In civil simulation, Thales has been selected to produce the full flight simulators for the new-generation A380 and Boeing 787 airliners, and for Sukhoi's new regional jet. Exports of simulators from the United Kingdom grew in 2006, with new airline contracts in China and India in particular.

In 2006, Thales strengthened its position in the UK security market, providing incident and resource management systems for the Kent Fire and Rescue Services as well as launching a comprehensive range of network encryption solutions to meet the security requirements of governments and financial organisations. As the principal supplier of telecom services to the UK rail industry, Thales UK won a major new two-year contract from British Rail in 2006.

Thales in the United States

Revenues generated in the United States in 2006: €934 m
Sales to United States in 2006: €952 m
Consolidated workforce at end of 2006: €2,241(1)

Thales has a legacy of over 45 years of successful operation in the United States. Today, the company's global multi-domestic strategy has led to a U.S. presence that includes ten primary operations in eight U.S. states and over 2000 employees.

In recent years, Thales has expanded its operation in the U.S. to focus on a wider range of core customer and market segments, while divesting non-core businesses such as the Magellan navigation product line in summer 2006. Leveraging domestic and overseas Thales capabilities, the company focuses in the U.S. on the naval, land forces, commercial aviation, military aviation, security and transportation domains.

Serving domestic (U.S.) and overseas customers, Thales U.S. operations include research, development, manufacturing, training and sales/marketing.

In 2006, U.S. land domain successes included a U.S. Army Communications-Electronics Command (CECOM) contract to delivery more than 9000 Thales AN/VRC-111 vehicle adapter systems. Thales was also awarded a competitive contract from the U.S. Air Force Joint Tactical Radio Systems program office for Multiband Inter/Intra Team (MBITR) radios. These radios were the first industry system to have passed the U.S. military's Joint Interoperability Test Command (JITC) testing process.

In the commercial aviation domain, Thales Aerospace operations in California and Washington State grew dramatically in 2006. A new facility opened in Seattle to meet growing worldwide demand from Boeing, Airbus and airline customers for Thales in-flight entertainment systems. Thales projects that approximately 50% of new large commercial jet aircraft entering airline fleets in the next five years will have Thales systems on-board.

Thales focus on homeland security programs resulted in the award of a contract within the U.S. Department of Homeland Security's high profile Strategic Border Initiative (SBI) program. Through a third-party licensing agreement, Thales will provide sensor systems to Boeing, the prime contractor for SBI.

In 2006, Thales joint ventures with several U.S. based industry leaders realized continued success. ThalesRaytheonSystems (TRS), formed in 2001 as the first transatlantic alliance between two global defense companies, was selected as part of an industry team to provide NATO with ballistic missile technology over five years.

Aviation Communications & Surveillance Systems (ACSS), a joint venture between Thales and L-3 based in Phoenix, Arizona, marked another successful year in 2006 with sales to a number of commercial, corporate and military customers.

And, in 2006 Thales took several important steps toward increasing the company's presence in the U.S. naval domain. In early 2007, Thales will announce new joint venture focused on U.S. Navy underwater sonar system opportunities, and the establishment of a U.S. based naval division.

(1) Employees under Thales management at end-2006: 2,864 people.

Thales in Australia

Revenues generated in Australia in 2006: €500 m
Sales to Australia in 2006: €459 m
Consolidated workforce at end-2006: 3,335

Thales serves the Australian defence and civil markets and is Australia's largest and leading defence contractor. Prior to October 2006, Thales had a 50% ownership interest in Australian Defence Industries (ADI). In October 2006, the Australian Government agreed to allow the Group to acquire the remaining 50% interest in the ADI joint venture from Transfield Holdings making ADI a wholly owned subsidiary of Thales. This operation led to the creation of Thales Australia, which regroups all Thales's operations in Australia.

In Defence, Thales is an important actor in land and communications systems and a major supplier to the Royal Australian Navy.

In Land systems, Thales is the leader in the design and manufacture of military vehicles. The Bushmaster armoured vehicle and the HMEV(1) have been delivered to Australian and export customers. The Bushmaster has been used on operations by Australian forces in Iraq and Afghanistan, and by the Netherlands army in Afghanistan.

The Australian Department of Defence has ordered a total of 300 vehicles, the first to be designed and manufactured in Australia since the Second World War. ADI has thus become a major player in vehicle markets in the United States, the Middle East and Europe.

In Joint systems, Thales is a leading supplier of communication and C4ISR systems. The company is a member of the consortium led by General Dynamics selected in 2005 to provide the Australian Army with the land battlespace communication system, and was selected in 2006 to develop the Royal Australian Navy's IP-based broadcast system. Thales has close involvement in developing network-centric architecture and technology for the Australian armed forces, particularly under a partnership agreement with Australia's DSTO(2) that was renewed in 2004.

Thales is also equipping the 22 Tiger helicopters ordered for the Australian armed forces from Eurocopter. Thales is supplying the mission systems, all the navigation and reconnaissance software, and the communication systems. Thales is also Eurocopter's partner for Air 9000, the NH90 programme in Australia.

In the Naval markets, Thales is upgrading FFG guided missile frigates for the Royal Australian Navy, including the installation of its new ADACS combat management system. The upgrade of ships HMAS MELBOURNE and DARWIN is underway and acceptance by Navy of HMAS Sydney occurred on December 15th 2006.

Thales previously delivered six HUON class minehunters to the Royal Australian Navy and in 2006 was awarded the contract for performance based support services on these vessels. The mine countermeasures system that Thales supplied to the Royal Australian Navy continues to sell well on export markets with opportunities being pursued in the USA and India.

Underwater Systems supplies sonar systems for the Collins submarines, ANZAC and FFG frigates and minehunters as well as providing through-life support for these systems. Thales is a member of the DJIMINDI Alliance to supply the MU90 IMPACT lightweight torpedo to replace the current inventory. Thales is also integrating torpedo launch systems on the ANZAC and FFG frigates and establishing through-life support at Fleet Base West, Garden Island.

In R&D, Thales plays a leading role with the opening of the Ocean Lab simulation and experimentation centre and its research into the Petrel mine and obstacle avoidance sonar, RASSPUTIN active sonorbuoy, the acoustic mine detection system and the joint development with DSTO(2) of the fibre laser hydrophone.

In Simulation, Thales Australia is the leading supplier of training solutions, supplying simulators to the armed forces and civil aviation customers. Thales supplies simulators for the F-111C bomber, Tiger reconnaissance helicopter, Wedgetail Airborne Early Warning and Control (AEW&C)

(1) HMEV: High Mobility Engineering Vehicle.
(2) DSTO: Defence & Science Technology Organisation

aircraft, and ASLAV armoured vehicle. It also supplies the Boeing and Airbus aircraft simulators for Qantas, Virgin Blue and Air New Zealand. Thales is now the Australian market leader in simulation.

Thales is also a key supplier of munitions to the Australian Defence Force through a 20 year strategic agreement, providing a local production capability that is of major strategic importance to the country in view of its geographic location.

In air traffic management, Thales Australia supplies many customers on export markets. In 2006 the Company was awarded contracts to supply air traffic control systems in China, Mexico and Taiwan and surveillance systems in Australia and China:

- The Eurocat air traffic control systems will be supplied for several airport approach centres in China.
- Phase 3 of the Mexican nationwide system including the replacement of the Mexico City air traffic control centre.
- An integrated nationwide system for the Air Navigation and Weather Services of the Civil Aeronautics Administration of Taiwan, R.O.C.
- And enhancements are being made to existing Eurocat systems in Australia and South Korea.

In the surveillance area, in 2006, contracts were awarded to supply several new primary and secondary radars in China and a complete replacement of the terminal area radars in Australia.

2006 also saw the transition to operational use of several Eurocat systems including Phase 2 of the Mexican nationwide system consisting of centres in Monterey, San Jose and Chihuahua; the new Bangkok International Airport in Thailand; and the integrated east coast system for Beijing, Shanghai and Guangzhou in China.

Thales in the Netherlands

Revenues generated in Netherlands in 2006: €480 m
Sales to Netherlands in 2006: €274 m
Consolidated workforce at end-2006: 2,020(1)

The Thales Group’s presence in the Netherlands dates back to the 1990 acquisition from Philips of Hollandse Signaalapparaten BV (Signaal), one of Europe’s leading suppliers and integrators of naval surface systems and a first-tier contractor to the Royal Netherlands Navy since the early 20th century. This background has made Thales Nederland the Group’s main naval centres of excellence for radars and combat management systems.

Its equipment and systems are installed on board surface vessels of all types and tonnages for every type of maritime mission. Thales Nederland supplies more than sixty navies throughout the world.

Thales Nederland also plays a dynamic role in research and technology. The company cooperates closely with the universities of Amsterdam, Enschede and Delft, and the association for radar development in the Netherlands. It is working on a variety of research programmes for the Dutch ministries of defence and the economy.

In the naval sector, Thales Nederland develops air defence and surveillance systems and equipment (APAR and Smart-L radars, Sirius infrared sensor) and combat management systems. Thales Nederland develops mission-critical naval sensors for new roles such as peacekeeping. For these new tasks, sensors need the ability to operate in coastal waters: Thales Nederland has extensive experience of littoral operations, with its Smart-S Mk2 radar and other products. For the land sector, Thales sensors that meet the new requirements include the Squire line of portable surveillance systems.

Outside the defence sector, Thales has also expanded in the Dutch services and security markets. For example, the company is developing a nationwide public transport ticketing system using contactless smart card technology that will ultimately be used by two million people.

In national security, Thales is drawing on its experience in the Dutch defence market to expand its civil business. With the sensor technologies and the integration skills of the company's Dutch operations, Thales has a key role to play in this area.

(1) Employees under Thales management at end-2006: 2,020 people.

C. International financing

1. Export financing

According to the local context and type of operation, the international financing department selects the most appropriate and competitive payment instruments and financing (cash, letter of credit, buyer's credit, supplier's credit, soft loans, private financing, structured finance, discounted commercial loans, leasing, barter, etc.).

This department arranges such financing with selected public or private financial partners. It liases with banks, export credit agencies, government agencies, international financial organisations, private insurers and the investors who assist in financing operations. It negotiates financing conditions with these partners and takes out the appropriate insurance to cover country risk.

The international financing department negotiates bid guarantees and bank guarantees for bids and contracts, and, where required, works with the Group's Finance Department to provide appropriate corporate guarantees.

2. Project financing

The Private Finance Initiative (PFI) department works with Thales operating units and the Group's Legal Department to address the legal and financial aspects of the project financing, concessions and outsourcing arrangements increasingly favoured by the Group's customers.

This department works for all Thales Divisions on such projects as Private Finance Initiatives (PFIs), Public-Private Partnerships (PPPs), Contrat de Partenariat avec l'Etat (CPE) in France, Government Owned Contractor Operated (GOCO), Build Operate Transfer (BOT), and delegated public service programmes.

3. International offsets

Thales International Offsets (TIO) is the company's specialised subsidiary for international offsets programmes. TIO negotiates and implements indirect offset requirements for the Group and for external customers. To fulfil these obligations, TIO promotes inward investment or invests directly in client countries in areas outside the scope of the company's core businesses, and promotes exports of industrial equipment or high-tech products from these countries.

III – Research & Innovation

A. Research key figures

On average, Thales devotes close to 20% of its consolidated revenue to Research & Development activities (R&D), which encompass design and production of new systems, products and equipment, as well as the new technology building blocks that will help the Group to retain its competitive edge in the future.

In 2006 the Group's company-funded R&D expenditure rose by 4% on a like-for-like basis, equivalent to 5% of consolidated revenue and representing more than 25% of total R&D activities.

In € m	2006 (a)	2005 (a)	2004	2003	2002
	IAS / IFRS standards			French standards	
Total expenditure	2,000	1,900	1,850	1,850	1,900
Company-funded	534	512	444	419	460
charged to the profit and loss account	361	366	368	381	430
capitalised (b)	157	138	68	38	30
Company-funded R&D as % of total	27%	27%	24%	23%	24%

(a) Includes €8 million and €16 million research tax credit respectively in 2005 and in 2006.
(b) See note 1.j) in the notes to the consolidated acounts, which defines in particular the criteria for capitalised development expenditures.

Thales expends 80% of its R&D efforts on developing large-scale systems for communications and airspace control, secure systems for public administration, operational command/control systems and combat systems; standalone and onboard equipment (sensors, radios, cameras, avionics, radar, sonar, etc.); and technology building blocks, i.e., subsystems and critical components. The remaining 20% (about €400 m) is devoted to preparing for the future through upstream research or demonstrators to test new concepts, equipment and systems.

The effectiveness of the Group's R&D effort hinges largely on the decentralised nature of operations, with 20,000 staff – over 70% of them engineers – based at more than 80 units in the Group's top ten countries of operation. Upstream research at the Group's central research laboratories, managed by Thales Research and Technology, accounts for 3% of total R&D and employs 500 people. Effective Group-wide networking throughout the world enables R&D engineers to share information, advice and best practice.

B. Innovation driving corporate strategy

In an increasingly competitive global market, Thales is making technological excellence – essential to maintaining the Group's competitive edge – the key to its corporate strategy and brand identity.

Thales designs and delivers critical information systems for customers in aerospace, security and defence. These activities draw extensively on dual-use technologies, but world-class in-house expertise and capabilities are required to develop competitive systems. That is why the Group works hard to sustain the skills needed to mature critical technologies and fulfil its role as a systems and equipment architect.

The competitiveness plan deployed across the Group in 2005 and 2006 includes an R&D element among the lines of action that hold most potential for improving Thales's productivity. This plan emphasises systematic, enterprise-wide sharing of R&D work and seeks to encourage Thales's involvement in major European, national and regional R&D programmes. The expected productivity gains will enable Thales to sustain and even boost its R&D spending.

Technical and technological innovation infuses most of the Group's functions: research and development teams designing new products, marketing teams analysing customers' future needs, and strategy teams defining the Group's positioning and preparing technology partnerships. Customers are also increasingly playing a role in this loop, helping to shape the innovative choices being made for their future products and thereby making a positive impact on the Group's development efforts.

To put innovative ideas into practice and assess their value, Thales has established a policy and a set of tools to foster interaction between innovation stakeholders. To this end, several initiatives are being pursued within Thales's divisions to get programme teams to innovate. Funding is provided to assess the utility and feasibility of selected projects, and then to promote and deploy them within the Group's major programmes.

Each unit draws up an annual strategic technology development plan as part of the broader Technical Strategic Plan (TSP) established every year at technical conferences bringing together specialists from all over the world. These plans, consolidated at Group level, are used to identify critical technologies, R&D priorities and commonalities needed to sustain product and system development.

To consolidate these analyses, Thales has created cooperative cross-functional structures to address key issues of common interest to all Group entities, focusing on:

- complex systems engineering,
- microwave, optical and optronics components,
- computer architecture and software design tools,
- information processing and data fusion,
- secure Internet technologies,
- security technologies.

These structures are organised as centres of operational excellence concentrating on critical issues such as digital processing architectures, command system transformation tools and object-oriented or domain-oriented design of large-scale secure software. Chief among these projects are Theresis, which is focusing on secure systems for e-government such as the tax portal for the French budget ministry, electronic patient records or the new ethnic art museum in Paris, and the diffusion of the Battlefield Transformation Centre architecture approach throughout the relevant Thales's units, the most recent being in the Netherlands.

Thales products and systems are then put together from these basic technologies and other components available on the market. Through this approach, the Group gains access to major projects such as the Mega-Joule laser, exploiting the very latest scientific and technological advances. To meet customers' requirements and benefit from the Group's partners' and technology suppliers' own research and innovation, Thales has contributed substantially to the international standardisation process, both for digital technologies (such as OMG(1) for software architectures and IETF(2) for networks) and for business lines, particularly avionics.

C. Corporate research

Thales Research & Technology (TRT) plays a central role in the Group's corporate research organisation: TRT comprises four research entities in France, the UK, the Netherlands and Singapore, as well as laboratories managed jointly by corporate research and Group subsidiaries and a network of research departments in operating units. By investing more than €60 m in refurbishing TRT's facility in France, located since 2006 on the campus of the Ecole Polytechnique engineering school, Thales confirmed its intention to play a full part in the French and international scientific community. This new research centre was officially opened in November 2006 by France's Minister for Research and Higher Education at an event organised to showcase major areas of scientific research in which Thales is active:

- the software factory to address the complexity crisis through the introduction of virtual prototyping, model assembly design, automatic production and validation methods and collaborative working, designed to achieve breakthroughs in development productivity and quality,
- analysis of complex situations, presented in the form of an image that human operators can use to ensure superior decision-making through effective management of critical information,
- new Internet technologies and applications focusing on network security, through integration of the latest technologies in authentication, biometrics and transmission security to protect large-scale applications for e-government (tax portal, security of public places and heritage sites, electronic patient records), banking (e-ticketing and payment systems) and infrastructures (transport and shipping traffic),
- night-vision systems, decamouflaging, decoy discrimination, surveillance of critical zones or infrastructures, quantum-well infrared photodetectors (QWIP) and polarimetric imaging, all dual-use technologies used to detect clinical anomalies or to combat terrestrial and marine pollution,
- home security technologies like semi-conductor materials for gallium-arsenide microwave monolithic integrated circuits (GaAs MMICs) used in radar power amplifiers and QWIP arrays in night-vision cameras. In 2004, Thales

(1) Object Management Group, a partnership between companies and institutions that develops standards for the entire IT sector to foster software interoperability.
(2) Internet Engineering Task Force, an international partnership of companies and institutions working on Internet architecture.

and Alcatel decided to set up a joint laboratory, Alcatel-Thales III-V Lab, to mature home security technologies. Such dual-use technologies underpin critical components that are key system elements with restricted availability, notably due to export controls,
- detectors for chemical and biological systems offering economical, effective solutions for medical, security (detection of B&C agents, explosives and drugs) and environmental applications,
- breakthrough areas, such as highly secure software, secure communications, microwave transmission used in radars and for countermeasures, highly precise navigation or biological marking and detection, where teams are working in concert with the national and international scientific community at the cutting edge of mathematics, the ultimate dimensional limits of materials and ultra-short timescales.

The efforts of TRT's teams to achieve world-class excellence were recognised in 2006 with the award of the prestigious Japan Prize(1) to a researcher working on nanotechnologies for the joint Thales/CNRS(2) research unit.

TRT conducts technology research activities close to its partners. Besides the French research centre now on the Ecole Polytechnique campus, the Dutch research centre is located at Delft University and the Singapore centre is operating a laboratory at Nanyang Technological University (NTU). TRT France employs 220 full-time staff, 40 doctoral students and 50 outside researchers (from CNRS, Ecole Polytechnique, IOTA(3) and universities). In the United Kingdom, the Reading centre has direct connections with major British universities including Cambridge, Surrey and Imperial College, London, and employs 120 staff and 15 doctoral students. In the Netherlands, the TRT team is based on the campus of Delft University and is a joint operation by Delft and Amsterdam universities, TNO, Thales Nederland and TRT. It employed 15 people in 2006. In Singapore, the Thales Technical Center Singapore (TTCS) had a 15-strong team in 2006. TTCS was set up in 2003 in close cooperation with local technology institutes, notably NTU for the joint Thales@NTU project.

TRT's research covers three main areas: hardware systems and components, software technologies, and software systems. Central engineering activities were attached to Thales's Services division at the start of 2005. Software system research, mainly conducted in the UK, focuses on four major system functions: communications technology, positioning and navigation services, signal processing and data fusion, and "virtual office" technology for collaborative working environments.

D. Technology partnerships

Thales has a policy of partnership and proactive networking with some of the most prestigious research centres and universities, as well as technology suppliers and certain customers. It is thus closely integrated in the scientific and industrial environment of the countries and regions where it operates, benefiting rapidly from research conducted worldwide to speed knowledge transfer throughout the Group. Implementation of this research and technology policy ties in with government-driven partnership actions and the European Union's R&D objectives set out at Lisbon in 2004, and is achieved through numerous regional, national and European cooperation projects that are the tangible results of a very successful public-private partnership.

These projects are adapted to the type of cooperation, the nature of work undertaken and delivery schedules. They range from joint leadership of a research team, working for example on a doctoral thesis – Thales teams jointly supervise more than 130 doctoral researchers, chiefly in Europe – to joint integrated research teams (see box) and all kinds of collaborative arrangements, including the sharing of costly equipment for hardware technology platforms.

As part of these efforts to pursue research synergies and share resources, in July 2004 Thales and Alcatel formed a joint research laboratory dedicated to III-V(4) semiconductor technologies, targeting applications in telecommunications, defence, space and security.

(1) The Japan Prize was founded 20 years ago by the Japanese government to reward science and technology achievements as a complement to the Nobel Prize.
(2) Centre National de la Recherche Scientifique, the French national scientific research centre.
(3) Institut d'Optique Théorique et Appliquée (theoretical and applied optics institute).
(4) III-V materials have respectively three and five electrons in their last atomic layer. Considerable transmission power can be generated by associating them.

At regional level, Thales has participated extensively in competitiveness clusters in response to the French Prime Minister's request for proposals. It is involved in 14 clusters across 9 regions.

Thales is playing a pivotal role in a number of clusters that are strategically important to the Group and classed as "global" or "globally driven" clusters:

- System@tic in the Paris region brings together 20 key industrial contractors, plus hundreds of SMEs and SMIs and 20 major players from academia working together to design, produce and mature complex industrial systems; Thales is currently chairing this cluster,
- aerospace Valley in the Midi-Pyrénées and Aquitaine regions (southwest France), for which Thales is chairing the Aquitaine side and is the lead member for air transport safety and security,
- minalogic in the Rhône-Alpes region (south-east France), where it is involved in medical and security imaging projects,
- the Mer (maritime) cluster in Britanny and Provence-Alpes-Côte d'Azur (Mediterranean), where it is the lead member for maritime safety and security,
- the Image, multimédia et vie numérique cluster (Imagery, multimedia and digital lifestyle), where it is responsible for multimedia content in the Paris region.

Activities at the Saclay science facility are a good example of what the Group is doing. In the Paris region, Thales has initiated and supported the creation of a centre of excellence for large complex systems, federating many public and industrial organisations around this joint objective. This initiative has led to the establishment of a chair with the Ecole Polytechnique, the first in Europe devoted to teaching of complex systems. Thales also supported the creation of DIGITEO Labs, a network of laboratories in the Paris region involving all the major public research centres working in systems and software (CNRS, CEA, Ecole Polytechnique, Université Paris Sud, Supelec and INRIA). The Group has also played an active role for many years in Optics Valley and its extension to this same area of research. Lastly, Thales is involved in the System@tic competitiveness cluster already mentioned.

At national level, Thales is a key stakeholder of the policy of Research and Technological Innovation Networks set in train by ANR, the national research agency. Group experts have chaired the micro- and nanotechnology research network (RNMT) and the national software technologies network (RNTL), assisted on the steering committee of the information and communication technologies networks (RNRT, RNTL, R3N and RIAM) and generated numerous projects in synergy with institutes and SMEs in associated fields. Thales has also contributed to several projects led by the Industrial Innovation Agency (AII) in such areas as information system security, border security, network security and air traffic control. This action was recognised at the highest level of government by the appointment of Dominique Vernay, the Group's Vice-President Research and Technology, as an industry member of the High Council of Science and Technology.

At European level, Thales has played a role in every EU Framework R&D Programme since the ESPRIT programme in the early 1980s, working on many European cooperation projects. So today, Thales naturally holds a leadership position on European technology platforms. The Group has contributed significantly to projects such as ACARE in the aeronautical sector, ARTEMIS for embedded systems, ENIAC for micro- and nanotechnologies, NESSI for software, systems and services, and e-mobility for mobile communications and other mobile electronic applications. These projects rely on very close partnership between large industrial contractors, research centres and SMEs and SMIs, which contribute key innovative technologies that will be vital competitive assets for Europe in the years ahead.

Also at European level, with the launch of the European Defence Agency (EDA) Thales has played a key role in defining CapTech (Capability-Technology) areas of expertise, proposing around 60 research topics that account for almost half the projects submitted and cover 8 of the 12 CapTechs selected. Thales has also taken a pioneering role in the organisation of its internal network of engineers and experts, and has been tasked with coordinating the French side of 4 of the 12 CapTechs.

This partnership policy is underpinned by cooperation agreements with strategic partners, involvement in numerous European, national and local cooperation initiatives, and hosting of technology research activities on the campuses of universities and elite engineering schools.

Some joint research teams in which Thales is involved
CARROLL: Embedded real-time and large software architectures and components, with CEA-LIST[1] and INRIA, the French national institute for research in computer science and control.
VCS (Virtual Collaboration Solution): Communication and multimedia technologies with the I-Lab research group at the University of Surrey.
EURONET Lab: Network technologies including Internet for critical situations with the IT laboratory of the Université de Paris VI (LIP6), CNRS, Telecom Paris and 6 Wind.
TIGER: Specific components based on new materials with IEMN[2] in Lille.
MEMS RF: Microwave microsystems with CEA-LETI[3].
NANOCARB: Carbon nanostructures with the Ecole Polytechnique, materials.
Thales@NTU: Semiconductor materials and devices, ultra-broadband communications and photonics with NTU.
DECIS: Decision-support systems with the universities of Delft and Amsterdam.

In addition, Thales is involved in cooperative ventures with institutes and universities near Group facilities in Germany, Asia (particularly Singapore), North America and Australia.

E. Intellectual property

Thales actively exercises its intellectual property rights in all countries where it is operating, mainly through patents, trademarks and licensing agreements, to maintain its competitive innovation advantage. This policy is implemented by a corporate entity, Thales Intellectual Property (TPI), which coordinates a network of intellectual property officers in the divisions and correspondents in the operating units, while outsourcing several administrative functions.

With a high number of inventions patented (292 new inventions in 2006), Thales is in a comparable position to its competitors, and indeed is often ahead of them. Its patent portfolio, which amounted to some 12,000 patents at end 2006, is managed to:

- defend the Group's positions in its markets,
- provide a negotiating tool in disputes with third parties,
- generate revenue in certain cases through licensing agreements outside the Group's current fields of activity.

To encourage Group engineers to innovate, a bonus is paid when the memorandum describing an invention is produced. This bonus is kept even if the invention is not ultimately patented.

The memorandum is dated, and it is then decided whether to keep it confidential, apply for a patent or publish it to prevent a competitor from filing a patent. Likewise, original software work is attested to certify the Group's ownership and the date of creation. Upstream, agreements with third parties contain contractual clauses to guarantee the Group's freedom to use the results. Awareness sessions on the importance of protecting the Group's technological assets are regularly held for engineers and operational managers.

(1) Laboratoire d'Intégration des Systèmes et des Technologies (systems and technology integration lab).
(2) Institut d'Electronique, de Microélectronique et de Nanotechnologie (electronics, microelectronics and nanotechnology institute).
(3) Laboratoire d'Electronique et de Technologie de l'Information (electronics and IT lab).

Shareholder information

I - Company and share capital

II - Corporate governance

III - Stock market information and financial communication

IV - Annual General Meeting of 16 May 2007

I – Company and share capital

A. Statutory information

Legal form

Thales is a public limited company with a Board of directors, governed by French law (specifically the Commercial Code and the Decree of 23 March 1967 on commercial companies, the Decree of 30 December 2005 regulating financial relations outside France, and certain articles of the amended Privatisation Act of 6 August 1986 as long as the French State holds more than 20% of the company's share capital).

Registered Head Office

45, Rue de Villiers, 92200 Neuilly-sur-Seine – France

Telephone: +33 0(1) 57 77 80 00

Registration Number

552 059 024 in the Nanterre Register of Trade and Companies; APE business identifier code: 332 A.

Duration

The company was formed on 11 February 1918 for a period of 99 years expiring on 11 February 2017. This period may be extended or the company may be wound up at an earlier date.

Corporate aims (Article 2 of the articles of association)

Engineering, design, manufacture, sale and hire of all components, hardware, equipment and systems implementing all applications of electronics, from radio, optics, optronics and information technologies to telecommunications, detection, identification, navigation and all other industrial and commercial activities; the holding of all securities in companies engaged in these activities.

Financial year

The financial year of the company covers a period of twelve calendar months from 1 January to 31 December.

Corporate documents and information may be consulted at the offices of the secretary to the Board of directors, at the registered head office.

Statutory distribution of profits

Profits are shared in compliance with current legislation. Under the articles of association, the General Meeting called to approve the financial statements for the previous financial year is empowered to grant each shareholder the option to receive payment of all or part of the dividend in cash or in shares.

Company's position in the Group

Thales, the parent company, operates as a holding company for the Group:

- it holds shares in the Group's major subsidiaries,
- it manages central functions: devises Group strategy, trading policy, legal and financial policy, operation monitoring, human resources policy, communication,
- it provides subsidiaries with specialised assistance: legal, fiscal and financial expertise, for which the subsidiaries pay fees,
- it provides financing and cash pooling (see page 22) and, where necessary, guarantees.

In addition to these functions, Thales parent company conducts its own research, described on page 117.

Financial flows between Thales parent company and its subsidiaries are the result of:

- payment of dividends,
- cash pooling,
- fees received for providing shared services.

The main operating subsidiaries are presented on page 106.

A table showing the main consolidated companies may be found on page 72.

B. General meetings

1. Notice of meetings and conditions for attendance

General Meetings of Shareholders comprise all shareholders, irrespective of the number of shares held. General Meetings are called and asked to vote as provided by law; the date and place of the meetings are stated on the notice of meeting as published in the Bulletin des Annonces Légales Obligatoires (BALO) and in the French national press at the latest 35 days before the date of the General Meeting.

Any shareholder may attend a General Meeting of Shareholders, on proof of their identity and share ownership, either in the form of an entry in the company's share register, or by provision of a certificate drawn up by the intermediary holding their share account.

Any shareholder who has already voted by post or proxy or requested an admittance card or share ownership certificate may at any time sell all or part of their shares.

However, pursuant to regulations, should the intermediary account-holder in the Company register a sale occurring before midnight preceding the 3rd trading day before the general meeting, the Company will invalidate or modify the vote expressed, proxy, admittance card or share ownership certificate, as the case may be.

No sale or other operation carried out after midnight (Paris time) preceding the third trading day before the meeting, by whatever means, is registered by the approved intermediary or taken into consideration by the Company, notwithstanding any agreement to the contrary.

The right to attend and vote in ordinary General Meetings belongs to the beneficial owner, and to the bare owner in extraordinary General Meetings. Owners of pledged shares retain their voting rights. Co-owners of shares are represented in General Meetings by one of the co-owners or by a joint proxy, the latter being appointed by the court at the earliest request of any co-owner in case of disagreement among the co-owners.

Each member of the General Meeting has one vote for each share owned or represented (except for double votes mentioned below) and subject to the exceptions provided by law.

2. Double voting rights and use of voting rights

Shareholders who can show proof that the shares have been registered in their name in the company's share register for a minimum of two years without interruption are entitled to double voting rights for each share held. Registered shares that have been granted to their beneficiary as bonus shares in respect of shares they already hold with double voting rights attached are also entitled to double voting rights as soon as the shares are granted.

Double voting rights will terminate automatically for any share converted into the bearer form or transferred (except as a result of inheritance, whether testate or intestate, division of property between spouses or gifts inter vivos between spouses or in favour of a relative).

Double voting rights may be abolished by an extraordinary General Meeting, following approval voted by a special General Meeting of shareholders entitled to double voting rights.

There is no statutory threshold limiting voting rights.

According to the law, shares owned by the company are not entitled to voting rights.

3. Statutory disclosure thresholds

Any natural person or legal entity, owning 1% (or any multiple of 1%) of the total number of shares representing the share capital of the company, is required to inform the company of the total number of shares held, within five trading days following the date on which this threshold or any threshold specified by law is exceeded.

This obligation to inform the company applies, under the same conditions, as and when the holding falls below one of the thresholds mentioned in the previous paragraph.

In the event of failure to observe the obligation to disclose the number of shares held, as stipulated in this article, the shareholder shall be deprived of the voting rights attaching to any shares exceeding the threshold in question, subject to the conditions and limits defined by law.

C. Share capital

At 31 December 2006, the share capital amounted to €516,020,424 divided into 172,006,808 shares of €3 par value each.

The Extraordinary General Meeting of Shareholders of 5 January 2007 approved the transfer from Alcatel Participations to Thales of the transport and security businesses of the Alcatel-Lucent Group, and consequently decided to increase the share capital by 25 million shares for Alcatel Participations.

At 5 January 2007, as at the date of this report, the share capital amounted to €591,020,424 divided into 197,006,808 shares of €3 par value each.

Changes in the share capital and rights of shareholders are governed by the relevant legislation.

Shares may be held in either registered or bearer form, at the shareholder's discretion. The share register is kept on behalf of the company by Société Générale (Département Titres & Bourse – 32 Rue du Champ de Tir – BP 81 236 – 44 612 Nantes cedex 3 – France), mandated to do so since 1998.

The share capital is fully paid up. It includes a golden share resulting from the conversion of an ordinary share held by the French State, as decided by Decree 97-190 of 4 March 1997 in application of the August 6, 1986, Privatisation Law (see page 132).

1. Change in share capital, five-year summary

Date	Type of operation	Share premium account & retained earnings	Number of shares issued	Nominal value of share capital variations	Value of share capital	Total number of shares issued
31 Dec. 2001		**2,724,320,105**			**503,194,539**	**167,731,513**
20 Dec. 2002	Capital increase reserved for Group employees	75,386,943	4,132,779	12,398,337		
31 Dec. 2002		**2,799,707,048**			**515,592,876**	**171,864,292**
31 Dec. 2003		**2,673,002,421**			**515,592,876**	**171,864,292**
2004	Exercise of share options	102,150	4,500	13,500		
	Exercise of share warrants	4,171	176	528		
31 Dec. 2004		**2,673,108,742**			**515,606,904**	**171,868,968**
2005	Exercise of share options		40,523	121,569		
	Exercise of share warrants		372	1,116		
31 Dec. 2005		**2,674,037,324**			**515,729,589**	**171,909,863**
2006	Exercise of share options or conversion of OCEANE bonds		96,945	290,835		
31 Dec. 2006		**2,676,344,983**			**516,020,424**	**172,006,808**
5 Jan. 2007	Capital increase reserved for Alcatel Participations	925,000	25,000,000	75,000,000		
5 Jan. 2007		**3,601,344,983**			**591,020,424**	**197,006,808**

2. Changes in share ownership five-year summary

a. Number of shares

At 31 December	2006	2005	2004	2003	2002
TSA (a) and Sofivision subsidiary	52,670,906	52,670,906	52,670,906	52,670,906	53,653,558
Sogepa (a)	1,081,256	1,081,256	1,081,256	1,081,256	1,081,256
French State (b)	2,022	2,022	2,022	2,022	2,022
Public sector	***53,754,184***	***53,754,184***	***53,754,184***	***53,754,184***	***54,736,836***
Alcatel Participations	16,262,481	16,262,481	16,262,481	16,262,481	16,262,481
Groupe Industriel Marcel Dassault (GIMD)	9,827,043	9,827,043	9,827,043	9,827,043	9,827,043
Industrial Partner	***26,089,524***	***26,089,524***	***26,089,524***	***26,089,524***	***26,089,524***
Shareholders bound by a shareholders' agreement	**79,843,708**	**79,843,708**	**79,843,708**	**79,843,708**	**80,826,360**
Free float (c)	**92,163,100**	**92,066,155**	**92,025,260**	**92,020,584**	**91,037,932**
of which employees (d)	7,597,504	7,960,572	8,756,461	8,690,141	8,148,410
of which Thales	3,134,701	3,163,613	6,585,651	9,600,528	9,600,528
Total	**172,006,808**	**171,909,863**	**171,868,968**	**171,864,292**	**171,864,292**

b. Percentages

At 31 December	2006	2005	2004	2003	2002
TSA (a) and Sofivision subsidiary	30.62%	30.64%	30.65%	30.65%	31.22%
Sogepa (a)	0.63%	0.63%	0.63%	0.63%	0.63%
French State (b)	--	--	--	--	--
Public sector	***31.25%***	***31.27%***	***31.28%***	***31.28%***	***31.85%***
Alcatel Participations	9.46%	9.46%	9.46%	9.46%	9.46%
Groupe Industriel Marcel Dassault (GIMD)	5.71%	5.72%	5.72%	5.72%	5.72%
Industrial Partner	***15.17%***	***15.18%***	***15.18%***	***15.18%***	***15.18%***
Shareholders bound by a shareholders' agreement	**46.42%**	**46.45%**	**46.46%**	**46.46%**	**47.03%**
Free float (c)	**53.58%**	**53.55%**	**53.54%**	**53.54%**	**52.97%**
of which employees (d)	4.42%	4.63%	5.09%	5.06%	4.74%
of which Thales	1.82%	1.84%	3.83%	5.59%	5.59%
Total	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**

(a) Companies wholly owned by French State.
(b) Including one golden share (see page 132).
(c) In accordance with the definition of free float used since 1 December 2003 by the Euronext-Paris Indices Steering Committee to calculate the CAC 40 index. Free float is taken to mean total share capital after deduction of shares held by Group companies, directly or indirectly by the founders or the State, controlling interests, shares within the scope of a shareholders agreement not already covered, and interests considered stable.
(d) Shares held by employees in a company savings plan or company investment fund.

c. Major changes in share ownership over last five years

In 2002, the free float increased sharply once more as a result of three operations:

- on 25 September 2002, Alcatel floated 10.3 million shares, equivalent to 6.1% of capital,
- on 20 December 2002 (under authority from the General Meeting of shareholders of 16 May 2001) the employee shareholding was increased by the issuance of 4.1 million new shares. This nearly doubled employee share ownership, from 2.72% at end-2001 to more than 4.74% at end 2002,
- Thales floated 1.1 million company-held shares, equivalent to 0.9% of the capital, reducing its interest to 5.6%.

In 2003, the free float continued to increase, albeit less than in 2001 and 2002, from 47.4% to 48.0%, with the transfer to employee shareholders of shares previously held by the Public Sector: the increase in employee shareholding of 982,652 shares (0.31% of capital) corresponds mainly to bonus shares allocated to those who subscribed to the 2000 capital increase reserved for employees, as stipulated.

In late 2004, the number of company-held shares fell as a result of the following operations:

- in November and December, direct or proxy sale of 1.2 million shares,
- in December, net sale of 1.3 million shares under a liquidity contract,
- in December, sale or transfer of approximately 520,000 shares to company investment funds, including free shares, under an employee shareholder operation.

The proportion of company-held shares consequently fell to 3.83% at 31 December 2004 compared with 5.59% at 31 December 2003.

In 2005, the free float continued to increase as a result of the following disposals of company-held shares:

- approximately 2 million shares were sold by proxy,
- approximately 1 million shares were sold under a liquidity contract,
- approximately 300,000 shares were sold to employees as options vested, and to a lesser extent, as part of the employee shareholder scheme.

Company-held shares amounted at 31 December 2005 to 1.84% of capital.

In 2006, the number of company-held shares varied little, since the excess of shares bought over shares sold was only approximately 29,000:

- some 457,000 shares were bought under a liquidity contract,
- some 388,000 shares were sold under a liquidity contract,
- some 98,000 shares were sold to employees exercising options.

Company-held shares amounted at 31 December 2006 to 1.82% of capital.

On 11 August 2006, Capital Group International Inc. disclosed that it had exceeded the legal threshold of 5% of the share capital and owned 8,813,389 bearer shares with the same number of voting rights. This amounted to 5.13% of the share capital and 3.52% of voting rights in the Company on the date of disclosure.

By 31 December 2006, Capital Group International Inc. had not disclosed that its holding had fallen below the legal threshold.

3. Voting rights over the last five years

a. Number of voting rights

At 31 December	2006	2005	2004	2003	2002
TSA (a) and its subsidiary Sofivision	105,341,812	105,341,812	105,334,464	105,334,464	107,305,124
Sogepa (a)	2,162,512	2,162,512	2,162,512	2,162,512	2,162,512
French State	4,044	4,044	4,044	4,044	2,023
Public sector	***107,508,368***	***107,508,368***	***107,501,020***	***107,501,020***	***109,469,659***
Alcatel Participations	32,524,962	32,524,962	32,524,962	32,524,962	32,524,962
Groupe Industriel Marcel Dassault (GIMD)	13,504,086	13,504,086	19,654,086	9,827,043	9,827,043
Industrial Partner	***46,029,048***	***46,029,048***	***52,179,048***	***42,352,005***	***42,352,005***
Shareholders bound by a shareholders' agreement	**153,537,416**	**153,537,416**	**159,680,068**	**149,853,025**	**151,821,664**
Free float	**96,739,429**	**96,962,043**	**93,658,933**	**86,590,356**	**84,667,231**
of which employees	14,752,876	15,432,533	16,319,640	12,133,768	10,895,056
Total	**250,276,845**	**250,499,459**	**253,339,001**	**236,443,381**	**236,488,895**

(a) Companies wholly owned by the French State.

Double voting rights are attached to shares that have been held in registered form for at least two years in accordance with the articles of association (see page 123).

b. Percentage voting rights

At 31 December	2006	2005	2004	2003	2002
TSA (a) and its subsidiary Sofivision	42.09%	42.05%	41.58%	44.55%	45.37%
Sogepa (a)	0.86%	0.86%	0.85%	0.91%	0.91%
French State	--	--	--	--	--
Public sector	***42.96%***	***42.92%***	***42.43%***	***45.47%***	***46.29%***
Alcatel Participations	13.00%	12.98%	12.84%	13.76%	13.75%
Groupe Industriel Marcel Dassault (GIMD)	5.39%	5.39%	7.76%	4.16%	4.16%
Industrial Partner	***18.39%***	***18.37%***	***20.60%***	***17.91%***	***17.91%***
Shareholders bound by a shareholders' agreement	**61.34%**	**61.29%**	**63.03%**	**63.38%**	**64.20%**
Free float	**38.65%**	**38.71%**	**36.97%**	**36.62%**	**35.80%**
of which employees	5.89%	6.16%	6.44%	5.13%	4.61%
Total	**100%**	**100%**	**100%**	**100%**	**100.00%**

(a) Companies wholly owned by the French State.

4. Share capital and voting rights on 5 january 2007

On 1 January 2007, the OCEANE notes issued in December 2001 to a nominal value of €500 million matured. Most of them were redeemed in cash. Consequently the operation impacted almost entirely the potential capital.

On 5 January 2007, the Extraordinary General Meeting of Shareholders called to approve the contribution by Alcatel Participations of Alcatel-Lucent's transport and security businesses voted an increase in capital of 25 million shares (amounting to 15% of share capital at end 2006), reserved for Alcatel Participations.

(1) GIMD no longer belonged to the shareholder's agreement from that date.

Alcatel Participations' holding in the Group's share capital rose from 9.46% on 31 December 2006 to 20.94% on 5 January 2007. The Public Sector's holding fell from 31.25% to 26.74%. The company-owned holding fell to 1.56% from 1.82% on 31 December 2006 (see table page 128). As a result of this increase in capital, the Company was informed of the following holdings above or below the legal thresholds:

- GIMD's individual holding fell below the 5% voting rights threshold on 5 January 2007, to 9,852,043 shares with 13,529,086 voting rights. This amounts to 5.00% of the Company's share capital and 4.91% of its voting rights, whereby GIMD retains an individual share of capital in excess of 5%[1],

- Alcatel-Lucent exceeded the 15% and 20% voting rights thresholds and 10%, 15% and 20% share capital thresholds on 5 January 2007, with a holding of 41,262,481 shares with 57,524,962 voting rights. This amounts to 20.94% of the Company's share capital and 20.90% of its voting rights,
- Capital Group International Inc. fell below the 5% share capital and voting rights threshold on 12 January 2007, with 9,624,400 shares and the same number of voting rights. This amounts to 4.89% of the Company's share capital and 3.50% of its voting rights.

Alcatel-Lucent also disclosed the following intentions to the Company, pursuant to Article L.233-7-VII of the Commercial Code:

- Alcatel-Lucent is bound by an agreement to act in concert with TSA,
- under the new shareholders' agreement between Alcatel-Lucent and TSA, the Company's Board of Directors includes 4 members proposed by Alcatel-Lucent,
- Alcatel-Lucent does not intend to increase or reduce its holding in the Company within the next 12 months,
- Alcatel-Lucent, in concert with TSA, controls the Company within the meaning of Article L.233-3 of the Commercial Code.

On 5 January 2007, share capital and voting rights were allocated as follows:

	Share capital		Voting Rights	
	Number of shares	Percentage	Number of votes	Percentage
TSA and its subsidiary	52,670,906	26.74%	105,341,812	38.26%
French State	2,022	--	4,044	--
Sogepa	1 081,256	0.55%	2,162,512	0.79%
Public sector	**53,754,184**	**27.29%**	**17,508,368**	**39.05%**
Alcatel Participations	**41,262,481**	**20.94%**	**57,524,962**	**20.89%**
Shareholders bound by a shareholders' agreement	**95,016,665**	**48.23%**	**165,033,330**	**59.94%**
Free float	**101,990,143**	**51.77%**	**110,293,748**	**40.06%**
of which Thales	3,064,815	1.56%	--	--
of which employees	7,584,459	3.85%	14,726,985	5.35%
of which GIMD	9,852,043	5.00%	13,529,086	4.91%
Total	**197,006,808**	**100.00%**	**275,327,078**	**100.00%**

Notes:
- in the new shareholders' agreement between the Public Sector and Alcatel-Lucent in force since 5 January 2007 the Public Sector does not include Sogepa's holding of 0.5%,
- on 5 January 2007, the total number of voting rights published by the company in an official gazette as required by law was 278,391,893 including the voting rights attached to company-held shares which Thales may not exercise.

D. Potential capital

1. Securities carrying immediate or future equity entitlements (Bonds, warrants and options)

a. OCEANE bonds

In December 2001, Thales issued 9,809,691 notes redeemable into new or existing Thales shares (OCEANE) and maturing on 1 January 2007. On that date, 9,809,675 bonds were redeemed at par for a total nominal value of €500 million (€499,998,309.70) plus a coupon of €12.5 million (€12,458,266.93). And 16 bonds were converted into 17 Thales shares.

b. Share warrants

The increase in capital reserved for employees in December 2002 involved the allocation to subscribers in Germany of 53,980 unlisted share warrants to replace the 20% discount on the share subscription price.

In fiscal year 2006, no share warrants were exercised. At 31 December 2006, 53,446 warrants remained to be exercised, each entitling the holder to subscribe to 1.03 share for €26.70 each. They mature on 2 April 2007.

c. Stock options(1)

Options outstanding at 31 December 2006

At 31 December 2006, the following options were outstanding:

- 1,292,417 purchase options, with a weighted average exercise price of €35.09,
- 15,777,283 subscription options, at the weighted average exercise price of €35.21.

Purchase options

Date of Board decision	13/11/2001	02/04/2001	10/05/2000	14/09/1999
Discount	none	none	none	none
Exercise period	from 13 Nov. 2005 to 12 Nov. 2011 (a)	from 2 April 2005 to 1 April 2011 (b)	from 10 May 2004 to 9 May 2010 (b)	from 14 Sept. 2004 to 13 Sept. 2009
Exercise price (c)	€42.18	€42.37	€37.72	€32.59
Number of options exercised since grant date	none	none	6,366	391,906
Number of options outstanding at 31 Dec. 2005	217,915	79,544	239,268	947,234
Options exercised in 2006	--	--	2,123	95,789
Options cancelled in 2006	65,079	21,212	5,306	2,035
Number of options outstanding at 31 Dec. 2006 (c) less options cancelled (d) and exercised	**152,836**	**58,332**	**231,839**	**849,410**
of which exercisable options at 31 Dec. 2006	152,836	58,332	231,839	849,410
of which outstanding options at 31 Dec. 2006 held by: - Chairman	--	--	--	63,629
- the other members of Comex (Executive Committee)	20,930	none	21,210	189,837
Number of grantees of outstanding options	**399**	**5**	**73**	**120**
Including members of Comex (except the Chairman) at 31 Dec. 2006	none	none	1	10
Total top ten grantees (at plan date)	20,000	70,000	101,500	290,000

(a) In France. Details in "Conditions of exercise" below.
(b) At the Board Meeting of 12 July 2001, the starting date of the exercise period was brought forward from the fifth to the fourth anniversary of the grant date.
(c) Exercise price and numbers have been adjusted according to the conditions provided for in the applicable regulations (Articles D. 174-12 and 174-13), as a result of the distribution of dividends by charging reserves after the option grant date.
(d) Notably due to termination of the contract between the grantee and the Group since the grant date.

(1) For convenience, although purchase share options have no impact on potential capital, since they concern existing shares, they are presented in this section together with subscription share options and share warrants.

Subscription options

Date of Board decision	09/11/2006	30/06/2005	01/07/2004	01/07/2003	02/07/2002	12/07/2001
Discount	none	none	none	none	none	none
Exercise period (a)	from 9 Nov. 2010 to 8 Nov. 2016	from 30 June 2009 to 29 June 2015	from 1 July 2008 to 30 June 2014	from 1 July 2007 to 30 June 2013	from 2 July 2006 to 1 July 2012	from 12 July 2005 to 11 July 2011
Exercise price	€36.47	€34.01	€29.50	€25.70	€40.97 (b)	€42.18 (b)
Number of options exercised since grant date	none	1,500	24,780	115,671	none	none
Number of options outstanding at 31 Dec. 2005	none	2,190,800	2,536,350	2,829,847	3,264,462	3,490,554
Options granted	2,223,950	--	--	--	--	--
Options exercised in 2006	--	1,500	24,780	70,648	--	--
Options cancelled in 2006	--	43,900	47,816	40,566	252,105	277,365
Number of options outstanding at 31 Dec. 2006, less options cancelled (c) and exercised	**2,223,950**	**2,145,400**	**2,463,754**	**2,718,633**	**3,012,357 (b)**	**3,213,189 (b)**
of which exercisable options at 31 Dec. 2006	--	192,140	338,823	555,090	3,012,357	3,213,189
of which outstanding options at 31 Dec. 2006 held by: - Chairman	80,000	80,000	100,000	100,000	102,954	83,718
- the other members of Comex (Executive Committee)	265,000	240,000	249,500	257,938	248,124	226,044
Number of grantees of outstanding options	**1,998**	**1,990 (d)**	**3,234**	**3,643**	**5,077**	**4,947**
Including members of Comex (except the Chairman) at 31 Dec. 2006	12	12	11	11	10	11
Total top ten grantees (at plan date)	235,000	275,000	285,000	280,000	263,000	329,500

(a) In France. Details in "Conditions of exercise" below.
(b) Exercise price and numbers have been adjusted according to the conditions provided for in the applicable regulations (Articles D. 174-12 and 174-13), as a result of the distribution of dividends by charging reserves after the option grant date.
(c) Notably due to termination of the contract between the grantee and the Group since the grant date.
(d) Higher than the figure in the 2005 Annual Report as a result of corrected recording errors.

Conditions of exercise

All options have been granted for a ten-year period, with an exercise price without any discount to the market price.

All options granted on 14 September 1999, 10 May 2000, 2 April 2001, 13 November 2001, 12 July 2001 and 2 July 2002 are now exercisable in full.

Options are progressively vested over four years and may be exercised as follows:

Subscription options granted on 1 July 2003 and 1 July 2004

In all countries except the Netherlands and France, up to 37.5% of the number granted eighteen months after the grant date, then up to 6.25% of the number granted at the end of each subsequent quarter, reaching a total of 100% four years after the grant date.

In the Netherlands, up to 75% of the number granted three years after the grant date, reaching a total of 100% after four years.

Subscription options granted on 30 June 2005 and 9 November 2006

In all countries except France, up to 37.5% of the number granted eighteen months after the grant date, then up to 6.25% of the number granted at the end of each subsequent quarter, reaching a total of 100% four years after the grant date.

In France, for legal reasons, beneficiaries employed by companies registered in France cannot exercise any option before the fourth anniversary of the grant date.

Options granted and exercised in 2006

	Number of options granted / of shares subscribed or purchased	Exercise price	Maturity date	Grant date
1 – Directors				
Options granted in 2006				
- Denis Ranque	80,000	€36.47	08/11/2016	09/11/2006
- Pierre Lafourcade	1,800	€36.47	08/11/2016	09/11/2006
Options exercised in 2006	none			
2 – Ten (a) largest grants to employees (b)				
Options granted in 2006	235,000	€36.47	08/11/2016	09/11/2006
3 – Ten largest exercises by employees (b)				
Options exercised in 2006	53,344	€32.59	--	14/09/1999
	15,375	€25.70	--	01/07/2003
	9,375	€29.50	--	01/07/2004

(a) During the 2006 financial year, the ten largest individual grants to employees of the Company or the Company's subsidiaries were between 40,000 and 15,000 options each: one grantee received 40,000, two grantees received 30,000, six grantees received 20,000 and five grantees received 15,000 options.
(b) Including affiliated companies.

2. Maximum potential capital on 5 january 2007

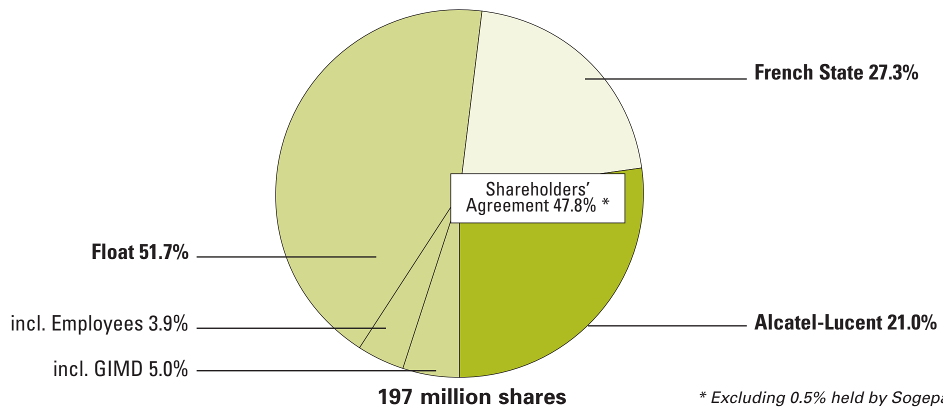
(In number of shares at €3 par value)		Maximum number of new shares	Called-up share capital
Share capital at 5 Jan 07 (after remuneration of assets contributed by Alcatel Participations)			197,006,808
Share warrants (not listed)		**55,049**	
Issued as part of 20 December 2002 leveraged capital increase (a)			
Outstanding subscription share options (b)		**15,777,283**	
- 12 July 2001 plan:	3,213,189 options at €42.18		
- 2 July 2002 plan:	3,012,357 options at €40.97		
- 1 July 2003 plan:	2,718,633 options at €25.70		
- 1 July 2004 plan:	2,463,754 options at €29.50		
- 30 June 2005 plan:	2,145,400 options at €34.01		
- 9 November 2006 plan:	2,223,950 options at €36.47		
Total potential new shares		**15,832,332**	
Maximum potential capital (+8.04%)			**212,839,140**

(a) Warrants issued for Group employees in Germany, in lieu of discount:
Exercise ratio: 1.03 shares for 1 share warrant at €26.70,
53,980 warrants issued on 20 december 2002, 534 exercised since issuance,
53,980 warrants in circulation on 5 January 2007,
Maturity date: 1 April 2007.
(b) For maturity dates, see "Conditions of exercise" on page 130. Generally speaking, 100% of options are exercisable four years after their grant date (plan date), for a period of six years from that date.

E. Shareholders

To the best of the company's knowledge, no shareholder other than those mentioned in this section holds 5% or more of the capital or voting rights.

1. Shareholding at 5 January 2007



** Excluding 0.5% held by Sogepa (100% French State).*

In view of the capital increase approved at the shareholders' meeting of 5 January 2007, immediately after the closure of the 2006 financial year, the shareholder information presented thereafter is mainly based on the shareholding structure at 5 January 2007.

2. Shareholders bound by a shareholders' agreement

a. Public Sector (TSA and Sofivision)

TSA is a holding company whose capital is held entirely by the French State. It holds 45,562,623 Thales shares directly.

Its wholly-owned subsidiary Sofivision holds 8,108,283 Thales shares.

The French State directly owns 2,022 share, including a golden share that gives it the rights detailed on page 134 (Article 3 of Decree 97-190 of 4 March 1997).

b. Industrial Partner

Alcatel-Lucent is a joint stock company whose shares are listed on a number of regulated stock markets and which holds through its subsidiary Alcatel Participations 41,262,481 Thales shares, representing 20.94% of Thales's share capital.

3. Shareholders' agreement and Agreement for the protection of national strategic interests

a. Shareholders' agreement

TSA and Alcatel-Lucent concluded a new shareholders' agreement to govern relations between Alcatel-Lucent and TSA within Thales, entered into force on the date of contribution of Alcatel Participations's assets, 5 January 2007.

The agreement was signed in application of the cooperation agreement between Thales, Alcatel-Lucent and TSA, which replace the previous cooperation agreement signed on 18 November 1999 between Alcatel, Thales and GIMD(1).

Pursuant to Law n. 86-912 of 6 August 1986 relating to privatisation:

- the objectives of this agreement were published in an announcement from the Ministry of the Economy, Finance and Industry(2),
- approval was received from the Commission des Participations et des Transferts(3),
- a decree was issued by the Minister of the Economy, Finance and Industry(4) authorising the increase in capital to remunerate the assets contributed by Alcatel Participations.

This agreement contains the main provisions of the shareholders' agreement signed on 14 April 1998(5) which it

(1) Available on the AMF website: www.amf-france.org
(2) Published in the French Journal Officiel of 12 December 2006 (see Journal Officiel website: http://www.journal-officiel.gouv.fr/jahia/Jahia/pid/1) pursuant to the provisions of Article 1-1 of Decree 93-1041 of 3 September 1993 and in application of the above mentioned Law n. 86-912 of 6 August 1986.
(3) Recorded as 2006-AC-6 of 28 December 2006 (see Journal Officiel website: http://www.journal-officiel.gouv.fr/jahia/Jahia/pid/1).
(4) Dated 2 January 2007, published in the Journal Officiel of 4 January (see Journal Officiel website: http://www.journal-officiel.gouv.fr/jahia/Jahia/pid/1).
(5) Available on the AMF website: http://www.amf-france.org

replaces. GIMD is not a signatory to the new agreement. The agreement is reproduced in the appendix to the Thales Board of Directors' report to the Extraordinary General Meeting of Shareholders of 5 January 2007, recorded by the AMF on 9 December 2006 as E.06-194 (http://www.thalesgroup.com/ir/home/)

The AMF considered[(1)] that the changes to the shareholders' agreement and the contractual provisions relating to the planned operations did not unbalance the shareholdings in that agreement within the meaning of Article 234-7 of the AMF's General Regulations, compared with the situation observed at the time of the decision made by its predecessor the CMF on 20 April 1998[(2)], and that consequently there was no need to file a public tender offer.

The main provisions of the agreement are as follows:

1. The Thales Board of Directors comprises 16 members as follows:

- 5 members proposed by the Public Sector (defined as TSA and Sofivision),
- 4 members proposed by Alcatel-Lucent,
- 2 employee representatives,
- 1 employee shareholder representative,
- 4 outside personalities.

The Chairman-Chief Executive Officer (or Chairman and Chief Executive Officer if the posts are separate) shall be chosen on the joint proposition of the Public Sector and Alcatel-Lucent. When the Board of Directors is renewed, the Public Sector and Alcatel-Lucent may adjust their representation on the Board in proportion to the number of Thales shares each of them holds on the date of the Board renewal.

2. The following decisions shall be submitted to the Thales Board of Directors and are not valid unless the majority of directors representing Alcatel-Lucent, present or represented at the Board meeting, vote in favour of the relevant motions: election and dismissal of the Chairman-Chief Executive Officer (or Chairman or Chief Executive Officer if the posts are separate) and any separation of the posts of Chairman and Chief Executive Officer; adoption of the Thales Group's annual budget and rolling multi-year strategic plan; a decision that may adversely impact cooperation between Alcatel-Lucent and Thales; all significant acquisitions and divestments[(3)] of holdings or assets, and all strategic agreements on alliances and technological and industrial cooperation.

3. In the case of persistent disagreement between Alcatel-Lucent and the Public Sector concerning major strategic decisions likely to adversely impact the strategic interests of the French State or concerning the appointment of the Chairman-Chief Executive Officer, to the extent that Alcatel-Lucent exercises its veto on the Thales Board of Directors, either the Public Sector or Alcatel-Lucent may unilaterally terminate the shareholders' agreement.

4. The Public Sector undertakes to enable Alcatel-Lucent to hold at least 15% of share capital and voting rights in Thales and to remain the largest private shareholder in Thales, while the Public Sector also undertakes not to exceed 49.9% (including the Sogepa holding) of share capital and voting rights in Thales.

5. Similarly, a mutual right of pre-emption is recognised for the Public Sector and the Industrial Partner, should either hold less than 15% of Thales share capital, to acquire the remaining holding of the party that falls below the 15% threshold. Furthermore, should either partner fall below the threshold, they shall no longer enjoy the provisions of the shareholders' agreement.

6. Should any of the following arise:

- serious unremedied breach by Alcatel-Lucent of its obligations under the Agreement on the protection of national strategic interests in Thales concluded between Alcatel-Lucent and the State (see below), likely to compromise the protection of the strategic interests of the French State,
- observation that Alcatel-Lucent's execution of a foreign law creates constraints for Thales that substantially compromise the protection of the strategic interests of the French State,
- the 20%, one-third, 40% or 50% thresholds of share capital or voting rights in Alcatel-Lucent being directly or indirectly exceeded by a person acting alone or in concert who is deemed to be incompatible with the State's strategic interests,
- the Public Sector may end the entitlements that Alcatel-Lucent enjoys under the shareholders' agreement and request Alcatel-Lucent either to immediately suspend its exercise of voting rights in Thales in excess of 10% or to reduce its holding to below 10% of Thales's share capital. Should Alcatel-Lucent not comply with this request, the State shall enjoy a purchase option on all Thales shares held by Alcatel-Lucent at a price equal to the Volume Weighted Average Price (VWAP) of the Thales share over a period of sixty (60) trading days.

(1) Decision n. 207C0013 of 2 January 2007, published in the Bulletin des Annonces Légales Obligatoires of 5 January 2007.
(2) See decision D&I 198C0370 of 21 April 1998.
(3) Significant meaning all operations either (i) equal to or higher than €150 million in revenues, or (ii) involving a commitment equal to or higher than €150 million.

7. TSA and Alcatel-Lucent declare that they act in concert with respect to Thales.

This agreement shall remain in force until 31 December 2011. It is tacitly renewable by five-year period unless notice to revoke is given by one of the parties six months before the termination date.

b. Agreement on the protection of national strategic interests

Alcatel-Lucent, TSA and the State have signed an Agreement on the protection of national strategic interests in Thales. The main commitments made by Alcatel-Lucent under this Agreement are as follows:

a) any candidates for the Thales Board of Directors proposed by Alcatel-Lucent shall be nationals of a European Union country (except for the explicit agreement of the State given on a case-by-case basis),

b) access to information relating to the businesses and governance of Thales shall be strictly controlled within Alcatel-Lucent,

c) Alcatel-Lucent shall use its best endeavours to avoid any action or influence in the governance and businesses of Thales by foreign national interests.

4. Specific Agreement[(1)]

The French State directly owns 2,022 shares, including a golden share that gives it the following main rights[(2)]:

- "Any increase in the direct or indirect holding of securities, of whatever nature or legal form, beyond a threshold of one-tenth, or multiple of one-tenth, of the capital or voting rights of the company, by any natural person or legal entity, whether acting singly or in concert, must be approved in advance by the Minister in charge of the economy (...)",

- "At the proposal of the Minister of Defence, a representative of the State sits on the Board as a non-voting director",

- "(...) Decisions to assign or allocate by way of guarantee the assets specified in the annex to this Decree may be opposed ".

These assets include majority interests in the capital of eleven Thales direct subsidiaries:

Thales Systèmes Aéroportés S.A., Thales Microwave S.A., Thales Optronique S.A., Thales (Wigmore Street) Ltd, Thales Communications S.A., Thales Air Systems S.A., Thales Nederland B.V., Thales Naval S.A., Thales Avionics S.A., Thales Services S.A.S., Thales Underwater Systems NV.

Since the contribution of assets brought Alcatel-Lucent above the 10% and 20% thresholds of share capital and voting rights in Thales, it was consequently submitted for prior approval to the Minister of the Economy, Finance and Industry, and approval was received by Alcatel-Lucent on 3 January 2007. However, the State wished to have adequate contractual guarantees for the protection of national strategic interests. The State and Thales signed an Agreement to provide the State with control over not only the transfer of assets already described in Decree n. 97-190 of 4 March 1997 but also the shares in Alcatel Alenia Space to be transferred to Thales by Alcatel Participations ("Strategic Assets").

a) where the Strategic Asset is a company ("Strategic Company"):

- any proposed transfer of shares in the Strategic Company to a third party such that the third party exceeds the 33.3% threshold in the share capital,
- any proposed transfer of shares in the company that directly or indirectly controls the Strategic Company to a third party such that the third party exceeds the 33.3% threshold in the share capital;

b) where the Strategic Asset is an isolated asset, unincorporated division or business branch ("Strategic Division"):

- any proposed transfer of shares in the company that possesses that Strategic Division to a third party such that the third party exceeds the 33.3% threshold in the share capital,
- any proposed transfer of shares in the company that directly or indirectly controls the company mentioned in the above paragraph to a third party such that the third party exceeds the 33.3% threshold in the share capital;

c) any proposed transfer of Sensitive Assets to a third party;

d) and any proposal intended or having as its effect to confer Particular Rights on a third party.

Any proposed transfer as described in paragraphs (a), (b) (c) and (d) above shall be notified to the State, which undertakes to communicate its approval or refusal within thirty (30) working days from reception of the notification; if no reply is received from the State during this period, this shall be considered equal to approval.

(1) This Agreement is reproduced in the appendix to the Thales Board of Directors' report to the Extraordinary General Meeting of Shareholders of 5 January 2007, recorded by the AMF on 9 December 2006 as E.06-194 (http://www.thalesgroup.com/ir/home/).
(2) In application of Article 3 of Decree 97-190 of 4 March 1997.

5. Company-held shares

At 31 December 2006, Thales held 3,134,701 treasury shares after successive purchases and sales on the market or otherwise under the authority granted to the Board of directors by the General Meeting of shareholders. At 5 January, Thales held 3,064,815 treasury shares, 1.56% of its capital, after the increase approved by the General Meeting of shareholders of that date.

These shares are subject to no restrictions and may be freely traded.

a. Authority to trade in its own shares

The Annual General Meeting of 10 March 1999, pursuant to the memorandum of 18 February 1999 (COB approval n. 99-142), authorised the Board to implement a buy-back programme as it thought fit. The General Meeting of 29 June 1999 authorised an extension to the objectives of this programme (memorandum of 18 May 1999, COB approval n. 99-621). The General Meetings of 23 May 2000 (memorandum of 7 May 2000, COB approval n. 00-703), 16 May 2001 (memorandum of 24 April 2001, COB approval n. 01-432), 16 May 2002 (memorandum of 24 April 2002, COB approval n. 02-440), 15 May 2003 (memorandum of 24 April 2003, COB approval n. 03-312), 11 May 2004 (memorandum of 20 April 2004, AMF approval n. 04-295) and 17 May 2005 (memorandum of 29 April 2005, AMF approval n. 05-330) authorised the continuance of this programme.

Under the authorities granted to the Board by the General Meeting, the company carried out the following operations:

- in 1999, 1.9 million shares were bought back,
- in 2001, Thales sold Alcatel its stake in Alcatel Space: the price of the transaction (€795 million) was paid half in cash and half in Thales shares, corresponding to 8.8 million shares,
- in 2002, 1.1 million shares were sold on the market,
- in 2004, 1.2 million shares were sold on the market, directly and by proxy, 1.3 million were sold under a liquidity contract, and approximately 520,000 were transferred to employees in an employee stock offer,
- in 2005, 2 million shares were sold on the market, directly and by proxy, 1 million were sold under a liquidity contract, and approximately 300,000 were transferred to employees as options vested. 87,000 shares were transferred to Group employees in the United Kingdom who had subscribed to the employee shareholding offer in December 2004,
- in 2006, some 457,000 shares were bought and 388,000 sold under liquidity contract and some 98,000 were transferred to employees as options vested.

The General Meeting of 16 May 2006 extended this authority for eighteen months, with a maximum purchase price of €50 per share. A minimum sale price of €25 per share was set by the Board meeting of 8 March 2007.

Details of the other conditions are given in Resolution 11 and the description of the share buy-back programme drafted in line with AMF general regulations (Articles 241-1 ff) below.

At 31 December 2006, the company was engaged in no trading in derivatives of its own shares.

b. Authority to cancel the company's shares

The Annual General Meeting of 17 May 2005 granted the Board of directors a 24-month authority to cancel shares acquired under the shareholder-approved buyback programme, within the limit of 10% of the company's capital. This authority was not used and expired on 16 May 2007.

The General Meeting of 16 May 2007 renewed this authority for a further 24 months on the same conditions.

c. Authority to grant free existing shares

The General Meeting of 17 May 2005 granted the Board authority to grant employees in Group companies, free of charge, existing Thales shares acquired under a buy-back programme, not to exceed 1.3 million shares (approximately 0.75% of current capital) and for a period of 38 months.

This authority expires on 16 July 2008.

The General Meeting of 16 May 2007 granted the Board authority to grant employees in Group companies, free of charge, existing Thales shares acquired under a buy-back programme, not to exceed 1.3 million shares (approximately 0.66% of current capital) and for a period of 38 months.

This delegation cancels and replaces that granted by the General Meeting of 17 May 2005, which had not been used.

Report to the General Meeting of Shareholders of 16 May 2007 concerning the granting of free shares
(Article L225-197-4 § 1 of the Commercial Code)

Financial year 2006
The General Meeting of Shareholders of 17 May 2005, in its eighth resolution, delegated to the Board of Directors the authority to grant free shares to staff, including to legally responsible mandataires sociaux within the meaning of the French Commercial Code.

This authority was granted for 38 months (expiring on 16 July 2008) for a maximum of 1.3 million existing shares, in one or more grants.

It was not used during financial year 2006.

d. Description of share buy-back programme

1. Description of share buy-back programme approved by the General Meeting of 16 May 2007

- Maximum proportion of capital subject to buy-back: 10% on buy-back date

- Maximum amount of programme: €985,034,000

- Maximum unit purchase price: €50

- Minimum unit selling price: €25 (set by the Board of Directors at their 8 March 2007 meeting) except for operations previously approved by the Board of Directors, requiring the sale or free grant of existing sales.

Objectives ranked in descending order:

- sell or allocate shares to Group employees and senior officers as stipulated by law, particularly when stock options are exercised or existing shares are granted free or contributed by the company, in the framework of an operation reserved to employees,
- retain shares for later use in external growth,
- allow trading in the share by a liquidity contract prepared in accordance with the conduct of business charter approved by the AMF,
- cancel shares in accordance with a resolution passed by the General Meeting.

Duration of programme: eighteen months from the General Meeting of 16 May 2007, or 14 November 2008 at the latest.

Liquidity contract: In November 2004, Thales signed a liquidity contract with Exane BNP-Paribas, in accordance with the AFEI conduct of business charter, to regulate trading in the share. The contract was modified to comply with the AFEI conduct of business charter appended to the AMF decision of 22 March 2005.

2. Results of previous approved programmes

Programmes before 15 May 2006

Under these programmes, the company bought 1,921,730 shares at an average unit price of €29.24. On 9 July 2001, the company received 8,821,894 shares as payment for its holding in Alcatel Space, at a unit price of €45.06. The company also sold 8,476,918 shares at an average unit price of €35.49 and bought 902,423 at an average price of €34.67.

At 31 March 2006, the final reporting date for these programmes, the company held 3,169,129 of its own shares.

Programme of 15 May 2006

The company's trading in its own shares from 1 April 2006 (date of previous report) to 28 February 2007 are summarised in the tables below:

- percentage of company-held capital: 1.53%,
- number of shares cancelled in previous 24 months: nil,
- number of shares sold from 1 April 2006 to 28 February 2007: 517,723, at average price of €35,65,
- number of shares acquired from 1 April 2006 to 28 February 2007: 355,597, at average price of €34,73,
- number of Thales shares held in portfolio at 28 February 2007: 3,007,003,
- (Gross) book value of portfolio: €135,206,357, corresponding to an average price of €44.96,
- market value of portfolio at 27 February 2007: €117,092,697, at closing price on 28 February 2007 of €38.94.

	Cumulative gross flows from 1 April 2006 to 28 February 2007		Positions open on programme description date					
	Purchases	Sales	Purchase positions open			Revenue positions open		
Number of shares	355,597	517,723	Call options bought	Put options sold	Forward purchase contracts	Call options sold	Put options bought	Forward sale contracts
Maximum average term			nil	nil	nil	nil	nil	nil
Average price	34.73	35.65						
Average exercise price	nil	nil	nil	nil	nil	nil	nil	nil
Amounts (€)	12,348,431	18,547,086						

Thales engaged in no trading in derivatives (forward sale contracts) as part of this buy-back programme.

Trading in company shares during 2006

At 1 January 2006, Thales held 3,163,613 of its own shares, 1.84% of capital, and at 31 December 2003, 3,134,701 of its own shares.

The net balance of 2006 trading was a sale of 28,912 shares, broken down by objective as follows:

a) Sale or allocation of shares to Group employees and senior officers as stipulated by law, particularly when options vest or existing shares are granted free of charge 97,912

b) Regulation of the market price by a liquidity contract prepared in accordance with the AFEI conduct of business charter -69,000

Breakdown of company-held shares by objective at 28 February 2007

The total number of shares held at that date was 3,007,003, equivalent to 1.53% of Thales' registered capital. The breakdown by objective was as follows:

a) Sale or allocation of shares to Group employees and senior officers as stipulated by law, particularly when options vest or existing shares are granted free of charge 2,313,630

b) Regulation of the market price by a liquidity contract prepared in accordance with the AFEI conduct of business charter 57,726

The net may be sold under existing regulations.

6. Shares held by the public

The company is entitled at all times, and as provided by law, to ascertain the identity of, and number of shares held by, holders of bearer shares that now or in the future amount to a specified fraction of its ordinary shares ("TPI Identifiable Bearer Security procedure").

Based on the most recent inquiry on identifiable holders of bearer shares carried out by Euroclear France, and the company's information about employee shareholders, private ownership of company shares is estimated as follows.

In thousand shares	05/01/2007	31/12/2006	31/12/2005	31/12/2004
French institutions and investment funds (a)	46,216	35,308	45,734	37,064
Non-resident institutional investors	37,456	37,456	22,276	29,255
Employee shareholders	7,584	7,584	7,961	8,756
Individual shareholders and non-profit bodies (b)	8,394	8,394	8,959	9,309
Not identified	357	287	3,972	1,055
Total general public	**100,007**	**89,029**	**88,903**	**85,440**
Total number of shares	197,007	172,007	171,910	171,869

(a) On 5 January 2007, Sogepa and GIMD left the shareholders' agreement and their holdings are recorded under "French institutions and investment funds". At 31 December, they were members of the shareholders' agreement, and their proportionate holdings are not included in the table.
(b) French residents.

	% of total capital				% of free float (excluding company-held)			
	05/01/2007	31/12/2006	31/12/2005	31/12/2004	05/01/2007	31/12/2006	31/12/2005	31/12/2004
French institutions and investment funds	23.5%	20.5%	26.6%	21.6%	46.2%	39.7%	51.3%	43.4%
Non-resident institutional investors	19.0%	21.8%	13.0%	17.0%	37.5%	42.1%	25.1%	34.2%
Employee shareholders	3.8%	4.4%	4.6%	5.1%	7.6%	8.5%	9.0%	10.2%
Individual shareholders and non-profit bodies	4.3%	4.9%	5.2%	5.4%	8.4%	9.4%	10.1%	10.9%
Not identified	0.2%	0.2%	2.3%	0.6%	0.4%	0.3%	4.5%	1.2%
Total general public	**50.8%**	**51.8%**	**51.7%**	**49.7%**	**100%**	**100%**	**100%**	**100%**

To the best of the company's knowledge, based on the TPI survey on 31 December 2006 and the number of bearer shares recorded on that date, the company's shareholders are estimated to be approximately 87,000 at end 2006.

A further survey was carried out in early 2007 of the main French and other institutional investors operating on the Paris market. This information, more recent than the TPI survey and more detailed as to the nationality of the institutional investors, is given in the table below.

	Shares held (thousands)	% of total capital	Number of investors
France	34,592	17.6%	104
United Kingdom & Ireland	13,949	7.1%	52
North America	17,012	8.6%	56
Continental Europe (outside France)	5,148	2.6%	110
Rest of world	1,347	0.7%	15
	72,048	36.6%	337

7. Employee shareholders

At 31 December 2006, employees within the meaning of Article L225-102 of the Commercial Code held 7,597,504 Thales shares, 4.42% of the share capital, via the Group savings plan (PEG) either directly or via a company investment fund (FCPE) or equivalent in the United Kingdom. After the capital increase to remunerate the assets contributed by Alcatel Participations on 5 January 2007, the employees' holding was reduced to 3.85% of the share capital.

At 31 December 2006, 73% of the Thales shares held by employees were freely tradable (compared with 59% at 31 December 2005). Shares acquired by the Group's existing and previous employees as part of the December 2002 capital increase reserved for employees became freely tradable on 2 April 2007.

F. Regulated agreements

1. Agreements made during 2006

- **Cooperation agreement with Alcatel-Lucent and TSA on 1 December 2006 (came into force on 5 January 2007) – Board of Director's meeting of 9 November 2006**

Directors concerned: Marcel Roulet and Serge Tchuruk (see Paragraph E.3 page 132).

- **Master Agreement with Alcatel-Lucent and Alcatel Participations on 1 December 2006 (came into force on 5 January 2007) – Board meetings of 9 and 23 November 2006**

Director concerned: Serge Tchuruk

The Master Agreement divides the closer cooperation between Thales and Alcatel-Lucent into two phases. The first is the transfer to Thales of Alcatel-Lucent's transport and security businesses, approved at the Extraordinary General Meeting of 5 January 2007. The second is the transfer to Thales of Alcatel Participations' holdings in Alcatel Alenia Space and Telespazio in April 2007, with the approval of the European Commission, after close examination in application of EU regulations on concentration.

- **Agreement appended to the Master Agreement** on compensation for Alcatel-Lucent should the second phase of closer cooperation relating to the satellite business not be executed

- **Memorandum of understanding with Alcatel-Lucent, GIMD and TSA of 28 December 2006 (came into force on 5 January 2007) – Board of Directors' meeting of 23 November 2006**

Directors concerned: Serge Dassault, Serge Tchuruk and Marcel Roulet

The memorandum of understanding with Alcatel-Lucent, GIMD and TSA orders the conditions for GIMD's exit from the cooperation agreement and previous shareholders' agreements.

2. Agreements authorised and made in previous years that continued in effect in 2006

- Cooperation agreement dated 18 November 1999 (approved by the Board of Directors on 18 October 1999)

This cooperation agreement between Alcatel, Groupe Industriel Marcel Dassault, TSA (formerly Thomson SA) and Thales, made when Alcatel increased its holding in Thales, came into force on 23 December 1999, when the French State transferred Thales shares to Alcatel. The agreement was intended to strengthen technical and commercial cooperation between Thales and Alcatel and remained in force until 5 January 2007, when the new cooperation agreement with Alcatel-Lucent, Thales and TSA came into force

- Agreement with Thomson concerning the "use and exploitation of the Thomson group's intellectual property" (approved by the Board of directors on 17 June 1997)

Under the terms of the agreement (as amended in 2000) concerning the management of Licensed Products (compact disks, video-disks, optical disk readers), Thales receives a proportion of the royalties on the Licensed Products paid by licensees.

Royalties received by Thales in 2006 amounted to €2,612,886 excluding tax.

- GIE with Alcatel (approved by the Board of directors on 1 July 2004)

This GIE was created on 5 July 2004 under the name Alcatel Thales III-V Lab in order to:

- manage a joint laboratory centralising the members' industrial research on optoelectronic and microelectronic III-V semiconductor component technology, specifically the design, manufacture and characterisation of these components,
- arrange forms of cooperation and partnership appropriate for this work,
- transfer the technologies developed to the members' component manufacture units or agreed industrial partners.

In 2006:

- Alcatel Thales III-V Lab generated revenues of €18.7 million,
- Thales invoiced €6.7 million to the joint lab, mainly for the salaries of seconded staff, support activities and rent of the premises.

The joint lab is funded equally by Alcatel and Thales, except for research projects specific to one of them. Sales and marketing action to ensure and increase external funding for the joint lab is directed towards the Ministry of Research, local authorities in the Paris region, and the European Commission under the IST programmes of the Sixth Framework Programme for Research and Technological Development.

- Agreement with TSA on the provision of financial, legal and administrative services (Board of Director's meeting of 30 June 2005)

Under this agreement, Thales provides TSA with assistance from the Group's specialist financial, legal and administrative services, since TSA no longer has the internal resources to operate alone.

Royalties received by Thales in 2006 amounted to €350,000 excluding tax.

- Partnership agreement between Thomson and Thales (concluded when TBM was sold to Thomson, as authorised by the Board of Directors' meeting of 24 November 2005)

This partnership agreement of 13 December 2005, concerns the management and distribution of high value-added video content, especially for in-flight entertainment, and in security and defence applications, using the two groups' expertise and competencies in these fields. The agreement was signed for 3 years and remained in force throughout 2006.

3. Agreement authorised and made during a previous year that did not need to be applied in 2006

- Amendment to Denis Ranque's suspended employment contract (Board of Directors' meeting of 11 March 2003)

The General Meeting of 15 May 2003 approved the addition of an amendment to the employment contract between the company and Denis Ranque in 1986, deferred in January 1998 when Mr Ranque was appointed Chairman and CEO.

The amendment contains the following provisions:

- at the date on which the employment contract becomes applicable once more, his basic compensation shall be at least equal to the average basic compensation of the

members of the Executive Committee (other than the Chairman and CEO),
- Denis Ranque shall be eligible for the Group's current variable compensation plan and the seniority he acquired while the employment contract was deferred shall be applied,
- when his employment contract becomes applicable once more, Denis Ranque, if he so agrees, shall be subject to any modifications to the employment contract of members of the Executive Committee that may have been made between the signature of this amendment and the date his contract becomes applicable once more.
  However, should any of these modifications amount to significant changes in Denis Ranque's employment contract subject under the Commercial Code to authorisation by the company's Board of directors, they may only be incorporated in his employment contract after being duly authorised by the Board,
- within two months of his employment contract becoming applicable once more, Denis Ranque must be offered a position appropriate for his competencies, including membership of the Executive Committee, and corresponding to his aspirations.
  Failing such an offer within that period, the company must dismiss Mr Ranque and make a severance payment equal to twenty-four months' salary (gross basic salary plus the average variable compensation paid the previous year to the members of the Executive Committee, other than the Chairman and CEO),
- should the employment contract continue to be applicable, M. Denis Ranque shall continue to be eligible in case of dismissal, except for serious cause, to a payment equal to twenty-four months' salary (including the statutory dismissal payment and any other current contractual provisions, but not including any sums in lieu of notice).

The provisions of this amendment did not need to be applied during 2006.

II - Corporate governance

A. Board of directors

Denis Ranque, Chairman & Chief Executive Officer of Thales

Positions held

Chairman of the Board of Directors
École Nationale Supérieure des Mines de Paris

Director
Saint-Gobain
Fondation de l'École Polytechnique
AFEP (Association of French Private Companies)

Chairman
Cercle de l'Industrie

Member of Advisory Council
Banque de France

First Deputy Chairman
GIFAS (French aerospace industry association)

Born: 7 January 1952 – Nationality: French

First appointment: 20 January 1998
Current term expires: OGM 2010

Number of Thales shares held: 5,203
(including via the FCPE company investment fund)

Jean-Paul Barth, former Senior Executive & Vice-President of Alcatel

Positions held

Chairman
Château Malescasse
Electro Ré (Luxembourg)

Director
Alcatel CIT (and Honorary Chairman)
Electro Assurances
Rockwell-Collins France

Member of the Supervisory Board
Faceo

Other positions held in the last five years

Director
Diot S.A.
Locatel
Electro Banque

Chairman
Générale Occidentale

Chairman & Chief Executive Officer
Alcatel Participations

Born: 10 April 1942 – Nationality: French

First appointment: 22 June 1998
Current term expires: OGM 2012

Number of Thales shares held: 500

Bruno Bézard, Managing Director of the French Government shareholding agency (APE)

Director representing the French State pursuant to Article 139 of the French corporate governance act (NRE), coopted by the Board of Directors on 6 April 2007 to replace Denis Samuel-Lajeunesse.

Positions held

Director (representing the State)
EDF
La Poste
Areva
France Telecom
Air France-KLM

Other positions held in the last five years
Director
Renault
France Télévisions
SNCF

Born: 19 May 1963 – Nationality: French

First appointment: 6 April 2007
Current term expires: OGM 2010

No Thales shares held, pursuant to Article 139 of the French corporate governance act (NRE)

François Bujon de l'Estang, French Ambassador (retd.)

Positions held

Chairman
Citigroup France

Director
CNES, the French space agency (public body)
Institut Français des Relations Internationales

Member of the International Advisory Board
Citigroup
Total

Other positions held in the last five years
French Ambassador to the United States

Vice-President of Institut Pasteur

Director of Tembec, Inc. (Canada)

Born: 21 August 1940 – Nationality: French

First appointment: 11 May 2004
Current term expires: OGM 2008

Number of Thales shares held: 500

Charles de Croisset, International advisor to Goldman Sachs International
Senior Advisor to Bain & Company Consulting

Independent director

Positions held

Chairman
Fondation du Patrimoine

Director
Bouygues
Renault

Member of the Supervisory Board
Euler & Hermes

Non-voting director (censeur)
SA des Galeries Lafayette

Other positions held in the last five years
Chairman & Chief Executive Officer
CCF

Born: 28 September 1943 – Nationality: French

First appointment: 11 May 2004
Current term expires: OGM 2010

Number of Thales shares held: 500

Director
HSBC CCF Asset Management Holdings
HSBC Bank Plc
HSBC Holdings Plc
HSBC Private Bankink Holdings
HSBC CCF Asset Management Group
Société des Amis du Louvre

Board member
HSBC Guyerzeller Bank AG
HSBC Private Holding (Suisse) SA

Permanent representative of SRRE Luxembourg on the Board of Directors of
Somarel

Chairman of the Supervisory Board
Nobel
CCF Charterhouse

Olivier Costa de Beauregard, Chief Operating Officer of Groupe Industriel Marcel Dassault (GIMD)

Director coopted by the Board (first appointment) on 6 February 2007 in accordance with the quota allocated to the Industrial Partner to replace Serge Dassault.

Positions held

Director
Socpresse
S.A. du Figaro

Managing Director
Dassault Belgique Aviation (Belgium)

Permanent representative of GIMD on the Board of Directors of
Artcurial SAS
Dassault Développement

Chairman of the Executive Board
Immobilière Dassault

Member of the Supervisory Board
Adenclassifieds
Journal Des Finances
Groupe Industriel Marcel Dassault SAS

Chairman & Chief Executive Officer
Dassault Multimedia SAS

Other positions held in the last five years

Managing Director
CCF

Chairman & Chief Executive Officer
Netvalor S.A.
Delaroche S.A.

Member of the Supervisory Board
Banque Dupuy, de Parseval

Born: 17 March 1960 – Nationality: French

First appointment: 6 February 2007
Current term expires: OGM 2008

Number of Thales shares held: 500

Director
Banque Accord
Loxxia
A.G.I.R.
Groupe Progres S.A.
Le Bien Public
Les Journaux de Saône et Loire
Publiprint Province N 1

Manager
S.C.P.I.

Permanent representative of
Socpresse on the Board of Directors of Le Dauphiné Libéré
Delaroche on the Board of Directors of Lyon Matin

Marie-Paule Delpierre, Manager at the Air and Naval Communications business of Thales Land & Joint Systems

Born: 20 December 1948 – Nationality: French

First appointment: 30 May 1989
Current term expires: 8 December 2010

Number of Thales shares held: 500

Roger Freeman, Consultant & Chairman of the Advisory Panel, PriceWaterhouseCoopers, London, UK

Born: 27 May 1942 – Nationality: British

First appointment: 24 July 1998 (effective from 1 Jan. 99)
Current term expires: OGM 2012

Number of Thales shares held: 615
(including via the FCPE company investment fund)

Positions held

Chairman
Thales Holdings UK Plc
Thomson (UK) Holdings Ltd
Thomson-CSF Plc
Racal Senior Management Trustee Ltd
Racal Staff Trustee Ltd
Racal-Decca Pension Trustee Ltd
Racal Executive Trustee Ltd
Metalysis Ltd
Radiation Watch Ltd
IDDAS Ltd
Cambridge Enterprise Ltd
Imprimatur Capital Ltd

Director
Chemring Group Plc
Global Energy Development Plc
CrossCore Optimization Ltd

Consultant
RP&C Ltd

Other positions held in the last five years
Founder Member
Hundred Group of Chartered Accountants

Chairman
British International Freight Association (1999-2002)

Member of Advisory Council
British Consultants and Construction Bureau (BCCB) 2003

Public offices
Member of Parliament 1983-1997
Privy Counsellor 1993
Life Peer 1997
Parliamentary Secretary Armed Forces 1985-1988
Parliamentary Secretary Health 1988-1990
Minister of State for Public Transport 1990-1994 (Railway Privatisation)
Minister of State for Defence Procurement 1994-1995
Cabinet Minister for Public Service 1995-1997 and Chancellor of the Duchy of Lancaster (Deregulation and Privatisation)
Vice Chairman and Special Advisor on Candidate Selection, Conservative Party, 1997-2001
President, Council of Reserve Forces and Cadets' Associations (UK), 1999
Chairman and Trustee, Busoga Trust 2000 – (African water source charity)
Companion, Royal Aeronautical Society, 1999
Member, House of Lords Science & Technology Sub Committee II
Member, House of Lords Select Committee on Speakership, 2003 and 2005
Member, House of Lords Select Committee on European Union Sub Committee C 2005
Co-Chairman, UK – Sierra Leone Business Forum 2004
Chairman of Trustees, Skill Force Development Ltd (Government supported educational charity for training school children), 2004
Trustee, National Army Museum, 2005

Didier Gladieu, Manager at the Finance Department of Thales Air Systems S.A.

Other positions held in the last five years
Director
Thales Naval S.A.

Born: 19 January 1958 – Nationality: French

First appointment: 26 September 1997
Current term expires: 8 December 2010

Number of Thales shares held: 500

Philippe Lépinay, Vice-President, Business Development, Thales International

Director coopted by the Board on 8 March 2007 with effect from 1 April 2007, to replace Pierre Lafourcade, who retired on 31 March 2007.

Positions held

Vice-Chairman
FAST (Federation of Associations of Employee Shareholders of Thales)
FAS (French federation of employee shareholders' associations)

Chairman
APAT (Thales French employee shareholders' association)

Member of the Supervisory Board
FCPE Thales employee shareholders' fund

Born: 3 December 1953 – Nationality: French

First appointment: 8 March 2007
Current term expires: OGM 2011

Number of Thales shares held: 550
(including via FCPE company investment fund)

Didier Lombard, Chairman & Chief Executive Officer of France Telecom

Positions held

Chairman of the Board of Directors
Orange

Director
Thomson

Member of the Supervisory Board
Radiall
ST Microelectronics
A2I (Agence de l'Innovation Industrielle)

Other positions held in the last five years

Senior Executive VP
France Telecom

Ambassador
Delegate ambassador for international investment

Born: 27 February 1942 – Nationality: French

First appointment: 30 June 2005
Current term expires: OGM 2008

Number of Thales shares held: 500

Klaus Naumann

Independent director

Positions held

Chairman of the Supervisory Board
OWR (Odenwald Werke Rittersbach)

Born: 25 May 1939 – Nationality: German

First appointment: 11 May 2004
Current term expires: OGM 2012

Number of Thales shares held: 500

Serge Tchuruk, Chairman of the Board of Directors of Alcatel-Lucent

Positions held

Member of the Supervisory Board
Alcatel Deutschland GmbH

Director
Total

Member of the Board of Directors
École Polytechnique

Other positions held in the last five years

Chairman & Chief Executive Officer
Alcatel

Chairman
Alcatel USA Holdings Corp.

Director
Alstom
Vivendi Universal
Société Générale
Institut Pasteur

Born: 13 November 1937 – Nationality: French

First appointment: 22 June 1998
Current term expires: OGM 2008

Number of Thales shares held: 500

Alcatel Participations

Director coopted by the Board of Directors on 6 April 2007 to replace Benoît Tellier, appointed Senior Vice-President of the Thales Group and CEO of Thales International.

Positions held

Director
Alcatel Business Systems

Other positions held in the last five years
Various terms as director of Alcatel group companies

First appointment: 6 April 2007
Current term expires: OGM 2012

Number of Thales shares held: 41,262,481

TSA, represented by: Marcel Roulet

Other positions held by Mr Roulet

Chairman of the Supervisory Board
Gimar Finance SCA

Director
HSBC France
Thomson
France Telecom

Member of the Supervisory Board
Eurazeo

Non-voting director (censeur)
Cap Gemini

Other positions held by Mr Roulet in the last five years
Chairman of the Supervisory Board
Pages jaunes

Director
ON-X

Non-voting director (censeur)
Pages jaunes

Born: 22 January 1933 – Nationality: French

Marcel Roulet holds 501 Thales Shares

First appointment of TSA as director: 22 June 1998
Current term expires: OGM 2012

TSA holds 44,562,623 Thales shares

B. Chairman's report to the General Meeting of 16 may 2007 on corporate governance and internal control

1. Board of directors on the date of notification for the General Meeting of 16 may 2007

On the date of notification for the General Meeting of 16 May 2007, the Board comprised 15 members, 13 of whom were appointed by the General Meeting and 2 elected by employees. Their average age is 60.

In February 2007, Olivier Costa de Beauregard was coopted as a member of the Board of Directors to replace Serge Dassault, who resigned. The General Meeting of 16 May 2007 is asked to ratify Mr Costa de Beauregard's co-option.

In March 2007, Philippe Lépinay was coopted as a member of the Board of Directors to replace Pierre Lafourcade, who retired on 31 March 2007. The General Meeting of 16 May 2007 is asked to ratify Mr Lépinay's co-option.

In April 2007, Bruno Bézard and Alcatel Participations were coopted as members of the Board of Directors, replacing Denis Samuel-Lajeunesse and Benoît Tellier respectively. The General Meeting of 16 May 2007 is asked to ratify their co-option.

a. Directors appointed by the General Meeting of Shareholders

Four outside personalities

Charles de Croisset, independent director
Roger Freeman
Klaus Naumann, independent director
One vacant position (following the resignation of Henri Proglio, independent director, on 12 February 2007)

One representative of employee shareholders

Philippe Lépinay

Five persons proposed by the Public Sector

Denis Ranque
Bruno Bézard
François Bujon de l'Estang
Didier Lombard
TSA, represented by Marcel Roulet

Four persons proposed by the Industrial Partner (Alcatel-Lucent from 5 January 2007)

Jean-Paul Barth
Olivier Costa de Beauregard
Serge Tchuruk
Alcatel Participations

b. Directors elected by employees

Marie-Paule Delpierre
Didier Gladieu

c. Other persons attending Board meetings (with no voting rights)

In addition to the members of Group management who may be invited by the Chairman to attend Board meetings, depending on the agenda, the following persons attend Board meetings in a consultative capacity:

Representing the French State's golden share

Patrick Auroy, 52, senior armaments engineer (IGA hors classe)

Appointed by decree of the Minister of the Economy, Finance and Industry on 23 November 2006.

Representing the French State on the Board of Directors of Thales, in application of Decree 97-190 of 4 March 1997 concerning the French State's golden share (see page 132) and as provided for in Article 10 of the articles of association.

Government Commissioner

Denis Plane, 59, Controller General of the French Armed Forces on special secondment

Appointed Government Commissioner to Thales and its subsidiaries by decision of the Minister of Defence dated 25 July 2003, under the act and regulations concerning defence contractors and companies engaged in the manufacture and sale of defence equipment.

Representing the Company Central Works Council

Alain Desvignes, 61, labour union representative

Appointed by the Central Works Council to represent it on the Board of Directors of Thales, pursuant to Article L. 432-6 of the French Labour Code.

Statutory auditors

As laid down in Board internal rules, also attending all Board meetings:

- **Ernst & Young Audit** represented by Christian Chiarasini, partner,

- **Mazars & Guérard** represented by Thierry Blanchetier or Jean-Louis Simon, partners.

To the best of the Thales Group's knowledge:

- There are no family ties between the members of the Board of Directors.

- No Board member has been found guilty of fraud over the past five years.

- No Board member has been involved over the past five years as a senior manager in a bankruptcy, receivership or liquidation, or has been incriminated or penalised publicly and officially by the statutory or regulatory authorities.

- No Board member has been forbidden by a court over the past five years to act as a member of a body dedicated to the administration, management and surveillance of a company, or to be involved in the management or running of such a company's affairs.

- No conflict of interests exists between the Board members' private interests and their duties to Thales.

2. Conditions under which work is prepared and organised

At the Board meeting of 8 March 2007, the Board of Directors adopted, on the recommendation of the two committees concerned[(1)], the Chairman's report on corporate governance and internal control, and asked the Chairman to brief the General Meeting of 16 May 2007 on its decision.

Thales subscribes to the principles contained in the AFEP/MEDEF paper on the governance of listed companies, published in October 2003. The Group applies these principles in full, with the exception of the recommendation on board membership, since the shareholders' agreement between the Public Sector and the Industrial Partner (Alcatel-Lucent) stipulates that the number of independent directors must be less than one-third of the total.

a. Board organisation and administration

Board membership rules

Under the terms of the shareholders' agreement, the Board comprises sixteen directors, of whom fourteen are appointed by the General Meeting and two are elected by the employees of the Group's French companies according to the law (Article L. 225-27 ff. of the Commercial Code) and the articles of association (Article 10).

Of the fourteen directors appointed by the General Meeting, four are "outside directors", one represents employee shareholders and the others are submitted to the vote of the General Meeting by the Public Sector (five) and by Alcatel-Lucent (four).

Since the General Meeting of 11 May 2004, roughly one-third of directors are appointed or re-elected every two years (the official term for a director remaining six years). In all cases, salaried Board members are elected or appointed for a six-year term.

The Board duly acknowledged the resignation on 4 September 2006 of Denis Samuel-Lajeunesse, director representing the French State pursuant to Article 139 of the French corporate governance act (NRE).

On 10 December 2006, Benoît Tellier resigned from the Board of Directors in order to assume his new role as Senior Vice-President of the Thales Group and CEO of Thales International.

At 31 December 2006, the Board comprised 14 members. Since then, Henri Proglio resigned with effect from 12 February 2007.

The Annual Report provides information about the directors in office on the date of notification for the General Meeting and the directors whose co-option in 2007 the General Meeting is asked to ratify.

Director independence

Under the Board's internal rules (see below) and on the proposition of the Nomination and Remuneration Committee, each year the Board reviews the status of each of its members with respect to criteria of director independence.

(1) The Nomination and Remuneration Committee for the corporate governance part and the Audit Committee for the internal control part.

The Board first determined that the directors appointed by the General Meeting on the proposal of a shareholder or category of shareholders could not be considered to be independent under the AFEP/MEDEF principles of corporate governance mentioned above. Similarly, the Board determined that the two directors elected by employees could not be declared to be independent.

After reviewing in detail the status of the four "outside directors" according to the criteria in place, the Board accepted the Committee's recommendation and determined that Charles de Croisset, Klaus Naumann and Henri Proglio could be qualified as independent with respect to financial year 2006. The status of Roger Freeman remains non-independent, due primarily to the compensation he receives in respect of his various functions within Thales in the United Kingdom (cf Table of compensation paid to directors in the Reference Document).

Internal rules

The Board internal rules adopted in July 2004 and revised in March 2005 and again in March 2007 do not supersede the legal and statutory provisions applying to the Board and its committees, or the provisions of the Thales Group's Code of Ethics and Code of conduct on privileged information and securities trading applying to directors.

In addition to the specific provisions of the Shareholders' Agreement, the Board internal rules include corporate governance best practices.

The Board internal rules comprise five sections:

- Board members (Board membership, independence, availability, prime duty, transparency, confidentiality, compensation).

  Concerning director independence, the rules stipulate that "outside directors" must on their appointment meet the criteria of independent directors, as described in the corporate governance recommendations generally applied in France.

- Board responsibilities (company representation and best interests, specific responsibilities, shareholders' agreement).

  The annual budget, under the rolling three-year strategic plan, and any acquisitions or divestments of a value exceeding €150 million are automatically submitted for Board approval, on the understanding that the Shareholders' Agreement stipulates that such decisions must also be made by a majority of the directors who represent the Industrial Partner.

  Any operations of a value exceeding €50 million are also submitted to the Board if they involved a change in the Group's strategy as previously approved by the Board.

- Board information (communication, training).

- Board committees (constitution and responsibilities, organisation, information, audit committee, nomination and remuneration committee, strategy committee).

- Board administration (meetings, attendance and representation, assessment).

Compensation and perquisites paid to Board members

Attendance fees

The General Meeting of 16 May 2001 set the total amount of attendance fees to be divided among directors at €400,000 a year. This annual amount has remained unchanged since 2001.

In accordance with Board internal rules, this amount is split equally between fixed and variable fees, €200,000 each. The fixed portion is €12,500 per director (proportionately reduced in the case of non-reappointment or resignation during the year) and the variable portion is allocated according to attendance at Board meetings.

In 2001, the Board also decided that a flat compensation of €4,000 a year would be allocated to each member of a Board committee, to be paid in proportion to the number of committee meetings attended.

Consequently, the total compensation for directors, for both Board and committee membership, is €464,000 a year. This amount has remained unchanged for six years.

After examination of the practices adopted by comparable companies and in view of new regulatory constraints and the increased workload of Directors, arising in particular from their work on the Board committees, the General Meeting of 16 May 2007 is asked to raise the maximum annual amount of attendance fees to €550,000 (an increase of 18.5%) with effect from 2007. The variable portion allocated according to attendance at Board and committee meetings will be greater than half the maximum amount, as laid down in the Board's internal rules.

On the condition that this resolution is approved by the General Meeting, the Board agreed at the meeting of 8 March 2007 to limit the fixed portion to €224,000, the variable portion being paid in proportion to the number of Board and committee meetings attended.

Compensation paid to the Chairman and Chief Executive Officer

The compensation paid to the Chairman and Chief Executive Officer is set each year by the Board of Directors at the suggestion of the Nomination and Remuneration Committee.

The components of the compensation paid to Mr Denis Ranque are the same as those used by the company for its senior executives. Its positioning is analysed and revised each year and takes account of performance over the previous financial year and salary surveys or market data.

The Reference Document provides full details of the compensation paid to the directors and the Chairman and Chief Executive Officer.

Total net compensation (including all perquisites) paid by the Company or Group companies to each Board member during 2006

In compliance with the recommendations of the AMF in January 2007, salaries paid to directors elected by Group employees or representing employee shareholders are not included in the following table.

In €	2006	2005
Denis Ranque	see table on page 160	
Jean-Paul Barth	29,000	30,412
François Bujon de l'Estang	31,083	23,039
Charles de Croisset	29,000	22,353
Serge Dassault	16,667	19,666
Roger Norman Freeman	133,958	106,567 (b)
Pierre Lafourcade	31,083	30,412
Didier Lombard	16,667	nil
Klaus Naumann	21,001	14,515
Henri Proglio	27,667	25,392
Marcel Roulet, permanent representative of TSA	31,083	30,412
Benoît Tellier (resigned on 10 December 2006)	27,083	26,412
Serge Tchuruk (a)	nil	nil
Marie-Paule Delpierre (a)	nil	nil
Didier Gladieu (a)	nil	nil
Denis Samuel-Lajeunesse (resigned on 4 September 2006)	nil	nil

(a) Director who has named a legal entity to receive their attendance fees and compensation for attendance at Board committee meetings.
(b) Figure adjusted with respect to the previously published figure, which did not include all sums received in the United Kingdom.

Except for Lord Freeman, the amounts mentioned above represent only Board committee attendance fees received in 2006 (part of which represents fees in respect of 2005). Mr Ranque has waived payment of these fees.

The attendance fees due to Denis Samuel-Lajeunesse (€31,083 in 2006) have been paid to the French Treasury (general State budget) under Article 139 of the corporate governance act (NRE).

b. Report on Board activity in 2006

Number and length of meetings and attendance record

The Board of Directors met nine times in 2006. Meetings lasted an average of two and a half hours and the director attendance rate was 84%.

Under Board internal rules, the auditors were invited to and attended all nine meetings. They received the same information as the directors.

Main topics discussed

In addition to recurring topics for Board meetings (annual budget and update of forecasts, annual and half-year financial statements, determination of the Chairman and Chief Executive Officer's compensation, notice of General Meeting and proposed dividend, approval of regulated agreements, dates of non-trading periods, the various responsibilities of the Chairman, etc.), the agendas in 2006 included the following points, in some cases with reports from the relevant Board committee (see below):

- renewal of the terms of directors and membership of Board committees,
- project to strengthen cooperation with Alcatel-Lucent,
- convergence with DCN,
- allocation of stock options,
- R&D policy,
- human resources issues,
- assessment of Board administration.

In addition, the Board made a one-day visit to one of the Thales Aerospace Division's industrial sites to meet operational managers and gain a closer understanding of the Division's activities.

c. Preparatory work for Board meetings

Information for directors

Board papers

Directors receive the notice for Board meetings between five and ten days before the date of the meeting (ten days is the notice required by the shareholders' agreement for certain topics). A provisional timetable of meetings is adopted at the end of each year for the following year.

Board internal rules set the minimum period at three working days, except in emergencies.

With each notice are enclosed the meeting agenda, preparatory material (or at least the main points if not complete in time) and the minutes of the previous meeting. In some cases, further material is sent to directors later, or handed to them during the meeting, if the matter is urgent.

The directors are also sent a press review and a selection of financial analyses relating to the Company. Furthermore, Thales press releases, other than those discussed at Board meetings, are e-mailed to them when they are issued.

Training

Senior corporate officers make a presentation about the Group for the benefit of directors appointed during the year. No new directors were appointed in 2006. Special information programmes are available, but none were requested.

Structure and administration of Board committees

The Reference Document gives details of the responsibilities of each of the committees, formally expressed in Board internal rules, as well as their membership on the date of notification for the General Meeting.

Audit Committee

At 1 April 2007, the members of the committee are Charles de Croisset (Chair), Jean-Paul Barth, Roger Freeman, Didier Gladieu and Klaus Naumann. Denis Samuel-Lajeunesse was a member of the committee until September 2006.

The statutory auditors take part in all discussions, except for the appointment or reappointment of the auditors.

The committee met four times in 2006, with a 78% attendance rate, for an average of two and a half hours per meeting.

The statutory auditors are invited to attend each committee meeting and take part in all discussions, except for the appointment or reappointment of the auditors, as was the case in late 2006 in preparation for the General Meeting of 16 May 2007.

In addition to the annual and half-yearly financial statements, in 2006 the committee examined developments in litigation cases, budget updates, problems related to externally funded pension schemes, capitalisation of development costs, funding structures and currency risk management, as well as the budget for the auditors' fees.

During the two annual meetings specifically devoted to auditing, the committee reviewed the reports of the Internal Audit Department, for which it had previously approved the annual work programme and made recommendations for follow-up to the Department's missions, particularly with respect to information systems.

The committee also noted changes to the structure of our risk management and the implementation of a network of compliance offices. These changes were among the various recommendations submitted in 2006.

At the two meetings on the financial statements, the committee members had an opportunity to talk to the auditors, after receiving their detailed mission reports.

The committee also helped draft the financial press releases and prepared the Board's decision on the dividend proposed to the General Meeting.

A written report of each meeting was given to the following Board meeting.

Strategy Committee

At 1 April 2007, the members of the committee are Denis Ranque (Chair), Marie-Paule Delpierre, Philippe Lépinay (replacing Pierre Lafourcade), Didier Lombard and Serge Tchuruk.

The committee met once in 2006 to examine the 2006 budget in the three-year plan. Half the committee members were present. The same budget document was presented at the next Board meeting in late January 2006.

As the Board examined the project to strengthen cooperation with Alcatel-Lucent, it became apparent that the Strategy Committee was not the most suitable entity to assist with this process due to conflicts of interest among its members.

As authorised by Board internal rules, the Board thus decided to create an ad-hoc committee for this operation.

It comprised four directors: Henri Proglio (chair), François Bujon de l'Estang, Roger Freeman and Marcel Roulet. The committee met three times and reported on its work at the following Board meeting.

Nomination and Remuneration Committee

At 1 April 2007, the members of the committee are François Bujon de l'Estang (chair since the resignation of Henri Proglio on 12 February 2007), Marcel Roulet and Serge Tchuruk.

The committee met five times in 2006, with a 75% attendance rate, for an average of one hour per meeting.

Topics examined by the committee in 2006 included compensation of the Chairman and CEO (with examination and recommendation of criteria for calculating the variable part), Group policy on stock options and allocation of bonus shares, as well as the top-hat pension scheme. At the end of the year, the committee also supervised the annual evaluation of Board administration, carried out in 2006 with the assistance of an outside consultant. In addition, it examined the independence of directors, as laid down in Board internal rules, and submitted its recommendations to the Board (see above).

A written report of each meeting was given to the following Board meeting.

d. Evaluation of Board administration

As recommended by the AFEP/MEDEF report mentioned above and in accordance with Board internal rules, an evaluation of Board administration was carried out in 2006 with the assistance of an outside consultant (the same consultant who carried out the 2003 evaluation, the 2004 and 2005 evaluations being conducted internally).

This evaluation in November 2006 showed that all directors had noticed a clear improvement in Board administration since the 2003 assessment.

While the difficulty was recognised of implementing certain features of corporate governance in a company controlled by shareholders bound by agreement, it was considered that the Board's administration in 2006 was satisfactory overall.

The following aspects were deemed to be entirely satisfactory: number and length of meetings, quality of information provided in the routine course of administration, leadership of the Chairman, participation of directors in discussions, and minutes of previous meetings.

Among the points that have improved since 2003 are: broader range of topics discussed, better division of time between presentation and discussion, and a visit by the Board to one of the Group's industrial facilities.

Two points are still pending: the relative proportion of independent directors on the Board and the membership and positioning of the strategy committee.

As in 2005, the points that directors felt should receive priority for improvement were regular monitoring of the implementation of Board decisions, more detailed review of risks and information on major contracts.

e. Possible restrictions on the Chief Executive Officer's powers

In compliance with the French corporate governance act (NRE), the possibility of separating the functions of Chairman of the Board of Directors and those of Chief Executive Officer was added to the articles of association at the General Meeting of 16 May 2002.

Since that date, the Thales Board has considered that there is no reason for such a separation, and Denis Ranque exercises the functions of Chairman and Chief Executive Officer, with no restriction of authority other than as laid down by current regulations concerning the specific powers of the Board of Directors or the General Meeting of shareholders.

As stipulated in §1.1 of *Board internal rules,* any acquisitions or divestments of a value exceeding €150 million are automatically submitted for Board approval, as are any operations of a value exceeding €50 million if they involve a change in the Group's strategy. This practice effectively constitutes a limitation to the Chief Executive Officer's powers.

3. Group's internal control procedures

a. Introduction

This section has been prepared on the basis of the main conclusions arising from work carried out by the Group in 2006 in the area of internal auditing and risk management. The results of this work were examined by the Risk and Internal Control Committee during the year and by the Audit Committee meeting of 1 March 2007 with the statutory auditors in attendance.

Definition and scope of internal control at Thales

The Thales Group applies the internal control principles laid down in the American framework (Committee of Sponsoring Organizations of the Treadway Commission), and the professional standards of IIA (Institute of Internal Auditors) and its French affiliate IFACI (Institut Français de l'Audit et du Contrôle Interne).

The definition of internal control given by COSO and adopted by Thales is:

"A process, effected by an entity's Board of directors, management and other personnel, designed to provide reasonable assurance of the achievement of objectives".

The Group's priority is to implement this internal control at all the main companies within its scope of consolidation, i.e. those companies in which Thales has an interest of more than 50% and/or which it manages directly. These companies together account for more than 90% of total employees.

Main changes to the internal control system in 2006

As a continuation of previous initiatives, the Group pursued its internal control efforts during the year and implemented the following improvments:

- the Risk Committee was given a broader mandate and changed to become the Group Risk and Internal Control Committee. The new committee is chaired by the Group's Senior Vice-President, Finance and Administration, and includes representatives of the various functional and operational departments. It examines all actions to improve and promote internal control and reduce risk factors,
- the mandate of the Internal Audit Department was also extended with the creation of a new risk management and internal control service. This service will work independently of Internal Audit and in close collaboration with the Risk and Internal Control Committee.

Since it was created in 2002, the Internal Audit Department has been engaged in a process of professionalisation. This process is now recognised by IFACI, which awarded two certifications in November 2006:

- ISO 9001 certification, demonstrating that the Internal Audit Department has achieved the same quality level as the operational departments in the Group,
- IIA certification of professional internal audit standards.

b. The Group's internal control environment

Thales's core values and management methods are an integral part of its internal control system. This set of organisational rules, policies and procedures as well as rules concerning ethical conduct and corporate responsibility is available on the Group Intranet and is distributed to all new employees as a handbook.

Board internal rules

In July 2004, the Board of Directors adopted internal rules for the administration of the Board and its committees. Section 1 of the Corporate Governance report provides more details about the Board and how it operates.

Principles and policies applied to processes

Key processes

Because Thales's business activities are centred on critical information systems for infrastructures, the Group gives priority to certain processes:

- medium- and long-term strategic processes,
- the bid submission process, designed to ensure that the Group meets customer needs cost-effectively while guaranteeing satisfactory profit levels and managing risk,
- continuous improvement of programme management techniques over time, both technically (product/service quality, timeliness) and financially (high-quality forecasting of revenues, production costs and cash flow).

Operating processes and principles

Documentary baseline
The Reference System deployed in 2001 is being progressively replaced by a new baseline available on the Intranet. This Group-level baseline provides:

- a map and description of the 19 processes in place, listed under three subheadings: management, operational and skills,
- a description of the role of each corporate function,
- a documentary database of policies and procedures.

Internal Control Handbook
The Group leverages on an Internal Control Handbook aligned with the 2001 Group Reference System. This Handbook was produced by a major auditing firm after a call for bids, then examined by the statutory auditors and distributed to units.

Codes and guides on good conduct

The Code of Ethics in place within the Thales Group is designed to ensure strict adherence to local and international regulations through a clear set of compliance and security rules. The Code describes the right reflexes to develop and covers relations with customers and suppliers. It also details the ethical behaviour that applies equally to other employees, shareholders and markets, as well as to the Group's tangible and intangible assets and the environment. The Code of Ethics is supported by a Code of Conduct concerning insider information with a specific section containing the Group's rules on ethical business practices.

Introduced in 2001, the reference guide on Export Control discusses the issues and implications arising from the Group's export activities and outlines current international regulations on the export of defence equipment and dual-use goods. It describes employees' responsibilities and the monitoring and control process in place to ensure that Thales's operations meet all these requirements.

Internal Audit Charter

In 2003, the Group produced an Internal Audit Charter laying down the basic principles of internal control, Internal Audit's mission, scope and limits of its responsibilities and its types of action in units. The Charter was submitted to the Audit Committee and then approved by the Board of Directors.

Under the terms of this Charter, Internal Audit may intervene in any company process to assess the quality of risk management and internal control.

In 2006, the Charter was modified with the support of the Audit Committee, in order to allow Internal Audit to convene whenever it deems necessary.

Permanent objective to improve quality and operational efficiency

The Thales Group defines and coordinates its quality management approach centrally. The different business units then adapt this approach according to the nature of their activities and the local context.

This approach has resulted in ISO 9000 certification at most of the Group's subsidiaries, demonstrating that they have incorporated ISO compliant procedures into all their processes and apply them effectively.

Shared information

Internal communication

As a tool to support the Group's internal control system and ensure overall coherence, internal communication aims to promote employee buy-in and increase motivation through relevant information on Group strategy and events. Different channels are used to promote Thales's values:

- **Information media** provide a means to communicate with all the Group's employees, in particular through the Group's Intranet (updated every day), *Login to Thales* publications (in-house magazines produced by the different divisions and countries) and news flashes circulated by e-mail.

- **Welcome seminars** held by the management team for new executives in order to share the Group's vision, strategy, corporate culture and values.

- **Awareness sessions** to give employees at each unit a sound culture of internal control. These sessions are part of a special 40-hour training course on the principles and methods of internal control.

- **Shared knowledge databases** that are freely accessible online, or protected depending on their content, and designed to facilitate the circulation of principles adopted and implementation of internal control best practices.

Information system

As well as enabling employees to share and exchange information, the Group's information system also contributes to internal control by protecting access to data and improving data reliability.

Consolidation of financial statements

Since 1991, the Thales Group has used consolidation software that has now become an industry standard. The tool currently in place has been IFRS- compliant since the end of 2004. It requires the reporting units to adopt fully standardised formats to ensure consistency of all accounting data. Control is automatic and transfers of accounting entries to Head Office are only authorised after validation. All the Group's accounting and financial staff are experienced in the use of this tool.

IT operations

In 2005, the Group launched an initiative to optimise IT operations at unit level and improve security, in particular by combining data processing at a limited number of sites. The Group's Security Solutions & Services Division was appointed to coordinate this initiative.

c. The main agents responsible for internal control

Corporate management and Executive Committee

These are the prime bodies responsible for the internal control system. The Chairman and Chief Executive Officer, together with the Internal Audit Department, also in charge of Risk Management, decides on the policy guidelines for internal control and ensures that the necessary resources are made available. This responsibility is directly delegated to division and unit senior management, who must ensure that these guidelines are implemented within their own area of responsibility.

General organisation by divisions and countries

Because of the Group's sector of activity, Thales subsidiaries must comply with a permanent control environment required by its main customers and regulatory authorities (Defence or Industry Departments, civil aviation authorities, etc.), including increasingly stringent certification and financial control.

Thales has put in place the necessary organisation to meet these requirements. The Group coordinates initiatives through its divisions, which are operational entities with global jurisdiction and authority over all units within their scope of activity, and through geographic organisations in each of its main countries of operation. At present, the country structure comprises Australia, Canada, France, Germany, Netherlands, Switzerland, the United Kingdom and the United States.

Responsibility for identifying risks and implementing internal control procedures is shared by countries and divisions.

Corporate departments

Corporate departments are responsible for ensuring the coherence and coordination of Group best practices. Certain complex or high-risk operations must be handled by corporate departments, which are responsible for setting up an adequate internal control system to manage the risks involved in these operations.

Accounting and financial function

Implementation of internal financial control to Group standards is entrusted to unit chief financial officers, under the authority of the division chief financial officer. Unit chief financial officers have teams of management controllers working closely with operational staff. These controllers apply internal control rules on the ground, together with their unit accounting colleagues.

Accounting and financial operations are overseen by the Group Finance Department. The Group's central organisation comprises:

- an accounting and consolidation function, responsible for preparing and presenting the Group's consolidated financial statements,
- a financial and budget control function, which consolidates budget data and analyses Group budget deviations. It operates on the basis of regular reports (monthly, quarterly, half-yearly and yearly) from the Group's units and divisions. These reports include analysis of operational performance with respect to budget objectives and figures for comparable periods of the previous year,
- a taxation function that provides support for operational entities on legislation and during tax audits. It also monitors tax consolidations within the group and ensures their overall coherence.

Investment and divestment

Acquisitions or disposals of activities, in whole or in part, are the exclusive jurisdiction of the Group's corporate management, which examines all acquisition and divestment plans submitted by the divisions at the regular meetings of the Mergers and Acquisitions Committee. This committee comprises the main corporate departments.

Treasury

The Group's corporate treasury and financing department coordinates all financial resources and manages Foreign exchange risks:

- It is in charge of the centralised management and optimisation of the Group's debt and financial resources. It handles the financing requirements of all Group subsidiaries, which are not authorised to conduct financing operations themselves. The only exceptions are due to fiscal or specific regulatory constraints and for the overdraft facilities that subsidiaries need for the running of their accounts.

  Every day, the bank accounts of local units in the main countries are balanced by transfers from or to the corporate treasury account (cash pooling, either zero balancing or notional). Financial agreements have been arranged with all Group companies to manage these relations in compliance with the relevant local regulations.

- It also manages Foreign exchange risks. Operational units are responsible for monitoring currency risks. Foreign currency transactions are analysed before any financial commitment is made and are hedged at Group level against foreign exchange risks as soon as winning the sales contract and/or signing a purchase order looks likely, except in special cases.

Financing of export operations

Each export finance operation (guarantee, buyer credit, documentary credit, as well as more complex financing operations) is prepared by local specialists reporting to local financial departments. They also report to the international financing department of Thales International. Any operation with a value of more than €10 million or with a certain degree of complexity is handled solely by Corporate.

Real estate

All real estate operations come under the exclusive jurisdiction of the Group real estate department, whose jurisdiction is worldwide. However, it may delegate certain operations, especially outside France, to a country structure, where there is one, or to a local company, even though it retains control of the operations.

Insurance

Thales Insurance and Risk Management, the Group's dedicated subsidiary, manages all insurance policies for all Group companies. In this way it optimises the cost of Group insurance and also ensures that all subsidiaries are properly covered for all insurable risk exposure.

Litigation, disputes and legal compliance

The Group legal affairs department directly handles all subsidiaries' disputes, and the subsidiaries must transfer any disputes as soon as they become aware of them.

The Group legal affairs department and country structures provide local units with support concerning local legislation, in order to manage any possible risk exposure, particularly for taxation, company law, labour law, environment, anti-fraud and anti-bribery regulations.

Contract intermediation

The commercial environment for the Group's international operations is handled by a specialised structure, Thales International. This company possesses the expertise and appropriate procedures for overseeing these operations in compliance with the applicable laws and regulations. Only Thales International and its subsidiaries, therefore, are entitled to sign contracts with external service providers for export operations. For domestic operations, in those countries where the Group has major manufacturing and sales businesses, procedures are laid down to improve customer relations and the security and legality of commercial operations.

Control bodies

The Board of Directors exercises permanent control over the way the Group is managed, either directly or through the various Board committees. Section 1 of this report on corporate governance and internal control provides detailed information about the organisation of the Board's work and the administration of the Board and its committees more generally.

Audit Committee

The Board Audit Committee validates corporate management's internal control guidelines and liases with the Internal Control and Risk department several times a year to verify which resources are being used and what action is being taken.

Risk and Internal Control Committee

This committee replaces the earlier Risk Committee. It is chaired by a member of the Executive Committee (the Senior Vice-President, Finance and Administration) and includes representatives of functional and operational departments. Secretariat services are provided by the Director of Internal Audit. The role of this committee is to:

- examine any audit reports with conclusions that are considered to be significant at Group level, and draw operational consequences,
- facilitate the improvement of the internal control by supporting the transverse and other actions required.

Internal Control and Risk Management Department

Reporting directly to the Chairman and Chief Executive Officer, the Internal Control and Risk Management Department works with the Audit Committee, all Group senior management and the statutory auditors. It provides support to all operational and functional managers to help them identify the risk exposures of their activities and implement the means to manage or reduce these risks. In particular, it ensures that adequate internal control resources are available in units. With bases in each of the Group's major regions of operation (France, Germany, Singapore, United States, United Kingdom), the team is continuing to expand and had 20 employees by end-2006.

Compliance officer network

At the initiative of the Risk and Internal Control Committee, the function of Compliance Officer has been created at country and division level. The role of compliance officers is to coordinate all actions concerning compliance with legislation, regulations and internal procedures. This network covers the divisions and main countries, and is currently being deployed at all Group subsidiaries.

d. Risk management and internal control activities

Major risks related to internal processes

The nature of the main external risk factors (financial, legal, environmental, dependence) and the Group's policy on insurance are detailed in Section B of the Director's Report.

In Thales's sector of activity, the main risks related to internal processes concern the submission of bids and cost overruns on major contracts. Given the size of some contracts, these risks can be particularly detrimental to the Group. Consequently, the Group has implemented procedures and tools to identify and manage risks during the bid phase and contract execution phase.

To date, there has never been an overrun so large as to endanger the Group's financial position. Nonetheless, vigilance will be continually maintained and strengthened in this area, in particular by the actions and tools described in this report.

Thales maps its risks by sector, in order to identify the main risks it would run as a result of any dysfunction in the products it supplies (flight control and air navigation, air, road and rail traffic control, security, detection, etc.) and takes action to eliminate these risks or reduce their probability of occurrence and financial impact.

Accounting and financial procedures

The Group has produced a set of manuals of procedures that are mandatory for all Group units. Unit Financial Officers are accountable to the Group Finance Department for compliance with these procedures.

Accounting Procedures Manual

This manual details the accounting rules and principles to be applied in producing consolidated accounts. It was updated in readiness for the introduction of the new IFRS standards.

In early 2005, Thales provided all accountancy and financial staff with instructions and training in understanding and applying the IFRS standards within the Group.

Management control procedures manual

This manual explains the budget process that the Group's divisions and units are required to follow. It defines in particular the content and format of the regular reports and contains a glossary to help standardise financial aggregates.

Cash-flow manual

This manual describes the respective roles of the central teams and unit teams relating to cash flow and financing operations.

It also details the procedures for short term cash flow management, operation of the exchange risk hedging system and the related reporting rules.

Guide to financial arrangements

This document defines the respective roles of the central teams and unit teams, as well as the procedures for the preparation and monitoring of the financial arrangements that accompany commercial bids. The objective is to optimise the cost of financial arrangements and ensure the best possible hedging against financial risks.

Budget process

Annual budget objectives are set each year in three stages:

- initially, the strategy department requests a ten-year strategic plan, with financial details, from each Group division,
- each division then submits a more detailed three-year budget plan to the Group's corporate management. This plan is based on the commercial forecasts prepared jointly by the divisions and the marketing and sales departments at Group and Country level,
- finally, Group corporate management sets the objectives for each division and ensures overall consistency between them.

Financial reporting

The Group's financial reporting system comprises various key components described earlier in this report:

- a corpus of accounting and financial principles and procedures that are regularly updated and circulated,
- a centralised consolidation process supported by a unique tool,
- a control framework involving both internal and external auditors.

Monthly results are analysed in order to identify any budget deviation and update annual forecasts concerning order intake, revenues, results and cash flow. This procedure is carried out by each unit and provides a consolidated vision at Division and Group level. It also makes it possible to identify any action plans needed to achieve the set objectives.

e. Assessing the level of Internal control

Control over financial information

Each year, Internal Audit reviews the financial audit manual with the statutory auditors. This manual describes the phases of the statutory auditors' work and specifies the particular topics to be audited.

The consolidated companies are assigned to three categories according to their size and the risks to which they may expose the Group. They may receive an in-depth review, a limited review or a flash review.

In the first two types of review, as well as assessing the unit's financial statements, the statutory auditors recommend improvements to its internal control. These recommendations are described in a dedicated section of the annual interim summary report issued to the unit and Group management in November each year.

Internal Audit ensures that units have taken into account these recommendations and have incorporated them in their action plans for the following six months.

Internal control self-assessment system

In late 2004, a software program was introduced to enable each subsidiary to conduct a self-assessment of its level of internal control. It helps them to verify that they address identified risks and that they have the adequate procedures, rules and organisation in place to achieve the objectives set in the Internal Control Handbook.

The program incorporates the entire contents of the manual and is used to assess progress in the implementation of internal control procedures and associated documentation. It enables all Group subsidiaries to apply the same risk assessment and management procedures to their processes.

Internal audit missions

Each year, the Internal Audit Department presents the Audit Committee with an audit plan covering the different aspects of compliance with legislation and regulations, assessment of internal control and identification and management of risks. It also monitors progress in the implementation of recommendations made by external auditors.

In 2006, Internal Audit conducted a range of missions related to compliance with procedures in the areas of contract intermediation, export control and IT security. Analyses were also carried out to complement internal control assessments at units.

C. Corporate management

1. Executive committee (Comex)

The Executive Committee of the Company and Group is a collegiate body chaired by the Chairman and Chief Executive Officer, comprising 14 members in charge of the main operational and corporate functions.

At 31 December 2006, the members of the Executive Committee were:

Denis Ranque(1), Chairman & CEO
Alex Dorrian, EVP, International Operations
Jean-Paul Perrier, EVP, International Operations
Yves Barou, Human Resources
Sylvie Dumaine, Communications
Patrice Durand, Finance & Administration
Jean-Loup Picard, Strategy, Research & Technology
Reynald Seznec, Operations
Alexandre de Juniac, Air Systems Division
Jean-Paul Lepeytre, Services Division
Jean-Georges Malcor, Naval Division
François Quentin, Aerospace Division
Bruno Rambaud, Land & Joint Systems Division
Reynald Seznec(2), Security Division

At 5 January 2007, the 14 members of the Executive Committee were:

Denis Ranque(1), Chairman & CEO
Alex Dorrian, EVP, International Operations
Jean-Paul Perrier, EVP, International Operations
Olivier Houssin, EVP, Commercial & Security
Yves Barou, Human Resources
Sylvie Dumaine, Communications
Patrice Durand, Finance & Administration
Jean-Loup Picard, Strategy, Research & Technology
Reynald Seznec, Operations, Components & Subsystems
Alexandre de Juniac, Air Systems Division
Jean-Paul Lepeytre, Security Solutions & Services Division
Jean-Georges Malcor, Naval Division
François Quentin, Aerospace Division
Bruno Rambaud, Land & Joint Systems Division

2. Compensation of senior corporate officers

a. Compensation paid to the Chairman and Chief Executive Officer

The components of the compensation paid to Mr Denis Ranque are the same as those used by Thales for its senior executives. Its relative positioning is analysed and revised each year and takes account of performance over the previous financial year and salary surveys or market data.

In March 2006, at the suggestion of the Nomination and Remuneration Committee, the Board of Directors decided to:

- maintain at €640,000 (gross) the fixed part of the compensation paid to Denis Ranque, Chairman and CEO, in respect of 2006,

- set the target variable part at 100% of the fixed part, with a maximum of 150% if the objectives are exceeded, and use two quantitative criteria as references for this variable part (budgeted income from operations and operational cash flow) as well as a qualitative assessment of the Chairman's action in implementing strategy.

On 8 March 2007, at the suggestion of the Nomination and Remuneration Committee, the Board of Directors decided that, on the basis of the 2006 results and the strategic operations concluded during the year, the variable portion of the compensation paid to the Chairman and CEO in 2007, in respect of 2006, would be €908,800 (gross), equal to 142% of the fixed part of his compensation, bringing total compensation in respect of 2006 to €1,548,800 (compared to €1,405,000 in respect of 2005).

At the same meeting, the Board of Directors decided to retain the same two quantitative criteria (income from operations and operational cash flow) for the variable portion of the compensation paid in respect of 2007 and to add a third criteria linked to order intake during the year, according to a weighting system the Board has put in place. In addition, the Board decided to retain one, more qualitative criteria, based on the completion of the various missions assigned to the Chairman by the Board, the list remaining open at this stage.

(1) Mandataire social (legally responsible), as defined by the French Commercial Code.
(2) From 16 January 2006, replacing Tim Robinson, who left the Group.

Details of sums charged to the accounts and salaries paid to the Chairman and CEO[(1)] in 2006 and 2005

In € k	2006		2005	
	Charged to the year's accounts	Paid during the year	Charged to the year's accounts	Paid during the year
Fixed part	640	640	640	640
Variable part	765	765 (a)	572	580 (a)
Extraordinary compensation	--	--	--	--
Total before contributions	**1,405**	**1,405**	**1,212**	**1,220**
Employer contributions	374	374	354	356
Total charged to accounts	**1,779**	**1,779**	**1,566**	**1,576**
Attendance fees	Waived	Waived	Waived	Waived

(a) Paid in respect of the previous year.

As mentioned above, the Chairman has waived payment of his attendance fees.

Denis Ranque holds 610,301 stock options, including 80,000 options awarded to him in 2006. The details of these options are given in the tables on pages 129 and 130. In addition, he is granted a company car and chauffeur.

In addition, by a decision of the Board of Directors, Mr Ranque is a beneficiary of the pension plan set up with effect from 1 January 1999 for Group executives whose compensation exceeds the Agirc contribution ceiling. The points, calculated as for Agirc, acquired for the compensation paid from 1999 to 2006, amount for Mr Ranque to an annual income of 5.5% of his fixed compensation for 2006.

The modifications to Mr Ranque's suspended work contract were recorded on 11 March 2003 (see page 139 of this annual report).

b. Compensation paid to senior managers

Total compensation paid to Executive Committee members during 2006, with the exception of the Chairman and CEO, amounted to €6,891,000, including a variable part of 37.6% in respect of 2005[(2)]. As in the case of the Group Chairman & CEO, the variable part is based on quantitative and qualitative performance criteria.

Details of sums charged to the accounts and salaries paid to the Executive Committee in 2006 and 2005

In € k	2006		2005	
	Charged to the year's accounts	Paid during the year	Charged to the year's accounts	Paid during the year
Fixed part	4,317	4,299	4,867	4,933
Variable part	2,592	2,592	2,758	2,758
Extraordinary compensation			936	596
Total before contributions	**6,909**	**6,891**	**8,561**	**8,287**
Employer contributions	2,040	2,059	2,117	2,057
Total charged to accounts	**8,949**	**8,950**	**10,678**	**10,344**

In addition, the members of the Executive Committee other than the Chairman and CEO together hold 1,606,710 stock options. The breakdown by grant date and detailed characteristics are given in the tables on pages 129 and 130.

(1) "Mandataire social": legally responsible senior officer.
(2) Variable compensation in respect of 2006 being paid in 2007.

D. Incentive plan and profit-sharing

1. Profit-sharing

The Group mutualised profit-sharing agreement signed on 23 December 2004 was applied for the first time in respect of 2006.

This agreement is designed to strengthen solidarity between Group companies in all sectors of activity. All Thales employees in France now receive payments under the profit-sharing scheme, regardless of the results of the individual companies to which they belong.

Total profit-sharing paid to employees in 2006 in respect of 2005 amounted to €32.5 million from 39 companies, an average of €910 for each of the 35,700 eligible employees.

Total profit-sharing represented 2.11% of the gross payroll in 2006.

2. Incentives

Unlike the Group profit-sharing agreement, the incentive scheme is not mutualised: each company negotiates an incentive agreement on the basis of indicators linked to its key objectives.

The terms of the Group profit-sharing agreement include a rule that sets an upper limit on payroll (total of incentives plus profit-share). Adherence to this rule is mandatory.

In 2006, 11 companies in the Thales Group's scope of consolidation paid a total of €19.2 million in incentives, an average of €845 for each of the 22,650 eligible employees. Total incentives accounted for 1.24% of the reference payroll.

In 2006, total incentives and profit-sharing amounted to €51.66 and accounted for 3.36% of the gross payroll.

Total sums paid out in incentives and profit-sharing in recent years

In € m	2006	2005	2004	2003	2002
Group (a) in France					
Profit-share paid	34.83	42.78	37.64	26.08	22.00
Incentives paid	19.57	7.92	9.51	15.84	19.00
By Thales parent company					
Incentives paid	2.57	2.56	2.51	2.69	--

(a) French companies including joint ventures.

E. External auditors

For the period covered by the historical financial data, the Thales Group's official auditors were the following:

Statutory auditors

Ernst & Young Audit
Faubourg de l'Arche, 11 allée de l'Arche
92037 Paris-La Défense
represented by Christian Chiarasini

Current auditors appointed by the General Meeting of 15 May 2003, for six years expiring at the end of the General Meeting called to approve the financial statements for 2008.

Mazars & Guérard
61 rue Henri Regnault, Tour Exaltis
92400 Courbevoie
represented by Thierry Blanchetier and Jean-Louis Simon

Current auditors appointed by the General Meeting of 16 May 2001, for six years expiring at the end of the General Meeting called to approve the financial statements for 2006.

Alternate auditors

Patrick de Cambourg
61 rue Henri Regnault, Tour Exaltis
92400 Courbevoie

Current auditor appointed by the General Meeting of 16 May 2001, for six years expiring at the end of the General Meeting called to approve the financial statements for 2006.

Pascal Macioce
41 rue Ybry
92576 Neuilly-sur-Seine Cedex

Current auditor appointed by the General Meeting of 15 May 2003, for six years expiring at the end of the General Meeting called to approve the financial statements for 2008.

Fees paid to auditors in 2006

	Mazars & Guérard		Ernst & Young		Total	
	Amount €k	%	Amount €k	%	Amount €k	%
Audit						
External auditors, certification, examination of individual and consolidated financial statements	5,227	68%	5,184	91%	10,411	78%
Other missions	2,448	32%	503	9%	2,951	22%
Sub-total	**7,675**	**100%**	**5,687**	**100%**	**13,362**	**100%**
Other missions	--	--	--	--	--	--
Total	**7,675**	**100%**	**5,687**	**100%**	**13,362**	**100%**

III – Stock market information and financial communication

A. Thales share

1. Listing

The Thales share has been listed on the single regulated market, *Eurolist by Euronext,* which replaced the Premier Marché, Second Marché and Nouveau Marché of Euronext Paris on 18 February 2005. It is eligible for the *SRD* deferred settlement system. It was previously listed on *Euronext Paris's* Premier Marché.

ISIN code[(1)]: FR0000121329

- Reuters: TCFP.PA

- Bloomberg: HO FP

As a component in the Paris market's main indices, the Thales share is also an underlying instrument on the Paris *Traded Options Market (MONEP).*

The shares were also listed on the *Deutsche Börse* (code 850842) in Germany from 1972 to 24 November 2006.

2. Share indices

The Thales share is included in the following market indices:

- Paris: CAC Next20 (since 1 August 2006), *CAC40* (from 31 December 1987, date of creation of the index, to 31 July 2006), *SBF120* (since 31 December 1990), *SBF250* and *CAC AllShares.*

Since 1 December 2003, the market capitalisation of CAC40 companies has been calculated on the basis of the free float only[(2)]. It was previously calculated on the basis of total share capital.

For information, at year-end 2006, Thales's market capitalisation was €6,498 m, or 4.97% of total CAC Next20 capitalisation.

- International: DJ Eurostoxx, FTSE Eurotop 300.

(1) International Securities Identification Numbers.
(2) Under the definition used by the Euronext Paris Indices Steering Committee, free float is taken to mean total share capital after deduction of shares held by Group companies, directly or indirectly by the founders or the State, controlling interests, shares within the scope of a shareholders agreement not already covered, and interests considered stable.

3. Share price and trading volumes on Euronext-Paris

a. Monthly figures from January 2004 to March 2007 (price in euros)

	No. of trading days	No. of shares traded	Total value traded (€m)	Average daily trading volume	Weighted average price	high	low	Period-end
2007								
January	22	11,873,016	466.10	539,683	39.26	40.78	37.52	40.39
February	20	8,645,014	346.73	432,251	40.11	41.33	38.50	40.24
March	22	19,908,407	799.94	904,928	40.18	43.77	36.10	40.13
Q1 2007	**64**	**40,426,437**	**1,612.77**	**631,663**	**39.89**	**43.77**	**36.10**	**40.13**
2006								
January	22	11,196,113	438.94	508,914	39.20	40.50	38.20	39.81
February	20	13,997,846	542.94	699,892	38.79	39.90	37.53	38.23
March	23	25,289,378	938.80	1,099,538	37.12	39.30	35.65	36.69
Q1 2006	**65**	**50,483,337**	**1,920.68**	**776,667**	**38.05**	**40.50**	**35.65**	**36.69**
April	18	17,590,025	621.90	977,224	35.36	37.95	33.75	34.06
May	22	22,736,900	727.40	1,033,495	31.99	34.44	29.00	30.03
June	22	22,040,058	656.01	1,001,821	29.76	31.25	26.72	30.54
Q2 2006	**62**	**62,366,983**	**2,005.32**	**1,005,919**	**32.15**	**37.95**	**26.72**	**30.54**
July	21	17,157,523	521.86	817,025	30.42	31.64	29.03	31.14
August	23	15,300,270	492.50	665,229	32.19	34.82	30.60	33.92
September	21	11,630,809	396.37	553,848	34.08	35.30	33.05	34.99
Q3 2006	**65**	**44,088,602**	**1,410.74**	**678,286**	**32.00**	**35.30**	**29.03**	**34.99**
October	22	11,297,330	404.97	513,515	35.85	37.28	34.26	36.21
November	22	9,639,884	355.30	438,177	36.86	37.96	35.33	36.07
December	19	9,008,802	330.10	474,147	36.64	37.95	35.76	37.78
Q4 2006	**63**	**29,946,016**	**1,090.36**	**475,334**	**36.41**	**37.96**	**34.26**	**37.78**
Cumulative total 2006	**255**	**186,884,938**	**6,427.09**	**732,882**	**34.39**	**40.50**	**26.72**	**37.78**
2005								
January	21	11,695,317	409.80	556,920	35.04	35.95	34.23	34.98
February	20	12,886,730	443.78	644,337	34.44	35.25	33.72	34.20
March	21	22,014,710	721.52	1,048,320	32.77	34.80	31.76	32.17
Q1 2005	**62**	**46,596,757**	**1,575.10**	**751,561**	**33.80**	**35.25**	**31.76**	**32.17**
April	21	15,198,486	493.60	723,737	32.48	33.89	30.99	31.38
May	22	9,944,738	323.46	452,034	32.53	33.95	31.40	32.45
June	22	15,635,321	531.07	710,696	33.97	34.99	32.34	33.59
Q2 2005	**65**	**40,778,545**	**1,348.13**	**627,362**	**33.06**	**34.99**	**30.99**	**33.59**
July	21	11,904,446	398.28	566,878	33.46	34.78	32.42	33.50
August	23	16,394,316	580.41	712,796	35.40	36.74	33.60	36.71
September	22	20,307,139	759.92	923,052	37.42	39.01	36.13	38.63
Q3 2005	**66**	**48,605,901**	**1,738.61**	**736,453**	**35.77**	**39.01**	**32.42**	**38.63**
October	21	12,350,674	455.73	588,127	36.90	39.22	34.50	35.94
November	22	11,176,154	411.41	508,007	36.81	38.14	35.34	37.85
December	21	12,308,675	468.06	586,127	38.03	39.34	37.09	38.30
Q4 2005	**64**	**35,835,503**	**1,335.20**	**559,930**	**37.26**	**39.34**	**34.50**	**38.30**
Cumulative total 2005	**257**	**171,816,706**	**5,997.04**	**668,547**	**34.90**	**39.34**	**30.99**	**38.30**

	No. of trading days	No. of shares traded	Total value traded (€m)	Average daily trading volume	Weighted average price	high	low	Period-end
2004								
January	21	14,561,028	409.79	693,382	28.14	29.90	26.17	29.21
February	20	16,004,486	485.23	800,224	30.32	31.92	28.67	30.62
March	23	15,805,644	482.63	687,202	30.54	32.00	28.57	31.14
Q1 2004	**64**	**46,371,158**	**1,377.65**	**724,549**	**29.71**	**32.00**	**26.17**	**31.14**
April	20	12,634,790	401.54	631,740	31.78	32.97	30.64	30.99
May	21	11,307,663	330.44	538,460	29.22	31.41	27.65	27.98
June	22	12,569,388	370.33	571,336	29.46	30.90	27.69	30.07
Q2 2004	**63**	**36,511,841**	**1,102.31**	**579,553**	**30.19**	**32.97**	**27.65**	**30.07**
July	22	8,770,002	254.90	398,636	29.06	30.66	28.00	28.93
August	22	8,935,555	247.89	406,162	27.74	28.98	26.63	27.75
September	22	11,137,535	309.43	506,252	27.78	29.02	26.61	26.80
Q3 2004	**66**	**28,843,092**	**812.21**	**437,017**	**28.16**	**30.66**	**26.61**	**26.80**
October	21	13,169,370	360.51	627,113	27.37	28.85	26.10	28.27
November	22	51,359,971	1,647.86	2,334,544	32.08	34.14	28.20	32.21
December	23	25,700,370	865.41	1,117,407	33.67	35.75	32.06	35.32
Q4 2004	**66**	**90,229,711**	**2,873.79**	**1,367,117**	**31.85**	**35.75**	**26.10**	**35.32**
Cumulative total 2004	**259**	**201,955,802**	**6,165.95**	**779,752**	**30.53**	**35.75**	**26.10**	**35.32**

b. Annual figures from 2002 to 2006 (price in euros)

Price and performance

	2002	2003	2004	2005	2006
Closing price	25.23	26.65	35.32	38.3	37.78
Session high	46.20	28.53	35.75	39.34	40.50
Session low	23.05	18.12	26.10	30.99	26.72
Weighted average price	35.53	24.93	30.53	34.90	34.39
Net dividend in respect of the previous year (€)	0.70	0.70	0.75	0.80	0.83
Total Shareholder Return (a)	-33.1%	+9.0%	+35.4%	+10.7%	+0.8%
Change in closing price from previous year	-34.9%	+5.6%	+32.5%	+8.4%	-1.4%
Index performance over the period (b)	-34%	+16%	+7.40%	+23.40%	+32%
Thales's position in index (b)	22e	28e	2e	31e	15e

(a) Total Shareholder Return: Differential between closing prices on 31 December of each year, plus dividend before tax credit paid during year in respect of previous year, relative to opening price.
(b) CAC40 for 2002-2005, CACNext 20 for 2006.

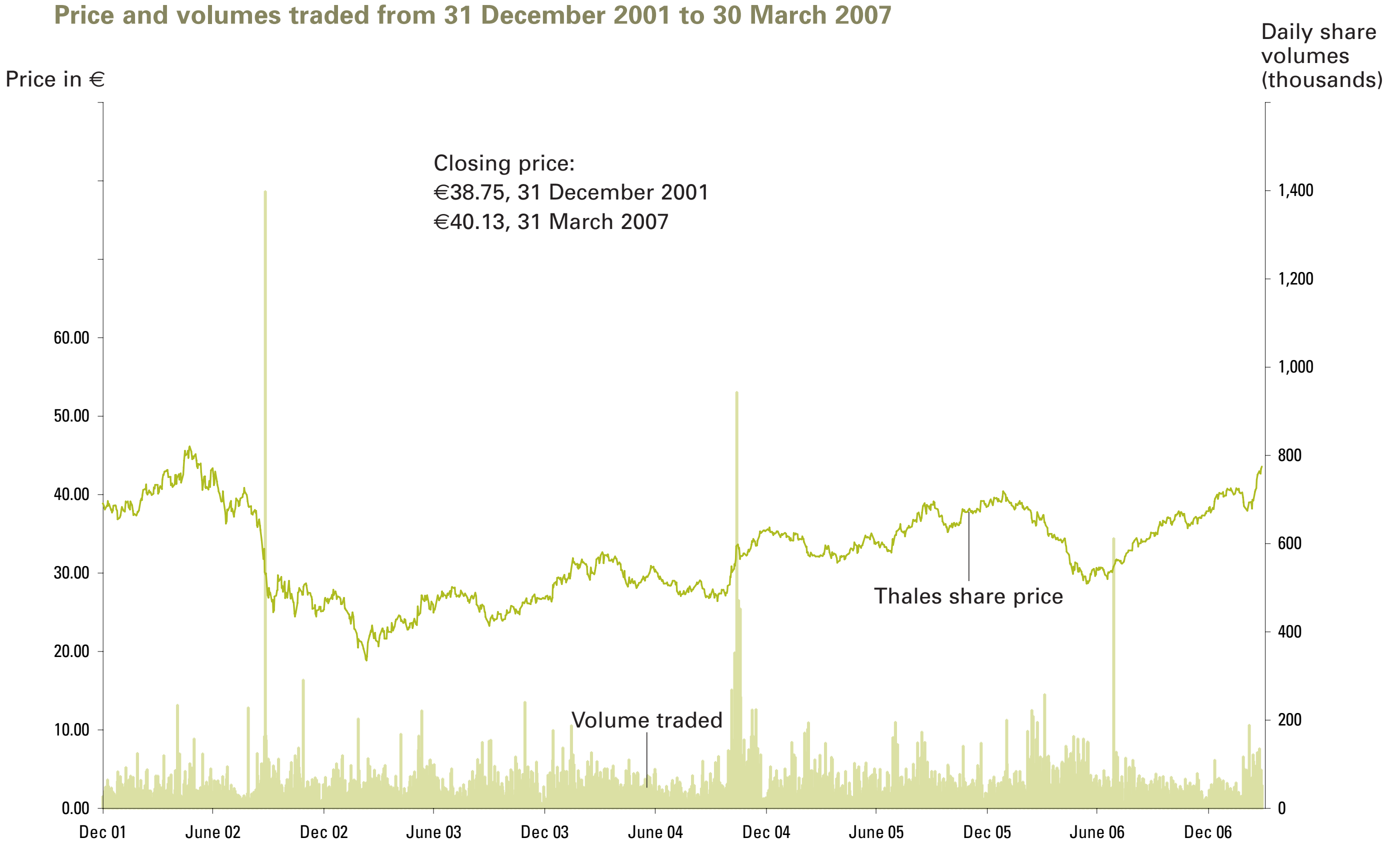
Volatility and liquidity

	2002	2003	2004	2005	2006
Average session high/low volatility (%)	+3.59	+3.47	+2.27	+1.63	+1.85
Thales share / index (a)	+2.62	+1.98	+1.03	+0.81	+0.54
Average number of shares traded per session (thousands)	678	635	780	669	733
Number of shares traded over the period (millions)	173	162	202	172	187
Total value traded over the period (€m)	6,146	4,039	6,166	5,997	6,427
Average number of shares traded per month (thousands)	14,415	13,502	16,830	14,318	15,574
Average value traded per month (€m)	512.17	336.55	513.83	499.75	535.59
Total number of shares in capital (period-end)	171.9	171.9	171.9	171.9	172.0
Total number of shares in free float at period-end (b)	91.0	92.0	92.0	92.1	92.2

(a) CAC40 from 2002 to 2005, SBF 250 in 2006 (source: Euronext).
(b) In accordance with the definition of free float used by the Euronext-Paris Indices Steering Committee to calculate the CAC 40 index.

c. Graphs and commentary on price and traded volume data from 31 December 2001 to 31 March 2007

Price and volumes traded from 31 December 2001 to 30 March 2007



Comments on share price

- In 2001 and 2002, the Thales share lost 50% of its value, in line with stock markets in general: in 2001, a decline of 22% for the CAC40 and 24% for the Thales share; in 2002, the CAC40 fell a further 34% and Thales 35%. The share's performance over these two years should also be seen in the light of two major share divestments by Alcatel in November 2001 and September 2002, which further depressed the Thales share price. The overhang(1) effect of the second divestment continued into the second half of 2003.

- At year-end 2003, the share began to rise again and grew nearly 6% over the year as a whole, underperforming the CAC40 (+16%). Its ranking in the CAC40 that year was 28th, the same as in 2002.

- In 2004, the Thales share price rose 32.53% over the year, significantly outperforming the CAC40 (+7.4%), and ranked second in the index.

At year-end, the share price bounced upwards amid speculation surrounding the alliance between Snecma and Sagem, both present in the aerospace and defence sectors, and rumours in the media about possible changes in Thales's shareholder base and scope of activities. The share price continued to rise to the end of 2004 and into 2005 as speculation continued.

- In 2005, the share rose 8.4%, while the CAC40 rose 23.4%. The Thales share ranked 31st in the index. The speculative atmosphere of Q4 2004 died down in the early weeks of 2005. After slowing towards the end of Q1, the share followed the market upwards, amid announcements of major orders, such as for Scorpene submarines in September and the multi-mission frigate order for Armaris in November. In December, the market responded well to the agreement on Thales's acquisition of a holding in DCNS.

- The share fell 1.36% in 2006, while the CACNext20 rose 32.04% over the year. The Thales share was ranked 15th in the index. This ranking, however, and the share's comparative performance against this index, are of limited significance, since the Thales share was only included in the CACNext20 as of 1 August 2006.

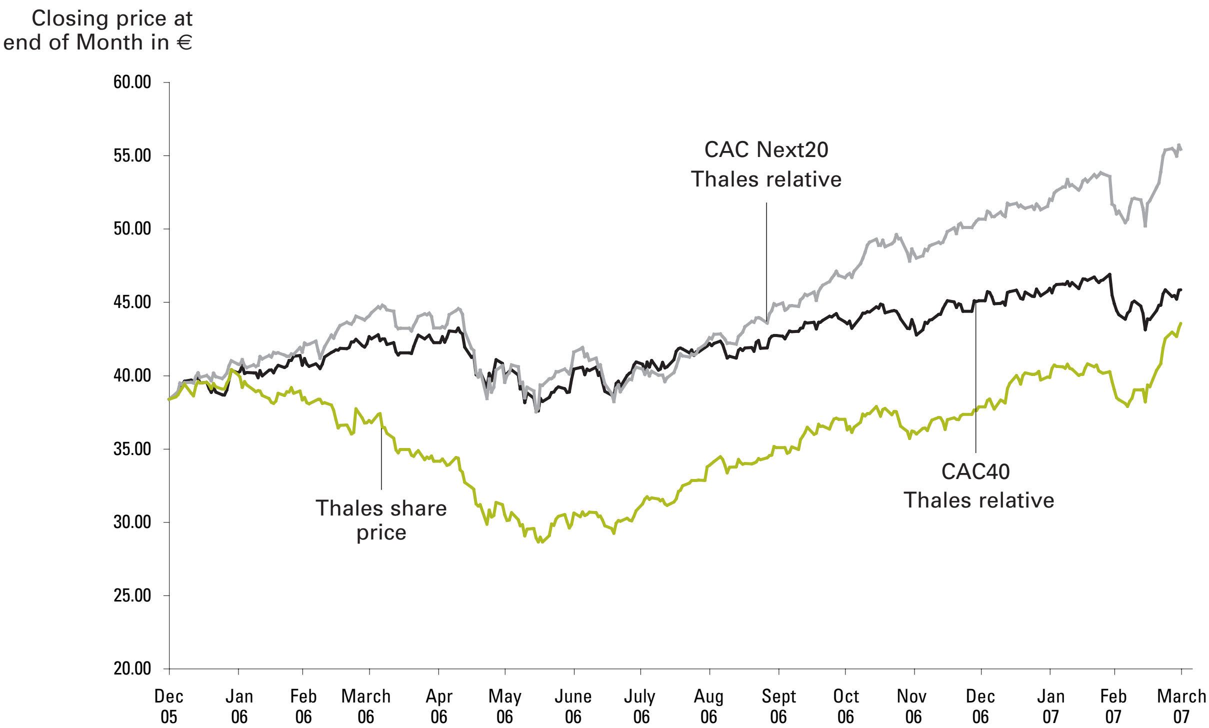
(1) Divestment of shares by one party to the Thales shareholders' agreement was widely interpreted as implying further major divestment by the same party or another party to the agreement. The overhang effect under-prices the share compared with its "intrinsic" market value.

2006 featured two contrasting periods, with a sharp share price fall in the first half, followed by a particularly robust rise in the second. This contrast was due mainly to events concerning the Group and only marginally reflects general trends recorded by stock markets in 2006:

- From January to mid-June 2006, the Thales share was affected by the gradual waning of previous speculation about possible aerospace restructuring in Europe. In particular, on 4 April, when the operation with Alcatel-Lucent was announced, the share fell more sharply, to €26.72 on 14 June, its lowest point since October 2004. During this first part of the year, its closing price decline was 26%, against a 2% fall for the CAC40.
- The turnaround after mid-June was significant and fairly regular, reflecting an interest in the Group's new strategic options on the part of investors, especially in the anglo-saxon world. Favourable perception of the half-year results supported the upward trend and the share did not suffer any correction when it left the CAC40 on 31 July 2006.

The upward movement generally continued in Q1 2007, strengthened by finalisation of some of the agreements concluded in 2006, full-year results considered to be satisfactory and the revenue and income growth objectives announced for the next few years.

Share price from 31 December 2005 to 30 March 2007



Comments on traded volumes

The number of shares in the free float rose sharply in 2002, from 77 million in 2001 to 91 million (including 10.3 million divested by Alcatel in September 2002). Since then the free float remained virtually stable, at 92 million shares, until 5 January 2007. Since 5 January 2007, the free float has been 102 million shares, and includes nearly 10 million shares previously held by GIMD.

- Traded volumes in Thales shares in 2003 varied little from 2002, when adjusted to exclude Alcatel's divestment. Average daily volume was 635,000 shares, compared with 638,000 in 2002 (and 678,000 without the Alcatel adjustment).
- In 2004, traded volumes rose significantly, totalling more than twice the free float for the year as a whole. Volumes were particularly high in the last two months of the year, averaging over 1.6 million shares per session, compared with roughly 500,000 per session over the first ten months.
- In 2005, traded volumes declined slightly: they amounted to 1.9 times the free float. They were more regular over the year and the session average was roughly 670,000.

- In 2006, traded volumes rose to a session average of 733,000. Volumes were higher in the first half than in the second, with a transition period of extremely high volumes when the share was leaving the CAC40, some 817,000 a day from 26 June when the announcement was made to 31 July when the share actually left the index. Subsequently, average daily volumes for the rest of the year returned to the levels of previous years, and leaving the CAC40 had no more effect on traded volumes than it did on the share price.

The predominant effect of events specific to the Group was evident in volumes, since from April to June these achieved a daily average of a million shares, as the speculation described above wound down.

4. Dividend policy

Dividends are paid to the holder of the share according to law and the articles of association. The Company uses the Euroclear direct payment procedure, which allows each shareholder to receive the dividend on the payment date.

This option has not been offered since, and the dividend has been paid in cash only. The dividend payment date, as decided by the Board of directors, is 31 May of each year, or the next business day. Any dividend unclaimed after five years lapses by law and is paid to the French tax authorities.

In accordance with new Article 158-3-2 of the French tax code, the dividend qualifies for the 50% reduction applicable to individual shareholders resident in France for tax purposes. This reduction is not applicable to other shareholders.

Dividends paid in respect of the last five years

In €	2002	2003	2004	2005	2006 (a)
Dividend before tax credit	0.70	0.75	0.80	0.83	0.87
Tax credit (b)	0.35	0.375	--	--	--

(a) Approved by the General Assembly of 16 May 2007 called to approve the financial statements for 2006. Payment date: 31 May 2007.
(b) No longer applies to dividends paid in respect of years following 2003 (new Article 158-3-2 of the French tax code).

B. Financial information policy

1. General

It is Group policy to communicate clear and accurate information to the markets concerning its financial condition, strategy and management policies, in compliance with regulations, its Code of Ethics, generally accepted practice, and the provision of the AMF's general regulations as revised to comply with European directives regarding financial communication by companies listed on regulated markets, in particular the Prospectus Directive in force in European Union countries since 1 July 2005, and the Transparency Directive that came into force on 20 January 2007.

This policy of financial disclosure entails regular publication of statutory information in legally required journals (such as the French official bulletin, BALO) and as recommended by the market authorities (e.g. press releases, also published on the Autorité des Marchés Financiers website[1], brochures and business reports). Thales also combines regulatory compliance with more qualitative information, e.g. press and telephone conferences when the annual and interim financial statements are published or major strategic operations announced. The Chairman and Chief Financial Officer use these opportunities to comment on business developments, strategy, market trends and Group objectives.

Since 2003, the Board of Directors has published a report on the Group's risk exposure, in compliance with the French corporate governance act (NRE) of 15 May 2001. Since 2004, the Chairman has conducted an annual review of Board administration, internal control procedures and possible restrictions to the Chief Executive Officer's powers, in compliance with the French Financial Security Act of 1 August 2003. These reports, either in full or summary, are presented in the directors' report and Corporate Governance sections of this annual report. They may also be obtained on request from Thales head office (Direction des Sociétés, 45 Rue de Villiers, 92526 Neuilly-sur-Seine cedex, France).

(1) www.amf-france.org

2. Financial disclosure diary for 2007

14 February	Publication of fourth-quarter and full-year revenues for 2006
8 March	**Publication of consolidated results for 2006**
25 April	Reference document filed with Autorité des Marchés Financiers (AMF)(1)
14 May	Publication of first-quarter 2007 consolidated revenues
16 May	Ordinary and Extraordinary General Meeting of Shareholders
31 May	Payment of dividend on earnings for fiscal 2006
26 July	**Publication of interim consolidated results for 2007**
14 November	Publication of third-quarter 2007 revenues and of report on financial situation.

3. Conference on 2006 results

The conference on the 2006 results was held on 8 March 2007, before the publication of the reference document. The slides presented and commented on at that conference have been available on the Thales website since that date.

Chairman Denis Ranque and Chief Financial Officer Patrice Durand commented on the Group's consolidated results, the situation in the markets on which Thales operates, and the Group's recent strategic agreements. Denis Ranque described prospects for the current financial year, in particular the implementation of the strategic operations agreed with Alcatel-Lucent on 1 December 2006, and the French Government and DCN on 30 January 2007. He also presented the objectives for the Group's revenues and operating margin, as follows:

- for 2007, consolidated revenues expected to exceed €12 billion as a result of anticipated organic growth and variations in the scope of consolidation entailed by the strategic agreements under finalisation, given that these will only be gradually implemented during the first half of 2007; operating margin should continue to rise, exceeding 7.5% of revenues(2),
- for 2008, the first full year of the new scope of consolidation, consolidated revenues of some €13 billion, and a targeted operating margin of approximately 8% of revenues(2).

These forecasts and targets do not take into account the contribution of Thales's 25% future interest in DCN, which will be carried under the equity method in the consolidated financial statements. The consolidation of 25% of DCNS's revenues would raise the Group's target to consolidated revenues of some €13 billion in 2007 and close to €14 billion in 2008.

4. Forecasts

The prospects and objectives given for revenues and operating margin in 2007 and 2008 are mainly based on the following hypotheses for both years, the first hypothesis being external to the Group:

- US dollar/euro parity of 1.30,
- completion of contracts recorded in the order book at 31 December 2006 as expected in terms of billing schedule and gross margin,
- order bookings in 2007, given that their impact on revenues and income of operating activities for 2007 will largely involve short-cycle business or medium-sized contracts,
- expected competitiveness gains from implementing the Optimum restructuring plan in both years.

In addition to these hypotheses about the Group's recurring business and results, there is the anticipated impact of the strategic operations finalised in 2007: transfer to the Group, effective 5 January 2007, of Alcatel-Lucent's transport and security businesses, consolidated as from 1 January, the transfer to DCNS of the Group's surface naval businesses in France, deconsolidated as from 1 April 2007, and the acquisition of Alcatel-Lucent's satellite businesses, consolidated as from second quarter 2007.

All these hypotheses have been analysed and assessed by the Thales senior management team, who consider them to be reasonable but cannot guarantee that they will be achieved in that certain factors may change. In particular, the occurrence of certain risks described in the "Risk factors" section (see pages 21 and following) may impact the Group's future businesses and performance.

(1) Document available from 26 April on the websites of the AMF (www.amf-france.org) and Thales (www.thalesgroup.com).
(2) Before purchase accounting on ex-Alcatel-Lucent businesses.

This is a free translation into English of the auditors' report signed and issued in the French language and is provided solely for the convenience of English speaking readers. Such report should be read in conjunction and construed in accordance with French law and French auditing professional standards.

The page number ("page 173") mentioned in this translation of the auditors' report refers to the page number of the "Document de référence" issued in the French language and dated April 25, 2007. The profit forecasts for Thales are included in page 169 of this annual report issued in the English language.

5. Statutory Auditors' Report on the profit forecast

(Free translation of a French language original)

To the Chairman–Chief Executive Officer,

In our capacity as statutory auditors and in accordance with EU Regulation N° 809/2004, we hereby report on the profit forecasts for Thales, which are included in page 173 of its "Document de référence" dated April 25, 2007.

In accordance with the requirements of EU Regulation 2004-809 and relevant CESR guidance, management is responsible for the preparation of these forecasts together with the material assumptions on which they are based.

It is our responsibility to provide an opinion, in terms defined by Appendix 1, Paragraph 13.3 of EU Regulation N° 809/2004, on these forecasts.

We conducted our work in accordance with French professional standards. This work consisted in assessing the procedures implemented by management for the preparation of the profit forecasts and performing such procedures as to enable us to assess whether the basis of accounting applied are consistent with the accounting policies adopted for the preparation of the Thales' historical financial statements. Our work also consisted in collecting information and making the necessary enquiries in order to obtain reasonable assurance that the profit forecasts have been properly prepared on the basis of the assumptions stated.

It should be noted that actual profits are likely to differ from the profit forecasts since anticipated events frequently do not occur as expected and the variations could be material. Consequently, we do not express any opinion on the possibility that such events will occur.

In our opinion:

- the profit forecasts have been properly prepared on the basis stated,

- the basis of accounting applied in the preparation of these profit forecasts is consistent with the accounting policies adopted by Thales.

This report is intended for the sole purpose of the public offering in France and other European Union countries in which the prospectus, registered with the French Stock Exchange Regulatory Body (AMF), will be published and may not be used for any other purpose.

Paris-La Défense, April 25, 2007

The Statutory Auditors

ERNST & YOUNG AUDIT	MAZARS & GUÉRARD	
Christian Chiarasini	Thierry Blanchetier	Jean-Louis Simon

6. Annual Information Document: shareholder information available

This section lists all information published in the twelve months preceding the filing of this reference document, pursuant to the provisions of Article 221-1-1 of the AMF general regulations.

The Thales website makes available to the general public the Group's articles of association and financial information about the Group.

Consolidated revenues 2005

> press release of 13 February 2006:
http://www.thalesgroup.com/all/pdf/Press_Revenues_130206_ENG.pdf
> slide presentation of 13 February 2006:
http://www.thalesgroup.com/all/pdf/Thales_2005_revenues_slide_show_eng.pdf
> announcement in the Bulletin des Annonces Légales et Obligatoires (BALO) of 15 February 2006:
http://balo.journal-officiel.gouv.fr/Files/2006/20/01034/200602150601034.htm

Annual results 2005

> press release of 10 March 2006:
http://www.thalesgroup.com/all/pdf/CP_Result_FR_100306.pdf
> slide presentation of 10 March 2006:
http://www.thalesgroup.com/all/pdf/Slide_show_Thales_2005_results_ENG.pdf
> annual consolidated accounts published in the BALO of 12 May 2006:
https://balo.journal-officiel.gouv.fr/Files/2006/57/04370/200605120604370.pdf

Planned increase in Thales's Satellite and Security businesses

> press release of 5 April 2006:
http://www.thalesgroup.com/all/pdf/PR_Thales_050406_ENG.pdf
> slide presentation of 5 April 2006:
http://www.thalesgroup.com/all/pdf/Slides_eng_050406V1.pdf

Consolidated revenues Q1 2006

> press release of 12 May 2006:
http://www.thalesgroup.com/all/pdf/PR_Q1_06_SALES__ENG.pdf
> announcement in the BALO of 15 May 2006:
https://balo.journal-officiel.gouv.fr/Files/2006/58/06245/200605150606245.pdf

Ordinary and Extraordinary General Meeting of Shareholders 2006

> preliminary notice of meeting and proposed resolutions in the BALO of 31 March 2006:
http://www.thalesgroup.com/all/pdf/avis_de_reunion_balo.pdf
> official notice of meeting in the BALO of 26 April 2006:
http://www.thalesgroup.com/all/pdf/Avis_de_convocation_Balo_26_avril_2006.pdf
> shareholders' meeting brochure pursuant to Article 133 of the Decree of 23 March 1967:
http://www.thalesgroup.com/all/pdf/d133__11_04_.pdf
> shareholders' meeting document pursuant to Article 135 of the Decree of 23 March 1967:
http://www.thalesgroup.com/all/pdf/D135_15_mai_2006.pdf
> reference document 2005:
http://www.thalesgroup.com/all/pdf/2006-025900.pdf
> quorum:
http://www.thalesgroup.com/all/pdf/Quorum__AG_du_15-05-06.pdf
> voting results:
http://www.thalesgroup.com/all/pdf/Resultat_du_scrutin__AG_du_15_05_06.pdf
> slide presentation to shareholders' meeting of 15 May 2006:
http://www.thalesgroup.com/all/pdf/AG_15_mai_06_.pdf

Consolidated interim revenues 2006

> press release of 27 July 2006:
http://www.thalesgroup.com/all/pdf/press_rel_H1_2006_Results.pdf
> announcement in the BALO of 4 August 2006:
https://balo.journal-officiel.gouv.fr/Files/2006/93/12400/200608040612400.pdf

Interim results

> press release of 27 July 2006:
http://www.thalesgroup.com/all/pdf/press_rel_H1_2006_Results.pdf
> slide presentation of 27 July 2006:
http://www.thalesgroup.com/all/pdf/Pres_H1_2006_Eng.pdf
> consolidated interim accounts published in the BALO of 8 September 2006:
https://balo.journal-officiel.gouv.fr/Files/2006/108/14055/200609080614055.pdf

Consolidated revenues for first nine months of 2006

> press release of 10 November 2006:
http://www.thalesgroup.com/all/pdf/Press_release_Thales_9_months.pdf
> announcement in the BALO of 15 November 2006:
https://balo.journal-officiel.gouv.fr/Files/2006/137/17058/200611150617058.pdf

Alcatel-Lucent and Thales sign final agreement on transfer of assets announced in April 2006

> press release of 4 December 2006:
http://www.thalesgroup.com/all/pdf/PR_Alcatel_Lucent_Thales_ENG_4_Dec_06.pdf

Extraordinary General Meeting of Shareholders of 5 January 2007

> preliminary notice of meeting and proposed resolutions in the BALO of 6 December 2006:
https://balo.journal-officiel.gouv.fr/Files/2006/146/17735/200612060617735.pdf
> updating of reference document 2005:
http://www.thalesgroup.com/all/pdf/Actua_Doc_de_ref_final.pdf
> official notice of meeting in the BALO of 20 December 2006:
https://balo.journal-officiel.gouv.fr/Files/2006/152/18129/200612200618129.pdf
> shareholder information brochure:
http://www.thalesgroup.com/all/pdf/Brochure_de_convocation_AG_5_janvier_2007.pdf
> due diligence auditors' report of 15 December 2006 on value of asset contributions:
http://www.thalesgroup.com/all/pdf/Rapport_valeur_15_12_2006.pdf
> due diligence auditors' report of 15 December 2006 on remuneration of asset contributions:
http://www.thalesgroup.com/all/pdf/Rapport_remuneration_15_12_2006.pdf

- > Document E:
  http://www.thalesgroup.com/all/pdf/docE_2007final.pdf
- > slide presentation of 5 January 2007:
  http://www.thalesgroup.com/all/pdf/
  AGE_5_jan_07_V_finale.pdf
- > press release of 5 January 2007:
  http://www.thalesgroup.com/all/pdf/
  Comm_presse_AG_FR_050107.pdf
- > voting results:
  http://www.thalesgroup.com/all/pdf/scrutin.pdf
- > number of shares and voting rights following the shareholders' meeting of 5 January 2007:
  http://www.thalesgroup.com/all/pdf/
  Actions_et_DV_post_AG_5_jan_07.pdf

Finalisation of closer ties between DCN and Thales's naval businesses in France on 30 January 2007

- > press release of 30 January 2007:
  http://www.thalesgroup.com/all/pdf/
  PR_Naval_DCN_Convergence_300107_ENG.pdf

Revenues 2006

- > press release of 14 February 2007:
  http://www.thalesgroup.com/all/pdf/
  PR_Thales_2006_Revenues_ENG.pdf
- > announcement in the BALO of 16 February 2007:
  https://balo.journal-officiel.gouv.fr/Files/2007/21/01651/
  200702160701651.pdf

Annual results 2006

- > press release of 8 March 2007:
  http://www.thalesgroup.com/all/pdf/
  Press_Release_res_2006_ENG.pdf
- > slide presentation of 8 March 2007:
  http://www.thalesgroup.com/all/pdf/Pres_Eng_9_mars.pdf

Entry into force on 29 March 2007 of agreement between DCN and Thales

- > press release of 29 March 2007
  http://www.thalesgroup.com/all/pdf/
  PR_Convergence_closing_29-03-07_vUK.pdf

Ordinary and Extraordinary General Meeting of Shareholders 2007

- > preliminary notice of meeting and proposed resolutions in the BALO of 30 March 2007:
  https://balo.journal-officiel.gouv.fr/Files/2007/39/03488/
  200703300703488.pdf

Creation of new satellite alliance between Thales and Finmeccanica

- > press release of 10 April 2007:
  http://www.thalesgroup.com/all/pdf/
  PR_Space_Alliance_100407_ENG.pdf

Ordinary and Extraordinary General Meeting of Shareholders 2007

- > preliminary notice of meeting and proposed resolutions in the BALO of 30 March 2007:
  http://www.thalesgroup.com/all/pdf/
  Avis_de_reunion_Balo_30_mars_07.pdf
- > official notice of meeting in the BALO of 27 April 2007:
  http://www.thalesgroup.com/all/pdf/
  Avis_de_convocation_Balo_27_04_07.pdf
- > shareholders' meeting brochure pursuant to Article 133 of the Decree of 23 March 1967:
  http://www.thalesgroup.com/all/pdf/
  Brochure_AG_mai_2007.pdf
- > shareholders' meeting document pursuant to Article R225-83 of the Trade Code:
  http://www.thalesgroup.com/all/pdf/
  R225-83_AG_mai_2007.pdf
- > reference document 2006:
  http://www.thalesgroup.com/all/pdf/
  Doc_Ref_Thales_2006_fra.pdf
- > press release to inform shareholders of the availability of documents for annual General Meeting:
  http://www.thalesgroup.com/all/pdf/
  AG_16_mai_07_com_mise_a_disposition.pdf
- > quorum:
  http://www.thalesgroup.com/all/pdf/
  QUORUM_DEFINITIF_THALES_2007.pdf
- > voting results:
  http://www.thalesgroup.com/all/pdf/
  Resultat_THALES_2007.pdf
- > slide presentation to shareholders' meeting of 16 May 2007:
  http://www.thalesgroup.com/all/pdf/
  Presentation_AG_16_mai_07.pdf

C. Other Thales securities listed

1. EMTN bond programme

On 30 November 2006, Thales made a new issue of bonds to the value of €700 million, listed on the Luxembourg market. These variable-rate bonds (3-month Euribor +0.125%) are redeemable in December 2009. The issue was part of the renewed EMTN (Euro Medium Term Notes) programme, first implemented in September 2000.

2. Convertible and/or exchangeable bonds (OCEANE)

On 31 December 2006, Thales's balance sheet included OCEANE convertible and/or exchangeable bonds with a nominal value of €500 million.

These bonds were redeemed on 1 January 2007. They were mainly redeemed in cash.

IV – Annual General Meeting of 16 may 2007

A. Agenda of the Annual General Meeting of 16 may 2007

Resolutions within the authority of an Ordinary General Meeting

- To approve the consolidated financial statements for fiscal year 2006
- To approve the parent company financial statements for fiscal year 2006
- To approve the payment of the dividend
- To approve regulated agreements entered into in 2006
- To limit the annual amount of attendance fees of Directors
- To ratify the appointment of Directors
- To reappoint Mazars & Guérard as statutory auditors and Mr Patrick de Cambourg as alternate auditor
- To authorise the Board of Directors to enable the Company to buy and sell its own shares as part of a share buy-back programme with a maximum purchase price of 50 euros per share

Resolutions within the authority of an Extraordinary General Meeting

- To authorise the Board of Directors to grant stock options
- To authorise the Board of Directors to cancel shares purchased under a share buy-back programme
- To authorise the Board of Directors to grant to employees free existing shares purchased under a share buy-back programme
- To amend the articles of association – modalities to appoint the Director representing employee shareholders
- To amend the articles of association – conditions to attend a General Meeting of shareholders
- Powers to perform legal formalities

B. Quorums and results of the votes

Quorum

Total number of shares outstanding as of 16 May 2007	197,166,010
of which company-held shares with no voting rights attached	2,746,758
Net, outstanding shares with voting rights	194,419,252
Number of shares held by shareholders attending or represented at the AGM, voting by mail or having appointed the Chairman to vote in their name	158,506,596
Quorum	**81,528%**

Number of voting rights expressed at this AGM

	Number of shares	Number of voting rights
Attending or represented at the AGM	108,269,158	180,896,590
Voting by mail	48,953,383	52,644,617
Having appointed the chairman to vote in their name	1,284,055	2,494,400
Total at this AGM	**158,506,596**	**236,035,607**

Results of the votes, in percent of voting rights expressed

Resolution number		% Yes	% No	% Abstention	Total voting rights expressed
Ordinary	1	99.74	0.26	0.00	236,035,607
	2	99.74	0.26	0.00	236,035,607
	3	100.00	0.00	0.00	236,035,607
	4	98.96	1.03	0.01	75,591,313 (a)
	5	96.56	3.44	0.00	236,035,607
	6	92.22	7.78	0.00	236,035,607
	7	92.31	7.69	0.00	236,035,607
	8	99.71	0.29	0.00	236,035,607
	9	97.38	2.62	0.00	236,035,607
	10	94.58	5.42	0.00	236,035,607
	17	93.98	6.02	0.00	236,035,607
	18	94.24	5.76	0.00	236,035,607
Extraordinary	11	85.33	14.67	0.00	236,035,607
	12	99.95	0.05	0.00	236,035,607
	13	90.97	9.03	0.00	236,035,607
	14	99.95	0.05	0.00	236,035,607
	15	99.76	0.24	0.00	236,035,607
	16	99.67	0.33	0.00	236,035,607

(a) Interested shareholders (TSA, Alcatel Participations and GIMD) being precluded from voting this specific resolution, pursuant to French commercial code.

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