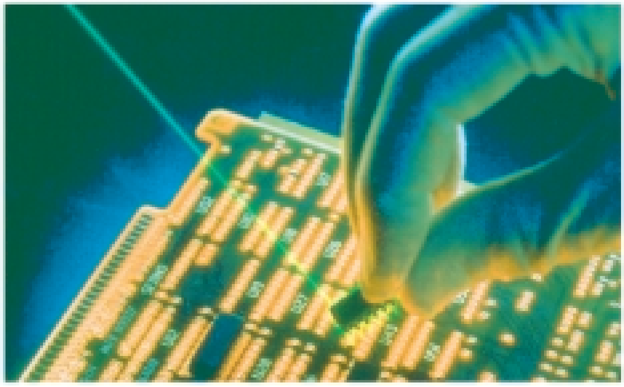
THALES



Annual Report
2003

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Chairman's message

Thales reached a turning point in 2003, *completing the phase in our development that began with the acquisition of Racal in the United Kingdom in 2000. That period marked a step change in our international expansion, but it was also a time for refocusing our portfolio of businesses in order. It was a time to develop synergies within the Group, to concentrate our energies on growth sectors, and to leverage our international dimension to the full.*

So 2003 marked the successful completion of a first series of measures that have strengthened Thales' ability to meet the challenges of the future, measures that have delivered satisfactory financial results despite a difficult international situation.

In defence, Thales is positioned on the right markets and in the right countries. Our strategy here has succeeded, leading to a series of major contract awards. Our overall design was retained for the new aircraft carriers in the United Kingdom, where we were also selected for the future infantry soldier system and shortlisted for the major unmanned air vehicle (UAV) programme. In France, order intake was satisfactory. And we were pleased to sign the first production contract from the Joint Armaments Cooperation Organisation (OCCAr) on the major European FSAF (Future Surface-to-Air System) missile system programme. In addition, 2003 was an exceptional year for some of our "multi-domestic" operations, particularly in South Korea.

In aerospace, despite the persistent down cycle in civil aviation, we are continuing to strengthen our valued relationship with Airbus as a first-tier partner, notably for the A380, and we are also striving to become a key partner for Boeing, particularly for the 7E7 programme.

In security markets, we launched the Thales SHIELD™ concept, which draws on all our security-related technologies and skill sets to position the Group as a European leader in national and collective security. In the market for secure payment and ticketing systems for public transport networks, we won significant contracts not only in Asia but also in Europe (in the Netherlands, for example), where we are now a market leader. We are starting to benefit from our moves to rationalise our portfolio of non-defence businesses, and from our strategic focus on growth sectors that complement our other businesses.

Our good performance in 2003 was a direct result of this strong strategic focus: operating income improved despite the impact of exchange rate fluctuations, defence order intake increased substantially, and we significantly reduced our debt.

A new chapter opens for Thales in 2004.

We live in a world fraught with armed conflicts and growing insecurity. Security requirements are on the increase at every level and in all walks of life. At the same time, customers are rightly keen to obtain value for money, and they expect us in the contractor community to assume more responsibilities as prime contractors for their projects. Institutional as well as industrial customers also expect a cost-effective service offering from contractors.

Our strategic objectives today are extremely clear, namely more growth and better competitiveness on three markets: defence, aerospace and civil security.

I am convinced that Thales, with its unrivalled platform of advanced technologies, a record of success in complex programme management and a growing international dimension, has what it takes to achieve those objectives.

To strengthen our chances of success, I announced a thorough reorganisation of the Group in May 2004, to make our organisation simpler, clearer and more visible to customers and investors, to reduce costs, and to build cohesion within Thales teams and between our different areas of business.

With a customer-facing organisation made up of six large divisions – Aerospace, Air Systems, Land & Joint Systems, Naval, Security, and Services – and each division organised on an international basis, we embrace the future with confidence on behalf of our customers, shareholders and employees.

Our strength tomorrow lies in innovation, openness to the world and the ability to listen to customers today.

Denis Ranque
Chairman and Chief Executive Officer, Thales

Timeline

Origins

1968: The professional electronics businesses of Thomson-Brandt (previously CFTH) merge with 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. Compagnie Générale de Télégraphie Sans Fil (CSF), founded in 1918, became a pioneer in broadcasting. It merged in 1957 with its subsidiary Société Française Radioélectrique SFR. Both companies were key players in the 1930s development of broadcasting, short wave, electro-acoustics and the very first radar and television.

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).

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

Strategic refocusing

1983 – 1987: The financial situation is turned round by refocusing the portfolio on professional and defence electronics. The company divests heavily in civil telecommunications (1983 agreement with CGE) and medical imaging (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.

Growth through mergers and acquisitions

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). Many 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 ST Microelectronics) are divested. The capital gains are used to finance further international growth.

Cooperation agreement and privatisation of Thomson-CSF

1998: In April Aerospatiale, Alcatel, Dassault Industries, Thomson-CSF and Thomson SA reach a cooperation agreement endorsed by the French government whereby (i) the professional and defence electronics businesses of Alcatel and Dassault Électronique are merged with Thomson-CSF, and (ii) the satellite businesses of Alcatel, Aerospatiale and Thomson-CSF become a new company owned jointly by Alcatel (51%) and Thomson-CSF. This agreement enables Thomson-CSF to strengthen its scope of business, consolidate its market positions in defence and industrial electronics, and expand the Group's industrial presence in Europe, particularly in Germany, Italy and Norway.

Following these operations, finalised in June 1998, the majority of the capital of Thomson-CSF is under private ownership. The French State's interest is reduced from 58% to 40%, and Alcatel and Dassault Industries are shareholders.

From Thomson-CSF to Thales

1998 – 2000: After privatisation is finalised, a vast restructuring plan is launched to integrate the businesses acquired from Dassault and Alcatel. 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, and expands its defence and information technology businesses.

These external growth operations also radically alter the Group's portfolio of businesses. A strategic review stresses the increasing importance of civil applications, particularly mobile telecommunications. In line with this strategic focus, a new organisation with three business areas is introduced in July 2000. This identifies the Group's "dual technology" expertise as a major strength. The new structure focuses civil businesses on areas possessing real synergies with the Group's proven defence and aerospace competencies, and expanding markets where the Group can gain a competitive position.

In December 2000, Thomson-CSF is renamed Thales, and forms the first 50/50 transatlantic joint venture in the defence sector with the American company Raytheon.

Security, a Thales core business

From 2001 to 2003: Geopolitical and economic upheavals following 11 September 2001, continued refocusing of business and the pursuit of the multi-domestic strategy. Thales acquires full control of several defence and aerospace subsidiaries originally held through joint ventures and divests its interest in Alcatel Space. Thales Defence Ltd, now the second-largest British defence contractor, is selected for a number of major Ministry of Defence programmes.

In IT&S, non-strategic businesses, including some making significant losses, are divested, and the civil security business takes on greater importance. In late 2003, Thales launches the Thales SHIELD initiative, demonstrating the Group's comprehensive commitment to the systems and technologies required to enhance civil security.

The capital structure changes, as the proportion of shares traded publicly increases to 54% at end-2003, from 35% two years earlier, while Alcatel reduces its interest in the company from 25.3% to 9.5% over the same period, and the French State reduces its interest to less than 31.3%, in favour of employee shareholders. Employee shareholders hold 5.1% at end-2003 compared with less than 2% at end-2000.

Overview

Thales is an **electronics** group serving professional equipment, systems and related services markets. Its businesses are heavily reliant on complex technologies, many of which are developed by in-house engineering teams.

Defence markets[1] account for the majority of consolidated revenues (some 70% in 2003). Thales serves all the armed forces, including land, naval, air and joint forces and air defence organisations. Its offering is becoming increasingly oriented towards comprehensive "system of systems" solutions, prime contracting and through-life support for both equipment and platforms. This development reflects moves by many countries to share more of the responsibility for major programmes between contractors and their customers, and in some cases to transfer full responsibility for a given platform to an industrial prime contractor.

Group businesses also serve new **collective and civil security** markets, where rising insecurity in the new geopolitical context is the main growth driver.

Thales expertise has applications in many areas of collective and civil security. Air transport security is one of the traditional core businesses of the Group's **Aerospace** businesses (avionics, air traffic control and pilot training), and Thales **IT&S** businesses now also serve the whole spectrum of civil security markets. Thales is a recognised player in security for transport systems, IT networks and electronic transactions, and in site protection and personal security and safety.

Thales businesses draw on a **common platform of technologies** underpinning the real-time information management and distribution capabilities its customers require. These include all the technologies needed to gather information (sensors) and to securely transmit and process that information in any form (voice, data, imagery). Digitisation has transformed all these technologies in recent years.

Another key feature of the Group's businesses is their **international dimension**: Most of Thales' markets are global and only just over half of its employees (55% of managed staff) are based in France, compared with more than 95% at the end of the 1980s. This changing pattern is a direct result of the strategy of external growth outside France that Thales has pursued for more than ten years.

In the defence market in particular, where customers are national governments, the Group's **"multi-domestic" approach** has proven its strategic importance. By investing in local industries, the Group can deliver tailored responses to customers' requirements and organise in-country solutions for a significant proportion of the specific developments needed, while guaranteeing the technology expertise that only a world-class player can provide.

(1) Including military avionics and simulation markets served by the Group's Aerospace businesses

Key figures

(in € million)	2003	2002	2001	2000	1999
Order book at year-end	18,743	19,009	19,744	18,366	15,428
Order intake	10,887	10,677	11,059	9,269	7,942
Consolidated revenues	10,569	11,105	10,268	8,580	6,890
France	26%	23%	25%	26%	32%
United Kingdom	12%	13%	15%	11%	8%
Other European countries	20%	19%	19%	23%	24%
Rest of world	42%	45%	41%	40%	36%
Operating income	698	597	645	540	381
EBIT	497	447	471	431	257
Net income (loss), Group share	112	111	(366)	201	275
Net income (loss) per share (in euros)	0.69	0.70	(2.26)	1.21	1.64
Total R&D expenses	(1,850)	(1,900)	(1,900)	(1,800)	(1,600)
Company-funded R&D expenses	(381)	(430)	(432)	(397)	(420)
Operating cash flows before working capital changes	770	591	539	396	335
Capital expenditures, net of disposals	(350)	(357)	(480)	(280)	(285)
Proceeds from disposal of real estate assets	48	198	467		
Net (acquisitions) disposals	124	79	58	(2,020)	(515)
Net debt (net cash position)	906	1,320	1,464	1,856	(410)
Shareholders' funds	2,014	2,139	2,146	2,425	2,367
Employees at year-end	57,439	60,662	62,494	57,312	48,920
France	56%	55%	54%	57%	69%
United Kingdom	18%	19%	20%	20%	10%
Other European countries	13%	13%	13%	14%	16%
Rest of world	13%	13%	13%	9%	5%

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DIRECTORS' REPORT

Management discussion and analysis of 2003 financial statements

Although 2003 was another difficult year for commercial aerospace, information technology and services, revenues remained stable, on a like-for-like basis (i.e., with an equivalent scope of consolidation and constant exchange rates), and the Thales Group's overall operational performance showed a marked improvement. These favourable trends were the result of good performance in defence markets and growth in civil security activities. With higher order intake and significantly lower net debt, the outlook for future revenue growth and improved profitability remains strong.

This strong outlook is largely attributable to the Group's experience and technology expertise in the field of security. As a major player in national and collective security, Thales is strategically positioned to meet demand in many areas of civil security as well as in defence markets. The Group's multi-domestic presence and extensive international sales and marketing network provide additional leverage for growth in these new markets in most of its client countries.

Furthermore, organisational realignment driven by new customer requirements continues to strengthen the Group's outlook in terms of both revenue growth and financial performance.

IMPACT OF EXCHANGE RATE FLUCTUATIONS AND CHANGES IN THE SCOPE OF CONSOLIDATION

The stronger euro resulted in a lower contribution by the UK and North American subsidiaries.

After conversion of their sales figures into euros, international subsidiaries in 2003 contributed €378 million less to consolidated revenues than in 2002. Most of this reduction came from the UK and North American subsidiaries: the euro gained an average of 10% against the pound sterling, and 20% against the dollar, between 2002 and 2003. This reduction represents 3.5% of overall consolidated revenues.

For comparison, revenue decreases due to exchange rage fluctuations were €144 million in 2002 (1.5% of consolidated revenues) and €43 million in 2001 (0.5% of consolidated revenues).

In 2003, the group further refocused its portfolio of businesses in 2003

The Group continued to rationalise its IT&S businesses, in particular by selling Thales Geosolutions to the Dutch group Fugro in November 2003. The geosolutions business uses satellite positioning technology to provide topographic services to the offshore industry, and had been making a loss since 2002. In addition to the sale of businesses in 2003, a number of divestments completed in 2002 had an impact on the 2003 financial statements. In particular, Thales Microsonics (telecommunications components) and Thales Contact Solutions (call centre management) were deconsolidated in November 2002. Together, disposals of businesses resulted in a reduction of €204 million in the Group's consolidated revenues, compared with €148 million the year before.

Newly consolidated businesses added €58 million to consolidated revenues, compared with €398 million in 2002. The net impact of changes to the scope of consolidation was thus a net reduction in revenues of €146 million (1.4% of consolidated revenues), compared with a net increase of €250 million (2.2%) the year before.

BUSINESS ACTIVITY

Breakdown of business activity

in millions of euros	**2003**	2002	Total change	Organic change
Consolidated revenues	**10,569**	11,105	- 5%	- 0%
Orders	**10,887**	10,677	+ 2%	+ 8%
Order book at year-end	**18,743**	19,009	- 1%	+ 2%

Stable revenues on a like-for-like basis

Consolidated revenues were €10,569 million in 2003, 4.8% lower than in 2002 (€11,105 million). On a like-for-like basis, the decrease was 0.1%. This virtual stability in overall revenues on a like-for-like basis includes a 5% increase in Aerospace sales and a 4% decrease in IT&S revenues, both on a like-for-like basis. Defence sales were nearly at the same level as in 2002.

Breakdown of revenues by business

Revenues in millions of euros	**2003**	2002	Total change	Organic change
Defence	6,599	6,736	- 2%	+ 0%
Aerospace	1,795	1,789	+ 0%	+ 5%
IT & S	2,071	2,497	- 17%	- 4%
Other extraordinary income (charges)	104	83	Ns	Ns
Consolidated revenues	**10,569**	11,105	- 5%	- 0.1%

In **Defence markets**, sales of communications and optronic systems for land and joint forces grew, particularly in France and Asia. This growth offsets a slight reduction in other Defence sales as a number of major export programmes moved into advanced stages of development, including the Sawari 2 frigates and the Mirage 2000 aircraft programmes. In naval markets, revenues of €400 million were recorded for the hull of the second frigate for Saudi Arabia under the

Sawari 2 programme. In 2002, €430 million had been recorded for the hull of the first frigate.

Despite the persistent crisis in commercial aviation, **Aerospace businesses** recorded a revenue increase of close to 5% on a like-for-like basis. Most of this growth is attributable to higher sales by the simulation and military avionics businesses.

IT&S sales on a like-for-like basis fell by 4.3%, largely due to the unfavourable economic climate early in the year and the downturn in the civil telecommunications market, which continued in 2003. However, full-year sales by the secure operations and positioning-based solutions businesses rose substantially, while electron tube sales remained stable and IT services fell slightly. Importantly, the IT&S businesses recorded organic growth of 7.5% overall in the fourth quarter of 2003. For most of these businesses, this improvement reflects a better economic climate and stronger markets.

As a proportion of total revenues, Defence sales continued to rise in 2003, while IT&S sales continued to fall under the combined effect of divestments and lower sales on a like-for-like basis in a depressed economic climate. Total Defence sales, including military sales by the Aerospace businesses, accounted for more than 70% of consolidated revenues in 2003, compared with 65% in 2002:

Breakdown of revenues by business

% of total revenues	2003	2002	2001
Defence	62%	61%	56%
Aerospace	17%	16%	18%
IT&S	20%	22%	26%
Others	1%	1%	--
Consolidated revenues in €m	**10,569**	**11,105**	**10,268**

Sales in European countries remained stable overall at €6.1 billion, although there were variations at individual country level: in particular, there was a marked rise in sales in France, with an 11% increase in Defence and a 9% increase in Aerospace, but a 10% decrease in IT&S; while UK sales fell by 15% compared with 2002. Most of this decrease is attributable to the depreciation of the pound sterling against the euro: with equivalent exchange rates, UK sales fell by just 6% in 2003. Exchange rate fluctuations had an equivalent effect on the breakdown of sales by origin: the Group's UK businesses generated sales of £1.2 billion in 2003, the same figure as in 2002, but recorded a 10% reduction in sales after conversion into euros. Thales UK's contribution to the Group's consolidated revenues in 2003 (including exports from the United Kingdom) was nonetheless comparable to its contribution in 2002.

Sales outside Europe fell by 10% to €4.5 billion, with exchange rate fluctuations accounting for half of the decrease. Middle East sales fell to €1.5 billion, and were overtaken in 2003 by Asia-Pacific sales, which were 4% higher than the year before. Sales to North America fell by 20% after conversion into euros, but by only 4% at equivalent exchange rates. Thales' North American subsidiaries account for 80% of these sales.

Breakdown of revenues by destination

	2003		2002		Overall
	in %	in €m	in %	in €m	*change*
France	*26%*	2,774	*23%*	2,602	*+ 7%*
The United Kingdom	*12%*	1,242	*13%*	1,461	*- 15%*
Other Europe	*20%*	2,069	*19%*	2,049	*+ 1%*
Total Europe	***58%***	**6,085**	***55%***	**6,112**	***- 0%***
North America	*9%*	926	*10%*	1,154	*- 20%*
Middle East	*14%*	1,473	*16%*	1,737	*- 15%*
Asia-Pacific	*15%*	1,543	*13%*	1,481	*+ 4%*
Rest of the world	*4%*	542	*6%*	620	*- 13%*
Total International	***42%***	**4,484**	***45%***	**4,993**	***- 10%***
Consolidated revenues	***100%***	**10,569**	***100%***	**11,105**	***- 5%***

Strong growth in new defence orders

Total order intake, at €10,887 million, was 2% higher than in 2002 (€10,677 million) and 8% higher on a like-for-like basis.

New Defence orders rose by 16% (19% on a like-for-like basis) to almost 7 billion euros compared with 6 billion in 2002. This sharp increase completely offsets the reduction in new orders booked by the Aerospace businesses, and the decrease in IT&S orders, which was primarily due to divestments and exchange rate effects.

New orders

in millions of euros	2003	2002	Total change	Organic change	Book to bill
Defence	6,950	5,976	*+ 16%*	*+ 19%*	1.05
Aerospace	1,610	2,185	*- 26%*	*- 21%*	0.90
IT&S	2,204	2,438	*- 10%*	*+ 6%*	1.06
Others	123	78	*ns*	*ns*	ns
Total order intake	**10,887**	**10,677**	***+ 2%***	***+ 8%***	**1.03**

• The book-to-bill ratio in the **Defence** business stood at 1.05 in 2003, which is virtually the same figure as in 2001 (1.06), and stronger than the 0.9 recorded in 2002. The variations in order intake recorded from one year to the next in this sector are partly the result of negotiations on the effective dates of major defence contracts. For example, the new order for €870 million booked by Thales in November 2003 for Phase 3 of the FSAF programme (the medium-range ground-to-air missile system being developed jointly by France and Italy) had been expected from 2002.

(1) FSAF : Future Surface-to-Air Family

The major new orders booked in 2003 were as follows:

- in air defence, in addition to the *FSAF* contract mentioned above, further orders on the *KSAM* programme in the Republic of Korea (short-range air defence system) and on the *Meteor* programme in the United Kingdom (rocket motors for medium-range air-to-air missiles)
- in airborne systems, the Meltem maritime patrol system for Turkey, and optronics for the Malaysian *Sukhoi* 30 MKM aircraft
- in air/land dominance, further development on the *SCCOA* programme[1] for the French Air Force and an upgrade of the communication system for the system's deployable component, C3M
- in naval markets, equipment and systems for the Hellenic Navy's S-class frigates and *Combattante* fast-attack craft, radars and identification systems for the Norwegian *Skjold* patrol boats and integrated sonar systems for the *Sycobs* combat systems of the French nuclear submarines.

• In **Aerospace**, the main new contracts were as follows:

- training simulators for Australia's *Tiger* helicopter programme, for which Thales is also supplying the avionics
- a combined arms simulation system for the Royal Netherlands Army.

• The main new orders for **IT&S** were:

- further upgrading of the communication and passenger information systems for the London Underground network
- development and deployment in Russia of IT systems for the supervision of natural gas pipelines securing Russia's domestic gas supply and export capability
- a contactless smartcard ticketing system for the main transport operators in the Netherlands
- a new batch of transmitters for TDF (Télédiffusion de France) as part of the contract initiated in 2001
- maintenance services for the British railway system's cable networks.

For the Group as a whole, the **book-to-bill ratio** stood at 1.03 for 2003, compared with 0.96 for the year before. In Aerospace, the ratio fell to 0.9 from 1.2 in 2002, primarily as a result of lower order intake by the air traffic management business. IT&S businesses had a book-to-bill ratio of 1.1, slightly higher than the end-2002 figure of 1.

The **order book** at the end of the year stood at €18.7 billion (€19 billion at end-2002), including €14 billion in Defence orders (the same as at end-2002), €3 billion in Aerospace orders (3.3 billion at end-2002) and €1.7 billion in IT&S (the same as at end-2002). These figures represent 25 months, 20 months and 10 months of revenues respectively, compared with 25, 22 and 8 months at the end of 2002.

RESULTS

2003 highlights

• **Significant rise in operating income, to €698 million**, resulting from good performance in Defence and a satisfactory trend in Aerospace. Total operating income of IT&S businesses, while lower than the full-year figure for 2002, recovered in the second half of the year.

• **An increase in restructuring costs to €197 million**, due to the accounting in 2003 of nearly all remaining "CASA" early retirement measures implemented in the company's operations in France.

• **A significant reduction in net financial expense to €109 million**, reflecting lower average net financial debt in 2003 ;

• **An increase in ordinary pre-tax income** income before the financial component of pensions to **€406 million** ;

• **Negative impact of the financial component of pensions of €85 million**, correlated with the unfunded status estimated at end-2002. Most of this charge corresponds to amortisation at end- 2002 of contractual variances on retirement plans in the United Kingdom.

In 2003, Thales recorded net income of €112 million, virtually unchanged from the €111 million recorded in 2002. The net income figure includes a €8 million gain on disposals (versus a gain of €67 million in 2002), an income tax charge reduced to €30 million, and goodwill amortisation of €174 million compared to €194 million in 2002.

Summary of financial statements

in millions of euros	2003	2002 as released	*Change*
Consolidated sales	**10,569**	**11,105**	***- 536***
Operating income	**698**	**597**	***+ 101***
Restructuring costs	(197)	(147)	*- 50*
Other operating income (expense)	(4)	(3)	*- 1*
Earnings before interest & tax (EBIT)	**497**	**447**	***+ 50***
Financial expense	(109)	(163)	*+ 54*
Equity in income of unconsolidated affiliates	18	29	*- 11*
Ordinary pre-tax income before financial component of pensions	**406**	**313**	***+ 93***
Financial component of pension charge	(85)	11	*- 96*
Gain on disposals	8	67	*- 59*
Net income before amortisation of goodwill	**329**	**391**	***- 62***
Corporation tax	(30)	(83)	*+ 53*
Amortisation of goodwill	(174)	(194)	*+ 20*
Minority interests	(13)	(3)	*- 10*
Net income, Group share	**112**	**111**	***+ 1***

The 2003 results must be analysed in the light of the negative impact on the 2002 figures of the non-recurring provision booked that year to cover the award against Thales in its arbitration with Euromissile. This provision had a €65 million impact on 2002 operating income and ordinary pre-tax income. Its negative impact on 2002 net income was €43 million.

(1) SCCOA: Système de Commandement et de Conduite des Opérations Aériennes

Strong improvement in operating income

Not including the Euromissile provision, operating income in 2002 would have been €662 million. On this basis, **operating income** rose by €36 million in 2003, which is an increase of 5.4%. On a like-for-like basis, operating income increased by €44 million or 7%.

Operating margin improved from 6.0% of revenues in 2002 to 6.6% in 2003. Revenues in 2002 and 2003 included €430 million and €400 million respectively for the hulls of the two Sawari 2 frigates already delivered to Saudi Arabia. Under the Sawari 2 contract, Thales earns no margin on the hulls purchased from the shipyard. Excluding these revenues, operating margin increased from 6.2% in 2002 to 6.9% in 2003. In comparable terms, operating margin stood at 6.0% in 2001.

Breakdown of operating income by business

in millions of euros	**2003**	2002 restated*	Total change	Organic change
Defence	**545**	482	*+ 13%*	*+ 19%*
% of revenues	*8.3%*	*7.2%*		
Aerospace	**140**	126	*+ 11%*	*+ 11%*
% of revenues	*7.8%*	*7.0%*		
IT&S	**37**	54	*- 31 %*	*- 40%*
% of revenues	*1.8%*	*2.2%*		
Other extraordinary income (charges)	**(24)**	--	*+ 5%*	*+ 7%*
Total operating income	**698**	662	*+ 5%*	*+ 7%*
% of revenues	*6.6%*	*6.0%*		

* 2002 operating income adjusted for Euromissile provision (adjustment of +€65 million applied to Defence figures and total)

The increase in operating income from Defence (excluding the impact of the Euromissile provision in 2002) and Aerospace more than offsets the reduction in operating income from IT&S, which fell for the second consecutive year. The decrease in IT&S operating income is partly attributable to the depreciation of the dollar (for electron tubes in particular) and the deterioration of the general economic climate over the last two years, which affected both the divested businesses (most of which were loss-making) and the recurrent businesses, whose profits were lower.

- **Defence:** almost all the Defence businesses contributed to the improvement in operating income, with the exception of airborne systems, whose contribution was slightly lower. Most of this decrease is attributable to lower billings on a number of combat aircraft programmes nearing completion. The highest increases came from communications, particularly in France and the United States, and naval systems, particularly through the multi-domestic subsidiaries.
- **Aerospace** : 2003 operating income includes the positive impact of the ruling in favour of Thales in litigation over the in-flight entertainment systems business in the United States. Adjusted to exclude this impact, operating income for Avionics is very close to the 2002 figure, thanks to good performance on military programmes. Income from military simulation and training business increased again, partially offsetting lower income from civil programmes. Income from the air traffic management business was slightly higher than in 2002 but remained relatively low as this business is still affected by the crisis in the air transport sector.
- **IT&S** : despite the sale at the end of 2002 of two loss-making subsidiaries, Thales Microsonics and Thales Contact Solutions, income from this business fell in 2003. This reduction is attributable partly to poorer performance by Thales Geosolutions, which was sold in November 2003, partly to higher losses by the businesses that were already making losses in 2002, primarily the microelectronics subsidiaries, and partly to the slight decrease in operating income from profitable businesses. This latter decrease mainly involved the electron tubes business, whose main markets remained soft in 2003, and, to a lesser extent, Thales Information Systems, whose operating margin was nonetheless one of the highest in the IT services sector in Europe. In the growth area of secure operations, income from recurrent businesses (i.e., excluding Thales Contact Solutions, which was sold in 2002) was substantially higher in 2003. This improvement was particularly significant in secure electronic transactions and secure systems and equipment for the transport sector.
- In addition, 2003 operating income includes a loss of more than €20 million booked by the parent company Thales SA in connection with the disposal of real-estate assets by the Group over the last three years, mainly in France: The operating units now rent most of the floorspace they occupy, and manage that occupancy very tightly. Rental payments for the floorspace no longer occupied by the operating units are assumed by Thales SA. These payments will gradually fall as the free floorspace is occupied by other Group operating units or non-Group businesses.

The increase in operating margin is attributable both to the improvement in **gross margin** (revenues less cost of sales) in 2003, which represented 22.4% of revenues compared with 22.0% in 2002 (and 21.4% including the Euromissile provision) and the overall decrease in other operating costs, including sales, marketing, administrative and R&D expenses, which represented 15.8% of total revenues compared with 16% the year before.

- **Sales and marketing expenses** were slightly lower in 2003 but represented 8% of revenues (excluding the *Sawari 2* hull), compared with 7.6% in 2002. This proportional increase, primarily in the Defence and Aerospace businesses, is largely due to demonstration costs on a number of new proposals. **General and administrative expenses** were markedly lower, particularly in Defence and IT&S, and represented 4.7% of revenues in 2003 compared with 5% the year before.
- At €1.85 billion, total **R&D expenses** remained very close to the 2002 figure (€1.9 billion). Company-funded R&D accounted for 20% of the total (€381 million). Most of the R&D expenses involved applied research and development programmes conducted by the operating units. Fundamental research accounted for approximately 5% of the total and 25% of company-funded R&D. An estimated total of 19,000 employees, of whom 70% are engineers, are involved in research and development.
  Company-funded R&D (€381 million) represented 3.8% of revenues in 2003 (excluding the *Sawari 2* hull), compared with €430 million and 4.0% in 2002. Two-thirds of this year-on-year decrease is the result of exchange effects and divestments (IT&S businesses). The decrease also reflects the higher figure for R&D expenses recorded on the assets side of the balance sheet: this figure increased from €76 million at the end of 2002 to €101 million at the end of 2003. This IAS-compliant practice (see note 1-k to the financial statements) relates to a few major research programmes, mainly the flight management system for the *A320*, the *RBE2* radar for the *Rafale*, and, for higher amounts in 2003, equipment for the *A380* (particularly the braking system).

Earnings before interest & tax (EBIT): €497 million

EBIT stood at €497 million in 2003, lower than the 2002 figure, adjusted for the Euromissile provision, of €512 million. This decrease in EBIT is attributable to higher **restructuring costs**, which increased by €50 million from €147 million in 2002 to €197 million in 2003.

- The increase in restructuring costs was largely due to the accounting in 2003 of nearly all remaining early retirement measures, including those planned for 2004, implemented in the company's operations in France, as part of the CASA(1) early retirement programme. The CASA programme, which involves approximately 1,800 employees, was launched in 2002 and will continue until 2004. Almost all the costs related to retirements planned for 2003 and 2004 were recorded in 2003, leading to a €50 million increase in the provision booked and an equivalent increase in restructuring costs between 2002 and 2003.

  As a result, restructuring costs for France increased from €95 million to €148 million. Overall restructuring costs break down into €109 million for Defence, particularly for airborne systems, €32 million for Aerospace, particularly for avionics, and €51 million for IT&S, particularly for communication components.
- Other operating income/expense was an expense of €4 million (expense of €3 million in 2002); this was mainly non-operating disputes and adjustments to previous financial years.

Ordinary pre-tax income before financial component of pensions: €406 million

Despite the decrease in EBIT, **ordinary pre-tax income** before the financial component of pensions was €28 million, which is 4.4% higher than the 2002 figure adjusted for the Euromissile provision (€389 million). This improvement is the result of the lower financial expense, which fell for the second consecutive year, reaching €109 million in 2003 compared with €162 million in 2002.

- **Financial income** (expense) includes a lower net financial expense, €99 million (€114 million in 2002), reflecting a reduction in average net debt, although the average rate of financing fell only slightly (4.56% in 2003 compared with 4.6% in 2002). A net translation gain of €7 million was recorded in 2003, compared with a net translation loss of €14 million in 2002. Other financial expenses totalled €17 million, which is significantly lower than in 2002 (€35 million). They included dividends received (€4 million) and depreciation of securities (€21 million, including €10 million for securities held by Thales Corporate Ventures).
- **Income from unconsolidated affiliates** was positive at €18 million in 2003 (€29 million in 2002), mainly due to contributions from the UK lottery operator Camelot and Satellite Information System Ltd.

Financial component of pensions

In 2002, the Group recorded a positive contribution of €11 million as "financial component of pension charge". In 2003, this figure was a charge of €85 million, which is €96 million lower than the year before and breaks down as follows:

Financial component of pensions

in million of euros	2003	2002	change
Interest cost	(159)	(158)	- 1
Expected return on plan assets	148	189	- 41
Amortisation of scheme amendments	3	3	--
Amortisation of actuarial gains	(65)	(25)	- 40
Reductions and scheme liquidations	(12)	2	- 14
Total	**(85)**	11	- 96

This change is mainly attributable to the United Kingdom subsidiaries, where expected long-term returns on plan assets fell to 7.8% compared with 8.7% in 2002, and where amortisation of actuarial gains/losses, which are amortised over 10 years, was significantly higher.

The financial component of pensions is recorded in the consolidated financial statements in compliance with IAS 19, which Thales has applied to all Group companies since 2002 (see notes 1-m and 17 to the financial statements).

This standard covers defined-benefit plans (as opposed to defined-contribution plans) both for retirement funds, as in most English-speaking countries, and for certain other benefits such as retirement awards and long-service awards. Application of this standard will be mandatory from 2005 under the International Financial & Reporting Standards (IFRS). Thales will have no further adjustments to make for this standard in its IFRS-compliant financial statements.

Positive net income

Thales recorded net income, Group share, of €112 million in 2003, following a net loss of €111 million in 2002. The 2003 figure, which reflects the impact of the financial component of the pension charge of €57 million euros after tax, includes:

- A **gain on disposals** of €8 million (compared with €67 million in 2002), including a gain of €49 million on the sale of the remaining shares in Indra (4%) and a gain of €13 million on the sale of further real-estate assets in 2003 (gains of €62 million in 2002 and €107 million in 2001). The disposal of Thales Geosolutions generated a total loss of €35 million, and depreciation of €13 million was booked to Thales Spectrum International NV, in which Thales still held a 49% interest at the end of 2003, to account for the potential negative impact of measures taken by the Argentinean authorities against certain private companies holding public service concessions.
- **Income tax** for 2003, at €30 million, was significantly lower than for 2002 (€87 million). This figure is based on local taxes applicable to the parent company's scope of tax consolidation, including the major French subsidiaries in which its interest exceeds 95%, and tax consolidations in the United States, United Kingdom and Germany. Total income tax breaks down into €37 million of current taxes, offset by deferred tax credit of €7 million on €55 million of previously unrecognized losses (activation of €23 million in 2002). The main non-deductible charges are goodwill amortisation; capital gains on disposals are taxed at lower rates.
- **Amortisation of goodwill**, at €174 million compared with €194 million in 2002, includes a recurring charge of €156 million, practically the same as in 2002 (€158 million).

(1) Cessation d'Activité des Salariés Agés

FINANCIAL SITUATION

Cash flow in 2003

The balance of cash flows for 2003 shows a net cash resource of €329 million, which is markedly higher than the €207 million recorded in 2002, despite the exceptional payment of €108 million to Euromissile pursuant to the ruling against Thales at the end of 2002. For the third consecutive year, Thales reduced its net debt at year-end and improved the structure of its balance sheet.

Summary of cash flows

in million of euros	2003	2002
Operating cash flow	770	591
Change in net working capital	(25)	(285)
Cash flow from operating activities before Euromissile payment	**745**	306
Payment to Euromissile	(108)	--
Cash flow from operating activities	**637**	306
Net capital expenditure	(350)	(357)
Net proceeds from disposals	204	277
Increase in capital & sale of own shares	--	144
Dividends	(162)	(163)
Net cash flow	**329**	207

- **Cash flow from operating activities**, at €745 million in 2003, was significantly higher than the year before (an increase of 143%) and more than covers both capital expenditures and the exceptional payment of €108 million to Euromissile. Cash flow from operating activities includes €770 million in operating cash flow (30% higher in 2003) and a slight increase in net working capital requirements (+€25 million compared with +€285 million in 2002).
- At €350 million, capital **expenditure** net **of disposals** remained close to the 2002 figure.
- Net **proceeds from disposals** were €204 million (€277 million in 2002) and include the following main operations:
  - further disposal of real-estate assets for €48 million, following more significant disposals in 2001 (€467 million) and 2002 (€198 million), as part of the strategy deployed two years before to outsource management of non-specific sites and optimise related expenditures,
  - the disposal of the remaining 4% interest in the Spanish company Indra Systems for €58 million,
  - disposal of non-strategic assets, particularly as part of the refocusing of the IT&S portfolio, including Thales Geosolutions and Thales Antennas.

Distribution of **dividends** for 2002 corresponds to a total outflow of €162 million, including €48 million of tax on dividend payments.

Further reduction in net debt

Shareholders' funds (excluding minority interests) stood at €2,014 million at the end of 2003, €132 million lower than the end-2002 figure (€2,146 million). This reduction is a result of the higher dividend payment (€162 million compared with €112 million for 2002) and the negative exchange adjustment of €74 million on the net assets of the British and North American companies.

For the third consecutive year, Thales reduced its **net debt**, by €414 million, including €329 million from net cash flow and €85 million from changes in exchange rates and scope of consolidation. At end-2003, net debt stood at €906 million, compared with €1,320 million a year earlier, and the Group's net gearing ratio (net debt to net debt-plus-equity) decreased again, from 38% to 31%. At end 2001, this ratio was 41%.

PROPOSED DIVIDEND

In view of the company's sound performance and improved financial structure, the Board of Directors proposed that the shareholders' Annual General Meeting of 11 May 2004 approve a 7% increase in the net dividend to €0.75 per share with a maximum tax credit of €0.375. The dividend was payable on 31 May 2004.

Dividends paid for the past three financial years:

Financial year	2002	2001	2000
Net dividend per share	€0.70	€0.70	€0.62
Tax credit	€0.35	€0.35	€0.31
Dividend including tax credit	€1.05	€1.05	€0.93

OUTLOOK FOR CURRENT FINANCIAL YEAR

In 2004, revenues are expected to show a moderate increase on a like-for-like basis, as a result of higher sales in IT&S and stable revenues in Defence and Aerospace.

Operating income is likely to improve further thanks to the recovery in IT&S performance, a favourable trend in Defence and a solid performance in Aerospace. Ordinary pre-tax income should also improve with significantly reduced restructuring costs.

Transition to IAS / IFRS accounting standards

For each financial year starting on or after 1 January 2005, European Union companies must prepare their consolidated financial statements in conformity with International Accounting Standards, known since May 2002 as International Financial Reporting Standards (IAS/IFRS), if their securities are admitted to trading on a regulated market. The new standards will also apply to financial statements for 2004, in order to make comparison possible. IFRS 1 offers several options, currently being evaluated, for applying certain standards.

Since Thales publishes half-yearly statements, the Group intends to present its consolidated accounts in accordance with IFRS as from the publication of its accounts for the first half of 2005.

In preparation, the Group's Chief Financial Officer in 2002 launched a project comprising three main phases:

1) Identify the impact of the change in standards on accounting principles and information systems;

2) Form working groups on key topics;

3) Train accounting teams throughout the Group and apply new baseline practices in subsidiaries.

During the first phase, the Group identified a limited number of differences between IAS/IFRS and the standards hitherto applied. These differences and their impact on information systems are being examined by dedicated working groups. They mainly concern the following standards:

- **IAS 39: Financial instruments, recognition and measurement**

  This standard applies to the financial instruments the Group uses to cover its exchange risks. The reason for the difference is that a proportion of the Group's business, estimated at less than 10% of consolidated revenues, comes from contracts denominated in foreign currencies, for which the exchange risk is hedged from the date they are booked as new orders. The Group also covers exchange risks for foreign-currency bids under negotiation over long periods.

- **IAS 11: Construction contracts**

  The accounting principles Thales applies to long-term contracts ("construction contracts") are already largely compliant with IAS 11. However, the Group will upgrade its information systems to meet the new obligations for disclosure. Modifications to the presentation of these contracts in the balance sheet are also being examined.

- **IAS 16: Property, plant and equipment**

  The Group is undertaking a detailed analysis of its tangible assets in the light of IAS 16 rules, and is considering changes to its information system. However, it does not anticipate any significant impact on the opening balance sheet, given the low capital intensity of its business.

- **IAS 36: Impairment of assets**

  Goodwill will no longer be amortised, but tested for impairment each year. Since the Group already tests for depreciation (see note 1-a to the Appendix to the consolidated financial statement), application of IAS 36 should not have any impact on the opening balance sheet.

The other differences identified are likely to have only a marginal impact on financial statements. They concern rules for recording employee stock option plans (IFRS 2), applicable to option plans granted as from 7 November 2002, and the disclosure and presentation of financial instruments (IAS 32), notably the Oceane-type convertible or exchangeable bonds issued in 2001. IAS 1 will also affect the presentation of the financial statement and balance sheet.

This list cannot be exhaustive, since some IFRSs have only recently been finalised or have not yet been endorsed by the European Commission. Furthermore, interpretations or detailed recommendations for applying the standards are not yet available.

Since 2002, Thales has applied IAS 19 on the accounting treatment and disclosure of pension charges and related costs to all Group companies. However, the Group does have the option of deducting from the net cash position in the 1 January 2004 balance sheet all the actuarial differences accrued to that date.

Report on risk management

MARKET RISK

Treasury management

Group policy is to optimise its funding and banking operations and 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.

This "cash pooling" links units by currency zone and, in some cases, by country (primarily the euro zone, with separate cash pooling for French units, the sterling zone and the dollar zone).

The clearing of assets and liabilities has accounting effects that vary by country. For example, for UK-based units, the clearing of assets and liabilities for a given amount is applied to notional amounts. It offsets the theoretical interest expense by the corresponding amount of interest receivable. However, the notional assets and liabilities thus cleared are not removed from the balance sheet but recorded as assets (under cash in hand) and liabilities (under other financial debts). This accounting practice consequently inflates both items by equal amounts, which were not significant at end-2002 and end-2003 (around €75 million at end-2003).

At 31 December 2003, the cash recorded under consolidated assets was €1.036 billion (compared with €918 million at end-2002), of which:

- €600 million from disposals to a value of around €150 million (primarily Thales Geosolutions), recorded at year-end but not yet used to repay short-term treasury notes, and from the Group's usual safety margin for managing liquidity risk. Of this year-end total, €522 million was recorded in the parent company's balance sheet and the remainder by subsidiaries.
- €436 million in cash that could not be immediately cleared by debt positions for technical reasons, including €148 million invested directly by joint ventures (prorated by Thales' interest in each joint venture), since cash pooling is not applicable to joint ventures. This also includes the bank credit balances of subsidiaries outside France.

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

- Moody's Prime-2 for commercial paper and short-term loans, and A3 for medium- and long-term loans
- Standard & Poor's A2 for commercial paper and short-term loans, and A-/outlook stable for medium- and long-term loans.

Interest rate and foreign exchange risk management for business activity

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.

The Group's exposure to interest rate fluctuations is covered by swaps. The interest paid or received for these swaps is recorded over the life of the underlying loans.

Thales conducts part of its business activity in foreign currencies [1] and has therefore adopted a specific policy to hedge the consequent exchange risk:

- bids under negotiation in foreign currencies are managed either by reinsurance with insurance companies, in particular Coface, or through market transactions (forward exchange-rate contracts and options)
- orders booked in foreign currencies are covered by forward sales denominated mainly in US dollars or sterling.

In currency terms, orders booked in 2003 (worth a total of €10,887 million) break down as follows:

- 56% domestic orders (i.e. within the countries in which the units concerned are based)
- 12% orders within the euro zone expressed in euros and orders for the United States expressed in US dollars.

Orders in these two categories, which account for 68% of the total in 2003, are not exposed to currency risk.

- 26% other export orders, expressed in the currency of the home country, including orders exported from euro zone countries expressed in euros and orders exported from the United Kingdom expressed in sterling, which account for 24%.

Orders in this category are not exposed to currency risk once they are booked, as they are expressed in the currencies of the Thales units concerned. Before these orders are signed, however, they may be exposed to commercial risk related to the currency in which they are expressed if the unit concerned is bidding against competitors working in other currencies (as was the case in 2003 with competitors working in US dollars, for example).

- 8% export orders expressed in currencies other than those of the units concerned (mainly orders denominated in US dollars). These orders are systematically hedged when they are first booked.

Consequently, orders are either "immune" from risks associated with currencies or destination countries, or are hedged when the contracts are first signed.

The underlying commitments and market values expressed in euros, and the maturities of these exchange and interest rate instruments are listed in note 22 to the consolidated accounts.

(1) Foreign currency: any currency other than the local currency

Management of risk relating to foreign currency-denominated assets

The Group hedges part of its foreign currency-denominated assets, mainly those assets likely to be sold 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.

LITIGATION

Due to the nature of its business, the Group is exposed to the risk of technical and commercial litigation.

With respect to litigation mentioned in last year's report, developments in 2003 are as follows:

- In the arbitration between Euromissile and Thales Air Defence, the Group has launched an appeal with the Paris Appeal Court to have the ruling handed down by the Arbitration Panel on 23 October 2002 in favour of Euromissile overturned. A decision is expected in late 2004.
- The suit filed by the official receiver against Thales with respect to the liabilities of Thomainfor [1] has been taken to the Court of Cassation, following the ruling by the Versailles Appeal Court ordering Thales to pay eight million euros in compensation.
- The request for arbitration submitted by a customer for an amount of $599 million in damages, arising out of the execution of an old contract for the supply of equipment and systems executed in conjunction with an industrial partner, continued in 2003. In proportion to each industrial partner's share in the contract involved, Thales' share would be approximately 30%. The Group is opposing this request and is organising its defence in conjunction with its industrial partner. Thales is not in a position to evaluate any possible financial risk.
- In late 2002, a group of French industrial contractors, including Thales and one of its subsidiaries, received a request for arbitration relative to the execution of old contracts. In proportion to each industrial partner's share in each contract involved, Thales would have been liable for around 20% of the total claim of $260 million. However, under an agreement designed to prevent the groups concerned from invoking statute of limitations provisions against the claimant, the latter withdrew its request for arbitration on 20 June 2003.

No other significant litigation was initiated in 2003. 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 impact on its results, financial situation or outlook.

ENVIRONMENTAL RISK

As a general rule, Thales' activities do not have any significant environmental impact. Nonetheless, for the last six years, Thales has taken a proactive approach to environmental issues connected with its real estate assets and industrial processes.

Management of environment risks includes:

- Administrative and technical conformity of plants
- Implementation of an environmental management system adapted to each site (over forty sites are certified to ISO 14001 to date)
- Mapping of environmental risks in Australia, Belgium, France, Germany, Greece, Italy, Korea, the Netherlands, South Africa, the United Kingdom and, in 2004, the United States. The aim is to identify any possible soil contamination or groundwater pollution and to ensure that site employees and neighbouring communities are not exposed to any health risks.
- Management of any risks identified, including possible modification of facilities and, where necessary, remediation and continued surveillance.

No significant risks calling for provisions in the financial statements were identified in 2002 or 2003. The provision of €7.5 million made in 2002 to cover pre-existing pollution in Australia was maintained in 2003.

NB: Detailed information on specific action taken by the Group, including the main indicators, is given in the Environmental Performance section on page 132.

(1) Group subsidiary sold in 1997

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.

Its main priorities are as follows:

- Risk identification policy, with risk-mapping for major businesses. Risk-mapping has been conducted on the core activities of the Group's Aerospace business area – avionics, simulation and air traffic control – where exposure to the risk of civil liability claims is highest.
- Prevention and protection policy for industrial sites, to reduce the frequency and extent of the risk of accidental fire or explosion. In 2003, 57% of insured assets were audited for fire safety by an outside body. This ratio is expected to reach around 80% in 2004.
- 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 €11.75 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 reactivate data backup plans launched in 2002 was pursued in 2003 and included drafting of a Group-wide scorecard and an action and implementation plan applicable at all sites. All critical corporate applications have been identified, and appropriate backup solutions have been put in place. One of these was recently tested under actual operating conditions and proved fully satisfactory.

In addition, business continuity plans have been put in place at different units across the Group.

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 2004. It can only be renegotiated in the event of a catastrophic increase in accident rates.

In 2003, total premiums paid for global cover amounted to 0.37% of consolidated revenues. This figure is likely to increase in 2004 following the renegotiation of the programme.

The maximum guarantee for damage to property and subsequent operating losses is set at 600 million euros. 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. In 2003, the Thales Group raised its insurance guarantee significantly (to two billion euros) for civil liability of its aerospace businesses, which is covered by a separate programme.

The exclusions common to the market as a whole (asbestos, etc.) now 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.

DEPENDENCE

Upstream: key supplies and technologies

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 (€1.85 billion invested in 2003) and controls the patents that are of critical importance to its businesses. Any risk of Group technologies and products depending on outside patents is analysed either during the procedures for obtaining patents or when technical studies or product development are launched. In the event of action by a third party against a Group company for infringement of intellectual property rights, the corporate entity TPI (Thales Intellectual Property) handles the case with the disputes team at the Group's legal department. 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.

Downstream: main customers

The Defence business area and part of the Aerospace business area have government agencies as their main customers. The French defence ministry is the biggest single customer for these businesses and accounted for sales of €1,955 million in 2003, or 18.5% of consolidated revenues. This compares with €1,696 million in 2002 and €1,590 million in 2001 (15% of consolidated revenues for both years).

These figures include sales as subcontractor. Sales to the British Ministry of Defence amounted to €768 million in 2003, or 7.3% of consolidated revenues. This compares with €889 million in 2002 and €784 million in 2001 [(1)]. As in 2002, Saudi Arabia remained the Group's second biggest customer in 2003, accounting for nearly 10% of consolidated revenues including the two Sawari 2 frigate hulls, which were billed in 2002 and 2003 and generated €400 million and €430 million respectively.

The Group pursued a "multi-domestic" development policy throughout the 1990s and early 2000s. This policy, which applies first and foremost to its Defence business area, has led to broad geographic diversification of the Group's customer base and made it much less reliant on orders from any one country.

The Aerospace business area's civil 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 around €450 million in 2003. This figure remains unchanged from 2002.

The IT&S business area serves a wide variety of customers in the industrial and services sectors, as well as public agencies and civil authorities (particularly in the field of transport infrastructures).

(1) In 2003, sales to the British Ministry of Defence were 16% lower than in the previous year after conversion into euros, but only 6% lower at identical exchange rates.

Q1 2004 revenues: €1.9 billion[(1)]

- **1.5% increase in revenues on like for like basis**
- **Growth confirmed in information technology and services**
- **Significantly reduced impact of foreign exchange fluctuations**

Thales revenues in Q1 2004 were €1,941 million, a decline of 1.7% compared to Q1 2003 (€1,975m). On a like for like basis, revenues increased by 1.5%. The changes in the scope of consolidation had a net impact of –€54 million and the fluctuation in exchange rates had a limited impact of –€9 million.

The change in the scope of consolidation is mainly due to the deconsolidation of Thales Geosolutions (as of Q4 2003).

The changes in consolidated sales per activity were:

	Q1 2003		Q1 2004		Total	Organic
	%	**€M**	**%**	**€M**	**Change**	**Change**
Defence	*59%*	1,156	*63%*	1,204	*4.4%*	*3.8%*
Aerospace	*18%*	353	*16%*	302	*-14.4%*	*-14.5%*
Information Technology & Services	*23%*	445	*21%*	404	*-9.3%*	*7.8%*
Others		21		31		
Total	***100%***	**1,975**	***100%***	**1,941**	***-1.7%***	***1.5%***

On a like for like basis and with a virtually unchanged scope of consolidation, **defence** sales increased 3.8% compared to Q1 2003. This increase is due to the recognition of milestones in major long-term contracts, especially airborne system export programmes, and to the good performance of communications, command & control and air defence activities.

The 14.5% organic decrease in **aerospace** revenues is due to the timing of revenues linked to the percentage of completion of certain military contracts and to the decline in sales of civil simulators (the number of civil simulators delivered in Q1 2003 was particularly high). The decrease is also explained by the ongoing downturn in the civil air traffic management business. The short term variation observed in Q1 2004 does not affect the prospects for growth in aerospace as a whole over the full year.

On a like for like basis, sales in **information technology and services** increased by 7.8%. Whilst market conditions remained weak in microelectronics and broadcast activities, elsewhere, the overall positive trend confirms the growth recorded at the end of 2003 in secure operations, the dynamism in positioning activities and the renewed growth in information systems revenues.

The **geographic destination of sales** remained virtually the same, with a slight increase in sales in France and the United Kingdom, which represented 27% (24 % in Q1 2003) and 15% (14% in Q1 2003) respectively. Sales outside Europe accounted for 38% of consolidated revenues (42% in Q1 2003), with the Asia & Pacific region once again representing an important 14% of sales.

(1) Press release of 11 May 2004

CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED PROFIT AND LOSS ACCOUNT

€ million		2003	2002	2001
Sales	(note 4)	10,569.4	11,105.1	10,268.0
Cost of sales		(8,202.9)	(8,727.5)	(7,856.1)
Research and development expenses		(380.7)	(430.1)	(432.3)
Marketing and selling expenses		(807.8)	(814.9)	(805.9)
General and administrative expenses		(480.1)	(535.7)	(528.3)
Operating income	(notes 4 et 18-2)	**697.9**	**596.9**	**645.4**
Restructuring costs		(197.5)	(146.7)	(160.3)
Other operating income (expense)		(3.7)	(3.0)	(14.3)
Earnings before interest and tax (EBIT)		**496.7**	**447.2**	**470.8**
Financial income (expense) *	(note 5)	(109.2)	(162.9)	(199.2)
Equity in income of unconsolidated affiliates	(note 11)	18.2	29.2	32.2
Ordinary pre-tax income		**405.7**	**313.5**	**303.8**
Financial component of pension charge	(note 17c)	(85.0)	10.5	39.0
Gain on disposal of assets and exceptional items	(note 6)	8.6	67.0	135.5
Income before taxation and amortisation of goodwill		**329.3**	**391.0**	**478.3**
Corporation tax	(note 7)	(30.3)	(83.3)	(73.2)
Net income (loss) before amortisation of goodwill		**299.0**	**307.7**	**405.1**
Amortisation of goodwill and badwill	(note 10)	(174.2)	(193.5)	(709.4)
Amortisation of acquired R&D		--	--	(57.5)
Minority interests		(12.4)	(3.1)	(4.4)
Income (loss), Group share		**112.4**	**111.1**	**(366.2)**
Earnings per share (in euros)	(note 8)	**0.69**	**0.70**	**(2.26)**
Diluted earnings per share (in euros)	(note 8)	**0.69**	**0.70**	**(2.26)**

* Financial component of pension charge not included.

The accompanying notes are an integral part of this consolidated profit and loss account.

CONSOLIDATED BALANCE SHEET

€ million		31/12/03	31/12/02	31/12/01
Assets				
Fixed assets				
Goodwill, net	(note 10)	2,146.2	2,336.1	2,655.8
Other intangible assets, net	(note 9)	206.3	173.6	153.3
Intangible assets, net	(note 9)	**2,352.5**	**2,509.7**	**2,809.1**
Tangible assets		3,261.8	3,494.7	3,787.8
Less: accumulated depreciation		(1,989.1)	(2,109.1)	(2,260.5)
Tangible assets, net	(note 9)	**1,272.7**	**1,385.6**	**1,527.3**
Equity in unconsolidated affiliates	(note 11)	61.5	81.7	77.8
Other investments	(note 12)	159.1	188.7	212.0
Pension and related costs	(note 17)	287.6	350.8	332.9
Other financial assets	(note 12)	142.6	163.2	155.1
Total investments and non-current assets		**650.8**	**784.4**	**777.8**
Total fixed assets		**4,276.0**	**4,679.7**	**5,114.2**
Current assets				
Inventories and work-in-progress	(note 13)	2,964.3	3,412.7	3,754.4
Accounts and notes receivable	(note 13b)	7,869.9	7,375.1	6,977.7
Current accounts with affiliated companies	(note 14)	167.9	109.3	127.7
Advances to suppliers		769.7	405.8	442.8
Other debtors and prepaid expenses		1,263.6	1,308.0	1,254.4
Marketable securities		3.5	0.1	0.1
Cash at bank and equivalents		1,035.7	917.8	1,680.1
Total current assets		**14,074.6**	**13,528.8**	**14,237.2**
Total assets		**18,350.6**	**18,208.5**	**19,351.4**
Liabilities and shareholders' funds				
Shareholders' funds				
Called up share capital (171,864,292 shares issued at 31 Dec. 2003 and 2002; 167,731,513 shares issued at 31 Dec. 2001; 3 € per share)		515.6	515.6	503.2
Share premium account and retained earnings		2,074.0	2,124.2	2,103.2
Cumulative translation adjustment		(153.7)	(79.4)	(6.7)
Treasury shares		(421.5)	(421.5)	(453.7)
Shareholders' funds (excluding minority interests)	(note 15)	**2,014.4**	**2,138.9**	**2,146.0**
Minority interests	(note 16)	43.4	29.0	27.7
Total shareholders' funds and minority interests		**2,057.8**	**2,167.9**	**2,173.7**
Pension and related costs	(note 17)	419.6	381.8	266.4
Other reserves for contingencies	(note 18)	996.9	1 194.1	1 249.5
Total reserves for contingencies		**1,416.5**	**1,575.9**	**1,515.9**
Current accounts with affiliated companies	(note 14)	152.5	231.4	166.7
Other debt	(note 19)	1,978.9	2,144.3	3,150.3
Total financial debt		**2,131.4**	**2,375.7**	**3,317.0**
Advances received from customers on contracts	(note 13b)	7,469.5	7,121.8	7,691.0
Accounts and notes payable		2,018.8	1,875.2	1,926.7
Accrued holiday pay and social security contributions		830.1	751.3	690.5
Other creditors and accrued liabilities		2,426.5	2,340.7	2,036.6
Total current liabilities		**12,744.9**	**12,089.0**	**12,344.8**
Total liabilities and shareholders' funds		**18,350.6**	**18,208.5**	**19,351.4**

Commitments and contingencies are presented in note 21.

The accompanying notes are an integral part of this consolidated balance sheet.

CONSOLIDATED STATEMENT OF CASH FLOWS

€ million		2003	2002	2001
Cash flows from operating activities				
Net income (loss) before minority interests		112.4	111.1	(366.2)
Minority interests		12.4	3.1	4.4
Add (deduct):				
Equity in income of unconsolidated affiliates (net of dividends paid)		(5.1)	1.5	29.1
Depreciation of goodwill		173.8	196.2	711.8
Depreciation of tangible and intangible assets (excl. goodwill)		281.8	307.4	323.7
Allowances for losses on fixed assets and provision for pension costs		184.1	100.0	44.7
Loss (profit) on disposals of assets (including marketable securities)		(9.4)	(68.3)	(150.6)
Net charges to costs on restructuring	(note 18-2)	20.4	(59.7)	(58.4)
Operating cash flows before working capital changes		**770.4**	**591.3**	**538.5**
Change in working capital requirements	(a)	50.4	(294.2)	142.5
Change in accrued costs on long-term contracts and other costs	(b)	(184.0)	8.7	(14.0)
Net global change in working capital requirements		**(133.6)**	**(285.5)**	**128.5**
Total	**- I -**	**636.8**	**305.8**	**667.0**
Cash flows from investing activities				
Capital expenditure	(note 20a)	(375.5)	(417.6)	(535.6)
Proceeds from disposal of tangible and intangible assets		25.5	60.9	56.0
Net operating investments		**(350.0)**	**(356.7)**	**(479.6)**
Proceeds from disposal of real estate assets		**48.3**	**198.4**	**466.9**
Acquisitions	(note 20b)	(67.9)	(38.3)	(509.8)
Disposals	(note 20b)	223.6	116.9	568.0
Change in loans to affiliated companies and other financial assets		(31.5)	1.0	(73.4)
Net financial investments		**124.2**	**79.6**	**(15.2)**
Total	**- II -**	**(177.5)**	**(78.7)**	**(27.9)**
Cash flows from operations	**- I + II -**	**459.3**	**227.1**	**639.1**
Cash flows from financing activities				
Increase (decrease) in equity and minority interests	(note 20c)	(162.1)	(19.2)	(153.3)
Increase in debt		302.6	94.3	1 087.1
Repayment of debt		(360.2)	(1 053.9)	(1 332.8)
Increase (decrease) in debt with affiliated companies		(75.3)	50.2	96.9
Total	**- III -**	**(295.0)**	**(928.6)**	**(302.1)**
Effect of exchange rate variations and consolidation changes	(note 3) **- IV -**	**(49.1)**	**(61.5)**	**25.5**
Net increase (decrease) in cash before changes in marketable securities	**- I + II + III + IV -**	**115.2**	**(763.0)**	**362.5**
Decrease (increase) in marketable securities		2.7	0.7	129.6
Total increase (decrease) in cash		**117.9**	**(762.3)**	**492.1**
Net cash position at year-end:				
Cash at bank and equivalents at end of period	(c)	1,035.7	917.8	1,680.1
Loans from financial institutions and partners included in "Other financial assets"		17.8	28.4	45.5
Current accounts with affiliated companies		167.9	109.3	127.7
Marketable securities		3.5	0.1	0.1
Total debt		(2,131.4)	(2,375.7)	(3,317.0)
Net cash position (net debt)		**(906.5)**	**(1 320.1)**	**(1 463.6)**

(a) Including changes in proceeds from non recourse sale of government receivables (€101.8 million in 2003, – €11.7 million in 2002, €6.8 million in 2001).
(b) Including, in 2003, a release of provision of – €108.0 million related to Euromissile litigation, following the payment made in February 2003.
(c) Includes respectively €403.6 million, €373.0 million and €873.7 million of negotiable notes and mutual funds maturing in three months or less.

The accompanying notes are an integral part of this consolidated statement of cash flows.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' FUNDS AND MINORITY INTERESTS

€ million		Number of shares outstanding (thousands)	Share capital	Share premium account and retained earnings	Cumulative translation adjustment	Treasury shares	Share-holders' funds	Minority interests
At 1 January 2001		**165,810**	**503.2**	**1,986.8**	**(8.7)**	**(56.3)**	**2,425.0**	**6.9**
Translation adjustment		--	--	--	2.0	--	**2.0**	0.5
Dividends (tax included)	(note 20c)	--	--	(152.6)	--	--	**(152.6)**	(1.0)
Purchase of own shares		(8,822)	--	--	--	(397.4)	**(397.4)**	--
Alcatel Space goodwill		--	--	640.3	--	--	**640.3**	--
Other		--	--	(5.1)	--	--	**(5.1)**	--
Net income 2001		--	--	(366.2)	--	--	**(366.2)**	4.4
Consolidation changes		--	--	--	--	--	**--**	16.9
At 31 December 2001		**156,988**	**503.2**	**2,103.2**	**(6.7)**	**(453.7)**	**2,146.0**	**27.7**
Capital increase	(note 15a)	4,133	12.4	75.4	--	--	**87.8**	--
Translation adjustment		--	--	--	(72.7)	--	**(72.7)**	(1.5)
Dividends (tax included)	(note 20c)	--	--	(162.5)	--	--	**(162.5)**	(0.7)
Change in own shares		1,143	--	75.3	--	32.2	**107.5**	--
Change in accounting method	(note 1m)	--	--	(79.0)	--	--	**(79.0)**	--
Other		--	--	0.7	--	--	**0.7**	--
Net income 2002		--	--	111.1	--	--	**111.1**	3.1
Consolidation changes		--	--	--	--	--	**--**	0.4
At 31 December 2002		**162,264**	**515.6**	**2,124.2**	**(79.4)**	**(421.5)**	**2,138.9**	**29.0**
Translation adjustment		--	--	--	(74.3)	--	**(74.3)**	3.1
Dividends (tax included)	(note 20c)	--	--	(162.1)	--	--	**(162.1)**	(0.8)
Other		--	--	(0.5)	--	--	**(0.5)**	--
Net income 2003		--	--	112.4	--	--	**112.4**	12.4
Consolidation changes		--	--	--	--	--	**--**	(0.3)
At 31 December 2003		**162,264**	**515.6**	**2,074.0**	**(153.7)**	**(421.5)**	**2,014.4**	**43.4**

The accompanying notes are an integral part of this consolidated statement of changes in shareholders' funds and minority interests.

Notes to the consolidated financial statements

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

1. ACCOUNTING POLICIES

The consolidated financial statements of Thales are prepared in accordance with the accounting policies applicable in France, namely C.R.C. 99-02 regulation.

The financial statements of consolidated subsidiaries and subsidiaries accounted for under the proportionate method, in accordance with the generally accepted accounting principles of their respective country of origin, have been restated accordingly.

a) Consolidation

The financial statements of significant subsidiaries directly or indirectly controlled by Thales have been consolidated.

Companies in which Thales does not have a controlling interest but in which it exercises significant influence, directly or indirectly, are recorded under the equity method. Companies under joint control are accounted for under the proportionate method.

Goodwill or badwill arising on acquisition is amortised over a period of twenty years, unless otherwise specified. When the fair value of assets acquired and liabilities assumed are adjusted prior to the end of the first financial year following the year of acquisition, the goodwill or badwill is adjusted accordingly. Moreover, beyond this one-year period, reserves for contingencies existing at the date of acquisition and no longer needed are reversed through the related goodwill.

Each year, the company performs impairment tests based on market prospects for the activities concerned. The goal of these tests is to determine that net goodwill is at most equal to the discounted future cash flows estimated for the remaining period of amortisation, less net assets.

As permitted under Article D.248-3 of the decree dated 23 March 1967, goodwill relating to acquisitions made before 31 December 1998 and paid for by the issuance of shares was offset against shareholders' funds for the amount of the share premium recorded at the time of the operation (note 10b).

b) Translation of the financial statements of foreign subsidiaries

Balance sheets are translated at the exchange rates prevailing at balance sheet dates ("Closing rates"). Profit and loss items and the statement of cash flows are translated at the average exchange rates for the period. Translation adjustments are reflected directly in Shareholders' funds (note 15).

The main closing and average exchange rates used for translation purposes in the last three financial years are summarised below:

€	31 Dec.2003		31 Dec.2002		31 Dec.2001	
	Closing rate	Average rate	Closing rate	Average rate	Closing rate	Average rate
AUD	1.6802	1.7398	1.8556	1.7418	1.7280	1.7354
GBP	0.7048	0.6934	0.6505	0.6298	0.6085	0.6194
USD	1.2630	1.1418	1.0487	0.9511	0.8813	0.8917

c) Accounting for foreign currency transactions

With the exception of transactions described in the next paragraph, foreign currency denominated monetary assets and liabilities are translated at closing exchange rates. Translation gains and losses are recorded under "Financial income (expense)" (note 5b) in the accompanying consolidated profit and loss account.

Foreign currency exposure is managed by the finance department of Thales which commits itself to buy or deliver foreign currencies from or to the operating units of Thales at specified exchange rates determined for each transaction; the assets and liabilities of the units are translated at such specified rates.

Premiums and discounts related to forward exchange contracts are recognised in income over the lives of the contracts on a straight-line basis. Translation gains or losses and premiums or discounts on forward exchange contracts designated to hedge commercial bids denominated in foreign currencies are deferred until those bids have become effective.

Translation gains or losses on forward exchange contracts entered into for purposes other than hedging are recognised in the profit and loss account; such gains or losses correspond to the difference between the forward rate of the currencies concerned at the balance sheet date and the contracted forward rate.

d) Interest rate instruments

The Group uses financial instruments to manage and reduce its exposure to fluctuations in interest rates. When these contracts qualify as hedges, gains and losses on such contracts are accounted for in the same period as the hedged item. Otherwise, if the market value of such instruments appears to be lower than that of the original trade, the potential loss is recognised in the profit and loss account.

e) Bond premiums and expenses

Bonds are carried at redemption value. Issue or redemption premiums are accounted for as assets or liabilities and amortised using the effective interest rate method.

Bond issuance expenses are amortised over the duration of the bond.

f) Marketable securities

Negotiable notes receivable maturing in three months or less are included in "Cash at bank and equivalents".

Marketable securities are accounted for at cost. Accrued interest not yet matured is classified in "Other debtors and prepaid expenses". Marketable securities are valued at the lower of their aggregate acquisition cost or market value at the balance sheet date.

g) Fixed assets

Property, plant and equipment are carried at their acquisition cost.

Depreciation of tangible fixed assets is computed under the straight-line or declining-balance method in such a way as to spread the economic depreciation of the related assets over their estimated useful lives.

Economic lives used in computing depreciation are as follows:
- 20 years for buildings,
- 1 to 10 years for plant and equipment,
- 5 to 10 years for other fixed assets (transport equipment, fixtures, etc.).

Fixed assets acquired through capital lease arrangements are recorded as assets at cost and are depreciated as described above, the corresponding debt being recorded as a liability.

Gains and losses on disposal of fixed assets are disclosed in note 6.

h) Other investments (note 12)

"Other investments" are not consolidated and are valued at their acquisition cost less depreciation based on their use value. Assessment of the latter notably takes into account the percentage of equity interests held, expected return on investment and market value (stock market price for quoted securities).

i) Inventories and work-in-progress

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

In accordance with industry practice, work-in-progress includes costs relating to contracts with production cycles longer than one year (note 13).

j) Long-term contracts

Income and expenses on long-term contracts are accounted for according to 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.

Interest income relating to long-term contracts is recorded as being earned in financial income except when advances received from customers significantly exceed costs incurred in connection with the related contracts. In such cases, a proportionate share of interest income is included in the contract revenues and allocated to the profit and loss account as indicated above.

Potential losses on contracts in progress or on the order book are fully recognised as soon as they are known. 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 Company, except when such claims have been accepted by the customer.

Progress payments under long-term contracts are shown as "Advances received from customers on contracts".

k) Research and development expenses (note 9)

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 strictly 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.

Such development costs are capitalised and amortised over the economic life of the product. The method of amortisation is determined according to expected future quantities or sales. The period of amortisation depends on the nature of the activity, but may not exceed 15 years.

When making an acquisition, the Group may allocate a portion of the acquisition price to R&D projects. If, at the acquisition date, these projects do not meet the criteria defined above, the value assigned to these projects is expensed immediately.

l) Deferred taxation (note 7)

The Group records deferred corporation tax when the tax value of an asset or liability differs from its book value.

Changes in the rate of corporation tax are recorded in the profit and loss account for the financial year in which the change was decided.

Deferred tax assets are not recognised in the balance sheet if the Group does not reasonably expect to recover the tax asset.

m) Pension and related costs (note 17)

In accordance with local legislation and practice in the countries in which it operates, the Group grants to its employees post-employment benefits (pension, retirement benefits, medical care…) and other long-term benefits (long-service benefits, long-service leave…).

Since 1 January 2002, the Group calculates pension and related costs in accordance with IAS 19 ("Projected Unit Credit method"). The accounting method is described below:

- for defined contribution schemes and multi-employers schemes, contributions paid are charged to the financial year to which they pertain;
- for defined benefit schemes, the actuarial method used is the "Projected Unit Credit method" with estimated future salary increases rates.

For post-employment benefits, actuarial gains (losses) exceeding the greater of 10% of obligations or plan assets are amortised over the expected average remaining working life of employees.

At 1 January 2002, the difference between the IAS 19 present value of the obligation net of plan assets and provisions recognised in the balance sheet at 31 December 2001, has been charged directly against shareholders' funds. Net of tax this amounted to –€79 million. The difference at 1 January 2002 is analysed below:

Difference at 1 January 2002	Gross	Tax charge	Net
France (long service leave)	(87.6)	29.8	(57.8)
Other Europe	(22.8)	--	(22.8)
Rest of the world	1.7	(0.1)	1.6
Total	**(108.7)**	**29.7**	**(79.0)**

The financial component of the annual pension charge (i.e. the unwinding of the anticipated yield on assets earmarked to finance this liability) is set out on a specific line (note 17c).

n) Early retirement

Some French affiliated companies have agreed to early retirement programs with their employees. This agreement allows employees who are more than 56 years of age to stop working and continue receiving a salary until they are entitled to full retirement benefits. This agreement is in place for three years, from 1 january 2002 to 31 december 2004. In accordance with the agreement, which requires agreement by both employer and employee, the cost of this action (€103.2 million in 2003 and €34.0 million in 2002) is recorded as a reserve once both parties have agreed to the early retirement. The corresponding payment will be spread over three years, on average, after the signing of the agreement.

o) Statement of cash flows

"Cash at bank and equivalents" includes cash and financial assets considered to be equivalent thereto. Changes in bank overdrafts are included in cash flows from financing activities. Thales purchases and sells securities maturing in more than three months, classified as marketable securities, as a means to optimise its cash management and these are therefore unrelated to its investment policy. Consequently, they are excluded from cash flows from investing activities and presented on a specific line entitled "Increase (decrease) in marketable securities".

2. CONSOLIDATION CHANGES

a) Major acquisitions and investments in 2003

- In August 2002, Thales acquired 100% of Odyssée. The company has been fully consolidated since 1 January 2003.
- Since 1 January 2003, the Spanish company Amper Programas, in which Thales holds a 49% interest, has been consolidated under the proportionate method. The company was previously consolidated under the equity method.
- In April 2003, Thales sold to Assystem its subsidiaries Technical Field Services International (T.F.S.I.) and Thales Technologies & Services (2TS) as well as some activities from Thales Industrial Services. These companies have been deconsolidated as from the 2nd quarter of 2003.
- In July 2003, Thales sold to Chelton Ltd its subsidiary Antennas Ltd, which was deconsolidated as from the second quarter of 2003.
- In November 2003, Thales sold to the Dutch group Fugro its subsidiaries Thales Geosolutions for an amount of €147.0 million (among of which €142.5 million were paid in 2003). These companies were deconsolidated as from the last quarter of 2003.

b) Acquisitions and investments in 2002

- In April 2002, Thales sold 6% of its 10.25% interest in Indra Sistemas. The gain on disposal amounted to €74.0 million (note 6). The company, consolidated under the equity method up to this date, was deconsolidated from this date onwards.
- In July 2002, Thales sold 15.8% of its 64.8% interest in Thales Spectrum International NV. Following this transaction, Thales now holds 49% of this company and its subsidiary Thales Spectrum Argentina. These companies have been consolidated under the equity method from 1 July 2002. The loss on disposal amounted to €8.0 million and was reported in the 2002 financial statements. An "impairment test" was applied to the remaining stake which led to a depreciation of these assets by €(18.4) million (note 6).
- In July 2002, Thales and "Direction des Constructions Navales" (DCN) created a joint subsidiary called Armaris, which gathers the commercial activities prime contractorship capabilities of Thales Naval France and DCN for new programs in the field of warships and naval combat systems. The company has been consolidated under the proportionate method from this date onwards.
- In November 2002, Thales sold the main part of the assets of Thales Contact Solutions to Nice Systems quoted on the NASDAQ. The transaction consists of $30 million in cash and 2,187,500 Nice Systems shares (14% of its share capital), and an additional payment due within the next few years, provided that certain financial performance criteria are met.

  The loss on disposal amounted to €55.2 million (note 6). Thales Contact Solutions was deconsolidated at this date and Nice Systems has been consolidated under the equity method since then.
- In November 2002, Thales sold Thales Microsonics, its subsidiary which specialised in surface acoustic wave components and VCO/PPL high frequency oscillators, to Temex. Thales Microsonics was deconsolidated at this date.
- In November 2002, Thales sold 50% of Thales Freight & Logistics to Geodis. The newly created joint subsidiary is specialised in the management and shipment of Defence and Aerospace sensitive equipment. The company, previously fully-consolidated, has been consolidated under the proportionate method from this date onwards.

3. INFORMATION ON A PROFORMA BASIS

a) Restated operating income

For purposes of comparison, 2003 and 2002 profit and loss accounts have been restated as follows:

	2003 Published	Less companies acquired *	2003 Restated	2002 Published	Less companies sold **	Exchange rate change ***	2002 Restated
Order backlog	18,742.6	(33.1)	**18,709.5**	19,009.4	(208.8)	(522.4)	**18,278.2**
Sales	10,569.4	(58.5)	**10,510.9**	11,105.1	(204.0)	(377.8)	**10,523.3**
Cost of sales	(8,202.9)	34.7	**(8,168.2)**	(8,727.5)	148.6	291.5	**(8,287.4)**
Research and development expenses	(380.7)	0.6	**(380.1)**	(430.1)	17.8	14.3	**(398.0)**
Marketing and selling expenses	(807.8)	8.6	**(799.2)**	(814.9)	31.2	29.4	**(754.3)**
General and administrative expenses	(480.1)	16.7	**(463.4)**	(535.7)	17.7	25.8	**(492.2)**
Operating income	**697.9**	**2.1**	**700.0**	**596.9**	**11.3**	**(16.8)**	**591.4**

* Companies acquired in 2003 are excluded from 2003 restated profit and loss account. The accounts of companies acquired during 2002 have been restated in order to allocate 2003 profit or loss to the identical period to the one for which they were consolidated in 2002.

** Companies sold in 2002 are excluded from 2002 restated results. The accounts of companies sold during 2003 have been restated in order to allocate 2002 profit or loss to the identical period to the one for which they were consolidated in 2003.

*** 2002 results are translated at 2003 average exchange rates.

b) Reconciliation of 2001, 2002 and 2003 balance sheet

The schedule below presents a complete reconciliation between opening and closing balance sheets, and discloses in full the effects of consolidation changes and of translation adjustments.

Reconciliation of 2001, 2002 and 2003 balance sheet

	Share-holders' funds and minority interests	Reserves for contin-gencies	Financial debt	Accounts and notes payable	Advances received from cus-tomers on contracts	Others current assets and liabilities	Fixed assets	Inventories	Accounts and notes receivable	Advances to suppliers	Cash at bank and equivalents
At 31 Dec. 2001	**2,173.7**	**1,515.9**	**3,317.0**	**1,926.7**	**7,691.0**	**1,344.9**	**(5,114.2)**	**(3,754.4)**	**(6,977.7)**	**(442.8)**	**1,680.1**
Financial flows											
Cash flow from operating activities	45.9	(22.2)	--	40.3	(471.7)	368.5	504.1	311.6	(485.1)	14.4	305.8
Cash flow from investing activities	68.3	--	--	--	--	12.0	(159.0)	--	--	--	(78.7)
Cash flow from financing activities	(19.2)	--	(909.4)	--	--	--	--	--	--	--	(928.6)
Changes in marketable securities	--	--	--	--	--	0.7	--	--	--	--	0.7
Non-financial flows											
Consolidation changes	0.4	(2.2)	(10.9)	(7.4)	(42.9)	(20.8)	53.2	2.4	(3.5)	23.9	(7.8)
Exchange rate variations	(74.2)	(29.7)	(59.1)	(84.4)	(54.6)	(74.4)	157.1	75.7	91.2	(1.3)	(53.7)
Change of accounting method / pension (note 1m)	(79.0)	108.7	--	--	--	(29.7)	--	--	--	--	--
Reclassifications and other	52.0	5.4	38.1	--	--	73.4	(120.9)	(48.0)	--	--	--
At 31 Dec. 2002	**2,167.9**	**1,575.9**	**2,375.7**	**1,875.2**	**7,121.8**	**1,674.6**	**(4,679.7)**	**(3,412.7)**	**(7,375.1)**	**(405.8)**	**917.8**
Financial flows											
Cash flow from operating activities	115.4	(127.9)	--	169.2	374.2	232.4	491.6	383.8	(632.3)	(369.6)	636.8
Cash flow from investing activities	9.4	--	--	--	--	(63.2)	(123.7)	--	--		(177.5)
Cash flow from financing activities	(162.1)	--	(132.9)	--	--	--	--	--	--		(295.0)
Changes in marketable securities	--	--	--	--	--	2.7	--	--	--		2.7
Non-financial flows											
Consolidation changes	(0.3)	(2.2)	(60.1)	(6.9)	3.7	(24.5)	14.0	(2.1)	74.2	5.2	1.0
Exchange rate variations	(71.2)	(21.0)	(42.6)	(18.7)	(30.2)	(86.4)	89.5	66.7	63.3	0.5	(50.1)
Reclassifications and other	(1.3)	(8.3)	(8.7)	--	--	86.0	(67.7)	--	--	--	--
At 31 Dec. 2003	**2,057.8**	**1,416.5**	**2,131.4**	**2,018.8**	**7,469.5**	**1,821.6**	**(4,276.0)**	**(2,964.3)**	**(7,869.9)**	**(769.7)**	**1,035.7**

4. INFORMATION BY SEGMENT

a) Information by business area

Thales supplies electronics, systems and services based on advanced technologies such as signal processing, complex system management and information system integration.

Its activities span three broad segments, namely Defence, Aerospace and Information Technology & Services, which have different development cycles and serve different markets.

31/12/2003	Defence	Aerospace	IT & S	Other and eliminations (c)	Total Thales
Consolidated sales	6,598.7	1,795.5	2,071.2	104.0	10,569.4
Inter-segment sales	85.0	52.0	211.1	(348.1)	--
Total sales	6,683.7	1,847.5	2,282.3	(244.1)	10,569.4
Consolidated order backlog (unaudited)	13,994.3	2,989.7	1,704.1	54.5	18,742.6
Consolidated new orders (unaudited)	6,950.1	1,610.3	2,203.7	123.3	10,887.4
Operating income	545.1	140.1	37.2	(24.5)	697.9
Capital employed (a)	(748.8)	267.3	506.8	159.8	185.1
Employees (year-end) (b)	31,652	9,462	14,017	2,308	57,439

31/12/2002	Defence	Aerospace	IT & S	Other and eliminations (c)	Total Thales
Consolidated sales	6,736.1	1,789.4	2,496.5	83.1	11,105.1
Inter-segment sales	87.4	51.0	242.6	(381.0)	--
Total sales	6,823.5	1,840.4	2,739.1	(297.9)	11,105.1
Consolidated order backlog (unaudited)	14,015.3	3,284.3	1,685.3	24.5	19,009.4
Consolidated new orders (unaudited)	5,976.3	2,185.4	2,437.9	77.7	10,677.3
Operating income	417.2	125.7	54.0	--	596.9
Capital employed (a)	(815.7)	299.4	683.2	229	395.9
Employees (year-end) (b)	32,472	9,659	16,547	1,984	60,662

31/12/2001	Defence	Aerospace	IT & S	Other and eliminations (c)	Total Thales
Consolidated sales	5,746.0	1,814.7	2,620.3	87.0	10,268.0
Inter-segment sales	99.5	44.7	231.5	(375.7)	--
Total sales	5,845.5	1,859.4	2,851.8	(288.7)	10,268.0
Consolidated order backlog (unaudited)	15,009.8	3,056.8	1,646.7	30.7	19,744.0
Consolidated new orders (unaudited)	6,116.0	2,315.0	2,544.1	84.2	11,059.3
Operating income	444.7	122.5	78.2	--	645.4
Capital employed (a)	(967.8)	260.0	776.3	180.6	249.1
Employees (year-end) (b)	33,118	9,831	17,748	1,797	62,494

(a) Capital employed includes tangible and intangible assets (except goodwill) and working capital requirement, net of reserves for contingencies.

(b) Data concerning consolidated employees at 31 December include all employees of fully-consolidated companies, and pro-rated figures for companies carried under the proportionate method. They do not include the work forces of companies carried under the equity method or unconsolidated companies. Corresponding personnel expenses amount to €3,681.3 million, €3,651.4 million and €3,554.0 million respectively in 2003, 2002 and 2001.

(c) The column headed "Other and eliminations" corresponds to the elimination of transactions between the three business areas and includes data concerning corporate activities, cost of R&D centres, facilities management and holding companies. The corporate operating income has been reallocated to each business area except, from 2003, operating income of facilities management corresponding to the cost of vacant premises (–€24.5 million).

b) Information by geographic area

Sales by geographic destination:

Sales (directly and indirectly)	2003	2002	2001
France	2,773.7	2,602.3	2,553.3
United Kingdom	1,242.1	1,460.7	1,490.9
Rest of Europe	2,068.5	2,049.3	1,976.2
North America	925.7	1,154.3	1,230.0
Middle East	1,472.9	1,737.3	1,251.8
Asia and Pacific	1,543.0	1,481.1	1,312.9
Africa and Latin America	399.2	471.3	334.0
CIS and Central Asia	144.3	148.8	118.9
Total	**10,569.4**	**11,105.1**	**10,268.0**

The main customers are:

- the French Ministry of Defence (through direct and indirect contracts), which represents sales amounting to €1,954.8 million, €1,695.9 million and €1,590.3 million respectively in 2003, 2002 and 2001.
- the UK Ministry of Defence (through direct and indirect contracts), which represents sales amounting to €767.8 million, €889.2 million and €783.9 million respectively in 2003, 2002 and 2001.

Sales and capital employed by origin:

Sales	2003	2002	2001
France	5,840.7	5,904.4	5,191.0
United Kingdom	1,725.4	1,918.9	1,950.4
Other European countries	1,238.7	1,235.0	1,178.6
Rest of the world	1,764.6	2,046.8	1,948.0
Total	**10,569.4**	**11,105.1**	**10,268.0**

Capital employed	2003	2002	2001
France	(860.0)	(727.3)	(343.6)
United Kingdom	631.0	629.1	438.4
Other European countries	214.0	217.0	136.8
Rest of the world	200.1	277.1	17.5
Total	**185.1**	**395.9**	**249.1**

5. FINANCIAL INCOME (EXPENSE)

Financial income (expense) (excluding the financial component of pension charge) of €(109.2) million, € (162.9) million and € (199.2) million respectively in 2003, 2002 and 2001 is analysed below:

a) Interest income (expense), net

	2003	2002	2001
Interest income:			
- on financial receivables *	37.7	28.6	51.9
- on interest rate swaps	48.7	60.0	80.8
	86.4	88.6	132.7
Interest expense:			
- on financial payables	(129.7)	(136.4)	(199.3)
- on interest rate swaps	(55.9)	(66.1)	(84.2)
	(185.6)	(202.5)	(283.5)
Total	**(99.2)**	**(113.9)**	**(150.8)**

* Including interest income on cash and marketable securities, and profit or loss on disposal of marketable securities.

b) Other financial income (expense), net

	2003	2002	2001
Translation gains	75.4	73.8	101.1
Translation losses	(68.6)	(88.3)	(108.6)
Net translation gain (loss)	**6.8**	**(14.5)**	**(7.5)**
Interest income on non-financial receivables	5.5	9.0	6.6
Interest expense on non-financial payables	(4.1)	(2.0)	(0.5)
Dividends received	4.1	6.6	8.3
Provisions for impairment of investments and securities	(19.7)	(43.4)	(37.0)
Debt forgiveness	(1.1)	(1.8)	(1.8)
Other	(1.5)	(2.9)	(16.5)
Total	**(10.0)**	**(49.0)**	**(48.4)**

6. GAIN (LOSS) ON DISPOSAL OF ASSETS AND OTHER EXCEPTIONAL ITEMS

	2003	2002	2001
Disposal of investments	**24.6**	**34.9**	**27.1**
Thales Geosolutions	(35.3)	--	--
Thales Instruments	14.2	--	--
TFSI	6.8	--	--
Thales Antennas	(7.3)	--	--
Indra (4% in 2003; 6% in 2002)	49.1	74.0	--
Thales Contact Solutions	(3.1)	(55.2)	--
Thales Geodis Freight & Logistics (50%)	--	6.3	--
Thales Microsonics	(0.5)	(2.8)	--
Alcatel Space	--	--	16.8
Gecat (34%)	--	--	8.0
Thomson-CSF Semiconducteurs Spécifiques (40%)	--	--	4.1
Assets brought into business for the creation of Armaris	--	19.1	--
Thales Spectrum International NV (15,8% among 64,8% held)	--	(8.0)	--
Other	0.7	1.5	(1.8)
Disposal of other assets	**(3.0)**	**50.5**	**108.4**
Real estate assets	13.1	61.9	106.8
Equipments	(16.1)	(11.4)	1.6
Other exceptional items *	**(13.0)**	**(18.4)**	**--**
Total	**8.6**	**67.0**	**135.5**

* At the end of 2002, Thales carried out an impairment test on its stake in Thales Spectrum International N.V. and its subsidiary Thales Spectrum Argentina. This test, based on the July 2002 transaction, led to a write-down of € (18.4) million on.

In January 2004, the Argentine authorities took a series of measures that affected the interests of private groups holding public service concessions, including Thales Spectrum Argentina, a company in which the Group indirectly owns a stake of 49%.

Currently, the Thales Group considers it has fulfilled its obligations as regards the concession agreement entrusted to Thales Spectrum Argentina and is studying all the provisions that may be useful in defending its interests.

As of 31 December 2003, this situation led Thales to take a write-down on all of the assets associated with its minority shareholding in the concession holders (€13.0 million).

7. CORPORATION TAX

Corporation tax takes into account the specific local rules used 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

	2003	2002	2001
Current tax	(37.1)	(51.8)	(76.9)
Deferred taxation	6.8	(31.5)	3.7
Total	**(30.3)**	**(83.3)**	**(73.2)**

b) Reconciliation of tax charge

The difference between the theoretical tax charge and the actual net tax charge is analysed below:

	2003	2002	2001
Net result Group share	112.4	111.1	(366.2)
Plus minority interests in net result	12.4	3.1	4.4
Less: corporation tax	30.3	83.3	73.2
Less: equity in profit or loss of unconsolidated affiliates (note 11)	(18.2)	(29.2)	(32.2)
Profit / (loss) before tax	**136.9**	**168.3**	**(320.8)**
Average tax rate *	33.2%	33.8%	34.4%
Theoretical tax income / (expense)	(45.4)	(56.9)	110.3
Reconciliation:			
Permanent differences and transactions subject to lower tax rates **	(32.1)	(31.7)	(204.6)
Utilisation (creation) of tax loss carry-forward not recorded in assets	(9.7)	(19.2)	(12.9)
Activation of previously unrecognized losses	54.5	22.8	47.1
Tax credits	1.5	0.7	0.3
Other ***	0.9	1.0	(13.4)
Actual net tax charge	**(30.3)**	**(83.3)**	**(73.2)**

* The average tax rate is determined by dividing the sum of the theoretical tax charge of all consolidated companies by consolidated pre-tax income. The theoretical tax charge of each consolidated company is calculated by applying the local legal tax rate to pre-tax income.

** Permanent differences correspond primarily to non-deductible goodwill amortisation and capital gains taxed at lower rates.

*** Primarily specific foreign taxation and long-term corporation tax.

c) Deferred tax assets and liabilities

"Other debtors and prepaid expenses" and "Other creditors and accrued liabilities" shown on the balance sheet respectively include the following amounts:

	31/12/03	31/12/02	31/12/01
Deferred tax asset	403.1	412.9	337.9
Deferred tax liability	(97.4)	(88.8)	(96.0)
Deferred tax asset, net	**305.7**	**324.1**	**241.9**
Of which:			
Tax loss carry-forwards	219.9	262.4	183.6
Timing differences	85.8	61.7	58.3

Changes in net deferred tax asset:

	2003	2002
1 January	324.1	241.9
Profit (loss) of the period	6.8	(31.5)
Exchange rate variations and consolidation changes	(22.6)	57.8
Adjustment of goodwill	(2.6)	55.9
31 December	**305.7**	**324.1**

Deferred tax assets not recognised in the balance sheet amount to €319.2 million, €411.4 million and €389.0 million respectively in 2003, 2002 and 2001.

8. 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 share equivalents having a dilutive effect. Antidilutive potential ordinary shares are excluded. Diluted earnings per share take into account the weighted average number of shares and equity-equivalent bonds outstanding during the financial year, less treasury shares. Net income is adjusted for after-tax interest expense, of related convertible bonds. The dilutive effect of share option plans is calculated using the treasury stock method, taking into account the average market price per share of the related period.

		2003	2002	2001
Numerator (in millions of euros)				
Income (loss), group share	(a)	112.4	111.1	(366.2)
Less, interest expense, net of tax on OCEANE bonds		-- *	-- *	--
Diluted income (loss), group share	(b)	112.4	111.1	(366.2)
Denominator (in thousands)				
Average number of shares outstanding	(c)	162,264	157,794	161,556
OCEANE bonds (note 15b)		-- *	-- *	--
Share options plans (note 15c)		--	80	--
Diluted average number of shares outstanding	(d)	162,264	157,874	161,556
Earnings per share (in €)	**(a) / (c)**	**0.69**	**0.70**	**(2.26)**
Diluted earnings per share (in €)	**(b) / (d)**	**0.69**	**0.70**	**(2.26)**

* Not taken into account in the calculation of DEPS because they are antidilutive.

9. FIXED ASSETS

		31 Dec. 03			31 Dec. 02	31 Dec. 01
		Gross	Amortisation	Net	Net	Net
Intangible fixed assets:						
Goodwill	(note10)	3,888.2	(1,742.0)	2,146.2	2,336.1	2,655.8
Patents and trademarks		131.8	(88.7)	43.1	47.5	37.2
Development costs		141.4	(40.1)	101.3	75.8	53.0
Other		152.8	(90.9)	61.9	50.3	63.1
Total		**4,314.2**	**(1,961.7)**	**2,352.5**	**2,509.7**	**2,809.1**
Property, plant and equipment:						
Land		64.6	(1.9)	62.7	73.8	108.4
Buildings		591.9	(250.3)	341.6	357.5	455.3
Plant and equipment		2,044.0	(1,403.8)	640.2	658.0	687.0
Other		561.3	(333.1)	228.2	296.3	276.6
Total		**3,261.8**	**(1,989.1)**	**1,272.7**	**1,385.6**	**1,527.3**
Items acquired under capital lease agreements included above:						
Land		2.2	--	2.2	2.1	5.8
Buildings		42.9	(10.4)	32.5	35.6	30.6
Plant and equipment		17.8	(16.2)	1.6	2.1	3.1
Other		0.2	(0.1)	0.1	0.2	2.1
Total		**63.1**	**(26.7)**	**36.4**	**40.0**	**41.6**

Maintenance and repair expenses in 2003, 2002 and 2001 amounted to €135.6 million, €127.2 million and €150.9 million, respectively.

10. GOODWILL AND BADWILL

a) Goodwill and badwill

Goodwill arising on the acquisition of subsidiaries and associated companies are included in "Intangible assets". "Other creditors and accrued liabilities" includes deferred revenues representing badwill. Goodwill and badwill are analysed below:

	31 Dec.03			31 Dec.02	31 Dec.01
	Gross	Amortisation	Net	Net	Net
Racal Electronics Plc	1,318.6	647.8	670.8	696.5	856.9
Former Philips defence activities	517.9	362.4	155.5	181.6	207.5
Thales Avionics	357.2	133.3	223.9	252.6	309.1
Avimo	226.6	36.1	190.5	202.3	211.8
Thales Training & Simulation Ltd	194.3	164.8	29.5	33.2	36.9
Thales Underwater Systems	143.8	16.2	127.6	134.8	151.8
Thales Air defence Ltd	101.4	24.2	77.2	82.2	87.3
Thales Information Systems	125.2	48.6	76.6	82.1	78.6
Australian Defence Industries	220.0	45.1	174.9	168.5	191.9
Former Alcatel, Dassault and Aerospatiale defence / space activities	74.7	20.7	54.0	57.7	61.5
Samsung Thales Company Ltd	59.0	11.6	47.4	60.8	68.8
Thales Navigation / Thales Navigation Solutions	56.5	6.8	49.7	52.6	88.9
Former ABB group activities	61.2	57.9	3.3	3.7	4.0
CGA Transport	61.5	9.2	52.3	55.3	58.4
Armaris	54.3	3.8	50.5	53.2	--
Thales Optronics Ltd	51.0	19.2	31.8	35.4	39.1
Thales ATM	50.9	19.9	31.0	33.0	37.0
Elettronica S.p.A.	19.1	6.7	12.4	13.4	14.3
Other	195.0	107.7	87.3	137.2	152.0
Total goodwill	**3,888.2**	**1,742.0**	**2,146.2**	**2,336.1**	**2,655.8**
Thales Underwater Systems	35.9	13.5	22.4	24.2	26.0
Armaments and Propulsion Activities	6.7	3.0	3.7	4.0	4.4
Other	5.3	2.1	3.2	3.5	3.7
Total badwill	**47.9**	**18.6**	**29.3**	**31.7**	**34.1**
Goodwill and badwill, net			**2,116.9**	**2,304.4**	**2,621.7**

Changes in net goodwill in 2002 and 2003 are analysed below:

	2003	2002
Net book value at 1 January	**2,304.4**	**2,621.7**
Acquisitions	**14.1**	**80.5**
Odyssée	5.4	--
Armaris	--	54.3
Thales Secure Solutions	2.9	9.7
HFBC	--	7.7
EOS-IT Vizion	--	4.3
Other	5.8	4.5
Changes in the acquisition balance-sheet	**(9.8)**	**(82.8)**
Thales Underwater Systems (50%)	--	(10.0)
Thales Navigation & Thales Navigation Solutions	--	(34.2)
Racal Electronics Plc (a)	(9.3)	(34.8)
Sage	--	(4.1)
Other	(0.5)	0.3
Cessions	**(7.6)**	**(75.0)**
Geosolutions	(2.1)	--
Antennas Ltd	(5.5)	--
Contact Solutions	--	(47.0)
Live TV	--	(21.6)
Heim	--	(4.8)
Indra	--	(1.6)
Amortisation	**(174.2)**	**(193.5)**
Ordinary amortisation	(155.6)	(157.1)
Accelerated amortisation	(18.6)	(36.4)
Reclassification, exchange and other	**(10.0)**	**(46.5)**
Net book value at 31 December	**2,116.9**	**2,304.4**

(a) Reversal of an unused reserve for contingencies (note 1a).

b) Goodwill charged against shareholders' funds

Goodwill recognised on the Alcatel, Dassault and former Aerospatiale 1998 assets bought in exchange for new Thales shares issued in June 1998, has been charged against Group shareholders' funds. The charge was equivalent to the share premium arising from this transaction.

	31 Dec. 03	31 Dec. 02	31 Dec. 01
Goodwill, gross	**680.1**	**680.1**	**680.1**
Accumulated amortisation	**(187.0)**	**(153.0)**	**(119.0)**
Goodwill, net	**493.1**	**527.1**	**561.1**
Of which: charged against shareholders' funds	605.4	605.4	605.4
Notional accumulated depreciation	(166.3)	(136.1)	(105.8)
Net value charged against shareholders' funds	439.1	469.3	499.6
Of which: recorded as an asset	74.7	74.7	74.7
Accumulated depreciation	(20.7)	(16.9)	(13.2)
Net value recorded as an asset	54.0	57.8	61.5

11. EQUITY IN UNCONSOLIDATED AFFILIATES

Thales' interest in the equity and income of unconsolidated affiliates

	Ownership %			Net equity			Profit (loss)		
	2003	2002	2001	2003	2002	2001	2003	2002	2001
Amper Programas	--	49	49	--	8.4	7.6	--	2.6	2.6
Camelot plc	20	20	20	16.1	18.9	21.1	8.8	11.1	11.1
Elettronica	33	33	33	7.5	7.5	6.4	1.0	2.3	0.9
Global Telematics	--	--	--	--	--	--	--	--	(4.4)
Indra Sistemas	--	--	11	--	--	18.7	--	1.4	5.7
NICE Systems	13	14	--	16.2	24.3	--	0.6	--	--
Thales Spectrum International N.V. (note 6)	49	49	--	--	4.9	--	--	--	--
Stesa	49	49	49	--	(3.4)	(4.4)	1.4	1.4	1.3
Satellite Information Systems ltd	22	22	22	1.2	(2.1)	4.7	3.1	3.8	6.7
Aviation Communications & Surveillance Systems	30	30	30	9.9	11.6	11.8	0.7	3.6	5.7
Other	--	--	--	10.6	11.6	11.9	2.6	3.0	2.6
Total				**61.5**	**81.7**	**77.8**	**18.2**	**29.2**	**32.2**

Changes in "Equity in unconsolidated affiliates"

Equity in unconsolidated affiliates at 31 December 2001	**77.8**
Income (loss) in 2002 of companies accounted for under the equity method	29.2
Dividends paid	(29.2)
Impact of consolidation changes (Indra, TSI NV and Nice)	11.6
Impact of exchange rate and other variations	(7.7)
Equity in unconsolidated affiliates at 31 December 2002	**81.7**
Income (loss) in 2003 of companies accounted for under the equity method	18.2
Dividends paid	(13.0)
Impact of consolidation changes	(14.8)
Impact of exchange rate and other variations	(10.6)
Equity in unconsolidated affiliates at 31 December 2003	**61.5**

12. OTHER INVESTMENTS AND FINANCIAL ASSETS

a) Other investments

	Net		
	31 Dec. 03	31 Dec. 02	31 Dec. 01
Embraer (a)	75.6	75.6	75.6
Investments held by Thales Corporate Ventures (b)	20.8	25.1	38.5
Other (individual net value less than € 15.0 million)	62.7	88.0	97.9
Total	**159.1**	**188.7**	**212.0**

(a) Share in Embraer, purchased in October 1999. At 31 december 2003, Thales holds 13,744,186 ordinary shares (corresponding to a 5.7% stake) and 1,953,132 preference shares (0.4%). At this date, the stock market value of this investment amounts to €87.0 million.

(b) The Group's venture capital vehicle.

b) Other financial assets

	31 Dec. 03	31 Dec. 02	31 Dec. 01
Loans to financial institutions and partners	17.8	28.4	45.5
Loan to employees as part of capital increase	1.1	22.1	--
Loans to financing GIE	39.3	44.6	44.1
Other	84.4	68.1	65.5
Total	**142.6**	**163.2**	**155.1**

13. INVENTORIES, WORK-IN-PROGRESS AND ADVANCES RECEIVED FROM CUSTOMERS ON CONTRACTS

a) Inventories and work-in-progress

	31 Dec. 03	31 Dec. 02	31 Dec. 01
Raw materials	491.6	556.7	577.7
Work-in-progress	2,264.5	2,643.4	3,027.2
Semi-finished and finished products	581.4	640.7	645.6
Finished goods for resale	155.7	153.7	201.3
Total, gross	**3,493.2**	**3,994.5**	**4,451.8**
Provisions for depreciation (note 18)	(528.9)	(581.8)	(697.4)
Total, net	**2,964.3**	**3,412.7**	**3,754.4**

b) Advances received from customers on contracts

Most long-term contracts entail advances from customers, which are included in the balance sheet until the customers concerned are invoiced. At 31 December 2003, these advances amount to €7,469.5 million. Consistent with this, the asset side of the balance sheet records, as accounts receivables, amounts recognised as sales (€4,678.0 million), and advances to suppliers (€769.7 million) as well as work-in-progress (€2,264.5 million).

14. RELATED PARTIES TRANSACTIONS

The main transactions between Thales and its consolidated subsidiaries on the one hand, and related parties on the other, are summarised below:

a) Cooperation agreement

In 1999, Thales and Alcatel settled a strategic partnership, following the industrial agreement of April 1998. Main fields concerned by cooperation are IP military networks, digital television and radio broadcasting, microwave microelectronics, electronic payment systems, and cryptology.

b) Financial current accounts

Current accounts with affiliated companies are summarised below:

	31 Dec. 03	31 Dec. 02	31 Dec. 01
Joint-ventures	129.8	67.4	38.9
Société de construction immobilière (SCICV)	--	--	71.0
Thales Electronics Greece	25.0	20.0	--
Other	13.1	21.9	17.8
Current accounts receivable	**167.9**	**109.3**	**127.7**
Joint-ventures	126.2	195.8	142.8
Other	26.3	35.6	23.9
Current accounts payable	**152.5**	**231.4**	**166.7**

c) Sales to affiliated companies

Sales to affiliated companies that are included in the Group financial statements are immaterial, with the exception of sales by Thales Avionics S.A. and Thales Systèmes Aéroportés S.A. to the Dassault Group, amounting to €164.0 million in 2003 (€149.6 million in 2002 and €156.6 million in 2001).

d) Investments and divestments

Thales sold to Alcatel its 48.83% stake in Alcatel Space in July 2001.

e) Received commitments

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

15. SHAREHOLDERS' FUNDS

a) Share capital

The share capital of Thales amounts to €515,592,876 and is made up of 171,864,292 shares with a par value of €3.

b) Debt securities entitling holders to equity in the Company at some future date

In December 2001, the Company issued 9,809,691 notes redeemable into new or existing Thales shares (OCEANE – note 19a). These notes mature on 1 January 2007 and are redeemable at par, in fine, or as from 1 January 2005, at the discretion of Thales if the average share price for 10 consecutive days exceeds 120% of the anticipated redemption price. Each bearer of these notes may choose to receive redemption in the form of Thales shares, at a redemption rate of 1.046 note, in lieu of redemption in cash.

c) Share-options

The General Meetings of 10 March 1999, 29 June 1999, 16 May 2001 and 15 May 2003 have authorised to grant share purchase and subscription options.

At 31 December 2003, the following options were outstanding :

- 2,048,413 purchase options, at the weighted average exercise price of €34.86;
- 9,982,156 subscription options, at the weighted average exercise price of €36.79.

d) Cumulative translation adjustment

This item reflects differences arising from the translation of the financial statements of foreign subsidiaries. The principal closing and average translation rates used are summarised in note 1b.

At 31 December 2003, this translation difference (–€226.4 million) was partly offset by the favourable impact of exchange differences (+€72.7 million) connected with currency-denominated debt used as hedges of corresponding investments.

e) Treasury shares

Thales held 9,600,528 of its own shares at 31 December 2003 and 2002 (10,743,624 shares at 31 December 2001).

In the consolidated financial statements, the corresponding value is subtracted from consolidated shareholder's funds (€421.5 million at 31 December 2003 and 2002, €453.7 million at 31 December 2001).

16. MINORITY INTERESTS

Minority interests are analysed below:

	31 Dec. 03	31 Dec. 02	31 Dec. 01
Australian Defence Industries	37.4	25.0	22.4
Other	6.0	4.0	5.3
Total	**43.4**	**29.0**	**27.7**

17. PENSION AND RELATED COSTS

The Group grants to its employees post-employment benefits (pension, retirement benefits, medical care, …) and other long-term benefits (long-service benefits, long-service leave, …). 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 each country and particularly in France, the Group takes part in state plans (Social Security State plans, compulsory additional plans such as ARRCO, AGIRC…) for which the pension charge within the fiscal year is equal to the contributions paid.

b) Defined contribution plans

These plans guarantee employees benefits related to the contributions paid and the return arising from the contributions. The pension cost paid by the company is limited to these contributions. In 2003, the pension expense was €3.4 million (€6.1 million in 2002).

c) Defined benefit plans

At 31 December 2003, the net position of assets (+€287.6 million) and liabilities (-€419.6 million) recognised in the consolidated balance-sheet amounts to -€132.0 million:

	United Kingdom	Netherlands	France	Other Europe	Rest of the world	Total
Post-employment benefits:						
- Pension	282.6	(34.7)	--	(100.1)	2.9	**150.7**
- Retirement allocations	--	--	(154.6)	--	--	**(154.6)**
- Medical care and other	--	--	--	--	(4.2)	**(4.2)**
Other long-term benefits:						
- Long service leave (France)	--	--	(99.2)	--	--	**(99.2)**
- Other long-term benefits	--	--	--	(7.3)	(17.4)	**(24.7)**
Total	**282.6**	**(34.7)**	**(253.8)**	**(107.4)**	**(18.7)**	**(132.0)**

Two categories of countries exist within the Thales Group:

A) Countries in which retirement and other benefits are largely funded externally: the UK and the Netherlands.

B) Countries in which the funding of retirement rests largely on defined contributions schemes and where certain other benefits (retirement awards, long service awards) are defined benefits and for which no external funding exists systematically. France and Germany are included in this category.

Most of pension and related costs obligations are financed through plan assets. Changes in obligations and plan assets in 2003 are described below:

A) Externally funded countries:

	United Kingdom	Netherlands	Total
Present value of obligations at 1 January 2003	**(1,881.0)**	**(579.3)**	**(2,460.3)**
Current service cost	(37.9)	(14.8)	(52.7)
Interest cost	(103.0)	(29.7)	(132.7)
Plan participants' contributions	(16.0)	(4.2)	(20.2)
Curtailment/settlements	(1.3)	--	(1.3)
New actuarial gains/losses	(135.1)	(2.3)	(137.4)
Benefits paid	66.8	13.8	80.6
Exchange rate variations and other	164.7	--	164.7
Present value of obligations at 31 December 2003	**(1,942.8)**	**(616.5)**	**(2,559.3)**
Fair value of plan assets at 1 January 2003	**1,503.3**	**442.1**	**1,945.4**
Expected return on plan assets	110.9	31.5	142.4
Employer's contribution	62.4	9.6	72
Plan participants' contributions	16.0	4.2	20.2
Benefits paid by plan assets	(66.8)	(13.8)	(80.6)
New actuarial gains/losses	23.2	--	23.2
Exchange rate variations and other	(118.2)	2.3	(115.9)
Fair value of plan assets at 31 December 2003	**1,530.8**	**475.9**	**2,006.7**
Unfunded status at 31 December 2003	**(412.0)**	**(140.6)**	**(552.6)***
Unrecognized actuarial (gain)/loss	694.6	105.9	800.5
Net assets (net provisions) at 31 December 2003	**282.6**	**(34.7)**	**247.9**

* In cases of external funding, solvency requirements can lead to a disbursement in order to fund short falls caused by the impact of financial performance of the pension funds. This short fall estimated as of 31/12/03 would cause, if it became payable, a cash outlay estimated at €380 million after tax impact.

B) Countries with largely internal funding:

	France	Rest of Europe	Rest of the world	Total
Present value of obligations at 1 January 2003	**(378.3)**	**(119.9)**	**(66.8)**	**(565.0)**
Current service cost	(19.1)	(3.3)	(4.3)	(26.7)
Interest cost	(17.3)	(6.1)	(3.4)	(26.8)
Plan participants' contributions	--	(0.1)	--	(0.1)
Business combinations	0.4	--	--	0.4
Curtailment/settlements	13.1	--	0.3	13.4
New actuarial gains/losses	(23.5)	0.4	(0.9)	(24.0)
Benefits paid	15.0	2.8	6.7	24.5
Exchange rate variations and other	(3.4)	(0.3)	5.1	1.4
Present value of obligations at 31 December 2003	**(413.1)**	**(126.5)**	**(63.3)**	**(602.9)**
Fair value of plan assets at 1 January 2003	**56.4**	**17.6**	**35.4**	**109.4**
Expected return on plan assets	3.0	0.7	2.2	5.9
Employer's contribution	0.3	1.5	3.7	5.5
Plan participants' contributions	--	--	--	--
Benefits paid by plan assets	--	(0.1)	(4.8)	(4.9)
New actuarial gains/losses	2.2	(0.9)	0.5	1.8
Exchange rate variations and other	0.8	(0.4)	(4.3)	(3.9)
Fair value of plan assets at 31 December 2003	**62.7**	**18.4**	**32.7**	**113.8**
Net value of obligations at 31 December 2003	**(350.4)**	**(108.1)**	**(30.6)**	**(489.1)***
Unrecognised actuarial (gain)/loss	120.6	0.3	10.5	131.4
Unrecognised past service cost	(24.0)	0.4	1.4	(22.2)
Net assets (net provisions) at 31 December 2003	**(253.8)**	**(107.4)**	**(18.7)**	**(379.9)**

* In cases of internal funding, disbursements occur at the rate at which staff retire and receive awards. There is no obligation to cover, via a supplementary outlay, the total value of the obligation. The level of provision varies annually according to the population covered by these schemes.

Actuarial assumptions used are calculated by actuaries following the specificities of each country and each scheme:

	United Kingdom	Netherlands	France	Rest of Europe	Rest of the world
General inflation	2.80%	2.00%	1.80%	1.25% - 3.00%	3.50% - 3.75%
Discount	5.90%	5.00%	4.60%	5.50% - 6.50%	5.60% - 6.25%
Expected long term return on plan assets	7.80%	7.00%	5.00%	7.00%	8.25%
Future compensation increase	3.80%	3.00%	3.60%	3.00% - 3.50%	0 - 3.75%
Expected average residual service life	10	13.6	15	13.60 - 14.10	10 - 14.5

Periodic cost for 2003 is analysed below:

	United Kingdom	Netherlands	France	Rest of Europe	Rest of the world	Total
Current service cost	**(37.9)**	**(14.8)**	**(19.1)**	**(3.3)**	**(4.3)**	**(79.4)**
Interest cost	(103.0)	(29.7)	(17.3)	(6.1)	(3.4)	(159.5)
Expected return on plan assets	110.9	31.5	3.0	0.7	2.2	148.3
Amortisation of schemes amendments	--	--	2.7	--	--	2.7
Amortisation of actuarial gains/losses	(46.9)	(3.8)	(14.0)	0.4	(0.4)	(64.7)
Reductions and shemes liquidations	(11.8)	--	--	--	--	(11.8)
Total included in financial result	**(50.8)**	**(2.0)**	**(25.6)**	**(5.0)**	**(1.6)**	**(85.0)**
Effect of curtailment / settlements	**(7.8)**	**--**	**4.8**	**--**	**(0.1)**	**(3.1)**
Defined benefit: total periodic cost	**(96.5)**	**(16.8)**	**(39.9)**	**(8.3)**	**(6.0)**	**(167.5)**

18. PROVISIONS FOR DEPRECIATION, CONTRACT AND OTHER PROVISIONS

18.1) Provisions for depreciation of assets

	Opening balance	Consolidation changes, exchange rate and other variations	Net Charges	Year-end balance
31 December 2003				
Investments and other non-current assets	188.0	(21.4)	19.7	186.3
Inventories	581.8	(58.7)	5.8	528.9
Doubtful accounts	194.7	(20.4)	4.7	179.0
31 December 2002				
Investments and other non-current assets	180.3	(30.5)	38.2	188.0
Inventories	697.4	(70.7)	(44.9)	581.8
Doubtful accounts	190.8	(5.7)	9.6	194.7
31 December 2001				
Investments and other non-current assets	198.5	(46.1)	27.9	180.3
Inventories	601.3	64.6	31.5	697.4
Doubtful accounts	220.5	(21.5)	(8.2)	190.8

18.2) Provisions for restructuring – Provisions on contracts and other items

	Opening balance	Consolidation changes, exchange rate and other variations	Charges *	Recoveries **	Year-end balance
31 December 2003					
Restructuring	126.0	(18.7)	116.3	(95.9)	127.7
Estimated losses on long-term contracts	363.3	0.2	62.6	(131.2)	294.9
Accrued costs on completed contracts	25.5	(2.1)	16.7	(7.5)	32.6
Accrued penalties claims	124.3	(0.5)	53.1	(46.8)	130.1
Litigation	201.6	(7.3)	27.6	(126.0)	95.9
Guarantees and performance obligations	170.8	(8.3)	28.7	(39.9)	151.3
Other	182.6	3.1	36.8	(58.1)	164.4
Total	1,068.1	(14.9)	225.5	(409.5)	869.2
Net Total	**1,194.1**	**(33.6)**	**341.8**	**(505.4)**	**996.9**
31 December 2002					
Restructuring	209.6	(23.9)	77.7	(137.4)	126.0
Estimated losses on long-term contracts	363.6	51.1	93.2	(144.6)	363.3
Accrued costs on completed contracts	30.4	(7.6)	6.4	(3.7)	25.5
Accrued penalties claims	124.8	(11.5)	46.5	(35.5)	124.3
Litigation	131.8	2.1	96.2	(28.5)	201.6
Guarantees and performance obligations	191.6	(11.1)	49.1	(58.8)	170.8
Other	197.7	(3.5)	68.7	(80.3)	182.6
Total	1,039.9	19.5	360.1	(351.4)	1,068.1
Net Total	**1,249.5**	**(4.4)**	**437.8**	**(488.8)**	**1,194.1**
31 December 2001					
Restructuring	231.4	36.6	112.1	(170.5)	209.6
Estimated losses on long-term contracts	257.4	122.0	73.3	(89.1)	363.6
Accrued costs on completed contracts	28.4	14.2	4.5	(16.7)	30.4
Accrued penalties claims	111.7	0.4	44.0	(31.3)	124.8
Litigation	116.6	8.9	58.9	(52.6)	131.8
Guarantees and performance obligations	164.0	24.5	55.0	(51.9)	191.6
Other	195.1	10.8	74.8	(83.0)	197.7
Total	873.2	180.8	310.5	(324.6)	1,039.9
Net Total	**1,104.6**	**217.4**	**422.6**	**(495.1)**	**1,249.5**

* Out of which, in 2003, €221.6 million included in "Operating profit", €116.3 million included in "Restructuring costs" and €3.9 million in "Financial expenses".

** In 2003, reversal of unused provisions amounts to € (20.4) million (out of which € (18.6) million included in “Operating profit” and € (1.8) million included in “Restructuring costs”).

a) Litigation

The Group is exposed to technical and commercial litigations in the ordinary course of its business. Litigations mentioned in 2002 annual report evolved as presented in the Board's report on risk management on page 16.

b) Environment

See page 16, report on risk management.

19. OTHER DEBT (SHORT- AND LONG- TERM)

The net debt of the Group is detailed at the bottom of the consolidated statement of cash flows. None of the debt listed below, other than capital lease obligations and project financing, is secured by Company assets.

a) By category

		Type of rate	Maturity date	31 Dec. 03	31 Dec. 02	31 Dec. 01
Borrowings from financial institutions	(a)	floating	june 2008	100.0	100.0	100.0
Other borrowings from financial institutions		--	--	16.0	9.2	39.2
Commercial paper	(b)	--	2004	300.0	539.0	1,062.0
Convertible notes (OCEANE)	(c)	2.5%	jan 2007	500.0	500.0	500.0
Bond issue	(d)	6.125%	nov 2005	500.0	500.0	500.0
Euro Medium Term Notes (E.M.T.N)		floating	mar 2005	30.0	30.0	30.0
Euro Medium Term Notes (E.M.T.N)		floating	feb 2006	17.0	18.4	19.7
Euro Medium Term Notes (E.M.T.N)		floating	2002	-	-	400.0
Capital lease obligations		fixed	-	72.3	82.5	60.8
Bank overdrafts		floating	-	96.4	26.4	67.0
Total				1,631.7	1,805.5	2,778.7
Project financing				227.3	197.4	192.7
Other borrowings	(e)			119.9	141.4	178.9
Total				**1,978.9**	**2,144.3**	**3,150.3**

(a) Including interest rate swap.
(b) At 31 December 2003, €26 million are at floating rate, and €274 million are at fixed rate swapped to floating rate at this date.
(c) 9,809,691 notes redeemable into new or existing shares for a face value of €50.97 per share (note 15b).
(d) Including €200 million swapped to floating rate at 31 December 2003.
(e) Includes €34.6 million, €43.9 million and €59.7 million respectively, at 31 December 2003, 2002 and 2001, in "loan notes" issued for the purpose of acquiring Racal Electronics Plc and repayable in 2005 at the latest.

At 31 December 2003, no significant financing used by the Group are accompanied by clauses of accelerated repayment, based on rating or financial ratios.

At 31 December 2003, undrawn confirmed credit facilities granted by banks amounted to €1,779 million, of which €1,230 million will expire in 2006 and €549 million within one year. These credit facilities are used to back commercial paper and financial reserve programmes. Pursuant to the credit facility documents, in the event that the state were not holding its golden share any longer and, simultaneously, the ratio between consolidated net debt and EBITDA* were to exceed 3, clauses providing for accelerated repayment would apply.

b) By maturity date

	31 Dec. 03	31 Dec. 02	31 Dec. 01
2002			1 570.2
2003		595.9	13.5
2004	392.2	9.3	8.0
2005	538.3	538.6	535.1
2006	25.6	24.8	651.9
2007	507.6	636.9	
2008 and after	168.0		
Total due in more than one year	1,239.5	1,209.6	1,208.5
Total	**1,631.7**	**1,805.5**	**2,778.7**

c) By currency

	31 Dec. 03	31 Dec. 02	31 Dec. 01
Euro	1,071.1	1,142.4	1,486.2
Pound sterling	318.4	392.7	591.9
US dollar	116.7	141.3	378.3
Singapore Dollar	56.0	66.0	224.1
Australian dollar	38.0	34.0	56.1
Other	31.5	29.1	42.1
Total	**1,631.7**	**1,805.5**	**2,778.7**

The breakdown by currency includes related hedging instruments. At the end of December 2003, financial instruments were used to hedge net investments in foreign companies (note 22a), except for the "loan notes" above mentioned.

(1) EBITDA = operating income plus amortisation of tangible fixed assets, plus any depreciation of intangible fixed assets, minus the amortisation of goodwill.

d) By type of rate

	31 Dec. 03	31 Dec. 02	31 Dec. 01
Fixed	878.5	1,546.3	1,723.1
Floating	753.2	259.2	1,055.6
Total	**1,631.7**	**1,805.5**	**2,778.7**

The above split includes interest rate swaps.

20. STATEMENT OF CASH FLOWS

a) Capital expenditures

Only acquisitions financed by a cash flow are presented in the statement of cash flows.

Fixed assets acquired under financial lease arrangements (€2.8 million in 2003, €40.2 million in 2002 and €13.3 million in 2001) are not included.

b) Net financial investments

• Investments in subsidiaries and affiliated companies

	2003	2002	2001
Payment of debt / IFS acquisition	(19.6)	--	--
Payment of debt / SGO acquisition	(6.7)	--	--
Acquisition of additional interest in Thales Secure Solutions	(2.1)	--	--
Investment in the Armaris joint-venture	(15.2)	(19.8)	--
Payment of equalization cash by Raytheon to the TRS joint-venture	--	24.3	--
Acquisition of Odyssée	--	(7.1)	--
Acquisition of EOS-IT Vizion	--	(5.0)	--
Acquisition of HFBC	--	(3.4)	--
Acquisition of additional interest in Faceo Contracting (19%)	--	(3.3)	--
Acquisition of additional interest in Avimo (75%)	--	--	(191.9)
Acquisition of additional interest in TMS (50%)	--	--	(84.8)
Acquisition of ACCS (30%)	--	--	(85.6)
Acquisition of Thales Navigation Inc (Magellan) & Navigation Solutions	--	--	(76.5)
Acquisition of additional interest in ATM (33%)	--	--	(27.1)
Capital increase in Thales Electronic Systems Hellas	--	--	(10.0)
Acquisition of Thales I.S. Finance Ltd (CWB)	--	--	(8.9)
Capital increase in Thales Secure Solutions	--	--	(7.0)
Partial payment of earn-out / acquisition of Thales I.S. Switzerland	--	(10.5)	(6.6)
Other	(24.3)	(16.8)	(38.9)
Investments in subsidiaries and affiliated companies	(67.9)	(41.6)	(537.3)
- Cash position of companies acquired	--	3.3	27.5
Investments in subsidiaries and affiliated companies, net	**(67.9)**	**(38.3)**	**(509.8)**

• Disposals

	2003	2002	2001
Geosolutions	142.5	--	--
Thales Instruments	12.5	--	--
TFSI	10.8	--	--
Antennas	7.4	--	--
FFF	3.7	--	--
Actions Nice Systems	3.3	--	--
Indra (4% in 2003; 6% in 2002)	57.7	87.3	--
Contact Solutions	(6.3)	30.5	--
Live TV	--	20.0	--
Heim	--	11.0	--
Thales Microsonics	--	(40.1)	--
Thales Freight Logistics (50%)	2.8	4.5	--
Alcatel Space	--	--	397.5
Thales Instruments	--	--	84.7
Camelot (6.67%)	--	--	11.7
Crouzet Automatismes (additional price)	--	--	8.6
Gecat	--	--	49.1
Thomson-CSF Semiconducteurs Spécifiques (40%)	--	--	11.4
Other	10.4	5.4	10.6
Disposal of investments	**244.8**	**118.6**	**573.6**
- Cash position of companies sold	(21.2)	(1.7)	(5.6)
Disposal of investments, net	**223.6**	**116.9**	**568.0**

c) Increase (decrease) in shareholders' funds and minority interests

	2003	2002	2001
Increase in capital	--	87.8	--
Dividend	(113.6)	(110.5)	(102.8)
Corporation tax on dividend payments	(48.5)	(52.0)	(49.8)
Sale of own shares	--	55.5	--
Other	--	--	(0.7)
Total	**(162.1)**	**(19.2)**	**(153.3)**

21. COMMITMENTS AND CONTINGENCIES

a) Bonds and warranties linked to commercial contracts

Within the context of long-term contracts, the Group "regularly" responds to invitations to bid. When requested by the customer, bid bonds are delivered in order to show the Group's financial condition and to provide for payment to the customer of the amount of the guarantee if the supplier fails to meet its commitments. At 31 December 2003, bid bonds amounted to €37.0 million.

From the signature of a contract up until its completion, the Group may deliver performance bonds to its customer, a bank as intermediary, in order to guarantee due and proper completion of the contract (and if not, to provide for payment to the customer of the amount of the guarantee). At 31 December 2003, performance bonds amounted to €1,240.6 million.

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 at completion of the contract. Failing that any potential risk is estimated, on a contract by contract basis, and accrued for in the Group financial statements if necessary.

In order to finance the completion of the contract, the Group receives advances from its customer, based on the terms of the contract, 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 2003, advance payment bonds amounted to €1,920.9 million.

At the end of the contract, 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 the warranty period can be replaced by the set up, a bank as intermediary, of a warranty retention bond. At 31 December 2003, warranty retention bonds amounted to €83.1 million.

Some Research and Development programmes launched by the Group are partially financed by advances received, and may be reimbursed according to specific conditions (success of the development of the new product, commercial success of the development programme in question, etc.). At 31 December 2003, advances received and not yet reimbursed amounted to €25.1 million.

Within the simulation business, the Group has granted put options on acquired simulators to some of its customers and has agreed to buy the equipment back according to price and date conditions defined in advance. At 31 December 2003, the total value of these buy-back commitments was €9.1 million.

If the market value of the simulator is lower than its contractual buy-back value, the Group records a provision for this risk.

The maturity dates of these commitments are:

	< 1 year	1 to 5 years	> 5 years	Total
Bid bonds	34.1	2.5	0.4	37.0
Performance bonds	301.6	774.8	164.2	1 240.6
Advance payment & warranty retention bonds	691.3	900.5	329.1	1 920.9
Warranty bonds	29.4	12.1	41.6	83.1
Other bonds	35.4	30.3	12.0	77.7
Reimbursable advances	0.2	2.7	22.2	25.1
Buy-back commitments for equipment	--	9.1	--	9.1
Total	**1 092.0**	**1 732.0**	**569.5**	**3 393.5**
%	32%	51%	17%	100%

b) Lease commitments

Lease contracts

Thales Group companies lease land, buildings, plant and equipment under non-cancellable operating lease agreements. The rents payable under these leases are subject to re-negotiation at various intervals specified in the lease contracts. Irrevocable lease and rental commitments at 31 December 2003 are analysed below:

Rents:	Total	< 1 Year	1 to 5 Years	> 5 Years
Finance leases	77.2*	12.2	34.8	30.2
Operating leases	855.9	128.2	374.7	353.0

* Capitalised interest included (€4.9 million). Corresponding debt is detailed in the consolidated balance sheet for an amount excluding interest (note 19a).

At the end of 2001, the Group initiated a disposal programme of real estate assets. In France, two transactions were finalised: the first one with Deutsche Bank in late December 2001 and the second one with Lone Star and Pario in late December 2002. The details of these transactions were as follows:

	2002	2001
- Book value of sold assets	133.6	362.0
- Sale price	204.4	466.9
Gain on disposal	70.8	104.9

The assets are now rented through operating leases as defined in IAS17.

Purchase of tangible assets

At 31 December 2003, irrevocable commitments to purchase of tangible assets amounted to €17.0 million.

c) Guarantees given (received) related to disposals (acquisitions) of companies

The contracts governing the acquisition (disposal) by Thales of some companies contain clauses committing the seller to make up 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 also include environmental risks.

Contracts concerning the acquisition (disposal) of some companies may include earn-out clauses depending on certain performance criteria for the entity concerned. At the acquisition / disposal date, the Group records in payables or receivables its best valuation of the expected price adjustment.

Contracts concerning the acquisition (disposal) of some companies may include options to buy or sell shares, which could modify the shareholding structure of these firms. At 31 December 2003 the main existing options are the following:

Armaris :

An agreement settled on 3 April 2002 granted DCN (Direction des Constructions Navales), the option to acquire Thales' shareholding in Armaris. If this option, valid until 31 March 2004, is exercised:

- The price of the shares for DCN is to be determined according to expert's opinion. However Thales has a right to buy back shares held by DCN at a price of at least 1.125 times the expert's estimate.
- In the event of the option being exercised, and on the basis of this expert's valuation, Thales or DCN will have the possibility to buy back their contribution in the joint venture.

Eurosysnav :

As a result of the agreement signed in April 2002 between DCN and Thales, Thales and DCN have put and call options respectively, under the following conditions:

- DCN is obliged to purchase Thales shares in Horizon and Eurosysnav in the event that Thales exercises its option to sell.
- Thales is obliged to sell to DCN its shares in Eurosysnav in the event that DCN exercises its option to buy.

As DCN transferred its rights and obligations to Armaris when the joint company was created, Armaris will supersede DCN in the agreements described above.

22. 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 held primarily forward exchange contracts at 31 December 2003, 2002 and 2001.

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.

	2003		2002		2001	
	Buy/ Lend	Sell/ Borrow	Buy/ Lend	Sell/ Borrow	Buy/ Lend	Sell/ Borrow
Forward exchange contracts						
USD	250.2	574.7	208.1	568.6	187.4	656.6
GBP	344.1	365.7	363.3	307.8	277.3	346.1
CHF	29.8	20.8	12.4	33.5	45.6	87.4
Other	166.4	73.4	210.2	86.3	187.2	35.3
	790.5	1,034.6	794.0	996.2	697.5	1,125.4
Foreign exchange swaps						
• To hedge investments						
USD	27.5	135.9	5.7	134.4	--	340.0
GBP	26.6	225.6	--	347.8	--	569.0
CHF	--	23.7	--	25.5	--	11.4
Other	--	94.1	--	100.5	--	271.6
	54.1	479.3	5.7	608.2	--	1,192.0
• To hedge commercial commitments						
USD	635.4	888.7	682.6	1,097.3	429.1	1,060.6
GBP	265.4	181.2	269.6	298.6	271.6	287.4
CHF	62.1	69.4	30.3	84.0	48.1	90.2
Other	260.8	191.8	214.2	228.2	185.8	149.4
	1,223.7	1,331.1	1,196.7	1,708.1	934.6	1,587.6
Total	**2,068.3**	**2,845.0**	**1,996.4**	**3,312.5**	**1,632.1**	**3,905.0**
Foreign exchange options						
PUT						
USD	--	--	17.7	73.4	--	--
CALL						
USD	1.9	28.0	2.4	77.6	9.5	58.8
	1.9	**28.0**	**20.1**	**151.0**	**9.5**	**58.8**

Corresponding market values:

	2003		2002		2001	
	Buy/ Lend	Sell/ Borrow	Buy/ Lend	Sell/ Borrow	Buy/ Lend	Sell/ Borrow
Forward exchange contracts	**(14.0)**	**64.0**	**(10.0)**	**48.0**	**4.0**	**(36.0)**
Foreign exchange swaps						
- to hedge investments	0.3	15.2	(0.3)	20.4	--	(23.0)
- to hedge commercial commitments	(1.7)	23.9	0.6	33.8	(1.0)	(8.0)
Foreign exchange options						
- PUT	--	--	--	0.4	--	--
- CALL	--	1.4	--	1.5	--	(1.0)

Maturity dates:

	2003		2002		2001	
	Minimum	Maximum	Minimum	Maximum	Minimum	Maximum
Forward exchange contracts	Jan-04	Dec-07	Jan-03	Dec-07	Jan-02	Dec-07
Foreign exchange swaps						
- to hedge investments	Jan-04	June-04	Apr-03	June-03	March-02	May-02
- to hedge commercial commitments	Jan-04	Apr-09	Jan-03	Apr-09	Jan-02	Apr-09
Foreign exchange options						
- PUT	--	--	--	--	--	--
- CALL	Jan-04	May-04	Apr-03	May-04	Jan-02	Oct-02

b) Interest rate risk management

Most of the interest rate swap contracts held by Thales at year-end 2003, 2002 and 2001 were intended to reduce the Group's sensitivity to interest rate movements. These financial instruments serve to hedge the net cash position of the Group as well as net cash flows generated on certain large contracts, either already signed or under negotiation; 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:

	2003		2002		2001	
	Buy/ Lend	Sell/ Borrow	Buy/ Lend	Sell/ Borrow	Buy/ Lend	Sell Borrow
Interest Rate Swaps	1 104.5	524.1	1 021.8	517.3	1 373.8	602.2
Currency swap	19.0	--	19.0	--	19.0	13.5
Floors	60.0	--	110.0	--	110.0	--

Corresponding market values:

	2003			2002			2001		
	Buy/ Lend	Sell/ Borrow	Closed positions	Buy/ Lend	Sell/ Borrow	Closed positions	Buy/ Lend	Sell/ Borrow	Closed positions
Interest Rate Swaps	1.7	(15.4)	(13.8)	1.9	(21.0)	--	2.7	(15.9)	--
Currency swap	(2.2)	--	--	(0.6)	--	--	0.2	(1.0)	--
Floors	--	--	--	3.0	--	--	1.6	--	--

Maturity dates range from January 2004 to June 2008.

c) Counterparty risk management

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

Interest rate swap transactions matched with the same counterparty:

	2003	2002	2001
Total nominal amount	1,010.0	390.0	285.7
Including matched transactions with the same counterparty	700.0	80.0	100.0

23. COMPENSATION OF SENIOR CORPORATE OFFICERS

Information on the CEO's compensation is given on page 101. Information on other senior corporate officers' compensation is given on page 103.

List of main consolidated companies * (not including Thales S.A.)

	% Control 2003	% Control 2002	% Stake 2003	% Stake 2002
1. CONSOLIDATED SUBSIDIARIES				
Aerospace				
Thales ATM (Europe, USA)	100%	100%	100%	100%
Thales Avionics (France, Canada, USA, Singapore, Ireland, UK)	100%	100%	100%	100%
Thales Avionics Electrical Systems (France, USA)	100%	100%	100%	100%
Thales Training & Simulation (France, UK, USA)	100%	100%	100%	100%
Defence				
African Defence Systems (South Africa)	80%	80%	60%	60%
Australian Defense Industries (Australia)	100%	100%	50%	50%
Avimo (UK, Singapore, USA)	100%	100%	100%	100%
Thales Air Defence (France, UK)	100%	100%	100%	100%
Thales Angénieux SA (France)	100%	100%	100%	100%
Thales Communication (Europe, USA)	100%	100%	100%	100%
Thales International (France)	100%	100%	100%	100%
Thales Missile Electronics Ltd (UK)	100%	100%	100%	100%
Thales Naval (France, Netherlands, UK)	100%	100%	100%	100%
Thales Nederland B.V. (Netherlands)	99%	99%	99%	99%
Thales Optronics (France, UK, Netherlands, Canada)	100%	100%	100%	100%
Thales Systèmes Aéroportés SA (France)	100%	100%	100%	100%
Thales Underwater Systems (France, UK, Australia)	100%	100%	100%	100%
Information Technology & Services				
Thales Telematics (UK, South Africa)	100%	100%	100%	100%
Thales Antennas (UK)	--	100%	--	100%
Thales Broadcast & Multimedia (France, USA, Switzerland, Germany)	100%	100%	100%	100%
Thales Computers (France, USA)	100%	100%	100%	100%
Thales Electron Devices (France, Germany, USA)	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)	100%	100%	100%	100%
Thales Geosolutions (UK, USA, Netherlands, South Africa, Singapore, Australia)	--	100%	--	100%
Thales Idatys SA (France)	100%	100%	100%	100%
Thales Identification (France)	100%	100%	100%	100%
Thales Industrial Services SA (France)	100%	100%	100%	100%
Thales Information Systems (Europe)	100%	100%	100%	100%
Thales MESL Ltd (UK)	100%	100%	100%	100%
Thales Microelectronics SA (France)	100%	100%	100%	100%
Thales Microwave SA (France)	100%	100%	100%	100%
Thales Navigation (USA)	100%	100%	100%	100%
Thales Navigation SA (France)	100%	100%	100%	100%
Thales Security and Supervision (France)	100%	100%	100%	100%
Thales Service Industries (France)	100%	100%	100%	100%
Thales Telecommunication Services (UK)	100%	100%	100%	100%
Thales Microsonics SA (France)	--	100%	--	100%
Thales Support Services (France)	--	100%	--	100%
2. ACCOUNTED FOR UNDER THE PROPORTIONATE METHOD				
Aerospace				
Diehl Avionik Systeme GmbH (Germany)	49%	49%	49%	49%
Defence				
Aircommand Systems International SAS (ACSI) (France)	50%	50%	50%	50%
Samsung Thales Company Ltd (Korea)	50%	50%	50%	50%
TDA Armement S.A.S. (France)	50%	50%	50%	50%
Thales Raytheon Systems (France, USA)	50%	50%	50%	50%
Armaris	50%	50%	50%	50%
Amper Programas (Spain)	49%	--	49%	--
Information Technology & Services				
Citylink Ltd (UK)	33%	33%	33%	33%
Thales Nixdorf Systèmes Bancaires S.A.S. (France)	50%	50%	50%	50%
Thales Navigation Solutions (USA)	60%	60%	60%	60%
United Monolithic Semiconductors (France, Germany)	50%	50%	50%	50%
3. ACCOUNTED FOR UNDER THE EQUITY METHOD				
Aerospace				
Aviation Communications & Surveillance Systems (USA)	30%	30%	30%	30%
Defence				
Amper Programas (Spain)	--	49%	--	49%
Arab International Optronics	49%	49%	49%	49%
Elettronica S.p.A. (Italy)	33%	33%	33%	33%
ESG (Germany)	30%	30%	30%	30%
Stesa (Saudi Arabia)	49%	49%	49%	49%
Information Technology & Services				
Camelot (UK)	20%	20%	20%	20%
Thales Spectrum de Argentina (Argentina)	49%	49%	49%	49%
Nice Systems	13%	14%	13%	14%
Satellite Information Systems (UK)	22%	22%	22%	22%

* Only main locations are mentioned for each company.

Statutory auditors' report on the consolidated financial statements

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. The statutory auditors' 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 consolidated financial statements. This information includes an explanatory paragraph discussing the auditors' assessments of certain significant accounting and auditing matters. These assessments were considered for the purpose of issuing an audit opinion on the consolidated 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.

This report should be read in conjunction with, and construed in accordance with, French law and professional auditing standards applicable in France.

To the Shareholders of Thales,

In compliance with the assignment entrusted to us by your shareholders' annual general meetings, we have audited the accompanying consolidated financial statements of Thales for the year ended 31 December 2003.

The 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.

Opinion on the consolidated financial statements

We conducted our audit in accordance with professional standards applicable in France. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated 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 consolidated financial statements give a true and fair view of the assets, liabilities, financial position and results of the consolidated group of companies in accordance with the accounting rules and principles applicable in France.

Justification of our assessments

In accordance with the requirements of article L. 225-235 of the French Company Law (Code de Commerce) relating to the justification of our assessments, introduced by the Financial Security Act of 1 August 2003 and which came into effect for the first time this year, we bring to your attention the following matters:

Accounting principles and policies

Note 1 to the financial statements sets out the accounting principles and policies relating to the preparation of Thales' consolidated financial statements. Within the scope of our assessment of the accounting principles and policies used by your company, we verified the appropriate nature of the aforementioned accounting methods and the information provided in the notes to the financial statements and we ensured that these principles and policies were correctly applied.

Accounting estimates

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.

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

• Long-term contracts

Thales recognizes income on long-term contracts in accordance with the methods set out in note 1.j to the financial statements. Such income is based on estimates of income on completion made by the project managers under the responsibility of Management.

Based on the information available 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 actual figures for the financial period and examining the procedures used by Management to approve such estimates.

• Acquisition goodwill

Acquisition goodwill, which appears in the balance sheet as of 31 December 2003 for a net amount of €2,146 million, was subject to impairment tests in accordance with the methods set out in note 1.a to the financial statements. We reviewed the methods for carrying out these tests, based on the current market prospects of the business activities and divisions concerned, and checked the consistency of the assumptions used with the forecast data taken from the strategic plans drawn up for each of these business activities and divisions under the Group's control.

• Deferred tax assets

As of 31 December 2003, net deferred tax assets recorded amounted to €306 million as stated in note 7.c 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 in the case of 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 in the consolidated financial statements and the off-balance sheet commitments are estimated on a statistical and actuarial basis, especially the provisions for pension plans and related commitments. The methods for calculating these headings are set out in Note 17 to the financial statements.

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

• 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 recognise such provisions from an accounting standpoint in satisfactory conditions. We also ensured that any uncertainties identified during the implementation of these procedures was described in appropriate terms in the notes to the financial statements, and, in particular, in note 18.

Within the scope of our assessments of said estimates we verified their reasonable nature. We wish to remind you that, as these forecasts are by nature uncertain, actual amounts may differ significantly from forecast amounts.

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

Specific verifications and information

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, 19 April 2004

The statutory auditors

ERNST & YOUNG AUDIT :
Christian CHIARASINI

MAZARS & GUÉRARD :
Thierry BLANCHETIER
Thierry COLIN

02 BUSINESS REVIEW

BUSINESS DESCRIPTION

BUSINESS IN FIGURES

In million of euros, except for staff

2003	Defence	Aerospace	IT & S	Other activities
Consolidated revenues	6,599	1,796	2,071	104
Operating income	545	140	37	-25
Order book	13,994	2,990	1,704	55
Order intake	6,950	1,610	2,204	123
Consolidated staff (1)	31,652	9,462	14,017	2,308

2002	Defence	Aerospace	IT & S	Other activities
Consolidated revenues	6,736	1,789	2,497	83
Operating income	417	126	54	--
Order book	14,015	3,284	1,685	25
Order intake	5,976	2,185	2,438	78
Consolidated staff (1)	32,472	9,659	16,547	1,984

2001	Defence	Aerospace	IT & S	Other activities
Consolidated revenues	5,746	1,815	2,620	87
Operating income	445	123	78	--
Order book	15,010	3,057	1,647	31
Order intake	6,116	2,315	2,544	84
Consolidated staff (1)	33,118	9,831	17,748	1,797

2000	Defence	Aerospace	IT & S	Other activities
Consolidated revenues	4,934	1,550	2,058	37
Operating income	337	83	141	--
Order book	14,136	2,414	1,795	22
Order intake	5,299	1,863	2,073	35
Consolidated staff (1)	28,781	9,165	17,698	1,668

1999	Defence	Aerospace	IT & S	Other activities
Consolidated revenues	3,816	1,391	1,615	67
Operating income	243	48	96	4
Order book	12,714	1,816	844	55
Order intake	4,695	1,601	1,575	71
Consolidated staff (1)	24,495	8,679	14,184	1,564

In the Defence business area, an order generally counts as 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 staff numbers fell by 3,223 (5%) during 2003. Most of the reduction (1,983) is attributable to disposals of assets, particularly Thales Geosolutions. On a like-for-like basis, staff numbers fell by 1,240.

(1) Consolidated staff figures include all employees of fully consolidated companies and prorated figures for companies carried under the proportionate method. It does not include staff working for companies that are carried under the equity method or for non-consolidated companies.

Defence

AIRBORNE SYSTEMS

Thales is a prime contractor, systems integrator, equipment supplier and service provider, proposing complete airborne systems solutions to meet air combat as well as airborne surveillance and intelligence requirements. The various segments of the airborne systems market are increasingly interconnected: users need simultaneous access to all the different functions, and many of the underlying technologies are the same.

The entire area is undergoing rapid change as sensor performance improves and processing and transmission capacities increase. In addition, UAVs[1] are playing a broader role in surveillance today, and will assume a combat role in the future with the emergence of UCAVs[2].

With these developments, airborne systems can respond to increasingly challenging situations: short-loop responses to high-mobility targets on the ground, higher precision for reduced collateral damage, standoff weapon delivery capabilities and enhanced platform survivability.

Combat aircraft

In 2003, Thales continued to contribute to several large-scale combat aircraft programmes, both on export, with the *Mirage 2000-5* for Greece and *2000-9* for the United Arab Emirates, and in France with new orders on the *Mirage* and *Rafale* programmes. As in previous years, these major programmes accounted for a significant proportion of Thales' airborne systems revenues.

Launched in 1998, the *Mirage 2000* programme for the United Arab Emirates involves thirty-two new aircraft and retrofits to bring thirty *Mirage* up to the *2000-9* standard.

In France, 2003 saw acceptance of the first production equipment – including the *RBE2* radar, *Spectra* electronic warfare system, *EMTI* modular mission computer and *OSF* forward-sector optronics system – for the first forty-eight *Rafale* aircraft.

Business was affected by the postponement of decisions on a number of procurements, particularly the *Mirage 2000* for Brazil and India, and increased American pressure. In late 2003, the Singapore Government downselected the *Rafale* with the American *F-15* and the *Eurofighter Typhoon*. In-flight evaluations of the downselected aircraft are scheduled for 2004.

Surveillance and intelligence

Thales has the key skills and capabilities needed to expand its business in two major segments of this growth market: UAV systems and maritime surveillance.

UAVs

In recent years, UAVs have gained broader acceptance by the armed forces and are a key asset in the battlespace of the future. New technologies and better reliability have made governments recognise the huge operational potential of UAVs, and particularly the role they can play in protecting forces in the field and providing operational pesistencepersistence and rapid-reaction capabilities.

Thales is well placed in this expanding market. Its advanced solutions draw on broad-based expertise in all aspects of UAV design, including processing architecture, optronic and radar imaging, electronic surveillance, jamming, communications and navigation.

Beyond the platform level, integration of UAVs into broader information-processing and transmission systems expands their operational role, particularly in terms of ISTAR[3] capabilities. Over and above its expertise as an equipment provider, therefore, Thales is positioned as a system architect and prime contractor for entire UAV systems. This positioning has led the Group to establish partnerships with platform manufacturers, selected to meet the specific requirements of each programme.

Thales is active in all areas of UAV development, with a particular focus on tactical UAVs and MALE UAVs[4].

In these two segments, the Group is involved in the following programmes:

- The *Watchkeeper* tactical UAV (surveillance and target designation) for the British Army. In February 2003, Thales was downselected for the System Integration Assurance Phase (SIAP). Final selection is expected in 2004. The in-service date is 2006/2007.
- France's *MCMM*[5] tactical UAV and *SDM*[6] UAV systems, which are expected to enter operational service at the end of the decade. Thales has been selected on both programmes to conduct preliminary studies, including system architecture and technical architecture. With its multi-domestic presence, Thales is equipped to support the European dimension of these programmes.

Thales is also preparing for other opportunities, including tactical UAV programmes in Australia and a number of planned UCAV programmes.

Maritime patrol and surveillance systems

Thales has a long background in maritime patrol and surveillance.

Its maritime patrol activities encompass a diverse range of equipment and missions:

- surveillance aircraft used to monitor activity within national Exclusive Economic Zones, fight trafficking, accidental or criminal pollution, and conduct search-and-rescue operations
- larger, longer-range aircraft used for similar surveillance missions as well as various military operations, including anti-surface warfare, anti-submarine warfare and crisis intervention in littoral zones.

Maritime surveillance has much in common with maritime patrol in terms of the systems used. The main differences are that maritime surveillance operations are not armed missions, and they can be conducted by smaller short-range aircraft such as seaplanes. In maritime surveillance, Thales works closely with Dassault Aviation, which builds the *Falcon 50* aircraft in service with the French Navy.

(1) UAV: Unmanned Aerial Vehicle
(2) UCAV: Unmanned Combat Aerial Vehicle
(3) ISTAR: Intelligence, Surveillance, Target Acquisition, Reconnaissance
(4) MALE: Medium Altitude, Long Endurance
(5) MCMM: Multi-Charge Multi Mission (multi-payload, multi-role)
(6) SDM: Système de Drones Moyenne altitude longue endurance (medium-altitude, long-endurance UAV system)

The Group is positioned as a systems integrator and prime contractor capable of assuming full responsibility for integration of complex multi-sensor systems. As an equipment provider, Thales covers the full spectrum of maritime patrol requirements, including surveillance radars, passive electronic warfare and optronic sensors, communications, aircraft self-protection, underwater detection and anti-submarine warfare. Thales integrates all this equipment and networks the sensors.

The Group has numerous references in this field. Its most recent successes include the major contract with Turkey for the *Meltem* programme. The first phase of this programme, worth some 307 million dollars, calls for nineteen maritime patrol and surveillance systems for Turkey's Navy and Coast Guard. Thales was selected as prime contractor for the programme, which was launched in July 2003. Nine systems will be integrated on in-service *CN235* aircraft and a further ten on new platforms currently being procured by Turkey.

This major contract with Turkey makes Thales the European leader in maritime patrol systems and strengthens its position with other customers.

Missile electronics

As Europe's leading independent supplier of electronic components and subsystems for missiles and munitions, Thales proposes a comprehensive offering encompassing everything from missile tracking systems to seekers and sensors.

In 2003, MBDA awarded Thales the contract for the development and initial production of the seeker system for the future *Meteor BVRAAM*[1] missile. Initial production under this contract will meet the needs of the British Royal Air Force. More broadly, the *Meteor* programme is designed to equip all European combat aircraft, including France's *Rafale*, Sweden's *Gripen* and the *Eurofighter* being developed by Germany, Italy, Spain and the United Kingdom.

The Meteor contract further consolidates the alliance in air-to-air missile seekers concluded between Thales and MBDA in 2002.

Raytheon also selected Thales to produce the seekers for the new *Precision-Guided Bomb* ordered by Britain.

NAVAL SYSTEMS

Thales' naval activities reached a turning point in 2003. The United Kingdom Ministry of Defence's decision early in the year in favour of the Thales design for the *CVF*[2] carrier programme is a clear endorsement of the Group's status as a major player on large-scale naval programmes.

- The global naval defence market is growing because the missions assigned to naval forces are expanding and diversifying beyond regional conflict to include protection against terrorist threats, immigration control and the interdiction of all forms of trafficking; as a consequence, governments and their current naval capabilities are stretched to the limit.

Despite budgetary constraints on naval defence funding in many client countries, the global market is expected to grow by around 20% over the medium-term (2001-2008), then level off at around €30 billion per annum. Since the early 1990s (i.e., immediately after the Cold War), European countries have increased naval defence spending by around 30%, partly for large-scale replacement programmes – the Franco-Italian *FREMM*[3] programme (27 ships) is a prime example – and partly for upgrade programmes. Overall, as requirements continue to grow faster than appropriations, customers are seeking to enhance their naval capabilities and improve value for money through off-the-shelf designs, technology networks, better support services and international cooperation. The French decision in early 2004 in favour of conventional propulsion for the proposed *PA2*[4] carrier sets the stage for greater cooperation in carrier programmes between France and the United Kingdom.

The context is not incompatible with further consolidation in the European naval shipbuilding industry.

- With its specialised naval expertise and experience and its multi-domestic dimension, Thales is in a position to benefit from the current market dynamic, offering a combination of technical performance and keen pricing to deliver solutions tailored to local customers' needs and to take part in cooperative programmes.

The Group has built its naval business not only in France, but also in the countries where its major international subsidiaries are located: the Netherlands and the United Kingdom, Australia, Germany, Korea, Singapore, South Africa and Canada.

In recent years, the dominant trend in naval procurement has been the transfer of programme management responsibility from government to industry. Thales offers procurement agencies the benefits of its international experience in naval equipment, systems, platforms and prime contracting, while meeting all their specific or national needs.

To support the expansion of its naval business, Thales has reorganised its offering around four strategic business lines: Warship Prime, Above Water Systems, Under Water Systems and Naval Services.

Warship Prime

As one of the world's leading players in warship prime contracting and naval equipment integration, Thales manages entire naval programmes and associated contractor logistic support. Thales has consistently demonstrated its capabilities as a prime contractor and integrator on major international naval programmes, providing effective risk reduction and delivering on time and on budget.

With proven expertise in combat management systems, radars and missile systems, Thales is playing a leading role in battlespace digitisation and new networking developments for joint and allied forces, including their naval components.

Thales assumes naval prime contracting and systems integration roles either on its own or in partnership with other prime contractors. In

(1) BVRAAM: Beyond Visual Range Air to Air Missile
(2) CVF: Carrier Vessel of the Future
(3) FREMM: Frégates Multi-Mission
(4) PA2: Porte-Avions 2

2002, Thales and DCN set up Armaris as a joint venture to combine the partners' commercial strengths and expertise in naval prime contracting for international and cooperation projects.

Armaris is the French prime for the Franco-Italian *Horizon* anti-air frigate programme and is expected to be appointed in the same role by the same countries for the *FREMM* multi-role frigate programme when it is launched in the near future. In 2003, Armaris booked several international orders, including one from Malaysia for anti-submarine warfare training and one from Norway for six combat management systems for *Skjold*-class patrol vessels.

In 2003, Thales teams continued to work on the *Sawari II* programme, which calls for the delivery of three frigates to Saudi Arabia. The second frigate, complete with its *Aster* medium-range anti-air missile system, was delivered in 2003.

As already mentioned, one of the year's highlights was the decision by the United Kingdom Ministry of Defence to form an alliance with Thales and BAE Systems, the two competitors for the *CVF* programme, to build the future aircraft carriers. The design proposed by Thales has been retained for this programme, which is the largest naval programme ever launched by the United Kingdom.

Other major European cooperation programmes are expected to be launched in the medium term.

Above Water Systems

Equipment commonality, joint protocols and sensor grids are the key enablers of cooperative engagements by allied forces. With its extensive experience of integrating the systems and equipment from its own portfolio, the company is well placed to support rapid development of radars and combat management systems and to propose interoperable, network-centric solutions that are cost-competitive because of the scale and scope of the Group's operations.

In 2003, the Hellenic Navy awarded contracts worth €400 million to Thales Naval Nederland to modernise its S-class frigates, supply radars and fire control equipment for two fast attack craft, and modernise four fast attack craft. In addition, with its *Tacticos* combat management and radar system, Thales is a serious competitor for the US Navy's Deepwater and Littoral Combat Ship programmes.

In Korea, the Samsung-Thales Corp. joint venture won a contract to supply combat systems for the Korean Navy's Landing Platform eXperimental (*LPX*) class of vessels.

The Group was also selected to develop an integrated maritime surveillance system for Turkey.

Under Water Systems

A world leader in underwater systems, Thales should benefit from growing European and global demand, particularly for unmanned underwater vehicles (UUVs) and networking developments in the underwater battlespace.

In 2003, Thales won major anti-submarine warfare contracts in Australia and the United Kingdom. In Australia, the Group is responsible for data processing and display upgrades for the sonar suites equipping *Collins*-class submarines and for supplying *Petrel* mine and obstacle avoidance sonars for *Anzac*-class frigates.

In the United Kingdom, the Royal Navy is equipping one of its bases with the Thales Sea *Guardian Swimmer Detection* Sonar to provide protection against underwater threats.

In France, the *Sycobs* new-generation integrated sonar system was selected for the *Barracuda* nuclear-powered attack submarines.

Naval Services

Contractor support for naval electronic equipment has grown from the provision of maintenance services into a business line that includes prime contracting for support programmes and through-life support services spanning shipboard equipment, systems and complete platforms. Thales also offers coastal and harbour surveillance and related technical services.

Naval Services is now an international business line drawing on the combined expertise of all Thales subsidiaries and benefiting from the resulting synergies to exploit new opportunities.

Following a successful trial by the United Kingdom Ministry of Defence, Thales signed a fleet-wide contractor logistic support contract in 2003 for the sonar systems in service with the Royal Navy. This first contract could be followed in 2004 by several ten-year support contracts that will improve force preparedness at significantly lower cost.

LAND & JOINT SYSTEMS

Communications

Modern armed forces are undergoing another major transformation. Deployment doctrines, organisational models and tactical manoeuvres themselves are changing rapidly as the concept of *Network Enabled Capability* comes of age. Information, communication and intelligence systems are becoming more and more closely integrated, playing an increasingly crucial operational role as the backbone and nervous system of the armed forces.

With its unique portfolio of equipment, systems and services, Thales is one of the world leaders in this area, alongside General Dynamics of North America. Positioned as a systems architect and prime contractor, Thales develops modular, comprehensive, highly secure solutions, or "systems of systems", particularly for land and joint forces. Thales draws on the complete range of military and commercial communications technologies. Its systems benefit from extensive use of COTS (*Commercial Off The Shelf*) components, partnerships with leading OEMs in the commercial sector, and the Group's specific expertise in high-level security solutions for mission-critical military applications.

Battlefield communications

• Land forces communications

Thales confirmed its world leadership in the tactical communications in 2003. The success of the PR4G radio, already in service in 32 countries and now available in an IP-capable version (F@stnet), continued with the sale of the 100,000th radio set. New orders in 2003 came from the Netherlands, Poland, Qatar, Spain, the United Arab Emirates and Yemen. In the United States, Thales Communications Inc. joined General Dynamics to bid for manpack, handheld, and small form fit radios on the Joint Tactical Radio System (*JTRS* (1)) programme (*Cluster 5*), and was awarded a contract modification by the US Special Operations Command to redesign its handheld *MBITR*(2) radio (*Cluster 2*).

The Group strengthened its position on the Tactical Internet in 2003. The French Army took delivery of its 100th *Rita* (3) terminal on the Rita 2000 programme, and Thales was awarded the contract to expand network functionality and improve availability. The Norwegian defence ministry also selected the *Sotas M2* multimedia intercom system, a key component in the future Tactical Internet, for combat vehicles and command posts.

• Aeronautical communications and navigation/identification

Thales consolidated its position as No. 2 worldwide in this market in 2003, for the first time providing equipment for Russian-built combat aircraft: full CNI (4) suites (radios, radio altimeters, GPS receivers and IFF (5) transponders) for Bulgarian *MiG 29s*, and navigation and IFF systems for Malaysian S*ukhoi 30*s.

Other IFF contracts in 2003 include equipment for the Spanish and Australian armed forces, and a *Variant 2D* surveillance radar with a fully integrated IFF system for the Royal Netherlands Navy.

In the market for UAV(6) systems, Thales is developing specialised expertise in very-high-speed data transmissions through its work on the *STANAG 7085* datalink for the Pod *Reco NG* programme. The Group is positioned on several strategically important procurements in this expanding market: in France, for example, a UCAV (7) programme and associated technology demonstrator is due to be launched in 2004.

• Naval communications

Thales has been appointed prime contractor for the *RIFAN* (Réseau Intranet de Force AéroNavale) network, one of the pillars of the French Navy's future collaborative engagement capability. For this programme, Thales will install an intranet aboard 67 French naval vessels and provide logistic support for a period of five years.

The network-centric naval force of the future will also rely on the French Navy's *SIC 21* new-generation information and command system. This programme has been awarded to Thales, and will enable any entity (from platform to chief of staff) to operate within national or coalition C3I (Command, Control, Communications, Intelligence) networks, regardless of force organisation or command structure.

• Priorities for the future

High-speed communications and interoperability are two of the key enablers of the battlespace of the future, and Thales is actively preparing the groundwork for this new environment. In France, the Group won the contract to design a high-speed radio demonstrator and conduct the software architecture study for future tri-service radios. Thales was also selected to design and develop the HF waveform specified in *STANAG 4444*. After the development phase, interoperability trials will be conducted on this waveform at the European level.

Cooperative fighting systems and dismounted combatant systems

As France prepares for development of the future BOA(8) cooperative fighting system, Thales was selected for the *SIM-EC3* study to simulate future systems concepts, and for the *ARCHI SC3* study to conduct a preliminary investigation of potential system architectures. France also ordered a concepts demonstrator for the future short-range combat system, confirming its comprehensive approach to its land capability. Positioned as the overall systems integrator within a coordinated approach open to international cooperation, Thales is ready to lead constructive teamwork with the best industry partners in the field.

The Group is also positioned as a cross-programme partner on several future systems for dismounted combatants. Thales is taking part in the US *Land Warrior* and *Objective Force Warrior* soldier system programmes with its *MBITR* and *JTRS Cluster 5* radios, and is a key player in the equivalent programmes in the United Kingdom (*FIST-Future Integrated Soldier Technology*), Germany (radio for the *IdZ-Infanterist der Zukunft*), the Netherlands (*D2S2*), Norway (*NORMANS*) and Australia (*Land 125*).

Battlefield intelligence and operational information systems

- Intelligence has become a critical function for manoeuvres in the theatre of operations. Thales was appointed prime contractor for the *SAEC*(9) **electronic warfare** system (*electronic support stations*

(1) JTRS: Joint Tactical Radio System
(2) MBITR: Multiband Inter/Intra Team Radio
(3) RITA: Réseau Intégré de Transmission Automatique
(4) CNI: Communication, Navigation, Identification
(5) IFF: Identification Friend or Foe
(6) UAV: Unmanned Air Vehicle
(7) UCAV: Unmanned Combat Air Vehicle
(8) BOA: Bulle Opérationnelle Aéroterrestre
(9) SAEC: Station d'Appui Electronique de Contact

for forward units) and was selected to conduct preliminary studies for future large-scale surveillance programmes (architecture for a joint theatre intelligence system, ground surveillance network for out-of-area operations).

- In **surveillance and image intelligence**, Thales delivered a new version of the *MINDS multi-sensor image interpretation and dissemination system* currently in service with all three armed forces. The Group is also bidding for the *DNG3D* digital geographical data programme, confirming its position in high-precision digital geography for military customers.
- For **artillery systems**, Thales is taking part in the European programme to renovate fire control systems for the multiple-launch rocket systems in service with France, Italy and Germany. Thales will co-develop the software, and supply the navigation and positioning unit and a secure interface between the fire control systems and the three nations' artillery command systems.

Infrastructure networks, data security and national security

• Communications infrastructures

Already the established European leader in this field, Thales confirmed its lead in **satellite communication** in 2003. New contracts include the supply of trunk encryption and high-speed optical transmission devices for France's *Aristote* joint forces transit network. In addition, Alcatel Space and Thales are responsible for upgrading satcom terminals throughout metropolitan France, and aboard surface ships and submarines in the *Archimede* programme.

In Korea, Thales won a contract to develop the strategic communication system for the Korean Navy's submarine fleet.

• Network and information system security

Security remains a fundamental and specific component of defence communications and information systems. Thales is one of the few companies with a complete range of network and data security solutions, including government cryptography. In this market, the 1,000th CHIP encryption unit for IP networks was delivered on time despite ambitious delivery date targets.

Thales has also been taking part in NATO's *NICE* (NATO Internet Crypto Equipment) programme since its Norwegian *Cryptel IP* system was selected for encryption of classified information transiting over the Internet. More than a dozen nations will be equipped to this commercially based standard in 2004.

• National security

Just as the demand for **Homeland Security** has grown in the United States, the need for national security safeguards has expanded in Europe. Thales is firmly committed to meeting these requirements. In 2003, the French Ministry of the Interior chose Thales to provide its private nationwide radio network. The Group is also pursuing its developments in data and text mining as a basis for processing huge volumes of open-source and closed-source information.

Services and Research & Technology

Thales is continuing to expand its range of innovative, value-added services to ensure high operational readiness with the forces and provide focused support as close as possible to the theatre of operations. Support for the *Rita 2000* and operational readiness agreements on the *Acropole* network illustrate Thales' proactive approach to service provision. Thales also supports the modernisation process through new types of procurement and financing arrangements. The Group is bidding on Defence Information Infrastructure programme, confirming its position in the logistic support and services market in the United Kingdom.

Optronics

Optronics is the art and science of combining optics, detectors, electronics, image-processing algorithms, software and displays to provide TV-quality real-time images at any time of day or night in almost any weather conditions. Using both active and passive sensor technologies, optronics provides the resolution and directional accuracy needed for the positive identification, precision targeting and situational awareness demanded by modern combat. Linked through digital communications channels, it also provides many of the elements of the "sensor-to-shooter" information chain.

Thales is the leading optronics supplier in Europe and one of the four world leaders in this field alongside Raytheon, Lockheed Martin and BAE Systems. Through a multi-domestic network of centres of excellence in France, the UK, the Netherlands, Canada, Korea and Singapore, Thales has the depth and breadth of resources to deliver solutions ranging from specialised components to major prime contracts and complex integrated systems. This end-to-end capability also provides the framework for comprehensive customer support tailored to local needs.

Although military requirements have driven advances in optronics for many years, many of the underlying technologies are essentially dual in nature, and are increasingly important in industrial, scientific, medical, telecommunications and other civil applications, including the rapidly expanding homeland security market.

- Most **airborne platforms** now rely on optronic systems, whose effectiveness has been vividly demonstrated in recent conflicts. For air-to-surface strike missions, Thales is a leading provider of laser designation pods for precision day/night guidance of air-launched weapons. Its *Damocles* multi-function targeting pod, which provides an effective long-range target identification and engagement capability, has been in service with the French Air Force since 2002 and was selected in 2003 to equip the Royal Malaysian Air Force's *Sukhoi* aircraft. This latest contract award is a major first for two reasons: Malaysia is a new customer in this field, and Thales will be providing optronics equipment for *Sukhoi* aircraft for the first time.

  The latest generation of air-to-air optronic systems, which provide a unique passive target detection, identification and tracking capability for *Rafale* and *Eurofighter*, entered production in 2002. Thales is now pursuing full-scale development of the next generation of electro-optic reconnaissance pods.

  Thales also integrates IR and TV cameras and laser rangefinders into gyrostabilised turrets for observation and surveillance by helicopters, UAVs and subsonic fixed-wing aircraft. New developments in missile warning sensors and optronic countermeasures offer potential solutions to increasingly sophisticated threats from surface-to-air missiles.
- In **land-based systems**, Thales is one of the world's leading suppliers of optronic systems for armoured combat vehicles, with an updated range of one-man turrets and stabilised remote weapon stations for light vehicles. Products include gyrostabilised sighting systems, thermal imaging cameras, laser rangefinders, pointers and designators. In the UK, the large-scale Battle Group Thermal Imaging (*BGTI*) programme entered the production phase in 2003. The programme sets new standards of cost-effectiveness and customer service for armoured vehicle fire control systems. Thales is also supplying sighting systems for the French Army under the equivalent *VCI*[1] programme.

(1) VCI: Véhicule de Combat d'Infanterie

Thales is the leading European player in the development of new technologies for next-generation soldier systems, particularly through its involvement in the UK's *FIST* programme. In March 2003, the UK Ministry of Defence selected Thales to lead the three-year assessment phase of the *FIST* programme. The MoD plans to conduct subsequent phases through a close partnership with the selected prime contractor as part of a new smart procurement approach led by Integrated Product Teams. Thales is well positioned as prime contractor for the demonstration, production and technical support phases of this programme.

The Group also offers one of the most extensive ranges of thermal imaging cameras on the market. At end-2003, around 5,000 *Sophie* second-generation thermal cameras had been sold in almost 40 countries. This product is ideally suited to new types of projected force operations. Other variants of the Sophie camera, designed to withstand extreme environments, have been selected for some of the most demanding vehicle retrofit programmes. These cameras have been deployed by the US Marine Corps in Iraq. Thales has also developed new solutions based on uncooled detector technology for optimum cost, and *QWIP* (1) technology for the most demanding applications.

- In **naval markets**, Thales is a world leader in optronic masts and periscopes for submarines, supplying these systems to the British Royal Navy and other naval forces. The Group also offers a range of infrared surface surveillance and fire control systems, which provide surface ships with a passive complement to conventional radar sensors. Samsung Thales is responsible for installing the fire control systems on the Republic of Korea Army's *K1A1* main battle tanks. These systems incorporate highly sophisticated panoramic displays (KCPS (2)).
- Combining the latest commercial technologies with long-standing experience in the most demanding military applications, Thales is a broad-catalogue supplier of advanced **optics**, **lasers**, **laser diodes** and **cryogenics** for defence, industrial, medical, telecom and space applications.

  Covering the entire spectrum from infrared to ultraviolet, the Group has the expertise to design and produce advanced optical and electro-optical components and products to meet the most stringent specifications. By way of example, Thales is supplying key subsystems and unique optical components for the French Laser Megajoule (*LMJ*) project.

AIR DEFENCE AND MISSILE SYSTEMS

Thales is one of only three companies in the world capable of assuming prime contractor responsibilities for a country's entire air defence system architecture.

Its offering includes detection systems, identification systems and air command and control systems (for defensive and offensive operations), very short-, short- and medium-range air defence systems to protect high-value assets and forces on the battlefield, as well as armaments and propulsion.

Raytheon and Lockheed Martin are the world market leaders. The other European players in this field are MBDA for surface-to-air missile systems, and Finmeccanica and BAE Systems for air defence and battlefield detection systems.

Air defence systems

The air defence market includes air command and control systems and battlefield air defence systems used both for defensive engagements and for planning and tasking for offensive missions.

Recent military conflicts have brought to light new types of airborne threats, including UAVs and tactical ballistic missiles, as well as aircraft and cruise missiles. They have also shown the crucial importance of system mobility and air-transportability as armed forces strengthen their power projection capabilities.

System interoperability and the ability to network sensors, weapon systems and command and control centres are essential for conducting multinational peacekeeping and conflict-resolution missions. Effective management of information and communication systems is vital in the new operational environment.

- For the last decade, Thales has factored in this new environment to design and develop interoperable defence systems. In **air command and control systems**, Thales is working through ThalesRaytheonSystems (TRS), its joint subsidiary with Raytheon, to replace NATO infrastructures to ensure allied interoperability both at European level and for force projection operations. ThalesRaytheonSystems (TRS) has a clear leadership position in this field and is building on the success of the first phase (*LOC1*) of NATO's *ACCS* (3) programme.

  TRS, the first-ever transatlantic structural partnership in the defence sector, was set up in June 2001. With facilities in both France and the United States, TRS is making an important contribution to system interoperability in the fields of air defence command and control, and surveillance radars. The alliance is a logical extension of earlier cooperation between Thales and Raytheon on major programmes, including the *Florako* airspace surveillance contract for Switzerland, which was awarded jointly to the partners in 1998, and the NATO *ACCS LOC1* contract, awarded in 1999.
- **Battlefield air defence** is also one of TRS's core businesses. In 2003, the company was selected by the United States Air Force for the *BCS-F* (Battle Control System-Fixed) programme, which will provide the replacement for the current air command and control system at the North American Aerospace Defense Command (NORAD). In France, TRS was awarded the development contract for a new multi-function radar based on *M3R* technology. The *M3R* (Mobile, Modular, Multi-function Radar) demonstrator is a major technological breakthrough and a key milestone in the development of the next generation of radars. The future *M3R* radar will offer unprecedented range capabilities on low-signature targets such as cruise missiles, and will provide effective responses to a diverse range of threats including conventional air defence, ballistic missile defence and low-level and very low-level air defence. The new radar

(1) QWIP : quantum well infrared photodetector
(2) KCPS : Korean Commander's Panoramic Sight
(3) ACCS: Air Command & Control System

will provide the *SAMP/T* land-based medium-range air defence system with the capability to acquire ballistic targets without external designation. This is part of a new concept of extended air defence.

In 2003, Thales continued to contribute to new programmes, including *Rapsodie*, the French Army's future land-based surveillance radar, the *Cobra* counterbattery radar developed by the EuroArt consortium, and the *Martha* programme for the French Army. Under development since 2000, *Martha* will be the first system in the world capable of simultaneously controlling very short-, short- and medium-range weapon systems.

- In **land-based surveillance**, Thales signed a contract with Greece in 2003 for the delivery of twenty *BOR-A550* radars in readiness for the 2004 Olympic Games. Also in 2003, Germany awarded Thales the contract for the production investment phase of the *SMAD* acoustic reconnaissance system, for which the prototype was delivered in 2001. This new contract includes a series of three additional systems and a highly sophisticated computer-based training system. Germany will then have the most advanced passive reconnaissance system in the world, capable of locating artillery and mortar systems of all calibres.

  Thales also won the *SL2A* contract for the development of an artillery location system based on acoustic detection for the French armed forces, and received an order from the Finnish Navy for seven *BOR-A550* radars and associated spares and accessories.

Surface-to-air missile systems

Thales is one of the world leaders in land-based and naval air defence systems. Its businesses range from missile production to integration of very short-, short- and medium-range missile systems (fire control systems and radars).

- **Medium-range**: As a partner in the Eurosam consortium, Thales is contributing to the major European missile system programmes *PAAMS* (1), *SAAMS* (2) and *FSAF* (3). Thales is developing the fire control system software and the *Arabel* radar for the land-based and naval versions. In 2003, the Joint Armaments Cooperation Organization OCCAr (4) awarded Eurosam:

- the upgrade and technical support contract for the SAAMS system that equips France's *Charles de Gaulle* aircraft carrier and will equip Italy's future *Andrea Doria* aircraft carrier and the Franco-Italian *Horizon* frigates.

- Phase 3 of the *FSAF* programme, which covers series production of the first eighteen SAMP/T land-based systems (5).

- **Short-range**: The *Crotale NG* (*New Generation*) system developed by Thales is designed to protect civil and military installations from airborne threats. Equipped with the *VT1* hypervelocity missile, it is in service with the French Air Force and Navy and the armed forces of several other countries. Thales is currently servicing two major international contracts in this segment. The first, with Greece, is nearing completion, and the last firing units have now been delivered. The second calls for a series of forty-eight *K-SAM* (Korean Surface-to-Air Missile) systems, produced by the joint venture Samsung Thales Co. Ltd. Thirteen of these were delivered in 2003 in line with the programme schedule. The contract for sixty-six additional systems was renewed.

- **Very short-range**: Thales Air Defence Ltd (TADL), the UK's second-largest missile manufacturer, won its first export contract for the *Starstreak* missile, which it will supply to South Africa under the GBAD programme (6). The company continued to work on a UK Ministry of Defence contract awarded in 1999 to supply the laser-guided *Starstreak* missile.

Contractor logistic support and customer services

To meet demand for contractor logistic support, Thales has combined its air defence and missile system maintenance and support resources to form a dedicated logistics platform near Orléans, France. The new platform helps customers to reduce their operating costs and optimise their budgets by providing a full range of capability sustainment and lifetime extension services that guarantee the long-term serviceability of their systems.

Thales employs 500 highly qualified technicians and engineers around the world focusing exclusively on air defence and missile systems. Logistics and support services represent a key development path that is expected to generate close to twenty-five percent of Thales' missile systems and air defence revenues in the coming years.

In 2003, Thales signed a new maintenance contract with Korea and continued to provide through-life logistic support for systems in service in France, Finland (*Crotale NG*), Saudi Arabia (*Crotale*, *Shahine*) and other countries in the Middle East, including the United Arab Emirates (*Crotale Naval*). Thales also provided contractor logistic support for radar systems in over thirty countries. System readiness levels increased significantly in 2003.

Armaments and propulsion

In the armaments market, Thales works through TDA, a joint venture with EADS, and specialises in four main areas: air-launched weapon systems, munitronics (munition electronics), weapon and missile components, and land-based weapon systems (mortars, munitions, anti-tank systems). TDA designs, produces and markets its own products, drawing on advanced technology expertise spanning pyrotechnics, detonics and electronics. To develop its weapon system business, TDA benefits from synergies with other Thales Group technologies, including optronics, radars, imaging and data fusion. In 2003, the French defence ministry awarded TDA the contract to develop and produce the next-generation *FBM21* bomb.

The missile propulsion business is conducted through Bayern Chemie/Protac, a joint venture with EADS GmbH, which supplies solid-propellant rocket motors for the major European tactical missile programmes conducted by MBDA, including air-to-air missiles (*Magic, Mica*), ground-to-air missiles (*VT1, Crotale, Shahine, Patriot*), anti-radar (*Alarm*) and anti-tank programmes.

Bayern Chemie/Protac is developing and producing the solid-fuel ramjet for the European *Meteor* programme, which was launched by France, Germany and the UK in late 2002. The development and production contract was signed in the first quarter of 2003.

(1) PAAMS: Principal Anti-Air Missile System
(2) SAAMS: Surface-Air Anti-Missile System
(3) FSAF: Future Surface-to-Air Family
(4) OCCAr: Organisation Conjointe de Coopération en matière d'Armement
(5) SAMP-T: Sol-Air Moyenne Portée/Terre
(6) GBAD: Ground-Based Air Defence

Aerospace

Thales, a key player in aviation safety and security

Thales' Aerospace businesses serve three major markets: avionics, air traffic management, and simulation and training. Thales is European leader and ranks second or third worldwide in each of these markets. It is the only company in the world to cover the whole spectrum of air transport safety and security, from airborne electronic systems and equipment to turnkey airport facilities and crew training.

This unique positioning is a significant asset for the Group at a time when technological progress is leading to closer integration between these businesses. A striking example of this convergence is the system developed by Thales to combine traditional ground-based radar with satellite navigation for long-haul flights crossing oceans and sparsely populated areas. This system is already operational in Australia and a dozen other Asia-Pacific countries, and is currently being deployed in China.

The combination of onboard navigation systems and air traffic management systems on the ground is expected to bring significant improvements in air transport efficiency and safety. To support this goal, leading industry players launched the Air Traffic Alliance in 2002 under the auspices of the European Union. In 2003, the Alliance set up a single company, an Economic Interest Grouping, to formalise the cooperation between Thales, Airbus and EADS.

Through its dual positioning in civil and military avionics and simulation markets, Thales benefits from technical synergies and greater stability in terms of revenue growth and profits. Civil markets accounted for 65% of Thales aerospace revenues in 2003, with military markets accounting for the remaining 35%. The breakdown in 2002 was 69% civil, 31% military. The change is the result of an overall increase in military aerospace sales of more than 10% and a reduction of 8% in civil aerospace sales, mainly avionics and air traffic management, caused by the crisis that has affected the air transport sector since 2001.

Background to civil and military aerospace markets

- Overall, 2003 was a **difficult year for the commercial aerospace businesses**, with flagging economic growth in the developed countries, major geopolitical uncertainty, particularly with the war in Iraq, and events like the SARS epidemic in Asia, which had a negative impact on air transport volumes.

  However, this third consecutive year of declining air traffic (the down cycle in the early 1990s only lasted two years) contained some signs of hope: although the crisis deepened at the start of the year, as a result of Iraq and SARS, overall traffic volumes in the second half of the year returned to 2000 levels. As a result of this reversal, overall air traffic volumes in 2003 were only 1% lower than in 2002.

  Some segments and players in the civil aerospace market have suffered less than others from these years of low growth. A case in point is the **low-cost carriers**, which captured a significant share of the commercial air transport market and partially offset the decline in other business. Thales won a major avionics equipment contract for the 120 Airbus *A320s* ordered by EasyJet. Similarly, 2003 saw slightly higher sales of **regional jets**, whose operating cost structures can be more flexible.

  It is generally accepted that the **prospects** for the civil aerospace market are relative stability in 2004, ending three years of decline, with a recovery likely in 2005, most probably in the second half. The overall financial situation of the airlines remains fragile. They are generally expected to return to profitability in 2004 and to resume some investment in 2005.

- **The sharp fall of the dollar** against the euro was one of the significant developments of 2003 in this sector. Thales policy is to systematically hedge its exchange risk, and the Group has specific cover for its aerospace businesses. Thales is also engaged in a continuous effort to improve productivity and enhance the technical features of its aerospace equipment and systems, so as to remain competitive with respect to US competitors who gain from a weaker dollar. With its "multi-domestic" presence, the Group can serve dollar-denominated markets to some extent from its locally based operations. However, Thales does not underestimate the risk that some of its aerospace businesses, particularly air traffic management, might become less cost-competitive if the current exchange rate situation persists.

- Last year saw a **historic performance by Airbus**, which delivered more aircraft than Boeing for the first time. Thales is Airbus' primary avionics supplier, and thus improved its global competitive position as an aerospace equipment provider despite the down cycle in civil aerospace.

- **In military aerospace**, 2003 was also a varied year. On the one hand, activity strengthened on a number of major programmes, including the *NH90* and *Tiger* helicopters, for which Thales is supplying avionics and simulation solutions. On the other hand, other major programme milestones were delayed or postponed because of customers' budget restrictions. This particularly concerned European combat aircraft programmes, such as the *EFA*[1] and the *Rafale*.

  In military aerospace markets, Thales also benefits from its favourable position with Airbus: the new *A400M* programme was officially launched in June 2003.

(1) European Fighter Aircraft

AVIONICS

The Thales Group's avionics business serves the markets for flight electronics, in-flight entertainment systems and onboard power generation.

Avionics technologies have made considerable progress over the last decade. Cockpit avionics suites have developed into integrated systems to help the pilot make decisions. Avionic systems, which aim to improve flight control and safety, are making growing use of developments in IT and communications. As LCD screens have replaced cathode-ray tubes, cockpit displays have become more compact and the associated data processing more advanced. Before long, cockpit avionics suites will have enough built-in intelligence to analyse the pilot's needs and display data accordingly.

While the global aviation market remains fairly evenly split between civil and military aircraft, Thales generated two-thirds of its 2003 avionics revenues from the civil sector and one-third from the military sector, which is the same breakdown as in 2002. Thales' dual customer base in avionics has helped to sustain revenues despite the downturn in civil aviation since 2001.

The **civil aerospace market** remained depressed for a good part of 2003, but showed some signs of recovery towards the end of the year. Like other aerospace groups, Thales sees 2004 as a transition year and does not expect a full recovery to start before 2005. In this challenging context:

- One highlight of 2003 was that Airbus overtook Boeing in terms of both orders and deliveries, confirming a long-term trend towards parity between the two. Slowly but surely, the fleets of Airbus and Boeing aircraft in service will also move towards parity.
- Other highlights included continuing progress on the Airbus *A380* programme, which generated new orders, and the launch of the Boeing *7E7* programme, signalling confidence in the long-term recovery of the commercial aerospace sector.

As a leading supplier of avionic systems to Airbus, Thales is benefiting from the aircraft manufacturer's growing success, and has consolidated and expanded its share of the equipment market for the *A380* programme.

The **European military market** remains subject to fluctuations in defence spending, with further rescheduling on several programmes in 2003. The *A400M* military transport aircraft programme has, however, received the green light and is a major opportunity for Thales. Military helicopter programmes are developing successfully, with export sales of the *Tiger*, *NH90* and *A109* to countries including Australia, South Africa and Sweden.

In a highly competitive market where most contracts are denominated in US dollars, Thales pursued the strategies it launched several years ago to raise productivity and improve cost-competitiveness.

Overall, the aviation industry is set to grow and Europe is likely to play a leading role. Thales is one of the pillars of the European aerospace industry and in 2003 made a major contribution to the ACARE[1] plan to develop a long-term strategic approach to European aeronautical research. Thales is also contributing to the European Union's Sixth Research & Technological Development Framework Programme.

Flight electronics

No. 1 in Europe and No. 3 worldwide (behind Honeywell and Rockwell-Collins), Thales is one of only three companies with the resources to design and deliver integrated flight management systems, cockpit electronics, flight control and communication systems and navigation and surveillance equipment. The company offers a full range of advanced products and technologies (LCD screens, laser gyro inertial navigation systems, etc.) backed by proven experience in complex safety-of-life systems.

Commercial airliners

As a major supplier to Airbus, Thales won new contracts in 2003, particularly for the *A380*. This programme was launched in 2000 and the first *A380* is scheduled to enter service in 2006. The *A380*'s avionic systems will feature the latest innovations including multifunction *IMA* (Integrated Modular Avionics) systems and, for the first time on a commercial airliner, a door and slide management system. Thales also supplies liquid-crystal head-up displays for all Airbus aircraft.

Developments for the *A380* are proceeding on schedule, and a number of products, including the *FMS2* flight management system, have achieved certification. Developed jointly with Smiths, the *FMS2* system is proving a major technical and commercial success with airlines and is considered the industry benchmark for flight management systems.

Corporate and regional aircraft

Testing carried out in October 2003 on the enhanced vision system head-up display (HUD-EVS) further strengthened Canadian aircraft manufacturer Bombardier's confidence in its partnership with Thales. The Group also pursued detailed discussions with Russian aircraft manufacturer Sukhoi with a view to participating in the *RRJ* regional aircraft project.

(1) Advisory Council for Aeronautics Research in Europe

Commercial helicopters

In 2003, Thales set up a new website for commercial helicopter operators and manufacturers and signed a series of agreements with Eurocopter on support services for avionics suites in various countries, including the United States. These agreements allow Eurocopter to expand its customer services.

Military aircraft and helicopters

2003 saw the official kick-off of the A400M programme, on which Thales is well positioned. Also in 2003, Venezuelan Air Force *C-130*s with modernised cockpits entered service, and the first *TopOwl*® helmet-mounted sight/displays for 180 *Cobra* and 100 *Huey* helicopter pilots were delivered on time to the US Marine Corps. The quality and technical performance of Thales products are now recognised in the most competitive and least accessible market in the world.

In-flight entertainment

The Group acquired this California-based business in 1999 to provide airline passengers with a full range of multimedia services including films, games, communications, laptop power and Internet access. Its most recent line of products, *Top Series*, offers passengers a totally interactive in-flight experience and features four versions of each product tailored to airlines' needs. Some of these products feature in the standard Airbus and Boeing catalogues. In 2003, several airlines chose Thales in-flight entertainment products.

Power generation

Thales designs, develops and produces onboard generators and power generation systems developing 0.5 to 120 kW. The company also produces static converters and electric motors for aircraft, naval vessels and land vehicles.

Thales is the world's leading supplier of onboard power generation systems for regional and corporate aircraft, the main supplier for all French military aircraft (including the *Mirage* and *Rafale* ranges) and a key supplier for the entire Eurocopter range of civil and military helicopters. Thales is one of the world's top three suppliers of electrical equipment for commercial aircraft.

In 2002, Thales was selected to supply the Auxiliary Power Unit starter motor for the *A380*. This success follows the contract awarded in 2001, in partnership with Goodrich (formerly TRW), to supply variable-frequency power generation systems for the *A380*.

Thales has also strengthened its position in emerging markets in the CIS and China, winning power generation equipment contracts for several regional airliner programmes.

SIMULATION & TRAINING

Thales is a world leader in simulation and training, ranking No. 1 in Europe and No. 2 worldwide behind Canadian company CAE. Its broad range of expertise and applications covers:

- training services for military customers
- simulators, from desktop units to full-flight simulators for civil and military fixed-wing aircraft and helicopters, military vehicles and land-based systems, trucks, nuclear plants and maritime applications
- modelling, simulation and synthetic environments (MS&SE) to design complex systems.

The simulation and training business has facilities in the United Kingdom, France, the United States and Australia. Thales also maintains a worldwide network of service centres to remain close to its commercial aviation clients and their training needs.

In recent years, Thales has generated a large proportion of its simulation and training revenues in military markets, primarily through its growing involvement in training services for fighter pilots. With its dual customer base, Thales has achieved satisfactory sales and profits despite the downturn in civil aerospace.

In **military simulation**, the start of a large-scale training programme for *Tornado GR4* crews strengthened Thales' position as a key service provider to the British armed forces. Thales is now the leading provider of synthetic training services for British military aviation, largely under innovative financing arrangements including PFI (Private Finance Initiative) contracts. Under these contracts, military customers can fund complete, fully integrated synthetic training programmes spanning several years or even decades.

In 2003, Thales also received an order worth €76.5 million for the supply and installation of a *TACTIS*(1) system for the Royal Netherlands Army. The system will be used to train infantry units and Leopard tank battalions in a highly sophisticated virtual and mobile environment.

Demand for **civil simulation** products and services remained buoyant despite the general slowdown, allowing Thales to confirm its leadership in this sector. Highlights of the year include large orders from Lufthansa, Malaysia Airlines, Egypt Air and ANA. Thales also launched the *Fidelity Systems Trainer*, a low-cost, easy-access system designed for a specific segment of the pilot training market. The first *Fidelity* trainers are already in service with North West Air's simulator centre in North America.

Thales booked significant orders for flight simulators from KLM, Singapore Airlines and Air France, and for truck simulators from leading European training providers.

In line with most other civil aerospace companies, Thales does not expect to see a significant recovery in 2004. Longer-term, the Airbus *A380* and Boeing *7E7* airliner programmes, and new regional and corporate aircraft now being developed by Bombardier and Embraer, should strengthen the recovery in commercial business.

(1) TACTIS: Tactical Indoors Simulation System

AIR TRAFFIC MANAGEMENT

Thales is No. 1 in Europe and No. 3 in the world in this market, and has a long background in air traffic management and a comprehensive range of products and services:

- **Sensors, control centres, navaids and landing equipment.** Thales has customers in 170 countries and the largest installed base of equipment in the world outside the United States. Its two main competitors, Raytheon and Lockheed Martin, have most of their customers in their extensive domestic market. Thales' capacity to provide a comprehensive response to customers' requirements hinges on an efficient multi-domestic organisation. Through its facility in Melbourne, for example, Thales is benefiting from new opportunities in the Asia-Pacific market.
- **Control centres and prime contracting for major complex systems.** Thales' recognised capabilities in air traffic management meet both current and future market needs, especially with the expected shift towards regionally integrated systems. The other major players in this sector include both European and US companies.
- **Customer services** to meet growing pressure on customers to increase the profitability of their operations. This growing demand should generate additional revenue streams from management of ATM installations. Thales expects this trend to continue throughout the world as airlines move to cut their infrastructure management costs.

In 2003, at a time when many air traffic management operators were cutting back or postponing their investment programmes, Thales confirmed its world leadership outside the North American market. Among the many contracts signed in 2003 were orders for control centres and radars (Australia, Czech Republic, Dubai, Finland, Hungary, New Zealand, Slovakia, Vietnam) and for navaids in Algeria, Italy and Latin America.

In control centres, 2003 saw the final acceptance of major centres in Finland, Ireland and Sweden. Acceptance testing milestones were achieved for the control centres being installed in China and for approach radars for Brazil.

Thales also launched large-scale development of new-generation flight plan processing systems for France and Italy, in cooperation with AMS in Italy. Systems developed as part of this programme (*EDFP/FI*[(1)]) will provide the capacity to accommodate traffic growth in the next twenty years. Thales is drawing on a full range of capabilities, particularly in communication techniques, to develop the new system.

Air Traffic Alliance

Airspace control, safety and security are key issues for governments, airlines and passengers alike. One major challenge in Europe today, as illustrated by initiatives by the European Union, Eurocontrol and national civil aviation authorities, is to develop an efficient air transport system capable of managing traffic volumes that are expected to triple in the next twenty years. The European Commission's Single European Sky initiative, launched in 1999, aims to unify and streamline air traffic management systems in Europe while improving safety and security standards.

Europe's aerospace industry leaders, Thales, Airbus and EADS, formed the Air Traffic Alliance in 2002 and consolidated their cooperation by forming an Economic Interest Grouping in June 2003. Their objective is to achieve close cooperation with airspace users, air traffic operators and all the other players involved. The Air Traffic Alliance plans to invite other European players to join and open up dialogue with North American partners. Specifically, it aims to:

- speed the deployment of new technologies;
- supply a comprehensive solution for increasing air traffic capacity;
- improve compatibility between aircraft systems and ATM systems on the ground on a worldwide basis, and increase efficiency through optimised, environmentally sensitive routing.

Airbus brings its experience as an aircraft manufacturer, EADS its expertise in satellites and other aerospace technologies, and Thales its know-how in air traffic management systems and onboard electronics. Drawing on these pooled competencies, the partners submitted a programme proposal to the European Commission in 2003 for deployment of the Single European Sky initiative.

(1) European Flight Data Processing/France Italy

Information Technology & Services

SECURE OPERATIONS

Thales has capitalised on its extensive skills and solid reputation in the defence and professional security sector to become a major player in the global market for security solutions for businesses and governments.

In response to the shift in demand from security products to complete security solutions and more integrated security services, Thales has become a major provider of end-to-end security solutions for corporations and governments. The Group's strength lies in its capacity to use a range of "transverse" technologies developed for both civil and military markets. Thales implements innovative technologies to maintain national security, protect people and property, make commercial transport safer and secure data networks and electronic transactions for large-scale, high-capacity information systems. In addition, the Group provides a full range of consulting, integration and security management services.

Thales focuses on four main areas in the security field:

- Networks and communications security,
- Secure payments and transactions,
- Secure transport systems,
- Secure identification systems, security of physical infrastructures and protection from nuclear, biological, and chemical threats.

Network and communications security

Protecting sensitive communications networks is a key issue for governments. Over the past decade, Thales has forged a strong position in this field globally and is market leader in Europe. The Group has continued to build on its skills and develop its product offering, often by leveraging expertise acquired in securing networks for military communications. By drawing on its dual-use technologies, Thales meets the needs of large manufacturing and banking groups as well as government and defence customers.

The Group's multi-domestic approach is an additional advantage shared by very few European players in the field. Thales already has extensive local teams working in the security field in France, the UK, Norway, the United States and Hong Kong.

European leader in the high-security protection of information networks, Thales has developed its range of cryptographic products and systems to take into account the most stringent confidentiality and secrecy requirements of defence applications. The Group is thus capable of accompanying government customers throughout the lives of their programmes. In France, the Group has also developed a range of IT security services covering systems integration and security consulting for major companies, government agencies and administrations.

Highlights of 2003 include the launch of the new *Guardisk* system for protecting sensitive data stored on UK government laptops. Guardisk is a hard-disk encryption device that renders the computers completely inoperable if lost or stolen.

Thales was also selected to be part of an industry team responsible for the development phase of the UK Ministry of Defence's *Falcon* programme. The programme aims to develop an information processing infrastructure, and is a key stage in the process of providing Network Enabled Capability (*NEC*) for the British Armed Forces.

Reuters UK also chose Thales to provide security for the screens it installs on customer premises.

In line with new European legislation, governments are expected to control the operations of transport companies more closely. The French government will soon require all commercial vehicles to be equipped with onboard digital tachographs to record driving times and rest periods, and has selected Thales to design and develop the encryption system for these devices.

Secure payments and electronic transactions

- The Group's offering in the field of **payment security** includes equipment, software and encryption systems for electronic transactions and credit card and Internet payment systems, all of which call on its cryptographic expertise.

  For years, payment security was based on simple magnetic stripe card technology and security systems installed in back and middle offices. However, fraud has risen to such dramatic levels that banks, merchants and credit card organisations have joined forces to set up new security standards to regulate all payment transactions worldwide. The development of smart card technology and related infrastructure is one of the best examples of this move towards tighter security standards.

  Thales has stayed abreast of all the major changes in payment systems over the years, and has led the way in introducing new security technologies, building on the Group's good relations with the major players in the field: Visa, Mastercard and the other main financial institutions involved.

  Thales is one of only a few worldwide players with a product offering that provides end-to-end payment security. For the back office, Thales has developed equipment security modules and pre-personalisation solutions to guarantee secure data entry onto smart cards. Its solutions are among the best on the market and have made Thales a world leader in this field. For middle office customers, Thales has acquired an authentication platform to validate and authorise millions of transactions each day. Finally, for front office customers, Thales has developed cryptographic mechanisms to validate *EMV* (Europay, Mastercard, Visa) certificates for Internet and point-of-sale payment systems.

- On the **electronic fund transfer** market, the Group's offering includes payment terminals such as the advanced *Artema* terminals, as well as transaction security products and associated services. The international EMV (Europay, Mastercard, Visa) smart card standard plays a major role on this market.

  In 2003, Thales was the first company ever in France to obtain *EMV* certification for electronic fund transfer software. As a result, the French bank Société Générale chose Thales to equip its business customers with electronic fund transfer solutions. The project, known as *Progecarte*, demonstrates the banking world's wide acceptance of the *Artema* platform developed by Thales.

The group also reinforced its position in China with the signing of a distribution agreement with China Union Pay Merchant Services. Last but not least, Thales continued to develop its offering of GSM payment solutions, a promising market. One of the most important customers to sign on in 2003 was the police department of the German federal State of North Rhine Westphalia, which uses Thales terminals for on-the-spot payment of traffic tickets.

Secure systems and solutions for the transport industry

In Transport & Services, Thales supplies all the components of a complete fare collection system: access control gates, onboard validators, automatic ticket vending machines, hand-held control devices, ticket reinitialisation and recycling systems as well as information systems in stations and central control rooms. Thales has also introduced new payment devices such as rechargeable magnetic cards and contactless smart cards.

- **On the market for fare collection systems for public transport,** Thales won major contracts in China, Norway, France and the Netherlands. The public transport operator of the city of Oslo chose Thales to supply the smartcard fare collection system for its entire urban transport network. In cooperation with a local manufacturing company, Thales also developed the ticketing system for public transport in Nanjing, China. In late 2003, the East West Consortium led by Thales, Accenture and Vialis announced that it would supply a completely contactless secure integrated fare system to be used by multiple transport operators across the Netherlands. The consortium is the first player to provide a countrywide multi-transport solution.
- Thales also provides **systems and solutions for safe and efficient transport networks**, using GPS technology in particular for electronic toll collection, urban traffic management, passenger information systems and public parking. The Group provides professional **telematics** services and systems to manage fleets securely and track stolen vehicles. With a broad customer base in sectors as varied as distribution, overland transport, public services and infrastructure, mail delivery services, transport of valuable objects and security and police forces, Thales supplies turnkey solutions covering the entire telematics chain. In this field, the Group relies on its expertise in *GPS*, *GLONASS* (the Russian global navigation satellite system) and *GSM* technologies.

  In 2003, Thales and China SpaceSat set up the joint venture AeroThales to develop telematics solutions using *GPS* and *GSM* technologies for the Chinese market. These solutions are aimed at customers in both the public and private sectors. Thales Telematics launched its French operations in 2003, and is expected to benefit from the high growth forecast for this field in the next few years, as well as from the Group's involvement in the Galileo project.

Identification systems for individuals, physical infrastructure security and nuclear, biological and chemical threat detection

This area of the security market has become a key concern for public authorities faced with terrorist threats and attacks. In the United States, $41 billion were allocated to **Homeland Security** in 2003, a 10% increase on 2002. Governments throughout the world are estimated to have spent approximately $550 billion in 2003 to protect their countries from terrorist acts, and this amount is expected to rise by at least 20 billion dollars between now and 2005. Thales was one of the first to recognise the strategic importance of these new risks, which are characteristic of the new worldwide geopolitical situation.

In 2003, Thales built its approach to the territorial and collective security market around a product and system architecture known as **Thales SHIELD**™ (Strategic Homeland Intelligence and Electronic Deterrence), a comprehensive offering based on preventive security products, software, systems and services and real-time operation. With this integrated offering of advanced solutions, the Group serves multinational corporations and governments and covers a wide range of security markets and applications.

In the markets for civil security, enterprise security and sensitive site security, Thales is one of the world's main suppliers of secure identification systems, site security and surveillance systems and NRBC (Nuclear, Radiological, Biological and Chemical) threat detection.

- Building on its expertise in **ID card design and biometrics**, the Group has developed high-security identification systems in over twenty countries. In 2003, Thales signed a new contract for an additional segment of a secure drivers' licence programme implemented for the South African Transportation Ministry over the past few years. The new segment includes systematic use of biometric identification techniques.
- In the field of **security systems for sensitive sites and infrastructures**, Thales acts as a systems integrator and supplier of customised security solutions including access control, video surveillance, intrusion detection and multi-site supervision systems.

  In particular, Thales has won contracts to secure the technical sites of oil and gas pipelines and pumping stations in several Middle Eastern countries. Thales has also supplied and installed a complete surveillance and protection system for the Louvre Museum in Paris.
- The Group's expertise in **NRBC detection for military authorities** is widely recognised in Europe, and in 2003 earned Thales a new contract with the German Navy for the installation of a biological threat detection system. In France, Thales is conducting pilot studies on NRBC detection in airports, and was awarded a major new contract by the French defence ministry to set up an NBC command and control system to protect sites and monitor NRBC threats and attacks.

INFORMATION SYSTEMS

With 40 local agencies in seven countries in Europe, Thales is a major player in the European IT services market. The company focuses on three main types of services:

- consultancy for information systems strategy and management,
- integration,
- outsourcing.

Thales has a broad customer base in finance, industry, the public sector and the services sector.

The revenues and financial performance of Thales' information systems business put it on an equal footing with the major players in the IT field, and its order book is particularly solid.

Since information systems must meet increasingly high security standards, there is a major market for the protection of IT assets, and the ability to provide this protection is a competitive advantage for any IT services company. Information systems and their security are critical to the operation of any business or organisation. IT service providers must therefore maintain a strong local presence close to their customers to benefit from the strong growth in the market for **IT outsourcing**.

In addition, the need for unified, flexible systems has led to the development of a **"portal offering"**. Through a portal, members of a project team gain immediate access to relevant resources via a single interface and use collaborative technologies to work together. Lastly, increasing pressure on costs has generated demand for information systems with low operating costs.

With its **solid know-how in systems security**, Thales is well positioned on these new markets. An extensive network of agencies provides the local presence that customers need, and also enhances the company's capacity to provide high-quality technical services by linking centres of excellence throughout the world.

In 2003, Thales pursued its international expansion. A centre of excellence for transport systems was opened in Singapore to meet demand related to public transport networks in the Asia-Pacific region.

The Group pursued its development in the strategic market for **IT outsourcing** (partial or total management of a company's IT systems). Thales increased its share of the outsourcing market, which is experiencing particularly strong growth in Europe. The Group also expanded its portal offering and developed solutions based on low-cost systems.

In 2003, Thales won a number of significant contracts in its four main markets:

- In the **financial sector**, for example, Thales has high-profile customers including BNP Paribas, Deutsche Bank, HSBC and Generali. In 2003, the Group developed an In-Shore™ portal for BNP Paribas that allows the bank to optimise the costs of the online banking system it operates for large corporate and institutional customers. This *In-Shore*™ system is managed from Barcelona. It provides an alternative to traditional offshore solutions, which rely on development and security resources in low-cost countries like India.

  Thales provided security solutions for Reuters terminals in 2003. The Group is also actively involved in setting up finance and management systems for the new IAS/IFRS and Basel II accounting standards.
- Thales developed a number of distribution network management portals for **industrial customers** in 2003. For example, Thales has developed a "Dealer Service Portal" to provide integrated management for Toyota France's dealership network. The contract signed by Toyota for its French dealerships will eventually cover the automaker's entire European network. The portal offering rounds out a broad range of products and services for the automotive sector, which includes secure fleet management systems and onboard information systems.
- In the **services and infrastructure sector**, Thales is providing a computerised surveillance system for 9,000 kilometres of gas pipelines in two parts of Russia, as part of a 100 million euro contract with Gazprom. Thales was also chosen to equip 150 London Underground stations with computerised surveillance systems and won a major contract to develop the traffic management system of the Caracas metro. These new contracts are part of a long list of achievements by the Group in the transport systems field, including the systems developed for Mexico City, Santiago de Chile and Canton.
- For its **public sector and government customers**, Thales continued to develop the online services portal for the French tax authority. This is part of a major modernisation project by the French administration designed to provide taxpayers with a comprehensive online tax management solution (information, filing, payment, claims, tracking and personalised services). Thales is also developing the social security management system in Spain. The company also implemented the information systems for the Georges Pompidou European Hospital and the French national library.

Many of the positive developments in 2003 are expected to continue in the coming years. Outsourcing, in particular, is a priority for Thales because the market is expanding and profitability is good.

The e-government market is also expected to show significant growth as governments and administrations modernise and rationalise their processes. Thales is adopting a similar approach with European institutions, particularly as part of the "*e-Europe 2007*" initiatives, with a dedicated Thales team assigned to the project. EU expansion is also generating opportunities for Thales as new member states develop their information systems at national level. Thales will draw on the combined system integration expertise of the entire Group to benefit from these opportunities.

OEM SOLUTIONS [1]

In this field, the Thales offering covers three main areas:

- **products and services for OEM customers** in the fields of transport, defence, health, telecommunications and security;
- **system integration solutions** for radio and television broadcasting, and for distribution and multimedia management;
- **consulting services and engineering solutions** for these markets.

Products and services for OEM customers

- In **electron tubes**, Thales is world leader, ahead of the American companies CPI, E2V and Litton, and Toshiba of Japan. Electron tubes are key components in a wide variety of products, particularly radar systems, satellites and medical imaging equipment.

  Technologically, Thales has a significant lead in electron tubes for satellite telecommunications and broadcasting. The Group is involved in most of the large international satellite programmes and with major manufacturers in the field, including Alcatel Space, Astrium, Boeing, Lockheed Martin and Loral.

  In 2003, demand was particularly strong in the radiology, scientific research and defence sectors. Thales has continued to record satisfactory growth in defence markets, particularly in Asia. The Group maintained its world market leadership for X-ray image intensifiers and high-definition X-ray camera tubes. For projects in this sector in China, the Group relies heavily on its Shanghai subsidiary, established in 1996.

  Trixell, jointly owned by Thales (51%), Philips (24.5%) and Siemens (24.5%), has confirmed its leadership in the market for flat digital detectors, with products in operation in over 200 medical radiology facilities worldwide. The first prototype digital detectors for dynamic cardiac imaging have successfully completed clinical trials in a number of European hospitals and are now available on the market.

  Thales is also making significant headway in tubes for scientific and applied research, particularly with its range of power sources for particle accelerators and applications for radiotherapy and food safety (sterilisation and quality control).

- Thales is France's second-largest manufacturer of **microelectronics** products, with a range including decoder subassemblies, components for payment terminals, mobile telephones, GPS receivers and various equipment for defence and aerospace applications.
- In 2003, Thales consolidated its leadership in **microwave modules** for defence equipment.
- United Monolithic Semiconductors (UMS), the 50-50 subsidiary set up by Thales and EADS to develop **gallium arsenide technologies**, is the European benchmark in this field, with applications in the automotive, telecommunications, defence and space sectors.
- **Thales Computers**, with facilities in Europe and the United States, is one of the world's leading producers of single board computers and high-quality, high-performance computing systems based exclusively on open hardware and software standards. These computers play a critical role in military radar, sonar and C3I systems and in advanced telecom and transport systems.

System integration

Thales provides telecom system integration solutions and services, particularly for broadcasting and communication systems.

- A major international player in digital audio, digital video and interactive broadcasting systems, Thales Broadcast & Multimedia specialises in equipment, systems and solutions for **terrestrial radio and television broadcasting, digital image processing and multimedia distribution**.

  Thales Broadcast & Multimedia has deployed its systems in over 170 countries and its customers include the major satellite and cable broadcasting operators in the United States, Europe and the rest of the world. The Group has become the supplier of choice as the industry pursues its transition towards digital television. Thales is already positioned in the emerging market for interactive television, for both consumer and professional applications. However, installation of broadcasting infrastructure for digital television has not yet begun in earnest: plans to deploy the new terrestrial infrastructure required and to upgrade and modernise existing infrastructure have been pushed back.

  In addition to its activities on the television and radio broadcasting markets, Thales has developed its video distribution business and is now the world leader. At the end of 2003, France Telecom chose the Group to develop its new video-over-ADSL offering, "*MaLigne TV*", which relies on the *SmartVision TV*™ platform designed by Thales.

(1) OEM: Original Equipment Manufacturers

Services

- Thales is the United Kingdom's leading supplier of **telecommunications services and integrated information systems for transport**, especially rail transport. In transport solutions, the Group develops, installs and maintains private lines and radio installations for the major British railway operators and the London Underground. Thales is drawing on its know-how in telecommunications for transport networks to expand into new markets. For example, the Group won a contract to maintain telecommunications equipment in the Palace of Westminster, the seat of the British Parliament.
- Thales also holds 33% of the private UK consortium **Citylink**, which won the prestigious twenty-year *Connect* contract in 1999 to replace the London Underground's radio systems. The programme is part of a Private Finance Initiative (PFI), a financing solution that the British government is adopting for a growing number of public contracts.
- In recent years, **Thales Engineering & Consulting** has become increasingly specialised in managing equipment installation projects in sectors where high standards of quality, safety and environmental protection are critical. In construction and industrial processes, major contracts include assembly lines for the *M51* missile, restructuring of Sanofi Synthelabo's pharmaceutical laboratories in Morocco, and the new hospital complex in Grenoble, France, for which the company has been appointed prime contractor. In transport, Thales is involved in the engineering of most of France's new light rail systems, including those in Clermont Ferrand and Le Mans, and a number of infrastructure projects around the world including the vast Egnatia motorway project in Greece and new transport systems in Cameroon.

INTERNATIONAL PRESENCE

Exports have historically played a major role in the business of Thales. In recent years the Group's international presence has expanded significantly, combining "multi-domestic" operations – international subsidiaries operating within their national territories – with export business. This can be seen from the geographical breakdown of the 2003 figures:

Breakdown by region

	Revenues Origin	Revenues Destination	Consolidated staff at 31 December
France	55 %	26 %	56 %
United Kingdom	16 %	12 %	18 %
Other Europe	12 %	20 %	13 %
Rest of world	17 %	42 %	13 %
Total	€10,569m		57,439

Although France is the Group's main country of operation in terms of facilities and customers, nearly half its revenues come from other countries, led by Thales UK, which contributed 16% to consolidated revenues in 2003, compared with 18% in 2002. The lower year-on-year ratio is entirely attributable to the 10% drop in the value of sterling against the euro.

International presence in figures

KEY FIGURES OVER FIVE YEARS

In million of euros, except for staff

2003	France	United Kingdom	Other Europe	Rest of world
Revenues by destination	2,774	1,242	2,069	4,485
Revenues by origin	5,841	1,725	1,239	1,765
Order book	6,244	2,930	3,260	6,309
Consolidated staff (1)	32,219	10,521	7,630	7,069

2002	France	United Kingdom	Other Europe	Rest of world
Revenues by destination	2,602	1,461	2,049	4,993
Revenues by origin	5,904	1,919	1,235	2,047
Order book	5,565	3,503	3,123	6,818
Consolidated staff (1)	33,236	11,478	7,791	8,157

2001	France	United Kingdom	Other Europe	Rest of world
Revenues by destination	2,553	1,491	1,976	4,248
Revenues by origin	5,191	1,950	1,179	1,948
Order book	5,298	3,533	3,470	7,443
Consolidated staff (1)	33,923	12,457	8,011	8,103

2000	France	United Kingdom	Other Europe	Rest of world
Revenues by destination	2,245	970	1,894	3,470
Revenues by origin	5,126	1,158	1,050	1,246
Order book	4,040	2,755	3,306	8,265
Consolidated staff (1)	32,687	11,392	7,972	5,261

1999	France	United Kingdom	Other Europe	Rest of world
Revenues by destination	2,204	569	1,651	2,465
Revenues by origin	4,825	606	917	542
Order book	3,394	1,543	3,086	7,405
Consolidated staff (1)	33,571	4,671	7,880	2,800

(1) Consolidated employee numbers include all employees of consolidated companies, and prorated figures for companies carried under the proportionate method. They do not include the employees of companies carried under the equity method and unconsolidated companies.

GEOGRAPHICAL BREAKDOWN OF REVENUES

Revenues by destination	2003	%	2002	%	2001	%
France	2,774	*26%*	2,602	*23%*	2,553	*25%*
United Kingdom	1,242	*12%*	1,461	*13%*	1,491	*15%*
Other Europe	2,068	*20%*	2,049	*19%*	1,976	*19%*
Total Europe	**6,084**	***58%***	**6,112**	***55%***	**6,020**	***59%***
North America	926	*9%*	1,154	*10%*	1,230	*12%*
Middle East	1,473	*14%*	1,737	*16%*	1,252	*12%*
Asia-Pacific	1,543	*15%*	1,481	*13%*	1,313	*13%*
Africa and Latin America	399	*4%*	471	*4%*	334	*3%*
CIS and Central Asia	144	*1%*	149	*2%*	119	*1%*
Total international	**4,485**	***42%***	**4,993**	***45%***	**4,248**	***41%***
Total	10,569	*100%*	11,105	*100%*	10,268	*100%*

MAJOR OPERATIONAL SUBSIDIARIES

The companies listed below are wholly owned subsidiaries of Thales.

The figures given below correspond to total revenues reported by the subsidiary, including sales to other units in the Thales Group. Data as at 31 December 2003.

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
Operations	Elancourt, Trappes, Brest, Pessac
Revenues 2003	€1,070m
Employees end 2003	5,234
Shareholdings (selected) :	50% of Consorzio Sigen, 49% of Cert Thales Institute , 50% of Ericsson-Thales-AEW-System,

Thales Naval SA

Naval systems

Registered Head Office	7-9 rue des Mathurins 92220 Bagneux – France
Operations	Bagneux
Revenues 2003	€962m
Employees end 2003	421
Shareholdings (selected) :	50% of UDSI, 50% of Armaris, 25% of Eurosysnav SAS 25% of Horizon SAS

Thales Communications SA

Information and communication systems

Registered Head Office	160 boulevard de Valmy 92700 Colombes - France
Operations	Colombes and Gennevilliers corporate functions and R&D Brive, Cholet, Laval, Marcq-en-Barœul, Massy (operations)
Revenues 2003	€1,038m
Employees end 2003	4,970
Shareholdings (selected) :	50% of Sapura Thales Electronics (Malaisie), 33% of TAC ONE, 25% of Euromids

Thales Avionics SA

Flight electronics

Registered Head Office	1 avenue Carnot – 91833 Massy - France
Operations	Bordeaux-Le Haillan, Meudon, Châtellerault, Toulouse, Valence, Massy, Vendôme, Moirans
Revenues 2003	€777m
Employees end 2002	3,892
Shareholdings (selected) :	100% of Thales Avionics Asia Pte Ltd, 100% of Thales Avionics Canada Inc, 99,5% of Thales Avionics LCD SA, 49% of Diehl Avionik Systeme GmbH, 34.6% of Thales Canada Inc.

Thales Nederland BV

Defence systems, primarily naval

Registered Head Office	Zuidelijke Havenweg 40 7554RR Hengelo – Pays-Bas
Operations	Hengelo
Revenues 2003	€564m
Employees end 2003	1,440
Shareholdings (selected) :	100% of Thales Naval GmbH, Thales Communications BV, Thales Munitronics BV, Thales Optronics BV, Thales Cryogenics BV, NCSS (Malaysia)

Thales Air Defence SA

Ground segment detection and missile control systems

Registered Head Office	7-9 rue des Mathurins 92220 Bagneux - France
Operations	Bagneux, Fleury-les-Aubrais, Limours, Conflans, Rouen
Revenues 2003	€519m
Employees end 2002	2,309
Shareholdings (selected) :	50% of Cosyde, 77.5% of Thales Systems Ireland Ltd, 50% of MOSS SAS, 33.33% of Eurosam

MAJOR MANUFACTURING SITES

These details refer to "managed" staff, including all employees of proportionately consolidated companies.

At 31 December 2003, 60% of employees in France worked at sites in the Paris region, Ile-de-France; next came Brittany with 8%, Rhône-Alpes (over 6%), Aquitaine (nearly 6%), and Provence-Alpes-Côte d'Azur, Centre and Pays de Loire (between 3% and 4%). Ile-de-France's preponderant position varies from business area to business area: 59% of Thales employees in the Paris region work for Defence, 29% for IT&S, and only 12% for Aerospace. Of Thales Aerospace employees, 11% work near Airbus operations in Aquitaine.

Twelve sites (including neighbouring sites in the same city) had more than 1,000 employees at end-2003, accounting for 36% of the total managed staff:

At 31 December 2003	Employees	Subsidiary
In France	**14,846**	
Colombes (1)	3,131	Thales Communications SA
Elancourt (1)	3,019	Thales Systèmes Aéroportés SA
Bagneux (1)	2,301	Thales Air Defence SA Thales Naval France SA Thales ATM
Brest	1,675	Thales Systèmes Aéroportés SA Thales Underwater Systems SA
Massy (1)	1,499	Thales Raytheon Systems Thales Microwave SA Thales Microélectronique Thales Communications SA ACSI Thales Security & Supervision
Malakoff (1)	1,133	Thales Information Systems Finance
Guyancourt (1)	1,107	Thales Optronique SA Thales Laser SA
Vélizy (1)	1,518	Thales Avionics SA Thales Electron Devices SA
Toulouse	1,102	Thales Avionics SA Thales Information Systems SA
In the United Kingdom		
Crawley	2,377	Thales Sensors Thales Training & Simulation Ltd Thales Communications Thales Information systems
In Australia		
Garden Island	2,525	ADI Ltd
In the Netherlands		
Hengelo	2,001	Thales Nederland BV
Total staff at named sites	**21,749**	

(1) In Paris region

International operations

The Group’s expansion outside France had been marginal until the end of the 1980s, when it acquired, in 1990, 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. At the late 1990s, the Group moved outside Europe to Australia, South Korea, South Africa and Singapore (see table).

Over ten years, the Group’s footprint has radically changed: the proportion of employees in international subsidiaries has risen from less than 20% at end-1993 to 44% at end-2003. The United Kingdom confirmed its position as the Group's second country of operation and has accounted for 20% 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 5.3% of the workforce and is the Group's third-largest country of operation in terms of numbers of employees, followed by Germany, the Netherlands and the United States.

Employees at 31 December	**2003**		**2002**		**2001**	
France	32,219	*56%*	33,236	*55%*	33,923	*54%*
United Kingdom	10,521	*18%*	11,478	*19%*	12,457	*20%*
Other Europe	7,630	*13%*	7,791	*13%*	8,011	*13%*
North America	2,128	*4%*	2,575	*4%*	2,675	*4%*
Latin America	6	*0%*	290	*0%*	106	*0%*
Africa	357	*1%*	471	*1%*	444	*1%*
Middle East	30	*0%*	110	*0%*	97	*0%*
Asia-Pacific	4,537	*8%*	4,704	*8%*	4,774	*8%*
Rest of world	11	*0%*	7	*0%*	7	*0%*
Total	**57,439**	***100%***	**60,662**	***100%***	**62,494**	***100%***

In many cases, the Group’s geographical expansion in defence markets has begun with 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.

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 the new subsidiary’s position in its original field, corporate policy is that each company should expand its field of competence to include all Group businesses.

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 the extensive competencies of these companies.

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.

MAIN INTERNATIONAL ACQUISITIONS AND EQUITY INVESTMENTS SINCE 1990

Year	Company	Field of business	Country	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	Ferrant
	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 ground-to-air missile systems	United Kingdom	Bombardier
	Hugues Rediffusion Simulation Ltd	Flight simulators	United Kingdom	Hugues 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
	JV Thomson Marconi Sonars	Anti-submarine warfare	United Kingdom, Australia	50% of GEC Marconi
	27% of Elettronica (to 33% in 1998)	Airborne electronic warfare	Italy	73% Finmecanica 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 (rest acquired in 2000)	Optronics	United Kingdom	Pilkington
	50% of African Defense Systems - ADS	Defence electronics	South Africa	South African government
	Contribution from 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 (rest acquired in 2000 and 2001)	Optronics	Singapore, United Kingdom	Alvis (and financial markets)
	50% of Australian Defence Industries -ADI	Defence electronics	Australia	Australian government 50% Transfield
	Thales In-Flight Systems	In-flight entertainment	USA	BE Aerospace
	Samsung Thales Electronics	Defence electronics	South Korea	
2000	Racal Electronics Plc.	Defence and professional electronics	United Kingdom	OPA
	Remaining 50% of Short Missiles (=>100%)	Very short range ground-to-air missile systems	United Kingdom	Bombardier
	JV Thales Raytheon Systems	Air defence	France/USA	Raytheon
2001	Magellan Corp.	GPS products	USA	
	Remaining 50% in Thales Marconi Sonar	Anti-submarine warfare	United Kingdom	BAE

Business highlights from three of the Group's major countries of operation – the United Kingdom, the Netherlands and Australia – are presented here as examples.

THALES IN THE UNITED KINGDOM

Thales UK revenues generated outside the Group in 2003: €1,725m

Revenues generated in the United Kingdom in 2003: €1,242m

Managed employees end-2003: 10,675

Although the first Thomson-CSF marketing operation in the United Kingdom dates back to 1973, the United Kingdom became the Group's second-largest country of operation after France in the 1990s, and particularly after the acquisition of Racal Electronics in 2000.

All the Group's defence businesses in the United Kingdom were merged and reorganised in 2002 as Thales Defence UK. These businesses have various origins and therefore cover a broad spectrum of activities, including simulation, optronics, very short range missiles and missile systems, airborne equipment and military communications. Thales Defence UK also provides the British armed forces with the full range of Thales competencies in the land-based, naval, airborne and joint sectors.

Thales UK has five major research and development centres, focusing on networks and secure communications, navigation and location for the *Galileo* programme, data analysis and encryption, and synthetic environments for simulation applications. For this work, Thales cooperates with numerous British laboratories and research centres, including the universities of Cambridge and Surrey, and Imperial College.

- For the **Royal Navy**, Thales is taking part in the upgrade of *Sea King Mk7* helicopters and *Hunt* minehunters, is fitting out the nuclear submarines in the *Astute* programme, and has developed numerous systems and equipment types for *T45* destroyers. In 2003, Thales and BAE Systems were selected by the Ministry of Defence for its flagship *CVF* [1] programme, under which two new aircraft carriers will be developed for the Royal Navy. The customer chose the design proposed by Thales for the new carriers.
- In **land-based systems**, Thales is servicing the *BGTI* (Battle Group Thermal Imaging) contract and continuing production of its *Starstreak* laser-guided missile. In 2003, Thales Defence UK was down-selected for the assessment phase of the *FIST* [2] programme to equip UK infantry soldiers.
- In **airborne systems**, Thales was down-selected in early 2003 for the first phase of the *Watchkeeper* tactical UAV programme for the British Army. Thales is also a member of the Eurotanker consortium selected in January 2004 for the Royal Air Force's *FSTA* [3] tanker programme.
- In **aerospace**, Thales is providing training for all Royal Air Force pilots under a 22-year PFI (Private Financing Initiative) contract signed in 2001.
- Thales UK is also involved in a number of civil markets, particularly for **safety and security**: transport (including the train management system for the London Underground), secure electronic transactions, sensitive sites (such as the Palace of Westminster, where Thales is installing a secure communication system) and infrastructure.

THALES IN THE NETHERLANDS

Dutch subsidiaries' revenues generated outside the Group in 2003: €413m

Revenues generated in the Netherlands in 2003: €314m

Managed employees end-2003: 2,440

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 of naval surface systems and a first-tier contractor to the Royal Netherlands Navy since the early 20th century.

This background explains why Thales Nederland is one of the Group's main naval centres of excellence for radars and combat management systems. Its equipments and systems equip surface vessels of all types and tonnages for every type of maritime mission. Its *Goalkeeper* combat system, and more recently the *Tacticos* combat management system, equip a large number of ships, including the frigates being built jointly by Canada, Germany and the Netherlands.

In research, too, Thales Nederland plays a dynamic role. Thales Nederland cooperates closely with the universities of Amsterdam 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. The *APAR* radar systems completed certification in 2003 and were delivered to the Dutch and German shipyards in early 2004.
- Thales Nederland is also a recognised player in the **military communications** market, with a strong position in switches.

Outside the defence sector, in 2003 Thales was awarded a major contract in the Netherlands for secure operations: the Group was selected, as part of the East-West E-Ticketing consortium, to develop one of the most advanced integrated public transport ticketing systems in the world (see page 65).

(1) CVF: Carrier Vessel of the Future

(2) FIST: Future Integrated Soldier Technology

(3) FSTA: Future Strategic Tanker Aircraft

THALES IN AUSTRALIA

Australian subsidiaries' revenues generated outside the Group in 2003: €568m

Revenues generated in Australia in 2003: €479m

Managed employees at end-2003: 3,220

Thales is present in the Australian defence and aerospace markets, and has been Australia's leading defence contractor since the Group acquired a 50% interest in ADI, privatised in 1999. The remaining 50% is held by the Australian infrastructure group Transfield. In earlier years, Thomson-CSF developed air traffic management, simulation and anti-submarine warfare systems in Australia.

In air traffic management, Thales ATM began installing in the late 1980s an extensive radar system covering most of the country. In 1995, the Group was selected to set up a new Australian air traffic management system, and then to maintain and support the system. Later, the Group began to mark up export successes in Asia-Pacific ATM markets from its base in Australia. In 2001, the Group was awarded a major contract to equip five of the biggest airports in China in preparation for the 2004 Olympics.

In simulation, Thales Training & Simulation (TTS Pty) supplies military simulators for the Australian Air Force and Army and simulators for Qantas' Airbuses. TTS Pty was also awarded the associated training contracts for these programmes.

In defence, Thales operates primarily through its ADI subsidiary, which employs 3,000 staff and already covers a large part of Thales' spectrum of defence businesses, and through Thales Underwater Systems (TUS Pty).

- **In land-based systems**, ADI was recently selected by the Australian Ministry of Defence to equip its new *Bushmaster* armoured vehicles, the first to be designed and produced in Australia since World War II. The contract calls for the delivery of 299 vehicles to the Australian Army. After conclusive trials in 2003, the first *Bushmasters* are due to be delivered in 2004. The *Bushmaster* is optimised for peacekeeping missions. It is a versatile vehicle with strong export potential, like the *IHMEE*[1] previously designed by ADI, of which 40 units have been ordered by the US Army. ADI is also closely involved in communications and C4ISR[2] programmes for the Australian armed forces.
- **In naval markets**, ADI is upgrading *FFG* frigates for the Royal Australian Navy, installing in particular a new combat management system. As part of the Minehunter anti-submarine warfare project, ADI delivered six minehunters to the Royal Australian Navy from 1999 to 2002 and won a contract to supply support services. The mine countermeasures system that ADI supplied the Australian Navy was later exported to Denmark, Indonesia, Japan, Poland, Thailand and the United States. TUS Pty equips the entire Australian fleet (*Anzac* frigates, *FFG*, *MHC* minehunters, and *Collins* submarines) with sonar systems and has been awarded the corresponding through-life support contracts.
- **In the airborne systems sector**, ADI is involved with Eurocopter in the programme to deliver 22 *Tiger* surveillance and attack helicopters to the Australian Army. ADI is supplying the mission systems, all navigation and reconnaissance software, and communication systems. In 2003, TTS Pty was also awarded the simulation and training contract for these helicopters.

(1) IHMEE: Interim High Mobility Engineering Excavator

(2) C4ISR: Control Command Communications Computer, Intelligence, Surveillance and Reconnaissance

Thales International

The prime mission of Thales International is to initiate, support and coordinate Thales sales and marketing policy throughout the world.

Its regional agencies, delegations and teams of experts working at corporate level provide operating units with a wide range of resources and competencies to contribute to the growth of the Group's business and help to manage its commercial environment. Thales International's contribution ranges from advance prospecting based on strategic intelligence and an in-depth knowledge of customer needs to carefully managed lobbying, communication and public relations operations.

The growing complexity of the Group's operations and regulatory environment requires a high degree of legal expertise. Thales International provides this expertise as well as specialised skills in international trade financing (financing arrangements and risk management) and offset operations. Furthermore, the Group's corporate treasury department covers exchange risk and optimises foreign exchange flows. These are essential functions, given the Group's exchange risks exposure, particularly on long-term export contracts.

Thales International is also responsible for ensuring strict compliance with legislation, ethical business practices and end-user control procedures for exports of sensitive equipment and systems (see section on relations with suppliers and customers on page 129).

Group policy is to develop, through Thales International, long-term relationships with customers, political decision-makers and local industries. The Thales International network enables Thales to maintain close ongoing contacts with its partners, and to understand their concerns, not only in terms of operational requirements but also in terms of industrial development, technology transfer, financing and direct or indirect offsets, and thus to offer an environment favourable to the Group's business.

INTERNATIONAL FINANCING

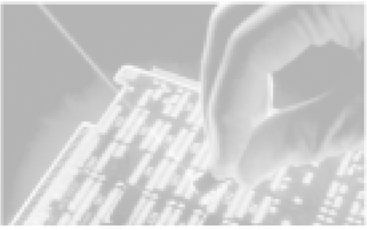
The Thales International structure specialising in international financing arranges financing for international contracts valued from a few million to several billion euros. It relies on its extensive international network to identify sources of financing as well as commercial and financial opportunities. This organisation provides Thales French and foreign units with a wide range of financial engineering services including financial risk assessment, conventional financing (buyer's credit, supplier's credit, soft loans), negotiation of international financing and special financing arrangements, including back-to-back financing, multi-sourcing and tax-based leasing, etc.

As services traditionally managed by the public sector have been privatised, Thales has developed a range of management and maintenance services and is putting in place long-term financing solutions suited to the new needs of its customers, including Private Finance Initiative and Public Private Partnership arrangements.

Thales operates in countries on every continent and needs cover against the risk of non-payment or contracts breaking-off, arising from political and business events in those countries. For every contract signed with an "at risk" country, Thales uses a public or private export guarantee organisation to obtain appropriate insurance, and, if necessary, makes provision in its accounts proportional to the level of risk involved.

THALES INTERNATIONAL OFFSETS (TIO)

International offset arrangements are key to the success of military export programmes and some exports of professional electronic systems. Offset programmes are geared to the new economic priorities of Thales' client countries. They may take the form of direct offset, where part of the equipment sold is produced in the client country, or indirect offset covering any other type of economic benefit to the client country.



RESEARCH & TECHNOLOGY

Key figures on Research & Technology

The capital intensity of Thales' business is relatively low, but the Group invests significant sums in research and development, approximately €1.9 billion a year in recent years (18% of consolidated revenues in 2003). By way of comparison, net industrial investment was €35m in 2003 and €357m in 2002.

Technological excellence is an essential component of Thales' strategy and identity, and innovation is a key factor in the success of its current and future systems. The technology content of Thales' business has increased considerably in recent years, and the Group invests heavily in research and development. Leveraging the expertise and capabilities of all units, the Group has built a solid platform of common technologies that now provides a reliable basis for collaborative development of sustainable solutions for the future.

Consistently high levels of R&D spending, even in a difficult business environment, are evidence of this importance of research and development for the Group:

Research & Development expenditure over four years

(millions of euros)	2003	2002	2001	2000
Total expenditure	1,850	1,900	1,900	1,800
Company-funded expenditure	419	460	453	410
of which recorded as expenses	*381*	*430*	*432*	*397*
of which recorded under balance-sheet assets[(1)]	*38*	*30*	*21*	*13*
Company-funded R&D as % of total	*23%*	*24%*	*24%*	*22%*

In 2003, company-funded R&D expenditure represented 4% of consolidated revenues, and total R&D expenditure represented 17.5%.

The effectiveness of the Group's research and development efforts is largely due to the decentralised nature of its R&D operations: the 19,000 staff concerned (over 70% of whom are engineers), are based at more than fifty units in the Group's top ten countries of operation, and are therefore fully aware of market requirements. Effective networking across the Group throughout the world enables R&D engineers to share information, advice and best practice.

Research and innovation

Innovation at Thales operates as an "open loop", with systematic cooperation and coordination between the various functions: advanced research and development, strategy, marketing and sales, and analysis and simulation of customer needs. As part of its collaborative development policy, Thales has introduced a set of tools to develop interactivity between the various players in innovation. A strategic technology plan is drawn up in each business each year and consolidated at corporate level. The plan is used to identify critical technologies, R&D priorities and commonalities needed for the sustainable development of the Group's products and systems.

Thales devotes some 25% of its R&D expenditure to preparing the products and systems of the future. This advanced research and development effort addresses:

- basic technologies and components, such as new semiconducting and superconducting materials
- components for microwave and infrared applications
- systems for optronics applications, security and safety
- software architectures, smart components, network communication quality, algorithms for signal and image processing, and positioning.

These technologies and components are then used to build technology platforms or demonstrators, where integration, evaluation and testing are conducted collaboratively with other technology suppliers.

(1) See note 1.k) in the Appendix to the consolidated financial statements, defining the criteria for recording development expenditure as assets.

Research & Technology cooperation

To benefit as quickly as possible from research conducted in Europe, Thales has a policy of openness, partnership and proactive networking, based in particular on its strategic relationships with some of the most prestigious research centres and universities. In France, Thales has particularly close relationships with CNRS [(1)], INRIA [(2)], CEA [(3)], ONERA [(4)] and the École Polytechnique; in the United Kingdom, the universities of Cambridge and Surrey, and Imperial College, London; and in the Netherlands, the Organisation for Applied Scientific Research (TNO) [(5)] and the Universities of Delft and Amsterdam.

As part of this policy of partnership and networking, common research and technology platforms have been set up since 2002 in which integrated teams work together to meet shared objectives. These common platforms and projects are of various types:

- internal cooperation programmes, in which Thales Group units combine their capabilities to meet strategic "transverse" objectives: software architecture, software componentry, Internet technology centres, hardware and software environments for signal processing, modelling and simulation;
- longer-term cooperation programmes with selected outside partners: embedded real-time software architecture and components with CEA-LIST [(6)] and INRIA; special components based on new materials with IEMN [(7)] in Lille; modelling, design and characterisation of microwave components with IRCOM [(8)] in Limoges, large-area electronics with CEA-LETI [(9)]; carbon nanostructures with the École Polytechnique, superconducting materials and spin electronics with CNRS; Internet Quality of Service with the University of Paris 6 and Telecom Paris, etc.;
- Hardware technology platform for sharing high-cost research equipment, with IOTA [(10)], the École Polytechnique and IEMN;
- Development programmes with industrial partners and suppliers of components, systems and software incorporated in the Group's products and solutions, including IBM, Softeam and Telelogic.

Thales is an active participant in a wide range of European military and civilian programmes (including Euclid and Eurofinder, the European 6th Framework Programme for R&D and Eureka). It is also a member of national research and technology networks in France, the United Kingdom and the Netherlands.

In addition, Thales is involved in cooperative ventures with institutes and universities near Group facilities in Germany, Asia (particularly Singapore), North America and Australia.

(1) CNRS: Centre National de la Recherche Scientifique
(2) INRIA: Institut National de Recherche en Informatique et Automatique
(3) CEA: Commissariat à l'Energie Atomique
(4) ONERA: Office National d'Etudes et de Recherches Aerospatiales
(5) TNO: Toegepast-Natuurwetenschappelijk Onderzoek
(6) LIST: Laboratoire d'Intégration des Systèmes et des Technologies
(7) IEMN: Institut d'Electronique, de Microélectronique et de Nanotechnologie
(8) IRCOM: Institut de Recherche en Communication Optique et Micro-onde
(9) LETI: Laboratoire d'Electronique et de Technologie de l'Information
(10) IOTA: Institut d'Optique et des Techniques Avancées

Corporate research

Within the Group's corporate research organisation, Thales Research & Technology (TRT) plays a central role : 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.

- In France, the Orsay centre on the Saclay science and technology campus south of Paris employs 350 full-time staff, and some 40 doctoral students and 50 outside researchers are present on site at any one time. At the end of 2004, the centre will be housed in a new building on the École Polytechnique campus.
- 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 some fifteen 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 employs about ten people.
- In Singapore, TRT opened a facility employing 15 staff in 2003, in close cooperation with the Nanyang Technological University, the Defence Science and Technology Agency (DSTA) and a number of Singapore technology institutes.

TRT research comes under four main headings: hardware systems and components, software technologies, software systems, and knowledge engineering and management:

- hardware systems and components research, mainly conducted by TRT France: microwave systems for radars and electronic warfare, optronic systems for detection and countermeasures, and security systems. To meet these needs, TRT develops hardware technologies such as superconductors and III-V semiconductors, nanotechnologies, microsystem assemblies and packaging, and new synthetic materials.
- Software technology research aims both to raise the productivity of software engineers working on software-intensive systems and embedded software, and to provide a technological edge in the systems Thales sells. Research is devoted to four areas: new technologies for system and software engineering; software and middleware architectures; hardware and software environments for data and signal processing; and smart software systems.
- Software system research, mainly conducted in the UK, focuses on three major system functions— communications technology, positioning and navigation services, image processing and data fusion.
- To make the Group's engineering processes more competitive, TRT and operating units jointly define processes, methods and tools to cut costs, manage complexity and reduce technological risk; these processes must also improve the productivity, quality, security and sustainability of the Group's technical capabilities and systems. Hardware, software and system aspects are all addressed so that the same methodologies and design tools can be shared across different contexts. The Group's knowledge management project is part of this integrated approach. It provides all Group employees with ready access to the Group's knowledge base, which covers all of its major activities.

Intellectual property

Thales actively exercises its intellectual property rights in all its countries of operation, mainly through patents, trademarks and royalties, to maintain the competitive advantage of innovation. This policy is managed by a central corporate entity, Thales Intellectual Property (TPI), which coordinates a network of intellectual property correspondents in operating units. In terms of numbers of patents filed (215 new patents in 2003), Thales compares well with its competitors with equivalent R&D expenditure in the same sectors.

The Group's patent portfolio (standing at 12,000 after various divestments) is used:

- to defend the markets in which the Group operates
- as a negotiating tool in disputes
- on occasion, as a further source of revenues by licensing applications outside the Group's current fields of activity.

To encourage Group engineers to innovate, an invention bonus is paid when the memorandum describing an invention is produced. 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 filing a patent. Similarly, original software work is electronically attested to certify Group 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.

03 SHAREHOLDER INFORMATION

COMPANY AND SHARE CAPITAL

Statutory information

Thales is a public limited company with a board of directors, governed by French law (specifically by the Code of Commerce and the Decree of 23 March 1967 on commercial companies, 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, 92526 Neuilly-sur-Seine Cedex – France

The board's decision to transfer the registered head office on 12 September 2003 has been ratified by the general meeting on 11 May 2004.

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 implementation of all applications of electronics, radio, optics, optronics and information technologies in 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, at the registered head office.

Statutory distribution of profits: these 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.

General Meetings

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 30 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. These formalities must be completed not later than five days before the date set for the General Meeting of Shareholders.

  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 Meeting 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.

DOUBLE VOTING RIGHTS AND USE OF VOTING RIGHTS

- Shareholders who are nationals of a European Union member state are entitled to double voting rights for each share held, provided they 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. This entitlement is extended to all shareholders, whether or not they are nationals of a European Union member state since the General Meeting of 11 May 2004 passed Resolution 23 removing the earlier restriction from the articles of association.

  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 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.

STATUTORY DISCLOSURE THRESHOLDS

Any natural person or legal entity, acquiring a number of shares equal to or exceeding 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 days from 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, 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.

Share capital

At 31 December 2003, as at the date of this report, the share capital amounts to €515,592,876 divided into 171,864,292 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 - BP 81312 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 Article 10 of the 6 August 1986 Privatisation Act (see page 92).

CHANGES IN SHARE CAPITAL FIVE-YEAR SUMMARY

(in euros, except for the number of shares)

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. 1998		**2,724,320,105**			**511,410,086**	**167,731,513**
31 Dec. 1999		**2,724,320,105**			**511,410,086**	**167,731,513**
10 May 2000	Conversion to euros of the share capital (3 euros per share compared with 20 French francs previously)	-	-	(8,215,547)	503,194,539	167,731,513
31 Dec. 2000		**2,724,320,105**			**503,194,539**	**167,731,513**
31 Dec. 2001		**2,724,320,105**			**503,194,539**	**167,731,513**
20 Dec. 2002	Share 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		**2,799,707,048**			**515,592,876**	**171,864,292**

The share capital consisted of 167,731,513 shares on 24 July 1998, and was increased by 4,132,779 shares issued to employees on 20 December 2002. The total stood at 171,864,292 shares at end-2002. No change in the number of shares or the value of the share capital was made in 2003.

CHANGES IN SHARE OWNERSHIP FIVE-YEAR SUMMARY

Number of shares

At 31 December	2003	2002	2001	2000	1999
TSA * and its subsidiary Sofivision	52,670,906	53,653,558	53,653,078	54,909,066	54,909,066
Sogepa *	1,081,256	1,081,256	1,081,256	1,081,256	1,081,256
French State **	2,022	2,022	2,022	2,022	1,761,182
Public sector	**53,754,184**	**54,736,836**	**54,736,356**	**55 992 344**	**57,751,504**
Alcatel Participations	16,262,481	16,262,481	26,562,481	42,413,109	42,413,109
Groupe Industriel Marcel Dassault (GIMD)	9,827,043	9,827,043	9,740,373	9,740,373	9,740,373
Industrial Partner	**26,089,524**	**26,089,524**	**36,302,854**	**52,153,482**	**52,153,482**
Coordinated shareholders	**79,843,708**	**80,826,360**	**91,039,210**	**108,045,826**	**109,904,986**
Free float ***	**92,020,584**	**91,037,932**	**76,692,303**	**59,585,687**	**57,826,527**
of which employees ****	8,690,141	8,148,410	4,562,300	4,327,473	3,690,093
of which Thales	9,600,528	9,600,528	10,743,624	1,921,730	1,921,730
Total	**171,864,292**	**171,864,292**	**167,731,513**	**167,731,513**	**167,731,513**

* companies wholly owned by French State

** including one golden share (see page 92)

*** In accordance with the definition of free float used since 1 December 2003 by the Euronext Paris Indices Steering Committee to calculate the CAC40 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.

**** shares held by employees in a company savings plan or company investment fund

Percentage					
At 31 December	**2003**	**2002**	**2001**	**2000**	**1999**
TSA * and its subsidiary Sofivision	30.65	31.22	31.99	32.74	32.74
Sogepa *	0.63	0.63	0.64	0.64	0.64
French State **	-	-	-	-	1.05
Public sector	**31.28**	**31.85**	**32.63**	**33.38**	**34.43**
Alcatel Participations	9.46	9.46	15.84	25.29	25.29
Groupe Industriel Marcel Dassault (GIMD)	5.72	5.72	5.81	5.81	5.81
Industrial Partner	**15.18**	**15.18**	**21.64**	**31.09**	**31.09**
Coordinated shareholders	**46.46**	**47.03**	**54.28**	**64.48**	**65.52**
Free float ***	**53.54**	**52.97**	**45.72**	**35.52**	**34.48**
of which employees ****	5.06	4.74	2.72	2.58	2.20
of which Thales	5.59	5.59	6.41	1.15	1.15
Total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

* companies wholly owned by French State
** including one golden share (see page 92)
*** 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.
**** shares held by employees in a company savings plan or company investment fund

Major changes in share-ownership since 1 January 1999

- **In 1999,** three changes were made to share-ownership

  In May 1999, Aerospatiale transferred the 3.87% of the share capital (6.5 million shares) it had held since Thomson-CSF was privatised in June 1998 to its shareholders, the French State and Sogepa.

  In December 1999, Alcatel acquired from the Public Sector 15.85 million Thomson-CSF shares, equivalent to 9.45% of the capital. This increased its stake from 15.84% to 25.29%.

  During the year, under the authority granted by the June 1999 General Meeting to trade in its own shares, Thomson-CSF bought back 1.9 million shares, equivalent to 1.15% of the capital.

- **In 2000,** current and former employees acquired 1,759,160 shares (1.05% of capital) on preferential terms from the French State, following the transfer of 9.45% of Thomson-CSF capital from the Public Sector to Alcatel in December 1999.

- **In 2001,** after two years of relative stability, the free float increased significantly with the sale by Alcatel of 9.45% of Thales capital from the 25.29% it held. The sale was carried out in two separate phases:

  - in July 2001, Alcatel bought back the Thales interest in Alcatel Space for €795 million, paid half in cash and half in Thales shares. Alcatel's stake in Thales fell from 25.29% to 20.03% and Thales treasury shares rose from 1.15% to 6.40%.
  - in November 2001, Alcatel sold 4.2% of Thales capital on the market (7 million shares). Its interest in Thales fell from 20.03% to 15.84%.
  - in June and September 2001, Thomson SA allocated bonus shares to employee-shareholders equivalent to 0.75% of Thales capital. This allocation of bonus shares was specified in the 1998 privatisation (Privatisation Act of 6 August 1986, amended).

- **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, reducing its interest to 9.46%.
  - 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 2.4% at end 2001 to more than 4.7% at end 2002;
  - Thales floated 10.7 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.

The Company has not been notified of any statutory thresholds being exceeded during 2003 or until the publication date of this report in 2004.

Maximum potential capital

SECURITIES CARRYING IMMEDIATE OR FUTURE EQUITY ENTITLEMENTS

OCEANE convertible bonds

The General Meeting of 16 May 2001 authorised the Board of Directors to issue securities carrying equity rights. In December 2001, under the authority granted him by the Board of Directors, the Chairman decided to issue OCEANE bonds convertible and/or exchangeable into new or existing Thales shares:

- number of bonds issued: 9,809,691 bonds issued, representing a nominal amount of €499,999,950
- nominal value per bond: €50.97
- issue price at par
- Issue date and settlement date: 20 December 2001
- Term of the bonds: 5 years and 12 days from the settlement date (maturity on 1 January 2007)
- Annual interest: 2.5 % per annum, i.e. an amount of €1.27 per bond, payable annually in arrears on 1 January of each year
- Gross yield to maturity: 2.5 % at the settlement date (unless converted to or exchanged for shares or redeemed early)
- Redemption at maturity: in full at par value plus accrued interest on 1 January 2007
- Early redemption upon Thales option, possible from 1 January 2005, if the average price of the Thales share exceeds 120% of the par value plus accrued interest over a period of ten consecutive trading days
- Conversion or exchange ratio: set at 1 share for 1 bond on issue date; this may vary in accordance with French law (Code of Commerce Article L225-174 and Decree 174-11) and the issue agreement (approved by the French financial markets authority COB on 11 December 2001, number 01-1415). The ratio was raised to 1.016 and then 1.046 shares for 1 bond, following the distributions of dividends by charging reserves approved by the General Meetings of 16 May 2002 and 15 May 2003. The ratio is 1.046 shares for 1 bond as of the publication date of this report.

Share warrants

As part of the capital increase reserved for employees in December 2002, 53,980 non-listed warrants to subscribe to new shares were granted to employees working in Germany, in place of the 20% discount at which new shares could be subscribed by employees elsewhere (in accordance with regulations applicable in Germany).

Each warrant gives rights to subscribe to 1.03 new shares at €26.70 each, and is valid until 2 April 2007. The ratio was originally set at one share for one warrant, and was adjusted to 1.03 shares when the payment of dividends by charging reserves was approved by the General Meeting of 15 May 2003.

Share options

• Share subscription options

At the General Meeting of 15 May 2003, shareholders authorised the Board of Directors to grant share options potentially leading to the issue of up to 6.5 million new shares. This authority replaced that granted by the General Meeting of 16 May 2001 (for 7.5 million shares), used to issue 7 million shares in July 2001 and July 2002.

• Share purchase options

The General Meeting of 10 March 1999 gave the Board of Directors a five-year authority to grant options to purchase up to a maximum of 8 million shares. Options may be granted on one or several occasions, within the above limit.

See table page 90 for the Board's use of these delegated powers.

The General Meeting of shareholders of 11 May 2004 will be asked to renew these authorities for a period of 38 months for 3 million shares.

At 31 December 2003, there were

- 9,982,156 subscription options, at the weighted average exercise price of €36.79
- 2,048,413 purchase options, with a weighted average exercise price of €34.86

Date of Board decision	01/07/2003	02/07/2002	13/11/2001	12/07/2001	02/04/2001	10/05/2000	14/09/1999
Option type	Subscription	Subscription	Purchase	Subscription	Purchase	Purchase	Purchase
Discount	nil	nil	nil	nil	nil	nil	nil
Exercise period	from 1 July 2007 to 30 June 2013 (1)	from 3 July 2006 to 1 July 2014 (1)	from 13 Nov. 2005 to 12 Nov. 2011 (1)	from 12 July 2005 to 11 July 2011 (1)	from 2 April 2005 to 1 April 2011 (2)	from 10 May 2004 to 9 May 2010 (2)	from 14 Sept. 2004 to 13 Sept. 2009
Exercise price	€25.70	€40.97 (3)	€42.18 (3)	€42.18 (3)	€42.37 (3)	€37.72 (3)	€32.59 (3)
Number of options exercised since grant date	nil	nil	nil	nil	nil	nil	nil
Number of options outstanding, less options cancelled (4)	**3,017,300**	**3,402,840 (3)**	**227,913 (3)**	**3,562,016 (3)**	**111,371 (3)**	**266,437 (3)**	**1,442,692 (3)**
of which							
• Chairman	100,000	102,954	-	83,718	-	-	63,629
• other officers members of Comex (Executive Committee)	222,500	205,912	-	222,904	58,326	21,210	164,380
Number of grantees	3,788	5,448	453	5,340	8	86	191
Including officers members of Comex (except the Chairman)	9	9	néant	9	2	1	6

(1) 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 have been granted for a ten-year period, at no discount to the market price. They may be exercised as follows:

- Stock purchase options granted on 14 September 1999 may be exercised as from the fifth anniversary of the grant date.
- Stock purchase options granted on 10 May 2000 and 2 April 2001 may be exercised as from the fourth anniversary of the grant date.
- For share purchase and subscription options granted as from 12 July 2001, two vesting systems have been implemented: one for the Netherlands and one for the rest of the world. Options may be exercised as follows:

In all countries except the Netherlands:

- for options granted from July 2001 to July 2002, up to 25% of the number granted twelve months after the grant date,
- for options granted in July 2003, up to 37.5% of the number granted eighteen months after the grant date,

then in every case, 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.

For legal reasons, beneficiaries employed by companies registered in France cannot exercise any option before the fourth anniversary of the grant date.

In the Netherlands, for options granted from July 2001 to July 2003, up to 75% of the number granted three years after the grant date, reaching a total of 100% after four years.

Except for the options granted in September 1999, 100% of options may in all countries be exercised four years after they are granted for a period of a further six years.

• **Options granted and exercised in 2003**

1 – Directors	Number of options granted / shares subscribed or purchased	Exercise price	Maturity date	Grant date
Options granted in 2003				
- Denis Ranque	100,000	€25.70	30/06/2013	1/07/2003
Options exercised in 2003	**Nil**			
2 - Top ten beneficiaries*	**Number of options granted / shares subscribed or purchased**	**Exercise price**	**Maturity date**	**Grant date**
Options granted in 2003	280,000	€25.70	30/06/2013	1/07/2003
Options exercised in 2003	néant			

(*) from all Group companies

MAXIMUM POTENTIAL CAPITAL AT 31 DECEMBER 2003

(in number of shares at €3 par value)	Maximum number of new shares	Called-up share capital
Share capital at 31 December 2003		**171,864,292**
Océane If all 9,809,691 bonds are converted to new shares: *1.046 shares for 1 bond at €50.97 par value - maturity: January 2007*	10,260,937	
Share warrants (not listed) Issued as part of the 2002 leveraged capital increase (reserved for employees in Germany) *1.03 shares for 1 share warrant at €26.70 - maturity: April 2007*	55,600	
Outstanding share warrants :		
July 2001 grant: options exercisable at €42.18 from 12 July 2005 to 11 July 2011	3,562,016	
July 2002 grant: options exercisable at €40.97 from 2 July 2006 to 1 July 2012	3,402,840	
July 2003 grant: options exercisable at €25.70 from 1 July 2007 to 30 June 2013	3,017,300	
Total	**20,298,693**	
Maximum potential capital at 31 December 2003 (+11.8%)		**192,162,985**

AUTHORITY GRANTED TO THE COMPANY OVER ITS OWN SHARES

Authority to trade in its own shares

The General Meetings of 10 March 1999, 29 June 1999, 23 May 2000, 16 May 2001, 16 May 2002 and 15 May 2003 approved the further authorities granted to the Company to trade on the Stock Exchange or otherwise in its shares. Power to use these authorities was delegated to the Board of Directors.

Since then, the Company has used this authority twice:

- In 2001, Thales sold Alcatel its stake in Alcatel Space: the price of the transaction (€795 million) was paid half in cash and half as 8.8 million Thales shares;
- In 2002, 1.1 million shares were sold on the market.

The General Meeting of 11 May 2004 extended this authority for eighteen months, with a maximum purchase price of €45 per share. A minimum sale price of €20 per share was set by the Board meeting of 11 March 2004.

Further details are given in the resolution 19 (page 117) and the disclosure document of 20 April 2004, registered under n° 04-295 by the French financial markets authority AMF.

Authority to cancel the Company's shares

The Annual General Meeting of 16 May 2001 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 extended for 24 months by the General Meeting of 15 May 2003.

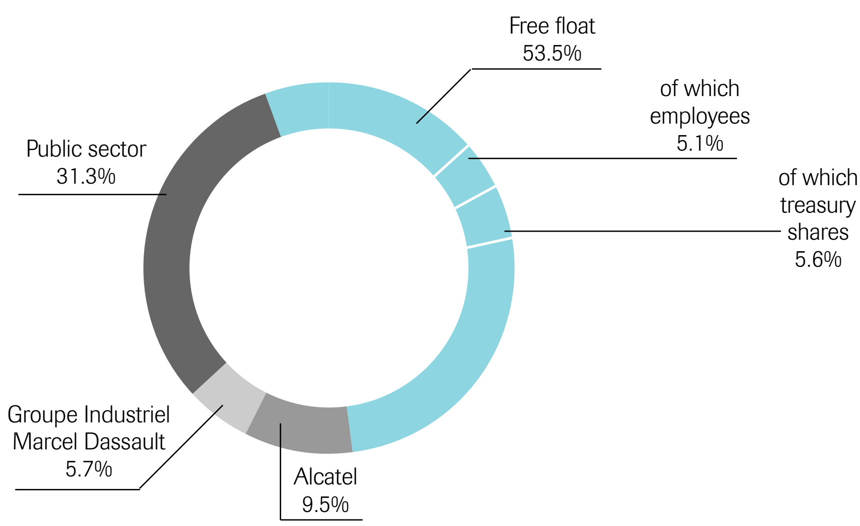
By the publication date of this annual report, the authority had not been exercised.

At 31 December 2003, the Company was engaged in no trading in derivatives of its own shares.

Shareholders and voting rights

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.

SHAREHOLDING AT 31 DECEMBER 2003 *



* unchanged as of the publication date of this report

SHAREHOLDERS BOUND BY A SHAREHOLDERS' AGREEMENT

TSA (formerly Thomson SA) 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.

Sogepa (Société de gestion des participations aéronautiques) is a holding company wholly owned by the French State, which holds equity interests in the defence and aerospace sectors. It holds 1,081,256 Thales shares directly.

The French State directly owns 2,022 shares, including a **golden share** that gives it the following rights (Article 3 of Decree 97-190 of 4 March 1997):

- "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.
Thomson (UK) Holdings Ltd.
Thales Communications S.A.
Thales Air Defence S.A.
Thales Nederland B.V.
Thales Naval S.A.
Thales Avionique S.A.
Thales Training & Simulation S.A.
Thales Underwater Systems NV

Alcatel is a joint stock company whose capital is owned by the investing public. It is listed on the Euronext Paris Stock Exchange, the London SEAQ, other European exchanges, the New York Stock Exchange and in Tokyo. As of 31 December 2003, Alcatel owns 16,262,481 shares through its subsidiary Alcatel Participations

Groupe Industriel Marcel Dassault (GIMD) is a holding company whose assets consist mainly of interests in aerospace companies and information technology companies. As of 31 December 2003, GIMD owns 9,827,043 shares.

SHAREHOLDERS' AGREEMENTS

The following two agreements were concluded for a ten-year period expiring on 30 June 2008.

General agreement between the "Industrial Partner" and the "Public Sector"

A shareholders' agreement exists between Thomson SA on the one hand, and Alcatel and GIMD on the other, as part of the cooperation agreement between the Company, the Public Sector and the Industrial Partner (Alcatel and GIMD). This was initially concluded on 14 April 1998 and was submitted to the French financial markets authority CMF, which publicised the main points of the agreement on 21 April 1998 (Decision n°198C0370). The agreement was revised on 18 November 1999 following Aerospatiale's exit from the arrangement and the raising of Alcatel's stake in Thomson-CSF, now Thales.

The agreement remains valid as long as the Industrial Partner (mainly Alcatel) and the Public Sector hold at least 15% each of Thales capital, and its main provisions relate to

- Membership of the Board of Directors (see page 96) ;
- A commitment to seek approval by a majority of the directors representing the Industrial Partner for decisions by the Board of Directors of Thales concerning:
  - the appointment and dismissal of the Chairman and Chief Executive Officer,
  - adoption of the annual budget,
  - significant acquisitions and disposals, or decisions liable to impair cooperation between Thales and the Industrial Partner;
- A commitment by the Public Sector to ensure that the Industrial Partner is in a position to remain Thales' leading private-sector shareholder. The Public Sector has undertaken not to raise its holding above 49.9% of the Company's share capital;
- A recognised right of pre-emption for the Public Sector concerning shares held by Alcatel if the latter loses its leading position within the Industrial Partner agreement, and a mutual right of pre-emption if either the Public Sector or the Industrial Partner falls below a 15% interest in Thales capital, for the party still above that threshold.

Shareholders' agreement between Alcatel and Groupe Industriel Marcel Dassault (GIMD)

Alcatel and GIMD have signed a shareholders' agreement whereby they declare themselves to be acting in concert in their capacity as the Industrial Partner, with GIMD acknowledging Alcatel's pre-eminence. In addition, the two parties have undertaken for a five-year period not to transfer shares received in exchange for their contribution of assets. The main provisions of this agreement were published by the CMF on 21 April 1998, and came into force on 22 June 1998, the date of the extraordinary General Meeting that approved the Company's exit from the Public Sector. The agreement was modified on 24 September 2002, in order to allow Alcatel to divest Thales shares on the market without reducing the Industrial Partner's interest in Thales capital below 15% or modifying the Alcatel's pre-eminence over GIMD within this agreement (CMF decision 02C1306).

The Company declares that it is involved in no agreement or pact with a listed company or an unlisted subsidiary likely to have a significant impact on the Thales share price.

COMPANY-HELD SHARES

At 31 December 2003, Thales held 9,600,528 treasury shares, including the remaining shares from successive shareholder-approved share buyback programmes, shares purchased on the stock market in 1999, shares purchased off-market in 2001 (sale of Thales' interest in Alcatel Space to Alcatel, paid half in cash and half in Thales shares), less shares sold on the market or otherwise, by the authority granted to the Board of directors by the General Meeting of shareholders.

These shares are subject to no restrictions and may be freely traded.

The Company's authority with respect to its own shares is detailed on page 91. Further authority was granted by the General Meeting of 11 May 2004.

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, the French market clearing and settlement body, on 31 December 2002, and the Company's information about employee shareholders, private ownership of Company shares is estimated as follows:

	Thousand shares		
	31/12/2003	**31/12/2002**	**28/12/2001**
French institutions and investment funds	**39,134**	37,850	26,094
Non-resident institutional investors	**22,635**	25,530	26,223
Employee shareholders	**8,690**	8,148	4,562
Individual shareholders and non-profit bodies*	**10,660**	8,492	7,030
Not identified	**1,301**	1,417	1,039
All private investors	**82,420**	**81,437**	**65,949**
Total number of shares	**171,864**	171,864	167,732

	% of total capital			% of capital held by the public		
	31/12/2003	**31/12/2002**	**28/12/2001**	**31/12/2003**	**31/12/2002**	**28/12/2001**
French institutions and investment funds	**22.8%**	22.0%	15.6%	**47.5%**	46.5%	39.6%
Non-resident institutional investors	**13.2%**	14.9%	16.2%	**27.5%**	31.3%	41.3%
Employee shareholders	**5.1%**	4.7%	2.7%	**10.7%**	10.0%	6.9%
Individual shareholders and non-profit bodies*	**6.2%**	4.9%	4.2%	**12.9%**	10.4%	10.7%
Not identified	**0.8%**	0.8%	0.6%	**1.6%**	1.6%	1.6%
All private investors	**48.0%**	**47.4%**	**39.3%**	**100%**	**100%**	**100%**

* resident in France

To the best of the Company's knowledge, based on the TPI survey on 31 December 2003 and the number of bearer shares recorded on that date, the Company's shareholders are estimated to be 105,000.

EMPLOYEE SHAREHOLDING

At 31 December 2003, within the meaning of Article L225-102 of the Code of Commerce, employees held, 8,690,141 Thales shares, 5.06% of share capital via the Group savings plan (PEG[1]) either directly or via a company investment fund (FCPE[2] or equivalent in the United Kingdom).

The employees' stake exceeded 5% in 2003 as a result of the allocation under the Privatisation Act of bonus shares for those who subscribed to the 2000 discounted share offer and held their investment for three years. This figure is likely to decline, *ceteris paribus*, since assets invested in FCPEs since 1998 (roughly a quarter of employee shareholdings) have been freely transferable since 1 July 2003.

The General Meeting of 11 May 2004 granted the Board authority for 26 months to execute capital increases reserved for employees up to a total of 4.5 million shares. Under the law of 19 February 2001 on employee savings plans, this resolution must be submitted to this General Meeting, which also granted the Board authority to increase share capital under French law. It replaces the resolution adopted by the General Meeting of 15 May 2003 for the same number of shares.

VOTING RIGHTS

At 31 December 2003, the total number of voting rights was 236,443,381. This includes the double voting rights attached to shares that have been held in registered form for at least two years in accordance with the articles of association (see page 86, below).

N.B. Until the General Meeting of 15 May 2003, the number of voting rights for the purposes of the declaration thresholds, as provided for by article L.233-7 of the Code of Commerce, is the number of voting rights outstanding at the previous General Meeting of 16 May 2002 (i.e. 239,726,209), because there has been no change of 5% or more since then.

At end 2003, 2002 and 2001, the total numbers of voting rights were as follows:

Number of voting rights

At 31 December	2003	2002	2001
TSA * and its subsidiary Sofivision	105,334,464	107,305,124	107,304,644
Sogepa*	2,162,512	2,162,512	2,162,512
French state	4,044	2,023	2,023
Public sector	**107,501,020**	**109,469,659**	**109,469,179**
Alcatel Participations	32,524,962	32,524,962	53,124,962
Groupe Industriel Marcel Dassault (GIMD)	9,827,043	9,827,043	10,747,870
Industrial Partner	**42,352,005**	**42,352,005**	**63,872,832**
Coordinated shareholders	**149,853,025**	**151,821,664**	**173,342,011**
Thales	**-**	**-**	**-**
Free float	**86,590,356**	**84,667,231**	**67,853,565**
of which employees	12,133,768	10,895,056	6,174,607
Total	**236,443,381**	**236,488,895**	**241,195,576**

Percentage voting rights

At 31 December	2003	2002	2001
TSA * and its subsidiary Sofivision	44.55	45.37	44.49
Sogepa*	0.91	0.91	0.90
French state		-	-
Public sector	**45.47**	**46.29**	**45.39**
Alcatel Participations	13.76	13.75	22.03
Groupe Industriel Marcel Dassault (GIMD)	4.16	4.16	4.46
Industrial Partner	**17.91**	**17.91**	**26.48**
Coordinated shareholders	**63.38**	**64.20**	**71.87**
Thales	**-**	**-**	**-**
Free float	**36.62**	**35.80**	**28.13**
of which employees	5.13	4.61	2.61
Total	**100.00**	**100.00**	**100.00**

* companies wholly owned by the French State

(1) *Plan d'Epargne Groupe* / Group Savings Plan

(2) *Fonds Commun de Placement d'Entreprise* / Company Investment Fund

CORPORATE GOVERNANCE

Board of Directors

Note: *This section contains the main points of the Chairman's Report required by the French Financial Security Act (LSF), submitted to the General Meeting of 11 May 2004.*

Thales subscribes to the principles contained in the AFEP/MEDEF paper on the governance of listed companies, published in October 2003. The Group endeavours to apply them, within the constraints imposed by the shareholders' agreement between the Public Sector and the Industrial Partner, particularly concerning Board membership (see page 92).

BOARD ADMINISTRATION

Board membership rules

The provisions of the shareholders' agreement, applicable until the General Meeting of 11 May 2004, stipulate that the Board comprises sixteen directors, of whom 13 are appointed by the General Meeting and 3 elected by the employees of the Group's French companies according to the law and the articles of association:

- **Directors appointed by the General Meeting of Shareholders**

  5 persons proposed by the Public Sector,

  4 persons proposed by the Industrial Partner,

  3 "outside directors", according to the shareholders' agreement,

  1 representative of employee-shareholders, as provided for in Article 10 of the articles of association

- **Directors elected by employees**

  3 employee representatives, appointed as provided for in article L. 225-27 of the French Commercial Code.

On the date of calling of the General Meeting of 11 May 2004, these positions were occupied as follows:

- Persons proposed by the Public Sector: Denis Ranque, Bertrand Dufourcq, Louis Gallois, Daniel Lebègue, and TSA, formerly Thomson SA, represented by Marcel Roulet
- Persons proposed by the Industrial Partner: Jean-Paul Barth, Marcel Dassault, Serge Tchuruk, Benoît Tellier
- Outside personalities: Roger Freeman and Henri Proglio [1]
- Representing employee shareholders: Pierre Lafourcade
- Representing employees: Marie-Paule Delpierre, Annie Legendre and Didier Gladieu

Modifications submitted to the General Meeting of 11 May 2004

The General Meeting of 11 May 2004 :

- ratified, appointed or re-elected thirteen directors (Resolutions 6 to 18), including five persons proposed by the Public Sector, four by the Industrial Partner and four outside directors, instead of three previously (see pages 116 and 117);

- and reduced the number of directors elected by employees from three to two (Resolution 21).

The purpose of these modifications is to increase the number of outside directors while maintaining the advantages of a shareholders' agreement.

Statutory requirements

Thales shares held by the Directors

- During his or her mandate, as of 30 June 2003 and in compliance with the articles of association (Article 10) except where a legal waiver may apply, each director must own at least 500 Thales shares (compared to 50 previously).

  On the date of calling of the General Meeting of 11 May 2004, the directors (natural persons only) held 16,785 Thales shares, approximately 0.01% of the Company's share capital.

- Under the Code of Conduct, directors, like any person holding insider information, must refrain from trading in Thales securities, as long as they hold privileged information which may affect the share price, and/or from disclosing this information to a third party. In particular, directors are obliged to refrain from trading twice a year, before disclosure of the annual and half-year financial statements, for a period laid down by Corporate management at the start of the year.
- In compliance with Recommendation 2002-01 from the French financial market authority COB, directors must disclose their transactions in Thales securities to the Company every six months. All transactions conducted by directors must be notified by the Company to the AMF (Autorité des Marchés Financiers), formerly the COB.

Duration of term

In accordance with the articles of association (Article 10), Board's directors are appointed or elected for a six-year term.

- The terms of directors appointed by the General Meeting expire at the end of the ordinary General Meeting called to approve the financial statements for 2003, except for Pierre Lafourcade (the meeting to approve the 2004 statements) and Benoît Tellier (the meeting to approve the 2005 statements). The General Meeting of 11 May 2004 was consequently asked to re-elect a large proportion of the Board of Directors, (see below):
- The three directors elected by employees were elected for six-year terms in November 1998.

Modifications approved by the General Meeting of 11 May 2004

The General Meeting of 11 May 2004 was asked to vote on changing the duration of terms (Resolution 20) for the twelve directors due to be appointed or re-elected on this occasion. The approved resolution states that one third of these twelve directors serve for two years, one third for four years, and one third for six years, to avoid the General Meeting having in the future to re-elect virtually all the Board at once. The official term for a director remains six years for any subsequent appointments or re-elections.

(1) After resignation of Mr Bilger in August 2003

Standing Orders

Until 2004, there have been no Standing Orders as such for the Board, since its administration was already covered by the provisions of the Code of Ethics, Code of Conduct and Shareholders' Agreement.

All the provisions relating to the administration of the Board and its standing committees will be consolidated and codified in Standing Orders by the board in 2004 upon proposal of the Nomination and Remuneration committee.

Board committees

By a decision of 24 July 1998, the Board set up standing committees of directors, and laid down their missions. They meet as required by their functions and any decisions taken by the Board as a whole.

Each committee reports back to the Board, makes proposals concerning the issues before it, expresses any opinions or suggestions it may consider appropriate, and draws the Board's attention to any points that it considers may raise difficulties or require a decision by the Board.

In 2001, the Board decided to grant a maximum flat-rate compensation of €4,000 per year to the members of these committees, prorated to attendance (see below).

Thirteen directors are members of committees.

• Audit committee

This committee ensures that the accounting methods used to draw up the Company's individual and consolidated accounts are appropriate and consistent, verifies that the internal procedures for collecting and monitoring information are properly enforced, and validates the quality of the information provided to shareholders. To that end, the committee examines the draft individual company and consolidated half-yearly and annual financial statements before they are submitted to the Board, examines any modifications to the accounting principles and rules applied in drawing up the accounts, and any failure to apply these principles or rules, and ensures the quality of the procedures used to comply with financial and stock exchange regulations.

In addition to these functions, this committee was given an auditing role at the Board meeting of 13 November 2003. The committee must ensure that internal control procedures are implemented to manage any risk that may impact the financial statements.

The four members of this committee in 2003 were Daniel Lebègue (Chair), Jean-Paul Barth, Roger Norman Freeman, and Annie Legendre.

• Nomination and remuneration committee

This committee's main area of interest is membership and administration of the Board of Directors; it examines the candidacies of future directors, and the compensation of the Chairman, and of any other senior officer who may be a legally responsible mandataire social within the meaning of the French Commercial Code. In addition, the Committee examines the compensation policies applying to senior managers, examines stock option plans, and makes proposals on profit-sharing incentives for the Group's employees. In particular it expresses its opinion on any plan to extend employee shareholding.

The members of this committee in 2003 were Serge Tchuruk (Chair), Bertrand Dufourcq, Didier Gladieu, and Marcel Roulet. In 2003, the committee did not include any "outside director" under the terms of the Shareholders' Agreement.

• Strategy committee

The Strategy Committee reviews the draft annual budget as part of the Group's strategic plan, before it is submitted to the Board of Directors. It monitors the application of the co-operation agreement signed on 18 November 1999 between the Company and its main shareholders, and reviews the progress of specific co-operation programmes covered by the agreement in the technical, industrial, commercial and intellectual property spheres. It examines significant acquisition and divestment plans, together with plans for strategic alliances and technological and industrial co-operation.

The members of the committee in 2003 were Denis Ranque (Chair), Serge Dassault, Marie-Paule Delpierre, Louis Gallois, Pierre Lafourcade and Serge Tchuruk. In 2003, the committee did not include any "outside director" under the terms of the Shareholders' Agreement.

DIRECTORS ON THE DATE OF CALLING OF THE GENERAL MEETING OF 11 MAY 2004

On the date of calling of the General Meeting of 11 May 2004, the Board comprised 15 members, 12 of whom were appointed by the General Meeting and 3 elected by employees. Their average age is 60.

As mentioned above, the terms of ten of the twelve directors appointed by the General Meeting expired at the General Meeting of 11 May 2004. Furthermore, Pierre Bilger, whose co-option was ratified by the General Meeting of 15 May 2003, resigned as director in August 2003. His position as an "outside director" has remained vacant until the General Meeting of 11 May 2004.

Directors appointed by the General Meeting of Shareholders

Denis Ranque
Age: 52 - Nationality: French
Number of Thales shares: 4,675 (1)
Chairman and Chief Executive Officer of Thales since 20 January 1998. For the Company's articles of association to comply with the New Economic Regulations Act (NRE), the Board of Directors confirmed in 2002 that the positions of Chairman and Chief Executive Officer are not separate.
Other positions held: Chairman of the Board of the Ecole Nationale Supérieure des Mines, Paris, Chairman of the Cercle de l'Industrie, director of Compagnie de Saint-Gobain and the Ecole Polytechnique foundation.

Jean-Paul Barth
Age: 62 - Nationality: French
Number of Thales shares: 500
Senior Executive Vice-President of Alcatel
Other positions held : Chairman and Chief Executive Officer of Alcatel CIT and Compagnie Financière Alcatel, Chairman of Electro-Ré, director of Château Malescasse, Alcatel Standard AG, Electro Banque, Alcatel Participations, Alcatel USA Holdings Corp., Diot and Rockwell-Collins France, member of the supervisory board of Faceo.

Serge Dassault
Age: 79 - Nationality: French.
Number of Thales shares: 3,757
Chairman and Chief Executive Officer of Groupe Industriel Marcel Dassault (GIMD)
Other positions held : Honorary Chairman of Dassault Aviation and the French Aerospace Industry Association (GIFAS). Director of Sogepa, Dassault Falcon Jet, Dassault Développement and Erbe. Legal manager of Château Dassault, Immobilière Argenteuil - Le Parc, Immobilière de Maison Rouge and Société Immobilière du Rond-Point des Champs-Elysées. Chairman of Rond-Point Immobilier SAS and Société de Véhicules Electriques SAS. Chairman of the supervisory board of Figaro Holding and member of the supervisory board of Socpresse.

Bertrand Dufourcq
Age: 70 - Nationality: French
Number of Thales shares: 500
Ambassador
Other positions held : Chairman of the Fondation de France and the Centre de Musique Baroque de Versailles, Director of Banque Transatlantique. Chairman and Executive Director of Trans Pacific Fund (NSMD).

Roger Norman Freeman
Age: 62 - Nationality: British
Number of Thales shares: 625 (1)
Chairman of the Advisory Board of PricewaterhouseCoopers Corporate Finance
Other positions held : Chairman of Thales UK plc, Racal Senior Management Trustee Ltd, Racal Staff Trustee Ltd, Racal-Decca Pension Trustee Ltd, Racal Executive Trustee Ltd and Metalysis Ltd. Member of the Advisory Board of IDDAS Ltd. Former UK Minister for Defence Procurement in 1994/1995.

Louis Gallois
Age: 60 - Nationality: French
Number of Thales shares: 501
Chairman of SNCF
Other positions held : Other positions held: Director of EADS N.V., Société de Gestion de Participations Aéronautiques (Sogepa), the Ecole Centrale des Arts et Manufactures and Sogeade Gérance SAS.

Pierre Lafourcade
Age: 59 - Nationality: French
Number of Thales shares: 2,064 (1)
Vice-President Strategy of Thales Business Group Land & Joint Systems
Other positions held : Vice-President of the Thales Employee Shareholders' Association (APAT), Director of the Centre d'Etudes et de Prospective Stratégique (C.E.P.S.) and the Maison des Polytechniciens S.A.

Daniel Lebègue
Age: 61 - Nationality: French
Number of Thales shares: 500
Chairman of the French Company Directors' Institute (IFA)
Other positions held : Director of Alcatel, Scor, Technip and Gaz de France. Member of the supervisory board of Areva.

Henri Proglio
Age: 54 - Nationality: French
Number of Thales shares: 500
Chairman and Chief Executive Officer of Veolia Environnement (VE)
Other positions held : various responsibilities in companies of the VE Group in Australia, France, Singapore, Spain, Sweden, United Kingdom, and United States; Director of Casino, member of the supervisory board of Elior, Director of the French Space Agency CNES and EDF International. Henri Proglio's appointment as member of the supervisory board of Lagardère SCA was approved by the General Meeting of that company on 11 May 2004.

Serge Tchuruk
Age: 66 - Nationality: French
Number of Thales shares: 500
Chairman and Chief Executive Officer of Alcatel
Other positions held : Chairman of Alcatel USA Holdings Corp. and Member of the supervisory board of Alcatel Deutschland GmbH. Director of Total, Société Générale and Institut Pasteur, member of the board of directors of the Ecole Polytechnique.

Benoît Tellier
Age: 54 - Nationality: French
Number of Thales shares: 500
Coopted by the Board on 1 July 2003, to replace Olivier Houssin. *The General Meeting of 11 May 2004 ratified this cooption as director (Resolution 6).*
Special adviser to the Chairman of Alcatel
Since joining the Alcatel Group in 1988, Benoît Tellier has been Deputy Chief Executive Officer of Alcatel Trade International, Deputy Chief Executive Officer of Câbleries de Lens, Financial Director of Alcatel Space, Financial Director of the Alcatel Group's telecoms sector, and Chief Executive Officer of Alcatel Space.
Other positions held : Director of Electro Ré

(1) including FCPE (company investment fund) units invested in Thales shares.

TSA – formerly Thomson SA
TSA holds 44,562,623 Thales shares and has no other directorship.
It is **represented by Marcel Roulet**, 71, former Chairman of TSA, Thales and France Telecom.
Mr Roulet holds 601 Thales shares in his own right [1].

Other positions held : Director of Thomson (formerly Thomson multimedia), Crédit Commercial de France and France Télécom. Chairman of the supervisory board of Gimar Finance SCA and member of the supervisory board of Eurazeo.

Directors elected by employees

In November 1998, three directors were elected, for terms of 6 years expiring in November 2004, by the employees of the Group, whose registered office is located in France, in compliance with Article L 225-27 of the French Commercial Code and the articles of association.

Marie-Paule Delpierre
Age: 55 - Nationality: French
Number of Thales shares: 562 [1]
Manager in the Naval and Aeronautical Communications business unit of Thales Communications S.A;

Didier Gladieu
Age: 46 - Nationality: French
Number of Thales shares: 500
Contract manager in the sales and marketing department of Thales Naval S.A.
Other directorships : Director of Thales Naval S.A.

Annie Legendre
Age: 54 - Nationality: French
Number of Thales shares: 500
Wiring fitter at Thales Air Defence S.A.

Modification submitted to the General Meeting of 11 May 2004

The General Meeting of 11 May 2004 approved the reduction of the number of directors elected by employees from three to two.

OTHER PERSONS ATTENDING BOARD MEETINGS (WITH NO VOTING RIGHTS)

In addition to the members of corporate 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 only:

- **Representing the French State's golden share**

  Yves Gleizes, 61, former Chief of Defence Procurement, French Ministry of Defence. He was replaced as the state's representative by **Laurent Collet-Billon**, 54 (decree of 17 May 2004).

  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 92) and as provided for in Article 10 of the articles of association.

- **Government Commissioner**

  Denis Plane, 56, Comptroller General of the Armed Forces on special secondment

  Appointed Government Commissioner to the Company 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**

  Christian Motreff, 53, labour union representative.

  Appointed in December 1998 and confirmed in this position in March 2003 by the Central Works Council to represent it on the Board of Directors of Thales, in compliance with Article L. 432-6 of the French Labour Code.

- **Statutory auditors**

  Also attending all Board meetings (including meetings held to approve the financial statements):

  Christian Chiarasini, 54, partner, Ernst & Young Audit.

  Thierry Colin, 49, partner, Mazars & Guérard

(1) including FCPE (company investment fund) units invested in Thales shares.

BOARD ACTIVITY IN 2003

The Board of Directors met six times in 2003 on dates set at the end of 2002; no further meetings were required. The meetings lasted on average three hours, and director attendance in 2003 exceeded 85%.

The auditors were invited to and attended the six meetings. They received the same information as the directors.

Main topics discussed

In addition to recurring topics for Board meetings (annual budget and updates, annual and half-year financial statements, compensation of the Chairman and Chief Executive Officer, notice of General Meeting, strategy review and examination of major current projects, approval of regulated agreements, etc.), the agendas in 2003 included the following points, in some cases with reports from the relevant standing committee (see below):

- cooption of directors,
- selection of an external auditor,
- allocation of stock options,
- transfer of the registered head office,
- adoption of an internal audit charter,
- evaluation of Board administration.

Preparatory work for Board meetings

Information for directors

Directors generally received the Notice for Board meetings, together with preparatory material and the minutes of the previous meeting, between six and ten days before the date of the meeting.

In some cases, further material was sent to them later, or handed to them during the meeting, if the matter was urgent. Since the end of 2003, the directors have been sent a press review and a selection of financial analyses relating to the Company. Furthermore, the Company's press releases, other than those discussed at Board meetings, are sent to them as they appear.

Senior corporate officers made a presentation about the Group for the directors coopted in 2003. Special information programmes are available, but none were requested.

Administration of standing committees

Audit Committee. The committee met four times in 2003, with an 81% attendance record, for varying periods averaging more than two hours per meeting. The external auditors attended all these meetings.

The Board meeting of 13 November 2003 decided to extend the committee's auditing role, which was formerly restricted to auditing of financial statements. The committee is tasked with ensuring that internal control procedures are implemented to manage any risk that may impact the financial statements.

In addition to the annual and half-yearly balance sheets and profit and loss statements, in 2003 the committee reviewed off-balance-sheet exposures and developments in litigation cases, budget updates, and the report of the internal audit, for which it had previously approved the annual work programme. At the start of the year, the committee also supervised the call for tenders for an external auditor, and recommended a candidate, who was approved by the Board and appointed by the General Meeting of 15 May 2003.

In line with new legal requirements relating to internal controls, the committee also submitted to the Board an internal audit charter and approved the implementation of an internal control manual throughout the Thales Group.

Nomination and Remuneration Committee. The committee met four times in 2003, with a 100% attendance record, for an average of one and a half hours per meeting.

Topics discussed in 2003 included the compensation of the Chairman and Chief Executive Officer and the addition of an amendment to his work contract (deferred in 1998), the cooption of directors, and stock option policy. The committee also prompted the decision taken in 2003 to evaluate the administration of the Board (see below)

Strategy Committee. The committee met three times in 2003, with an 89% attendance record, for an average of two and a half hours per meeting.

In addition to the annual budget within the moving three-year Strategy Plan, topics discussed included R&D, IT&S strategy, and naval and aerospace strategies. Each committee reported on its work and submitted any recommendations to the following Board meeting.

Evaluation of Board administration

In July 2003, at the suggestion of the Nomination and Remuneration Committee, the Board decided for the first time to have a formal evaluation made of its own and the Standing Committees' administration with the assistance of an outside consultant chosen after competitive tender. The evaluation report produced by this mission was presented to the Board in November 2003.

After noting that its administration was judged in the report to be satisfactory overall, the Board asked the Nomination and Remuneration Committee to make recommendations for improvements both in form and substance. The committee made proposals that were adopted in February 2004. Details of implementation will be provided in the Chairman's Financial Security Act (LSF) Report on 2004.

DIRECTORS' COMPENSATION

Attendance fees and other compensation paid to directors

The General Meeting of shareholders set the total amount of attendance fees at €400,000 per year as from 2001. The Board of Directors decided to split this amount equally between fixed and variable fees. The fixed portion is shared equally among directors (proportionately reduced in the case of resignation, appointment or cooption during the year) and the variable portion is allocated according to attendance at Board meetings. The fixed annual fees and variable fees for the second half of each year are paid at the beginning of the following year.

At the time of his appointment in 1998, Chairman Denis Ranque informed the Board that he would waive payment of his attendance fees. Louis Gallois has also waived payment of these fees.

The Board of Directors has decided to award to each member of the various Board committees an annual fee of €4,000 per person per committee, prorated to attendance. The total fees amounted to €42,333 for 2003 and were paid in January 2004.

The Chairman and Louis Gallois have also waived payment of these fees.

Compensation paid to the Chairman and Chief Executive Officer

The gross fixed portion paid by Group companies to the Chairman, Denis Ranque, in respect of 2003, totalled €600,000.

After examination by the Nomination and Remuneration Committee, the Board of Directors decided in March 2003 that the variable portion of compensation for the Chairman and CEO in respect of 2003 would be set according to results (EBIT), cash and other qualitative criteria.

On 11 March 2004, the Board of Directors decided that, on the basis of the 2003 results, the gross variable portion of the compensation paid to the Chairman and CEO in 2004, in respect of 2003, would be €572,000, representing 95% of the fixed part of his compensation.

As mentioned above, the Chairman has waived payment of his attendance fees.

Denis Ranque also holds 350,301 stock options (see table on page 90). In addition, he has a company car.

Total compensation (including all perquisites) paid by the Company or Group companies to each Board member, during 2003

In compliance with the recommendations of the COB in January 2003, salaries paid to directors elected by Group employees or representing shareholder employees are not included in the following table.

	Euros
Denis Ranque	876,497
Jean-Paul Barth	31,139
Pierre Bilger (coopted in January 2003, resigned in August 2003)	5,444
Gerhard Cromme (resigned in 2002; replaced by Henri Proglio)	9,358
Serge Dassault	26,242
Bertrand Dufourcq	33,139
Jacques Dunogué (resigned in 2002; replaced by Olivier Houssin)	2,299
Roger Norman Freeman	84,579
Louis Gallois	nil
Olivier Houssin (resigned in May 2003, replaced by Benoît Tellier)	22,893
Pierre Lafourcade	38,482
Daniel Lebègue * for 2003 only	6,483
Henri Proglio (coopted in January 2003)	5,444
Bruno Roger (resigned in 2002; replaced by Pierre Bilger in 2003)	18,977
Marcel Roulet, permanent representative of TSA (previously Thomson SA)	33,139
Serge Tchuruk *	nil
Marie-Paule Delpierre *	nil
Didier Gladieu *	nil
Annie Legendre *	nil

* Director who has named a legal entity to receive their attendance fees and compensation for attendance at Standing Committee meetings

Except for Mr Ranque and Lord Freeman, the above-mentioned amounts represent only Board and Committee attendance fees received in 2003 (part of which represents fees in respect of 2002, as mentioned under "Attendance fees" above), Messrs Ranque and Gallois have waived payment of these fees.

BOARD OF DIRECTORS FOLLOWING THE GENERAL MEETING OF 11 MAY 2004

• *Directors appointed by the General Meeting of Shareholders*

	Term and expiry of directorship	
5 persons proposed by the Public Sector		
Denis Ranque, reappointed	*6 years*	*OGM 2010*
Louis Gallois, reappointed	*4 years*	*OGM 2008*
François Bujon de l'Estang, appointed	*4 years*	*OGM 2008*
Denis Samuel-Lajeunesse, appointed	*6 years*	*OGM 2010*
TSA, reappointed	*2 years*	*OGM 2006*
4 persons proposed by the Industrial Partner		
Jean-Paul Barth, reappointed	*2 years*	*OGM 2006*
Serge Dassault, reappointed	*4 years*	*OGM 2008*
Serge Tchuruk, reappointed	*4 years*	*OGM 2008*
Benoît Tellier, ratified		*OGM 2006*
4 outside personalities		
Charles de Croisset, appointed	*6 years*	*OGM 2010*
Roger Freeman, reappointed	*2 years*	*OGM 2006*
Klaus Naumann, appointed	*2 years*	*OGM 2006*
Henri Proglio, reappointed	*6 years*	*OGM 2010*
1 representative of employee shareholders, appointed by the General Meeting of 10 March 1999		
Pierre Lafourcade	*6 years*	*OGM 2005*

• *Directors elected by employees*

3 employee representatives,
elected in November 1998 for a term of 6 years

Marie-Paule Delpierre
Didier Gladieu
Annie Legendre

The four "outside directors" are not appointed upon proposal of one or more sharehodlers bound by a shareholders' agreement.

The four new directors whose appointment was approved by the General Meeting of 11 May 2004 are:

François Bujon de l'Estang
Age: 63 – Nationality: French
Ambassador. Former French Ambassador to the United States, from September 1995 to December 2002.
Other positions held : Chairman of Citigroup France and member of the International Advisory Board of Citigroup, since January 2003; Director of French space agency CNES, Institut Français des Relations Internationales (IFRI) and Vice-President of the Institut Pasteur
He held no Thales shares on the date of notification of the General Meeting of 11 May 2004.

Charles de Croisset
Age: 60 – Nationality: French
Since 1988, held various senior executive positions at the Crédit Commercial de France, and became Chairman and Chief Executive Officer from 1993 to 1 March 2004.
Other positions held : Director of Bouygues, and member of the supervisory board of Euler & Hermès, and SA des Galeries Lafayette Charles de Croisset's appointment as director of Renault was approved by that company's General Meeting of 30 April 2004.
He held no Thales shares on the date of notification of the General Meeting of 11 May 2004.

Klaus Naumann
Age: 64 – Nationality: German
Bundeswehr general (ret.), Chairman of the NATO Military Committee from 1996 until his retirement in 1999.
Since then, he has had various roles of consultancy and assistance with international, especially UN, bodies, and was Managing Director Europe for Teledesic Seattle from 1999 to 2002.
Other positions held : Chairman of the supervisory board of OWR (Odenwald Werke Rittersbach) since 2003.
He held no Thales shares on the date of notification of the General Meeting of 11 May 2004.

Denis Samuel-Lajeunesse
Age: 56 - Nationality: French
Managing Director, State Owned Assets Agency of the French Treasury
Previously, he was Chairman and Chief Executive Officer of Lyonnaise de Banque and Banque Vizille (from 1992 to 2002).
Other positions held : Director representing the State on the Boards of France Telecom and Air France.
He holds no Thales shares.

Since the Board meeting of 12 May 2004, the audit committee is chaired by Charles de Croisset, outside director; the other members are Jean-Paul Barth, Roger Norman Freeman, Annie Legendre and Denis Samuel-Lajeunesse; the nomination and remuneration committee is chaired by Henri Proglio, outside director; the other members are François Bujon de l'Estang, Didier Gladieu, Marcel Roulet and Serge Tchuruk; since the Board meeting of 12 May 2004, the membership of the strategy committee has remained unchanged.

Corporate management

EXECUTIVE COMMITTEE

The Executive Committee of the Company and Group is a collegiate body chaired by the Chairman and Chief Executive Officer, comprising nine members in charge of the main operating and corporate functions.

At 31 December 2003, the members of the Executive Committee were:

- **Chairman-Chief Executive Officer**
  Denis Ranque, 52
- **Vice Chairman**
  Bernard Rétat, 65
- **Executive Vice Presidents**
  John Hughes, 52,
  COO Civil Business Development
  François Lureau*, 59,
  COO Competitiveness
  Jean-Paul Perrier, 58,
  Chief Marketing Officer, Chairman and CEO Thales International
- **Senior Vice Presidents**
  Yves Barou, 56, Human Resources
  Alex Dorrian, 57, Senior Vice President, Defence, and Chief Executive Thales UK plc
  Alexandre de Juniac, 41, Corporate Secretary
  Ross McInnes, 50, Chief Financial Officer
  Jean-Loup Picard, 58, Group Strategy & Development

The Chairman and CEO is the only member of the Executive Committee who is a legally responsible mandataire social within the meaning of the French Commercial Code.

** On 18 February 2004, François Lureau was appointed Chief of Defence Procurement by the French government. Since that date and as at the publication of this report, his temporary replacement has been Bernard Rocquemont, now a member of the Executive Committee.*

POWERS OF THE CHIEF EXECUTIVE OFFICER

In compliance with the French New Economic Regulation Act of 15 May 2001, the possibility of separating the functions of Chairman of the Board of Directors and 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.

COMPENSATION OF SENIOR CORPORATE OFFICERS

Compensation paid to the Chairman and Chief Executive Officer of Thales in respect of 2003

Details of the compensation of the Group Chairman and Chief Executive Officer are given on page 101.

Compensation paid to senior managers

The total compensation paid to the nine members of the Executive Committee other than the Chairman present in respect of 2003 amounted to €5,150,469 , including a variable proportion of 35%. As in the case of the Group Chairman-CEO, the variable compensation is based on quantitative and qualitative performance criteria.

The nine members of the Executive Committee other than the Chairman have been granted a total of 895,232 stock options, dates and details of which are given in the table on page 90.

Incentive plan and profit-sharing

Most Group companies have negotiated incentive agreements. In respect of 2002, fourteen companies paid out a total of €15.84m in incentive bonuses, an average of €1,003 for each of the 15,800 eligible employees.

Profit-sharing in 2003 amounted to €26.08m from eighteen companies, an average of €1,208 for each of the 21,500 eligible employees.

Total profit-sharing and incentives accounted for 2.6% of the gross 2003 payroll.

Gross incentives and profit-sharing payments over five years

Payments made in respect of previous year (€m)	2003	2002	2001	2000	1999
	Group in France		Thales SA		
Profit-sharing	26.0	22.0	0	0	0
Incentives	15.8	19.0	2.0	1.2	0

"Group in France" includes the company, all subsidiaries under majority control, and joint ventures.

Payments by the Group in France in 2001 in respect of 2000 are estimated at €17.8m for profit-sharing and €10.2m for incentives. In the interests of accuracy, the table gives figures for the parent company only before 2002.

Internal audit

BACKGROUND

For some fifteen years now, Thales has had internal control procedures that apply in particular to its accounting and cash management systems, sales and marketing, purchasing, production and information technology. From the outset, the Group's external auditors have been involved in this process, and each year they produce a special report on the quality of internal control in the Group's main companies. They also helped Thales over ten years ago to design a 40-hour training course which approximately 300 financial officers had followed by 2000. They assisted the development within the Group of a robust corporate culture of internal control, mainly in France until the beginning of the 2000s. For more than ten years, the Group has also required all its subsidiaries to obtain ISO 9000 qualification; their staff are thus familiar with the rules and constraints of internal control and how to apply the procedures. Given the nature of their business, the Group's companies are at all times subject to strict regulatory controls imposed by the public authorities (defence, industry, civil aviation, etc.) in their main client countries; these have become significantly stricter in recent years.

CURRENT ORGANISATION AND RESOURCES

Defined according to the United States COSO Framework [1] and the professional standards of the IIA and IFACI [2], the internal control procedures used within Thales are intended to apply to all companies in which the Group has a controlling interest or manages operations. Compliance will be verified first in the 137 largest companies in the Group, which account for 92% of total consolidated revenues. To ensure good governance, in 1998 Thales created three Board standing committees (see page 100) and in 2000 produced a Code of Ethics and a corporate ethics manual.

- A reference system was drafted in 2000 and deployed in 2001 in all the Group's operating units. The system comprises:

- the Group's mission statement and values

- the Code of Ethics

- a description of the Group's organisation, overall structure and the role of each component, particularly the central and operational structures.

- It is supported by a highly detailed database, the common Thales knowledge base, which lists by topic the directives and procedures of all Group corporate departments. The knowledge base is maintained and updated by a dedicated team.

- On 1 January 2002, a specific structure reporting to the Senior Vice President, Chief Financial Officer was set up: Internal Audit fulfils its missions in cooperation with the Board's Audit Committee, all of corporate management, and the external auditors. At end-2003, Internal Audit had seven members including one in the United Kingdom and one in the United States.

An internal audit charter laying down the basic principles of internal control, the Internal Audit's mission, scope and limits of its responsibilities and types of action was approved by the Board in November 2003. Specifically, Internal Audit may intervene in any key Company process to assess risk management and the quality of internal control.

- In 2003, the internal control manual was produced, reviewed by the external auditors, and distributed to all Group units. The manual identifies the major risks to which the Group's processes are exposed, and proposes an appropriate internal control response for each risk and the process to adopt to manage it [3]. Internal Audit also runs a dedicated intranet site accessible by all unit heads, containing the internal audit charter and internal control manual. It gives access to the Group reference system and all relevant specific details.

IMPLEMENTING INTERNAL CONTROL

Internal control is implemented by the Chief Financial Officers of Group companies with the support of the management control team to ensure proper operational control in all units. They apply the rules of internal control "in the field" together with the account managers of their operating units. Internal control also applies to complex, high-risk operations handled by corporate services for all Group units, namely:

- **Capital investment and divestment**

  No Group company or unit may decide to acquire or divest, in whole or in part, any external company without the approval of the Group strategy and development department.

(1) "Internal control is broadly defined as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives", Committee of Sponsoring Organizations of the Treadway Commission (COSO), 1992

(2) IIA : Institue of Internal Auditors; IFACI : Institut Français de l'Audit et du Contrôle Interne

(3) A total of 450 risks have been identified, between 2 and more than 20 for each process (an average of 10 per process).

- **Short-term cash-flow**

  No Group company may lend to or borrow from local banks, except for the overdraft facilities necessary for the proper administration of its accounts. The Group's corporate treasury department centralises the management of cash-flow for all units and has laid down specific agreements with each Group company to ensure that their relations are managed in compliance with local regulations.

- **Medium- and long-term financing**

  The Group's project export and trade finance department covers financing requirements for all subsidiaries. No local financing operations are authorised.

- **Financing of export programmes**

  Each export finance operation (guarantee, customer credit, documentary credit, or other more complex operation) is prepared by local experts working with the Group's international project export and trade finance department. For any operation involving large sums or a high degree of complexity, financing is handled directly and exclusively by this corporate department.

- **Exchange rate hedging**

  All units' exchange rate risks connected with purchases as well as sales must be hedged. This hedging is the sole responsibility of the Group's corporate treasury department.

- **Property management**

  All property transactions are the sole responsibility of the Group's real estate department. The department may delegate the transaction, especially outside France, either to the Group's central organisation in a given country, if there is one, or to a local Group company. In every case, the corporate real estate department retains control of the transaction.

- **Company law**

  The Group companies department holds a central file on all Group companies comprising all their legal and financial details updated each year. The department monitors changes in their net cash position, board membership, and, for joint ventures, the application of the shareholders' agreements.

- **Insurance**

  The Group has a specialised subsidiary that handles all insurance policies for all Group companies, in order to optimise their total cost and ensure that all the insurable risks to which the subsidiaries are exposed are adequately covered (see also page 17).

- **Litigation**

  All legal disputes involving subsidiaries must be entrusted to the Group legal affairs department, which handles them directly.

Country management teams for the Group's main countries of operation provide the operating units in those countries with support concerning local legislation, particularly for taxation, company law, labour law, environment, anti-fraud and anti-bribery regulations.

KEY GROUP PROCESSES

The Group's reference system details all the key processes specific to its professional electronics and defence businesses, often as part of long-term contracts with a relatively small number of large customers in each country. In this way the Group focuses on:

- **Long-term strategic processes**, even exceeding ten years.
- **Optimising bid submission processes** to meet the customer's requirements most effectively at least cost, while ensuring a satisfactory return for the Group.
- **Continuous improvement in the management of long programmes,** both technically (product and service quality, on-time delivery) and financially (cash management, profit forecast accuracy);
- **Optimal management of technical and technological resources,** particularly through improved knowledge management.
- **Special arrangements for international sales and marketing,** managed globally by the Group subsidiary Thales International.
- **Human resources management:** Thales' competitiveness and expertise crucially depends on the excellence and competencies of its staff.

The other major processes subject to internal control are less specific to Thales, and include purchasing, information technology, quality, etc.

The Group reference system describes a total of 18 main processes in four sections: Management, Products and Programmes, Engineering and Manufacturing, and Support. Each process has its own objectives, strategy and key sub-processes, and the reference system explains their role and cites the relevant directives. The responsibilities of Group staff involved in each key sub-process are specified and referenced to data in the common knowledge base.

CONTROL OF FINANCIAL INFORMATION

Unit Chief Financial Officers are responsible for the application of accounting and financial procedures. They refer to manuals on accounting procedures, management control procedures, cash flow management and financing.

Consolidated financial statements have been prepared since 1991 with consolidation software that has become an industry standard. The software not only ensures that the accounting data are entered in a standard, consistent manner, but also verifies them automatically and transfers the validated data to the central accounting department.

The Group also uses a single software package for management and accounting reporting, ensuring that the two procedures are consistent.

Each year, Internal Audit and the external auditors review the financial audit manual that describes the phases of the external auditors' work and specifies the particular topics to be audited that year. Following the reviews made by the external auditors as part of their mission, Internal Audit inspects units to see that any remarks made by the external auditors are being followed up by an action plan for the next half-year.

INTERNAL AUDIT MISSIONS IN 2003

These missions included both recurring audits and audits specific to 2003. They were presented to the Board Audit Committee in March 2004. Recurring audits mainly concerned the follow-up to the external auditors' recommendations. Specific missions concerned:

- **The call for tender for a new external auditor,** following the expiry of Andersen's six-year term as Thales' external auditors.
- **Compliance with OECD guidelines on the bribery of public officials.** Compliance is also regularly audited at Thales International's regional agencies and at operating units. During the 2003 missions, no major anomaly was detected.
- **The quality of internal control in units that have joined the Group since 1998.** This only concerns Group companies outside France. Regular audits were made in 2002 and 2003 of the Group's 26 consolidated subsidiaries in the United States. Similar audits were started in the United Kingdom in 2003. Given the size and number of the Group's UK companies, this process will continue for a number of years.

Specific audits were also carried out at the request of corporate management, of which the longest, lasting 18 months, concerned the Group's compliance with methodological standards for defence and aerospace tendering. No major anomaly was detected in the operating units audited. The audit did, however, identify some failings in application and methodology, and remedial action plans have been launched.

PRIORITIES FOR 2004

The main areas for developing internal control procedures in 2004 are as follows:

- **Expansion of the Internal Audit staff** from seven to ten by the end of the year, with three additional staff members based in France, Germany and the United Kingdom.
- **Application of the internal control manual in operating units** so that they evaluate their internal control with respect to the 450 risks identified for all processes. Remedial action plans will be drawn up for risks that are not covered or insufficiently covered. The Internal Audit, in agreement with the Audit Committee, will produce a multi-year plan to cover one or more chapters in the manual each year for all Group companies.
- **Risk mapping.** The action plans implemented following previous mappings will be audited in 2004 and the defence business mapping will begin. A balance-sheet-type risk analysis will also be studied.
- **Improved information and training** for operational managers and their financial officers: effective deployment of internal control procedures as per the internal control manual depends to a great extent on managers' awareness of the issues involved and their ability to address them.

External auditors

Statutory auditors

• **Ernst & Young Audit**, Faubourg de l'Arche, 11 allée de l'Arche, 92 400 Courbevoie, represented by **M. Christian Chiarasini**	current auditors appointed by the Annual General Meeting of 15 May 2003, for six years expiring at the end of the Annual General Meeting called to approve the financial statements for 2008.
• **Mazars & Guérard**, Le Vinci, 4 allée de l'Arche, 92 075 La Défense Cedex, represented by **MM. Thierry Colin et Thierry Blanchetier**	current auditors appointed by the Annual General Meeting of 16 May 2001, for six years expiring at the end of the Annual General Meeting called to approve the financial statements for 2006.

Alternate auditors

• **Patrick de Cambourg**, Le Vinci, 4 allée de l'Arche, 92 075 La Défense Cedex,	current auditors appointed by the Annual General Meeting of 16 May 2001, for six years expiring at the end of the Annual General Meeting called to approve the financial statements for 2006.
• **Pascal Macioce**, Faubourg de l'Arche, 11 allée de l'Arche, 92 400 Courbevoie	current auditors appointed by the Annual General Meeting of 15 May 2003, for six years expiring at the end of the Annual General Meeting called to approve the financial statements for 2008.

Fees paid to auditors in 2003

	Mazars & Guérard		Ernst & Young Audit	
	Sum (K€)	%	Sum (K€)	%
1 – Audit				
Audit, certification, examination of individual and consolidated financial statements	5,174	76 %	4,282	68 %
Other missions	1,233	18 %	1,574	25 %
Sub-total	**6,407**	**95 %**	**5,856**	**93 %**
2 – Other services	371	5 %	420	7 %
Total	**6,778**	**100 %**	**6,276**	**100 %**

STOCK MARKET INFORMATION

Thales share

Listing

Thales shares are listed on the first market of the **Euronext Paris** Stock Exchange, where they are eligible for the SRD deferred settlement system.

- ISIN [1] Code: 12 132

- Reuters: TCFP.PA

- Bloomberg: HO FP

The share is included in the CAC40 index and the SBF 120 index, and is also an underlying share for options traded on the Paris Traded Options Market (MONEP).

Thales was traded on the official list of the London Stock Exchange from December 2000, and listed on the SEAQ. Listing was discontinued on 25 July 2003 because of negligible trading volumes.

Share indices

The Thales share is included in the following market indices:

• Paris: CAC40 (since 31 December 1987),
SBF120 (since 31 December 1990)

Since 1 December 2003, the capitalisation of CAC40 companies has been calculated on the base of the free float only [2]. When the index was first instituted, it was calculated on the basis of total share capital.

For information, at year-end 2003, Thales' market capitalisation, based on the 55% of shares held by the public, was €2,519m, or 0.4% of total CAC40 capitalisation; on the basis of total share capital, it would have been €4,580m.

• Euronext: Euronext 100

• International: DJ Eurostoxx, FTSE Eurotop 300

(1) International Securities Identification Number

(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.

SHARE PRICE AND TRADING VOLUMES ON EURONEXT-PARIS

Monthly figures for 2002, 2003 and Q1 2004 (price in euros)

2004	No. of trading days	No. of shares traded	Total value traded (€m)	Average daily trading volume	Weighted average price	Price per share high	Price per share low	Period-end
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
1st Quarter 2004	**64**	**46,371,158**	**1,377.65**	**724,549**	**29.71**	**32.00**	**26.17**	**31.14**

2003	No. of trading days	No. of shares traded	Total value traded (€m)	Average daily trading volume	Weighted average price	Price per share high	Price per share low	Period-end
January	22	16,254,922	433.56	738,860	26.67	28.19	25.00	26.04
February	20	12,473,646	289.13	623,682	23.18	26.94	19.86	21.26
March	21	14,110,443	308.54	671,926	21.87	23.65	18.12	21.06
1st Quarter 2003	**63**	**42,839,011**	**1,031.23**	**679,984**	**24.07**	**28.19**	**18.12**	**21.06**
April	20	12,117,929	272.72	605,896	22.51	24.27	23.74	23.97
May	21	10,083,854	238.75	480,184	23.68	24.75	22.12	23.60
June	21	19,628,412	505.98	934,686	25.78	27.66	22.73	25.85
2nd Quarter 2003	**62**	**41,830,195**	**1,017.46**	**674,681**	**24.32**	**27.66**	**22.12**	**25.85**
July	23	11,744,600	313.29	510,635	26.68	28.44	24.60	28.11
August	21	7,102,729	192.70	338,225	27.13	28.53	25.95	26.11
September	22	15,858,920	404.93	720,860	25.53	27.74	22.31	23.30
3rd Quarter 2003	**66**	**34,706,249**	**910.93**	**525,852**	**26.25**	**28.53**	**22.31**	**23.30**
October	23	14,418,413	348.20	626,888	24.15	25.22	22.60	24.80
November	20	16,373,642	417.98	818,682	25.53	26.50	24.51	26.01
December	21	11,861,143	312.80	564,816	26.37	27.43	25.52	26.65
4th Quarter 2003	**64**	**42,653,198**	**1,078.97**	**666,456**	**25.30**	**27.43**	**22.60**	**26.65**
2003	**255**	**162,028,653**	**4,038.59**	**635,406**	**24.93**	**28.53**	**18.12**	**26.65**

2002	No. of trading days	No. of shares traded	Total value traded (€m)	Average daily trading volume	Weighted average price	Price per share high	Price per share low	Period-end
January	22	9,954,075	377.48	452,458	37.92	39.15	36.35	38.00
February	20	9,996,997	380.00	499,850	38.01	39.50	36.65	37.65
March	20	9,665,688	388.83	483,284	40.23	41.77	37.11	41.16
1st Quarter 2002	**62**	**29,616,760**	**1,146.31**	**477,690**	**38.70**	**41.77**	**36.35**	**41.16**
April	21	12,196,453	510.44	580,783	41.85	44.21	39.67	42.40
May	22	19,837,311	868.36	901,696	43.77	46.20	41.05	43.88
June	20	13,281,435	559.99	664,072	42.16	45.27	39.66	43.00
2nd Quarter 2002	**63**	**45,315,199**	**1,938.79**	**719,289**	**42.78**	**46.20**	**39.66**	**43.00**
July	23	12,912,506	512.63	561,413	39.70	44.50	34.70	39.10
August	22	8,355,370	324.99	379,790	38.90	38.96	38.20	38.30
September	21	30,532,180	979.93	1,453,913	32.10	38.99	26.76	27.05
3rd Quarter 2002	**66**	**51,800,056**	**1,817.56**	**784,849**	**35.09**	**44.50**	**26.76**	**27.05**
October	23	18,815,699	513.91	818,074	27.31	30.20	24.50	27.25
November	21	17,274,045	463.07	822,574	26.81	29.31	23.05	28.42
December	20	10,160,010	266.37	508,001	26.22	25.84	24.95	25.23
4th Quarter 2002	**64**	**46,249,754**	**1,243.35**	**722,652**	**26.88**	**30.20**	**23.05**	**25.23**
2002	**255**	**172,981,769**	**6,146.00**	**678,360**	**35.53**	**46.20**	**23.05**	**25.23**

SHARE DATA

	Q1 2004	2003	2002
Thales share performance over the period *	+16.8%	+ 5.6 %	- 34.9 %
CAC40 performance over the period *	+1.9%	+ 16.0 %	- 33.7 %
Thales share performance within the CAC40	5th	26th	26th
Volatility high/low, in % (average per session: Thales / CAC40)	+ 2.59 / +1.13	+ 3.47 / +1.98	+ 3.59 / + 2.62
Trading volume (in number of shares traded) over the period	46,371,158	162,028,653	172,981,769
Trading volume in million euros over the period	1,377.65	4,038.59	6,146.00
Number of shares traded (monthly average)	15,371,158	13,502,387	14,415,147
Trading volume in million euros (monthly average)	459.22	336.55	512.17
Total Shareholder Return **	Not applicable	+ 9.03 %	- 33.08 %

* Closing prices

** Differential between closing prices on 31 December of each year, plus dividend before tax credit paid in the course of the year in respect of the previous year, relative to the opening price.

SHARE PRICE AND TRADING VOLUME 1999-2004

Thales share price (€)	**1999**	**2000**	**2001**	**2002**	**2003**	**Q1 2004**
Period-end	32.79	51.05	38.75	25.23	**26.65**	**31.14**
yearly change	*- 10 %*	*+ 56 %*	*- 24 %*	*- 35 %*	***+ 6 %***	***+ 17%***
Weighted average price	31.55	44.90	43.05	35.53	**24.93**	**29.71**
yearly change	*na*	*+ 42 %*	*- 4 %*	*- 17 %*	***- 30 %***	***+ 19 %***
High	37.50	57.75	55.00	46.20	**28.53**	**32.00**
Low	25.20	32.00	37.00	23.05	**18.12**	**26.17**
Average trading volume per session (€ '000)	280	290	444	678	**635**	**725**
Number of shares traded (millions)	71.0	73.4	112.2	173.0	**162.0**	**46.4**
Shares held by the public (millions) *	55.9	57.6	65.9	81.4	**82.4**	**82.4**
CAC40 – period-end	5,958.32	5,926.42	4,624.58	3,063.91	**3,557.90**	**3,625.23**
yearly change	*+ 51 %*	*- 1 %*	*- 22 %*	*- 34 %*	***+ 16 %***	***+ 2 %***

* period-end

Comments on traded volumes

Traded volumes in Thales shares in 2003 varied little from 2002, when adjusted to exclude Alcatel's divestment of 10.3 million shares in September 2003. Average daily volume was 635,400 shares, compared with 678,360 in 2002 (or 638,000 with the Alcatel adjustment). The total number of shares traded in 2003 was more than 162 million, compared with 173 million in 2002 (or 163 million with the Alcatel adjustment).

These relatively high figures compared with earlier years (71 million shares traded in 1999, 73 million in 2000, and 112 million in 2001) should be seen against the increase in the number of shares held by the public in recent years (see page 88), as a result of Alcatel's divestment of Thales shares in November 2001 and September 2002. On the other hand, operations reserved for employees, involving the obligation to hold the shares for a certain period, had little effect on trading volumes, although they did increase the free float.

For information, trading volumes in 2002 and 2003 amounted to roughly twice the free float at year-end, compared with factors of 1.7 for 2001 and 1.3 for 2000 and 1999.

Comments on share price

- Twice in the last five years, the Thales share price has diverged significantly from the CAC40, the major index of the Paris market: in 1999, when the "technology bubble" expanded at the expense of "traditional economy" stocks, such as Thales (then Thomson-CSF); and in 2000, when this bubble burst and investors returned to defensive stocks, such as Thales. However, in 2001 and 2002, the Thales share price moved in line with the index: in 2001, the CAC40 fell 22% and Thales 24%; in 2002, the CAC40 fell 34% and Thales 35%, ranking 26th of the 40 stocks in the index.
- **2003** : After two years of sharp decline, the Thales share price rose nearly 6%, but performed ten points below the CAC40 (+16%) over the year, ranking 26th as in the previous year.

In the first few months of the year, the share price continued to suffer from the impact of the Alcatel divestment at the end of 2002: investors anticipated a possible arrival of Thales shares on the market, released by either member of the shareholders' pact (overhang effect).

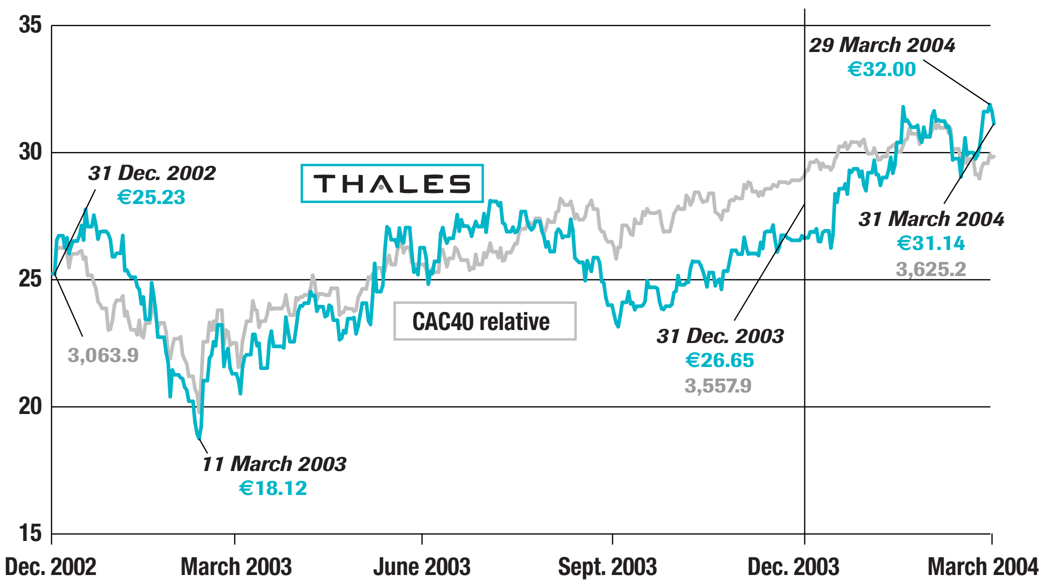
The general environment remained gloomy and uncertain, depressing market prices. From early January to August, the Thales share price moved more or less in line with the CAC40. Its year low came on 12 March at €18.12 (down 28% from the 2002 closing price), while the CAC40 was down 25%. From then until August, the price gradually rose in line with the index, to settle at €27-€28.

After August, the price began to fall, gradually under-performing the CAC40, which was rising: investors were disappointed by half-year results for IT&S and cautious about possible Thales moves in the European naval sector.

Third-quarter figures published in mid-November were favourably received, particularly since the revenue decline in IT&S had been halted, and the share price began to rise again and narrow its gap with the CAC40.

NB: detailed information on the stock markets and the Thales share price is given on Page 111.

Share performance, 31 December 2002 to 31 March 2004



Other Thales securities listed

EMTN programme

(see table on page 39)

Under the authority delegated by the General Meeting of 16 May 2002, for a five-year period, the Board of Directors meeting the same day vested in the Chairman powers to renew the Euro Medium Term Notes (EMTN) global programme totalling €1.5 billion. This programme was first implemented in September 2000.

At 31 December 2003, bond-denominated indebtedness under this programme was €547 million, including:

- a fixed rate debenture with a 6.125% coupon and a nominal value of €500 million, fully redeemable on 14 November 2005. Issued on 27 October 2000, this debenture was the first issue launched under the EMTN programme. These bonds are listed on the Paris and Luxembourg markets, but volumes traded are low. Placed at €100.084 on 27 October 2000, these bonds traded at €105.90 at year-end 2003 and at €105.96 at the end of first quarter 2004.
- Other variable rate borrowings, issued within the framework of this programme, stood at €47 million at year-end 2003.

OCEANE convertible bonds

These bonds convertible and/or exchangeable into new or existing Thales shares were issued in December 2001 and will be redeemed on 1 January 2007. Details of these bonds are given on Page 39.

These bonds are listed on the Luxembourg market but volumes traded are low. Issued at €50.97 in December 2001, they traded at €51.27 at year-end 2003 and at €52.65 at the end of first quarter 2004.

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.

In 1995 and 1996, shareholders were offered the option of dividend payment in the form of shares for the 1994 and 1995 financial years. 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.

Dividends paid over the last five years and the overall dividend yield as a percentage of the year-end share price for that year:

euros**	2003*	2002	2001	2000	1999
Dividend before tax credit	0.75	0.70	0.70	0.62	0.61
Tax credit	0.375	0.35	0.35	0.31	0.30
Dividend including tax credit	**1.125**	**1.05**	**1.05**	**0.93**	**0.91**
Year-end closing price	26.65	25.23	38.75	51.05	32.79
Total yield	4.2%	4.2%	2.7%	1.8%	2.8%

* Payment date 31 May 2004.

** The 1999 dividends were paid in French francs (FRF 4.00 before tax credit).

Financial information policy

It is Company policy to communicate clear and accurate information to the markets concerning its financial condition, strategy and management policies, in compliance with its Code of Ethics and generally accepted practice. Since 2003, the Board of Directors has published a report on the Group's risk exposure, in compliance with the French New Economic Regulations Act (NRE) of 15 May 2001. In 2004, the Chairman conducted a 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.

This policy of financial disclosure entails regular publication of mandatory information in legally required journals (such as the French official bulletin, BALO) and as recommended by the market authorities (e.g. press releases, repeated on the *Autorité des Marchés Financiers* website (1), brochures and activity reports). Thales also combines regulatory compliance with more qualitative information e.g. through twice-yearly conferences when the annual and interim financial statements are published. The Chairman and officers use these opportunities to comment on business developments and strategy, and give their views on market trends and Group objectives.

Financial disclosure diary, 2004

13 February	Publication of consolidated full-year revenues for 2003
15 March	**Publication of consolidated results for 2003** **Conference to comment on annual results**
11 May	Publication of consolidated first-quarter revenues for 2004
11 May	Ordinary and Extraordinary General Meeting of Shareholders
31 May	Payment of dividend on earnings for fiscal 2003
13 August	Publication of consolidated first-half revenues for 2004
16 September	**Publication of interim consolidated results for 2003** **Conference to comment on interim results**
12 November	Publication of consolidated third-quarter revenues for 2004

(1) www.amf-france.org

Conferences on results

The most recent press conference before publication of this report was held on 15 March 2003 for an audience of financial analysts and journalists. Chairman Denis Ranque and Chief Financial Officer Ross McInnes presented the Group's consolidated results for 2003 and commented on the prospects for growth in consolidated revenues and operating income in current year 2004. The Chairman also mentioned the uncertainties of the general economic environment and commented on the specific situations and prospects for the Group's business over the current year and the next two years.

Prospects for 2004, excluding exchange rate effects, were as follows:

- in Defence, stable revenues and slight growth in operating result;
- in Aerospace, stable revenues and operating result as in 2003;
- in IT & S, 10% growth in revenues for businesses retained and significant improvement in operating result over the full year;
- for Thales as a whole, consolidated revenues up roughly 2% and operating result up between 2% and 5%.

For 2005 and 2006, barring any major change in the business environment, the impact of major defence contracts, recovery in the aerospace market, success for Airbus and Eurocopter, and the Group's strategic positioning in the security business all make it possible to anticipate annual growth of roughly 5% in consolidated revenues and roughly 10% in operating result.

The next conference is scheduled for 16 September 2004 and will concern results for the first half of 2003.

All the information, including slides, presented at press conferences, can be consulted in the "Investor Relations" section of the Group website.

Shareholder Information available

- Annual report for fiscal year 2003, published in the form of a "*Document de Référence*" registered with the French market authority
- Corporate brochure on the Company and its operations
- Yearly report to shareholders
- Interim report
- Financial press releases (on results and any other financial information)
- Notice approved by market authority AMF on the share buyback programme submitted to the General Meeting of Shareholders of 11 May 2004.

Thales website: www.thalesgroup.com/ir

Please note: the information on the Thales website is mainly in English at present. However, all financial documents are available in both French and English.

Persons responsible for financial information

Ross McInnes Senior Vice President, Chief Financial Officer

Sylvie Lucot Vice President, Investor Relations

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Annual General meeting of 11 May 2004

RESOLUTIONS WITHIN THE AUTHORITY OF AN ORDINARY GENERAL MEETING

1. To approve the consolidated financial statements for the year ended 31 December 2003

The General Meeting of Shareholders approves the consolidated financial statements of Thales for the year ended 31 December 2003, which show a net profit of €112.4 million (Group share).

2. To approve the parent-company financial statements for the year ended 31 December 2003

The General Meeting of Shareholders approves the parent-company financial statements of Thales for the year ended 31 December 2003, which show a net profit of €315.9 million.

3. To approve the allocation of net result and payment of a dividend

The General Meeting of Shareholders resolves to appropriate the distributable income of €322.9M to the payment of a net dividend of €0.75 per share, to the equalisation tax on dividends *(précompte mobilier)* and to retained earnings (€137.2 million)

The payment date for the net dividend, with attached maximum tax credit *(avoir fiscal)* of €0.375 per share, is 31 May 2004.

Dividend history for the preceding three years:

Year	*Net dividend per share*	*Attached tax credit*	*Gross dividend*
2000	€0.62	€0.31	€0.93
2001	€0.70	€0.35	€1.05
2002	€0.70	€0.35	€1.05

4. To approve a regulated agreement

The General Meeting of Shareholders approves the regulated agreement made in 2003, about which it has been informed.

5. To ratify the transfer of the registered head office

The General Meeting of Shareholders ratifies the transfer of the registered head office to 45, rue de Villiers at Neuilly-sur-Seine (Hauts de Seine).

6. To ratify the co-opting of Benoît Tellier as Director

As proposed by the "Industrial Partner" under the terms of the shareholders' agreement, Mr Tellier will be co-opted for the remaining term of departing director Olivier Houssin, i.e. until and including the General Meeting of Shareholders convened to approve the financial statements for 2005.

7. To appoint François Bujon de l'Estang as Director

As proposed by the "State sector" under the terms of the shareholders' agreement, Mr Bujon de l'Estang will be appointed for a four year period i.e. until and including the General Meeting of Shareholders convened to approve the financial statements for 2007, on condition that the 20th resolution regarding directors' term of office shall be approved.

8. To reappoint Louis Gallois as Director

As proposed by the "State sector" under the terms of the shareholders' agreement, Mr Gallois will be appointed for a four year period, i.e. until and including the General Meeting of Shareholders convened to approve the financial statements for 2007, on condition that the 20th resolution regarding directors' term of office shall be approved.

9. To reappoint Denis Ranque as Director

As proposed by the "State sector" under the terms of the shareholders' agreement, Mr Ranque will be appointed for a six year period, until and including the General Meeting of Shareholders convened to approve the financial statements for 2009.

10. To appoint Denis Samuel-Lajeunesse as Director

As proposed by the “State sector” under the terms of the shareholders’ agreement and as required under section 139 of the act of 15 May 2001 (Act 2001-420), Mr Samuel-Lajeunesse will be appointed for a six year period, until and including the General Meeting of Shareholders convened to approve the financial statements for 2009.

11. To reappoint TSA Company as Director

As proposed by the “State sector” under the terms of the shareholders’ agreement, TSA will be appointed for a two year period, until and including the General Meeting of Shareholders convened to approve the financial statements for 2005, on condition that the 20th resolution regarding directors’ term of office shall be approved.

12. To reappoint Jean-Paul Barth as Director

As proposed by the “Industrial Partner” under the terms of the shareholders’ agreement, Mr Barth will be appointed for a two year period, until and including the General Meeting of Shareholders convened to approve the financial statements for 2005, on condition that the 20th resolution regarding directors’ term of office shall be approved.

13. To reappoint Serge Dassault as Director

As proposed by the “Industrial Partner” under the terms of the shareholders’ agreement, Mr Dassault will be appointed for a four year period, until and including the General Meeting of Shareholders convened to approve the financial statements for 2007, on condition that the 20th resolution regarding directors’ term of office shall be approved.

14. To reappoint Serge Tchuruk as Director

As proposed by the “Industrial Partner” under the terms of the shareholders’ agreement, Mr Tchuruk will be appointed for a four year period, until and including the General Meeting of Shareholders convened to approve the financial statements for 2007, on condition that the 20th resolution regarding directors’ term of office shall be approved.

15. To appoint Charles de Croisset as Director

As an outside director under the terms of the shareholders’ agreement, Mr de Croisset will be appointed for a six year period, until and including the General Meeting of Shareholders convened to approve the financial statements for 2009.

16. To reappoint Roger Freeman as Director

As an outside director under the terms of the shareholders’ agreement, Mr Freeman will be appointed for a two year period, until and including the General Meeting of Shareholders convened to approve the financial statements for 2005, on condition that the 20th resolution regarding the directors’ term of office shall be approved.

17. To appoint Klaus Naumann as Director

As an outside director under the terms of the shareholders’ agreement, Mr Naumann will be appointed for a two year period, until and including the General Meeting of Shareholders convened to approve the financial statements for 2005, on condition that the 20th resolution regarding the directors’ term of office shall be approved.

18. To reappoint Henri Proglio as Director

As an outside director under the terms of the shareholders’ agreement, Mr Proglio will be appointed for a six year period, until and including the General Meeting of Shareholders convened to approve the financial statements for 2009.

19. To authorise the Board of Directors to enable the Company to buy and sell its own shares

The General Meeting of Shareholders authorises the Board of Directors to trade in the shares of the Company, with a maximum purchase price of €45 per share.
This authorisation is valid for eighteen months and supersedes the authorisation granted by the General Meeting of Shareholders on 15 May 2003.

RESOLUTIONS WITHIN THE AUTHORITY OF AN EXTRAORDINARY GENERAL MEETING

20. To amend the articles of association: directors' term of office

In order to avoid in the future a requirement to reappoint almost the whole Board of Directors, the General Meeting of Shareholders resolves that one third of the new or renewed terms of office (resolution 7 to 18) run for two years, another third for four years. The four remaining run for a period of 6 years in accordance with the articles of association.

21. To amend the articles of association : number of directors elected by employees

The General Meeting of Shareholders resolves to reduce the number of directors elected by employees from three to two.

22. To amend the articles of association: compliance with the French legislation *(loi de sécurité financière)* as regards crossed thresholds disclosure

The General Meeting of Shareholders resolves to remove from the articles of association (article 7) the reference to the fifteen day period reduced to five days by the French law *(loi de sécurité financière)*.

23. To amend the articles of association: assignment of double voting rights

The General Meeting of Shareholders resolves to remove from the articles of association the condition to belong to a member state of the European Economic Community to be entitled to double voting rights.

24. To authorise the Board of Directors to grant options to subscribe to new shares of the Company

The General Meeting of Shareholders authorises the Board of Directors for a period of 38 months to grant options giving the right to purchase existing shares. The purchase price shall not be lower than the average of the opening prices over the 20 trading days preceding the date of grant (up to a maximum of 3 million existing shares).

25. To authorise the Board of Directors to issue, with maintenance of preferential subscription rights, securities giving access to capital

The General Meeting of Shareholders authorises the Board of Directors for a period of 26 months to issue, with maintenance of preferential subscription rights, shares of the company or any other transferable securities convertible for new shares or exchangeable for existing shares (up to a maximum of 12 million new shares and €500 million in bonds).

26. To authorise the Board of Directors to issue, with removal of preferential subscription rights, securities giving access to capital

The General Meeting of Shareholders authorises the Board of Directors for a period of 26 months to issue, with removal of preferential subscription rights, shares of the company or any other transferable securities convertible for new shares or exchangeable for existing shares (up to a maximum of 12 million new shares and €500 M in bonds).

27. Limitation to the authorities conferred by resolutions 25 and 26

The General Meeting of Shareholders resolves to set at €36 million the maximum face value of any capital increase (equivalent to 12 million shares of €3) and at €500 million or the equivalent in foreign currency, the maximum face value of any bond issue pursuant to the previous two resolutions.

28. To authorise to the Board of Directors to issue shares to be subscribed by the employees

The General Meeting of Shareholders authorises the Board of Directors to issue shares to be subscribed by employees of the Company or of companies included in its consolidation scope and up to a limit of 4.5 million shares for a 26 month period.

29. Powers to perform legal formalities

04 CORPORATE SOCIAL RESPONSIBILITY

A responsible company

Companies' employees, customers, suppliers, shareholders, and society at large now recognise social responsibility as an essential corporate value. For Thales, the commitment to corporate social responsibility is particularly important:

- The Group's high-technology capabilities reside primarily in its employees.
- Thales' businesses are focused on the long term, from the earliest research to the development of equipment and systems that are often tailored to specific requirements, and need to be supported and upgraded over long periods of time.
- The Group forges close relationships with its customers at the local level. These relationships are real partnerships based on mutual trust and benefiting from the credibility afforded by the Group's commitment to ethical conduct.
- Thales' performance also depends on that of its suppliers, which the Group also treats as real partners.
- Although its businesses generally present little risk for the environment, Thales is committed to strict compliance with environmental standards.

Thales has taken steps to establish a Group-wide culture of ethical behaviour, with a dual objective:

- improve the Group's long-term competitiveness by favouring sustainable development and environmental sensitivity, and thereby strengthening its corporate image and legitimacy with respect to its customers;
- ensure compliance with new local or international regulations by defining specific procedures and organisational models to guarantee compliance and meet security requirements.

The Group has progressively introduced an ethics system comprising:

- a **Code of Ethics**, which is the cornerstone of the system and provides guidelines for Thales employees' professional conduct
- a **Corporate Ethics Committee**, which oversees compliance with the Code. It is chaired by a member of corporate management and includes representatives of business units and functional departments from all the Group's main countries of operation
- a network of seventeen **Ethics Officers** providing local points of contact for the Committee throughout the Group.

In 2003, Thales signed up to the United Nations Global Compact

Operational since 26 July 2000, the Global Compact aims to rally companies, United Nations agencies, professional organisations and civil society around nine universal principles relating to human rights, labour standards and protection of the environment. These principles are based on the Universal Declaration of Human Rights, the Declaration of the International Labour Organisation concerning basic working principles and rights, and the Rio Declaration on the environment and development.

By signing up in September 2003, Thales made a proactive commitment to promote the nine principles within its sphere of influence. The Corporate Ethics Committee coordinates the actions and policies relating to this commitment.

CODE OF ETHICS

The Code of Ethics establishes rules of conduct applicable within the Group without seeking to replace the national and international legal regulations applicable in its countries of operation. These rules of good conduct address the following matters:

- relationships with external **partners, customers and suppliers**: Thales "establishes lasting relationships, based on mutual trust and respect"
- **human resources management**, around the key principle that "people are the most important of the Group's resources"
- protection of the Group's tangible and intangible **assets**, "which are key to its long-term development"
- responsibility towards **shareholders** and financial markets, which implies application of the principles of good corporate governance
- responsibility towards the **community at large, and its environment**, based on good citizenship and a desire to contribute to sustainable development.

The Code of Ethics provides a single frame of reference for all the Group's employees. It is the result of extensive internal consultation and validation and summarises Group best practice with respect to the new standards governing international trade, social issues and the environment. It reflects a strong conviction on the part of management that these values should be shared throughout the Group.

Implementation in the Group

The **Code of Ethics** has been issued to each employee in the Group, and may also be released outside the Group, for example to customers, suppliers and shareholders.

Thales corporate management is responsible for disseminating the Code of Ethics and ensuring that it is applied. In particular, the Corporate Secretary, who is responsible for Group security and protecting and leveraging the Group's assets, defines how the Code is put into practice and how its application is monitored.

The thirteen-member **Corporate Ethics Committee**, chaired by the Corporate Secretary, is responsible for dissemination of the Code, as well as ensuring that it is both understood and applied throughout the Group. It conducts investigations as needed, puts forward recommendations and facilitates the network of the Ethics Officers. Any matter of relevance may be referred to the Committee by an Ethics Officer, or directly by any Group employee. Each year, the Committee submits a report to the Group's Board of Directors describing the main issues encountered and the action taken.

Ethics Officers are responsible for disseminating good practices, providing advice to employees and management, proposing amendments to the Code and informing the Committee about non-compliances. Each Officer has a dual obligation of strict confidentiality on personal matters and total transparency in dealing with the Corporate Secretary and the Ethics Committee on matters relating to the application of the Code.

In 2002, the major action taken was to raise **awareness** of ethical issues among the Group's employees. Group-wide dissemination of the Code, in four main languages: English, French, Dutch and German, and, locally, in other languages, was supported by more than 500 presentation meetings attended by over 25,000 members of staff.

New employees receive a copy of the Code when they are hired. In addition, there is an Ethics section on the Thales corporate intranet where employees can ask questions and share their experiences. Finally, training sessions on ethical behaviour and the Code of Ethics are included in all management training programmes at Thales University, with a particular focus on ethics in international trade (see below).

In 2003, the Corporate Ethics Committee:

- defined a three-year programme with Thales University with a view to integrating a specific ethics module in all training courses for all business lines
- launched a communication campaign to inform Group employees about issues additional to those mentioned in the Code of Ethics, and published two guides: "Guide to ethical behaviour in international trade" and "Guide to behaviour with privileged information"
- produced the Ethics Committee's first annual activity report. The report has been presented to the Thales Board of Directors, and describes the Thales ethics system, the various employee awareness campaigns, and local action by Ethics Officers.

Thales is committed to an ethics policy focused on the long term. That policy reflects the Group's determination to construct a model of development that goes beyond business and economic considerations to embrace the broader implications of its operations. As part of this process, this report on corporate social responsibility presents the main lines of the Group's approach to employment, the environment, customer and suppliers.

Employment policy and citizenship

Thales is a global group employing **61,500 staff** in nearly fifty countries, predominantly in Europe.

The breakdown of the Thales workforce by region and professional category illustrates the two major factors guiding the Group's employment policy:

- its **worldwide presence**, with 28,000 (45%) of its 61,500 employees working outside France at end-2003, including 10,675 in the United Kingdom, 3,376 in Germany, 3,220 in Australia, 2,439 in the Netherlands and 2,143 in the United States.

Breakdown of managed workforce by business area and region (1)

At 31 December 2003	France		Other Europe		Rest of world		Total	
Defence	17,424	*51%*	10,645	*31%*	6,219	*18%*	34,288	*100%*
Aerospace	5,907	*59%*	3,035	*30%*	1,037	*10%*	9,979	*100%*
IT&S	8,444	*59%*	5,005	*35%*	846	*6%*	14,295	*100%*
Other	2,047	-	866	-	38	-	2,951	-
Total	**33,822**	***55%***	**19,551**	***32%***	**8,140**	***13%***	**61,513**	***100%***
At end-2002	35,042	*54%*	20,705	*32%*	9,192	*14%*	64,939	*100%*

- and **its technical skill base**, with engineers making up over half of the workforce, and technicians roughly one-third (2). In France, the overall proportions are 58% engineers and managers, and 21% technicians and supervisors, broken down by business area as follows:

French companies' employees at end-2003

	Total	Engineers and managers	Other staff*
Defence	17,424	*62%*	*39%*
Aerospace	5,907	*53%*	*47%*
IT&S	8,444	*54%*	*46%*
Other	2,047	*54%*	*46%*
Total	**33,822**	***58%***	***42%***
At end-2002	35,042	*56%*	*44%*

* clerical, technical, shop-floor

Group employment policy complies with the principles of the **International Labour Organisation**, not least in terms of non-discrimination and the protection of workers' health and safety. In September 2003, the Group signed up to the United Nations **Global Compact**, confirming its commitment to ethical and responsible practices towards its employees, and its intention to contribute to regional development in all its countries of operation.

The principles of ethical conduct that the Group applies to and requires from its employees are laid out in the corporate **Code of Ethics**:

- "Equality of treatment, which means avoiding any discrimination…"
- "respect for the individual, which prohibits any aggressive behaviour and any unwarranted interference in the private life of any individual… "
- "A safe and healthy working environment for each individual"
- "Each Thales employee must ensure that all commitments are met, that all information needed is made available, and owes loyalty to the Group."
- "To promote cooperation with employees and their representatives, the Group is committed to providing them with high-quality information on topics of mutual interest".

(1) This figure is greater than the consolidated workforce on pages 4, 70 and 73 and includes all employees of joint ventures together with those of companies that are controlled but not consolidated for reasons related to consolidation criteria.

(2) In an increasingly international Group, it is no longer possible to establish meaningful employee categories on a Group-wide basis, since definitions vary so widely from one country to another.

PROFESSIONAL DEVELOPMENT

Recruitment and integration of new employees

In 2001, Thales launched an outreach programme with higher education establishments involved in areas of relevance to the Group's businesses. In 2003, sixty "campus managers" in France targeted some fifteen engineering schools, holding monthly meetings with management, teaching staff and students. Student classes were sponsored in 2003 at schools including ENSIETA [(1)], ENST [(2)], Ecole Centrale de Paris (aerospace year), ISEP [(3)].

In Britain, Thales UK has forged close ties with various educational establishments, including Raynes Park High School, which Thales Avionics Ltd helped to become the DfES-designated Technology College of the London Borough of Merton. Thales UK is a partner on recognised programmes such as SETNET (Science Engineering & Technology Network), which promotes linkages between local schools and the professional world, via Young Engineers, Young Enterprise, Arkwright scholarships, Engineering Education Scheme and the School Aerospace Challenge.

In the Netherlands, Thales Nederland has long-standing links with the University of Twente and Saxion College. The company contributes to local teaching programmes, providing speakers and equipment.

Future employees are also attracted by information days about careers in the Group, restricted to interns and students from the targeted graduate schools: in France, the Interns' Forum has hosted more than 1,800 interns since it began in 2001, including 650 in 2003. Roughly 25% of those attending Forum events subsequently join the Group.

Promotion of internal mobility

For some years Thales has pursued a proactive policy of internal mobility, run by a central team and supported by dedicated tools.

In France, the Opportunities Forum is an area where people can meet and obtain advice about vacancies, and where interested employees can find the right contacts. Since the Forum started in June 2003, 1,312 applications have been processed, and 1,026 internal moves have been finalised in this way. Further action was taken in 2003 to energise the Thales internal job market and urge managers to look first at internal resources. Internal mobility is now well established in France, and 1,142 jobs were filled in this way in 2003, compared with 968 by outside recruitment.

A similar approach has been adopted in the United Kingdom with the Forum for Opportunities for employees seeking a move, and the RED (REDeployment) network for human resources managers, which is designed to share information about vacancies and about employees seeking mobility opportunities. In 2003, 281 internal moves were made in the United Kingdom.

In addition, other tools were made available to Group employees in 2003: a new job market with access to all vacancies in the Group worldwide; a new dedicated human resources website with a large amount of information and offers of services; and to meet local requirements, regional mobility networks have been set up for five areas in France and six in Britain.

A specific policy is in place to maintain the employability and professional motivation of senior staff members. The AVEC agreement on capitalisation of experience and end-of-career management, which was signed with employee representatives in 2001 and deployed in the Group's French companies in 2002 and 2003, offers attractive opportunities for mobility.

Internal mobility is also particularly useful during restructuring, when the Group's is committed to re-employing staff internally wherever possible. It complements the support given for individual career projects, such as assistance for forming a new business or training for a new career. The methods used vary from one country to another and are often agreed with local employee representatives. In the Netherlands, for example, Thales works closely with the re-employment agency SMEO [(4)], which the Group helped set up in the 1980s, and which has a nearly 80% success rate.

Training development

One of Thales' core principles is to be an employer of choice by providing training as a way of promoting professional development: the development of each individual employee is a necessary condition for the Group's collective success.

Group training policy has a dual purpose:

- meet the needs of the company by supporting change management and performance improvement projects
- consider employees' individual needs by helping them to improve their professional skills in their current job and to realign those skills in the case of professional mobility.

Training is organised both for individual businesses and individual employees.

The Group's businesses are managed by professional family, making it easier to analyse and support change, and enabling employees to seize opportunities in their sector.

Since the 1990s, the Group has conducted "People Reviews" to anticipate the needs of the company, offer employees the chance of taking on extended responsibilities, and identify the key men and women of the future.

In 2003, measures to optimise training provision included:

- preparation of the training policy for 2004. The objectives of the 2003 People Review were to prepare for future business requirements and organisational models and identify employees' development needs.
- creation of a training managers' network in France and the United Kingdom. The role of the training managers is to identify local training needs and set priorities at the local level.

Training is an area of intensive activity for the Group: in 2003, as in 2002, more than 16,000 employees in France – nearly half the total French workforce – attended training courses. There is a direct linkage between training and human resources management: each employee has two interviews a year with their manager, one focusing on

(1) ENSIETA: Ecole Nationale Supérieure des Ingénieurs des Etudes et Techniques d'Armement

(2) ENST: Ecole Nationale Supérieure des Télécommunications

(3) ISEP: Institut Supérieur d'Electronique de Paris

(4) SMEO: Stichting Metaal en Elektro Opleidingen Zeeuws Vlaanderen

professional development and the other serving to set objectives for the coming year. The Thales training system benefits from constructive dialogue with employee representatives.

The role of **Thales University** is to support the professional development of Group employees and develop a common corporate culture based on the Group's key values. Eighty percent of Thales University teaching staff are experts and managers from the Group itself. In 2003, programmes were provided by 370 trainers from Thales and 80 trainers from outside the Group, and just over 4,000 people attended courses.

As one of the pillars of Group training policy, Thales University provides training courses that cover all the Group's key competencies:

- management (finance, human resources, individual development and career choice, team management)
- sales & marketing, bids and programme management
- engineering and product development (systems engineering, engineering & management, software, information technology, integrated logistics support, equipment & production, technologies and techniques
- "transverse" processes (purchasing/supply chain management, quality, Customer Commitment and customer service, information systems, security).

As the Group has expanded its portfolio of businesses, Thales University has developed its international activities and now has its own training centres in the United Kingdom, which in 2003 trained nearly 4,000 employees of Thales UK.

COMPENSATION POLICY

The Group's human resources policy is based on the key concepts of managing performance and professional development under the joint responsibility of the employee and the company. These principles are behind variable compensation and stock option plans that are applied throughout the Group and adapted to the particular context of each subsidiary. A Group-wide computerised personnel management system is being introduced to address the Group's increasingly international dimension and to improve and harmonise career and skills management methods in all Group companies.

Compensation, incentives and profit-sharing (France)

In 2003, the overall increase in compensation was roughly 2.9%, of which individually based increases accounted for nearly 80%.

In addition to changes in base compensation, the Group in 2001 defined a worldwide variable compensation plan that specifies how compensation is calculated according to level of responsibility. The plan also specifies target percentages for variable compensation and the compensation actually granted on the basis of individual performance and company results. This plan for engineers and managers is being deployed incrementally.

In 2003, fourteen Group companies in France paid out a total of €15.84m in incentive bonuses in respect of 2002, an average of €1,003 for each of the 15,800 employees involved. Under profit-sharing programmes, eighteen Group companies in France paid out a total of €26.08m in respect of 2002, an average of €1,208 for each of the 21,500 employees involved. Profit-sharing and incentives amounted to 2.6% of gross payroll in France (1).

Stock-options (2)

On 1 July 2003, the Board approved a share option subscription plan slightly less extensive than that approved in 2002. The new plan concerned 3,828 employees in 22 countries on the grant date, mainly senior executives, managers and confirmed experts, plus key contributors among employees at all levels of responsibility.

(1) See also page 103 of this report
(2) See also page 89 of this report

THALES GROUP SAVINGS PLAN AND EMPLOYEE STOCK OWNERSHIP (1)

- **The Group savings plan** was set up in 1998 when the Group was privatised, to implement the share offering for employees of its French companies. The 2000 share offering was included in the plan, and in 2002 it was extended to employees in international subsidiaries in those countries where the Group had a significant presence. That same year, the share capital reserved for Group savings plan members was increased.

  At the end of 2003, the employees' savings scheme was overhauled to simplify and extend the degree of capital management made available to employees and to offer them a more diversified range of savings products. The new scheme came into effect at the start of 2004.

- **Group employee stock ownership** began during the privatisation stages in 1998 and 2000, when share offerings were made to employees under the provisions of French law. The capital increase reserved for employees in December 2002 raised employee stock ownership to 4.7% at year-end. On 31 December 2003, Thales employee stock ownership stood at 5.1%, the State having transferred bonus shares to employees who had subscribed to the 2000 offering and kept their shares for three years.

  Thales employee shareholders have one representative on the Board of Directors, under the amendment to the articles of association approved by the General Meeting of shareholders in June 1998. The first director representing employees shareholders was elected by the General Meeting of 10 March 1999 to serve a term of six years expiring at the end of the General Meeting called to approve the financial statements for the year ending 31 December 2004.

ETHICS AND SOCIAL RESPONSIBILITY

Constructive dialogue with employees and their representatives

To promote cooperation with employees and their representatives, in compliance with the principles expressed in its Code of Ethics, the Group is committed to providing them with high-quality information on topics of mutual interest and to ensuring that trade unions have the material resources they need to operate.

Structures and resources

- In France, Thales supports the role of national trade union federations in their work concerning labour protection, retirement pensions and sectoral negotiations. To that end it distributes an annual budget allocated by published rules to the various unions according to their representation within Thales.

  In addition to the existing negotiating structures, a "consultation-negotiation" structure was created for the whole Group in 1998, mainly to facilitate framework agreements that would then be deployed in the various Group companies in France. This structure negotiated the framework agreement on the reduction of working hours, the AVEC agreement on senior employees, and in 2003, the framework agreement on professional equality between men and women, signed in January 2004.

  In 1999, the Group formally recognised structures known as "Intercentres", whose role is to interface with Thales management to address mutual problems and forestall labour conflicts. Since then, each trade union represented nationally has had a central structure with a permanent representative and its own budget. Since 2002, the Intercentres have maintained a dedicated trade union section on the Group's intranet.

  The Group Committee (France) also comprises trade union representative from all the French subsidiaries.

- The Group Committee (Europe), created in 1993, obtained broadly increased attributions in an agreement signed in 2002. Under the agreement, the Committee meets at least twice a year, and more often if exceptional circumstances require, particularly a relocation, merger, acquisition or divestment involving at least 500 staff, or in the case of collective redundancies of more than 150 staff in at least two countries.

- In 2002, Thales formalised relations between Group management and trade unions active in its sector of activity in the United Kingdom. An equivalent step had already been taken in the Netherlands. This agreement with Amicus and GMB includes the principle of permanent consultation on changes to Thales activities in the United Kingdom liable to have an impact on employment.

Results of collective agreements in 2003

The AVEC agreement on capitalisation of experience and end-of-career management, signed in 2001, was deployed in the Group's French companies in 2002 and 2003. In particular, an early retirement scheme (CATS/CASA [2]) was set up for some 1,700 Group employees in France, to last three years from 2002 to 2004. By 31 December 2003, nearly 900 staff had taken early retirement under this scheme.

(1) See also page 94 of this report

(2) Cessation d'Activité de certains Travailleurs Salariés/Cessation d'Activité des Salariés Agés

Equality and non-discrimination

The principle of equality between men and women, reaffirmed in the corporate Code of Ethics, was discussed in 2003 in the consultation-negotiation structure in France, and in January 2004 a Group agreement was signed with all the trade unions representing Group employees in France. The agreement stipulates a methodology applicable in French subsidiaries for introducing action plans to promote equality, with guarantees concerning compensation policy and career opportunities for female employees on maternity or adoption leave, and for male employees who choose part-time work or a set number of shorter working days.

Non-discrimination in employment is also a Group objective expressed in the Code of Ethics as follows: "equality of treatment (…) means avoiding any discrimination on the grounds of origins, sex, sexual orientation, political or religious opinions, union membership or personal handicaps. Allowance for the nationality of an individual must be strictly limited to the exceptions laid down in national legislation relating to the protection of national interests." For staff representatives, agreements have existed since 1984 to guarantee that their career advancement is comparable to other Group staff.

Integration of disabled workers

The integration of the disabled received extensive media coverage in 2003, which was designated European Year of the Disabled to remind people of the difficulties that the disabled face and to mobilise all the players concerned.

Thales has been a pioneer in this field. In 1992, the Group signed a formal agreement to encourage the employment of the disabled, and the agreement has been systematically extended since then. The fourth agreement covered the period 2001 to 2003.

As a result of the lower qualifications of some disabled people with respect to the high technology competencies required by Thales, and the insufficiency, or absence, of technical solutions to compensate for handicaps, the Group has defined action plans in its agreements to promote employment and technological innovation for the disabled. The human resources department has set up a dedicated structure, the Integration Mission, to promote and coordinate the action of the thirty French companies that have signed equivalent agreements.

This two-pronged approach has delivered good results: the proportion of disabled persons in the Group workforce has risen steadily since the first agreement, from 2.9% in 1992 to 5.8% at end-2003.

Furthermore, innovative aids for the disabled, using Group technologies, have been developed to provide practical solutions for the professional integration of the disabled. One example is the *Handi Aéro Surveillance* project for monitoring of forest fires by pilots with motor disabilities. Four disabled pilots were hired during summer 2003. At the end of 2003, the authorities modified the regulations to allow disabled pilots to exercise this type of job. Thales Training & Simulation has also developed a CD-ROM for learning sign language and cued speech, two means of communication used by people with impaired hearing. Projects to help people with impaired vision include *Portanum* software designed by Thales Research & Technologies for reading wall charts. To consolidate the success of its disabled integration policy, Thales has organised employee awareness programmes, and at the end of 2003 published a brochure on this topic for all employees in France.

A major distance learning project has been launched as a cooperative venture by Thales and Garches hospital in the Paris region. Based at the hospital, this training system is designed for accident victims who need to prepare their return to professional life.

Good working conditions

Hygiene and safety

In its Code of Ethics, the Group states that it wishes to provide "a safe and healthy working environment for each individual by, as a minimum, implementing the statutory provisions in force, monitoring procedures, preventing health risks and professional hazards, and providing personnel training."

Safety is a major concern for Thales, and is the subject of a reference guide describing the practices and procedures to be applied within the Group to manage risk and ensure safety. The reference guide is available to all employees on the Group intranet. Since the 11 September 2001 attacks, Thales has formed a team to operate as a crisis unit in any serious emergency or whenever the Group or its employees are under threat.

In the United Kingdom, Thales UK supports the Directors' Code of Practice published by the Health & Safety Commission. The subsidiary Thales Telecommunications Services Ltd has received the British Safety Council's 5-Star Safety Award for the quality and high standards of its hygiene and safety practices.

Assessment of professional risk

In 2002, in compliance with legal regulations published in 2001, Thales set up a process for assessing professional risk as an essential preliminary step in incident prevention efforts. The process involves consultation with employees' representatives and will be updated on an ongoing basis.

Health at work

In this field, Thales focuses on problems arising from the radical changes to its activities, which have shifted from metallurgy to high technology in the space of a few decades. These changes are behind Thales' focus on employee training, as described above. Some categories of employees have found it difficult to adapt to these changes, and, as a result, certain job profiles have been marginalised or even eliminated.

In France, together with some thirty company physicians and a specially recruited epidemiologist, the Group human resources department launched a major survey on the health of Group employees[1], to record, quantify and analyse how the relationship between age, health and work varies during the careers of employees in the high-technology sector. This research is designed to identify the exposures and professional constraints that affect health and the aging process. It will also help company physicians and health and safety officials to identify and prevent work processes that are liable to cause difficulties for employees in the last fifteen years of their working lives. The survey will begin in 2004 with a statistical analysis, and will be monitored by a committee comprising the Thales human resources department, trade union representatives, the Ministry of Employment, and the French agency for the improvement of working conditions. It will be jointly funded by Thales and the *Fonds d'Aide à l'Amélioration des Conditions de Travail.*

(1) THEOREM: Travail Humain Et Organisation, Recueil Epidémiologique en Médecine du Travail

Regional development

- Thales' main contribution to regional development is in the **professional integration of young unemployed** people. The Group has helped set up and fund two apprenticeship training centres in France, for industrial technologies and, with Air France, aerospace trades. Apprentices qualifying from the two centres have a particularly high rate of employment.

  In the United Kingdom, Thales funds scholarships for apprentice pilots and technology students.

- In France, Thales takes part in other **local actions** to develop the regions where the Group operates. In particular, the specialised subsidiary Geris supports employees who wish to set up or take over a business enterprise.

  For some years, the Group has also been one of the sponsors of the Tour de France à la Voile, a world-class sailing event, and the Thales Sailing Team includes some forty Thales employees from all its countries and business lines.

  In the United Kingdom, Group subsidiaries support a large number of local structures and initiatives, mainly connected with young people and technology: financial support for the Richard House Children's Hospice, the Childnet web-based education programme, and the Women in Science and Engineering (WISE) Campaign.

  In the Netherlands, Thales is involved in a number of regional development initiatives. The Group supports the SMEO organisation, which is a local interface between employers in the metallurgy industry, which includes Thales. It is a founder sponsor of the HEIM regional technical museum in Hengelo, and in 2003 was the main sponsor of the international athletics meeting in the Netherlands, called for the occasion Thales FBK Games.

  In the United States, the Group's subsidiaries support a number of initiatives, mainly charities. Some subsidiaries regularly collect food, clothes and toys for charities. Most of them are involved in local action for children's hospitals, housing support associations, and education programmes for children in difficulty.

Relations with suppliers and customers

RELATIONS WITH SUBCONTRACTORS

Purchasing accounts for close to €5 billion in annual expenditures, or almost one-half of the Group's consolidated revenues. Non-Group purchases in France represent 60% of this total.

In view of the nature of its businesses, 90% of the Group's suppliers are based in EU countries. Technical audits in North African countries, Poland and Pakistan show that the Group's local subcontractors employ neither child labour nor forced labour.

Most subcontracting falls into one of three categories: procurement of complete subsystems on programmes for which Thales is prime contractor (22% of the total in 2003), industrial subcontracting for mechanical assemblies, printed circuits, circuit boards and assembly/wiring (21%), and services such as technical assistance, consultancy and specialised services (14%).

Subcontracting within the Group accounts for 32% of total purchasing expenditure.

A competitive supply chain depends on clearly defined purchasing procedures, which are applied by Group units in compliance with the principles relating to relations with customers and suppliers laid down in the Thales Code of Ethics.

Internal cross-sector networks define standard solutions for the Group and identify target suppliers. Some 800 employees in these Group-wide networks work creatively in their areas of specialisation and are involved at the design phase of products and systems. They work in partnership with target suppliers to achieve the levels of performance required.

Thales' conditions of purchase require that suppliers provide a sworn statement of compliance with the rules on undeclared labour.

To keep suppliers informed of the purchasing company's labour practices, subcontractors' works committees received information about employment-related changes during restructuring operations.

Group purchasing procedures comply with the principles of the Code of Ethics: "Thales establishes cooperative relationships with suppliers, based on mutual good faith. Acting in good faith towards suppliers involves treating competing suppliers fairly, treating information about them as confidential, and protecting their intellectual property rights."

Group purchasing staff undertake to apply the following principles:

- Programme management based on a spirit of cooperation with suppliers
- Fair selection of suppliers based on objective evaluation of their performance and level of commitment
- Reliability and sincerity with respect to suppliers and commitments
- Confidentiality
- Intellectual property.

END-USER CONTROL

A changing world

Recent years have seen an increase in local and regional crises liable to threaten international stability, a trend that marks a sharp break with the bipolar model of international relations that prevailed until the late 1980s.

The events of 11 September 2001 revealed the nature of new, not strictly military, threats connected with terrorism, but also with organised crime and the emergence of "rogue" States.

In this new geopolitical context characterised by the need to control destabilising accumulations of arms, arms exporting countries such as France form government-to-government partnerships with client countries. In strategic terms, these agreements are part of a policy of conflict prevention, and their main purpose is to enable partners to guarantee their security in accordance with the United Nations Charter.

Governments are aware of the risk that exports may be diverted or misused, and have put in place responsible policy instruments to control the sale and transfer of defence equipment.

Strict national and European regulations

In France, for example, **arms exports** are forbidden except with a government licence.

The French export control system is highly rigorous, requiring two successive authorisations: prior approval (1), submit a proposal and negotiate a contract, followed by the grant of a licence to export defence equipment (AEMG (2)). In this way, the authorities ensure that all phases prior to delivery (negotiation, contract, manufacture) have complied with regulations.

The decision to grant an export licence is taken at the highest level, by the Prime Minister's office. Each of the two stages is examined by the interministerial commission on defence exports (CIEEMG (3)), chaired by the Secretary General for National Defence. Their opinion is used to support the Prime Minister's decision.

CIEEMG decisions take into account France's international commitments (Non-Proliferation Treaty, Wassenaar Arrangement, UN embargoes, etc.), and European commitments such as the EU Code of Conduct adopted by the Council of Ministers on 8 June 1998.

(1) Prior approval usually requires the exporter to obtain non-re-export assurances from the customer.

(2) AEMG: Autorisation d'exportation de matériel de guerre

(3) CIEEMG: Commission interministérielle pour l'étude des exportations de matériels de guerre

The Code pursues two objectives:

• set high common standards as minimum requirements for the control of conventional arms transfers by all EU Member States

• strengthen the exchange of relevant information with a view to achieving greater transparency.

The Code of Conduct lays down eight criteria which the Member States have agreed to take into account when granting arms export licences, and a consultation and notification procedure [1] is used to reduce divergences between States in interpreting these criteria and making export decisions at the national level.

France has also undertaken to control small arms exports, along the lines of European practice.

Furthermore, **the export of dual-use goods and technologies** is strictly controlled.

These export controls, typically to combat proliferation and terrorism, concern goods, equipment, technology, etc. that could be used in military applications. Notwithstanding the principle of free circulation, the import and export of these "goods", by reason of their sensitive nature, is strictly controlled or in some cases prohibited.

Controls of this sort have existed in France for more than fifty years, and since 1 July 1995 have been governed by EU regulations that replace earlier national regulations and are complemented by national provisions of application.

In the United Kingdom similarly, regulations are extremely strict and have been modified by the Export Control Act 2002, due to come into force in the second half of 2004. The main changes to the regulations concern stricter control of technology transfer, particularly transfers of military technology by non-material means such as e-mail, and the control of arms brokerage activities. The brokerage provisions apply to UK and non-UK nationals on British soil dealing in arms sales from other countries.

With the globalisation of trade and the increase in international industrial cooperation (between companies or units in the same group), national export control regulations are not always adequate because of their purely national dimension.

For an international Group such as Thales, whose end products almost always integrate subassemblies, components and technologies from European and non-European countries, compliance with regulation goes beyond strictly national boundaries. Consequently, to ensure the strict application of national and international export control regulations on defence and dual-use equipment, Thales has proactively set up a system of responsible export controls that guarantees strict compliance and the highest standards of conduct in this area.

EXPORT CONTROL

Thales has chosen to implement a transparent, comprehensive system for all countries to ensures complete traceability in the Group's operations.

Underpinning the system is the principle that all Group units, in complying with regulations, will converge towards the highest applicable standards.

The Thales system includes:

• a guide entitled "Standard of export compliance best practices"

Thales has long ensured compliance with the regulations applicable in its countries of operation.

However, the level of maturity of Group units depends on actual national regulations and differs according to the country in which they are based.

For this reason, Thales has defined a "standard of best practices" in twelve areas (such as identification of requirements for export licences, control of purchasing and subcontracting, and audits) applicable to all Group units.

Thales intends to use this standard to progressively bring all its units up to the highest level of maturity.

To achieve this objective, a control programme using the standard as its baseline is being launched in each Group unit.

• an export control monitoring committee

The committee defines Thales Group policy to ensure compliance in the broadest sense with international rules and legislation, evaluate improvements in compliance processes, and validate proposed improvements.

• a committee for exports to sensitive countries

The committee examines all export projects to countries deemed sensitive, whether or not they are controlled by domestic legislation, to verify whether export complies with the international commitments made by the Group as part of its global approach to responsible export control.

• a network of national export control delegates

National delegates have been appointed in all the countries in which the Group has significant operations, including Australia, Canada, France, the Netherlands, South Africa, the United Kingdom, and the United States.

The delegates' main missions are as follows:

- ensure full compliance by local units with local legislation on the transfer of goods
- coordinate with local authorities
- inform Group corporate management of any change in regulations and national export policy
- support the international general secretary's office during audits of local units.

• a specific awareness and training programme

(1) If a State wishes to grant a licence which has been denied by another Member State for an "essentially identical transaction" within the last three years, it will first consult that State. Following consultations, if the State nevertheless decides to grant a licence, it will notify the Member State or States issuing the denial(s), giving a detailed explanation of its reasoning. The decision to grant or deny the licence remains at the discretion of each Member State.

ETHICS IN INTERNATIONAL TRADE

The end of the Cold War brought a sudden change: organised crime, bribery and money-laundering joined the list of new threats. The common feature of these new threats is the risk they pose to basic human rights and democratic institutions.

These activities are changing as globalisation continues and as the territorial jurisdiction of States weakens. Companies have a role to play, alongside States and international bodies, in the globalisation process.

Thales' aim is to be a responsible player and is taking steps to comply with the highest ethical standards in its international relations. A system has been set up to ensure compliance with national and international trade rules:

- Thales has undertaken a major awareness, information and training campaign, and the Reference Guide on Ethics in International Trade was issued to all sales and marketing staff in 2002. A handy abbreviated version focusing on gifts and receptions was issued in 2003. Since 2000, the Group has organised a training course on Business Ethics. In addition, specific modules on combating bribery are incorporated in all Thales internal courses on sales and marketing.
- A dedicated structure, Thales International, provides specialised sales and marketing support to operating units. It both raises the Group's commercial efficiency and guarantees strict control of operational compliance. In 2003, Thales International's regional structures achieved certification to ISO 9001 and the central office's certification was confirmed. ISO certification is an endorsement of the quality of Thales International's comprehensive approach.

The Group's commitment in these matters was demonstrated in 2003 when the OECD Working Group examined France's implementation of the anti-bribery Convention signed in May 1997. Thales was one of the panel of companies selected by the Working Group for its examination of France. French companies, the report revealed, demonstrate clear awareness of the risks associated with bribery. Company systems such as codes of conduct, charters, ethics committees and ethics officers are evidence of this awareness.

To maintain constructive dialogue with anti-bribery NGOs, Thales has strengthened its relations with Transparency International and Trace.

In 2003, the Group continued its compliance efforts with new versions of a directive on money-laundering and tax havens, and a detailed reference manual for operational staff presenting Thales International's expertise and consultancy role within the Group on matters of ethics of international trade.

Environmental performance

In 1997, the Group adopted a proactive approach to environmental management in its various countries of operation, applying first to France, then to the United Kingdom and the Netherlands, and finally to all the other countries in which the Group has a significant presence.

The first objective was to achieve administrative and technical compliance for the Group's sites. Subsequently, environmental analyses were carried out and some sites were upgraded to improve environmental performance in specific areas (asbestos, wastewater disposal, etc.). The first analyses involved the Group's buildings and land, and industrial processes were covered from 2000 onwards.

To encourage synergy within the Group and address the shared environmental concerns of its operations in different countries, Thales uses common analytical tools wherever possible. The Group's organisation is based on subsidiarity, or local control at the country or unit level, to adapt the speed of application to the specific constraints of each business and each local context, while achieving convergence between all units on shared objectives for improvement. This modular approach is needed because of:

- product diversity (software, equipment, antennas, other sensors, display systems)
- the variety of applications involved (civil, military, consumer, space programmes)
- site configurations
- company history (recent or long-standing acquisition, reconfigured or shared site, etc.).

Thales' current activities generally generate little pollution, because they focus on research and development, and integration and testing of electronic assemblies and subassemblies. Some activities, however, such as pyrotechnics, shipbuilding, mechanical engineering and component manufacture, are more directly concerned by environmental issues. Some sites may also have a long history of industrial activity.

Shared objectives include effective environmental management of industrial processes, risk management for sites and their surroundings, and full recording of each site's historical background.

In line with this approach, the Group tracks the environmental performance of its suppliers and incorporates environmental considerations into product design.

ENVIRONMENTAL MANAGEMENT ORGANISATION

The Group's organisational model for environmental management reflects its international scope and the diversity of its businesses:

- A central structure reporting to corporate management is in charge of environmental risk management and the initiation and coordination of international actions. This central structure also defines common improvement objectives for industrial processes, clean technologies and decommissioning procedures.
- In countries where Thales conducts major operations, a country manager coordinates local actions and collects the information needed to complete environmental scorecards. The country manager has correspondents in each local operating unit. This type of country organisation is in place in Australia, Belgium, Canada, France, Germany, Greece, Italy, the Netherlands, Singapore, South Africa, South Korea, the United Kingdom, and the United States.
- Where necessary, business line correspondents are appointed.

POLICY AND ACTION PLANS

Site management (real estate)

In France, Thales has launched a site management programme with the following objectives:

- compliance of buildings and technical plant with environmental quality standards
- large-scale remediation to enable industrial operations to grow while managing their environmental risk exposure.

Major actions in France include:

- systematic removal of asbestos during construction projects (over and above regulatory requirements)
- analysis and repair of drainage networks, and systematic installation of oil interceptors and dedicated waste areas during these construction projects
- replacement of spray cooling towers with air-to-air heat exchange systems
- soil, subsurface and groundwater pollution audits, using the methodology applicable in France
- decontamination of certain sites, whether or not this is required by local authorities
- incorporation of environmental considerations into construction, redevelopment and demolition projects.

Faceo, a property and facility management company 51% owned by Thales, has been closely involved in these operations.

Operations

In France, an incremental environmental management strategy has been in place since 2000 to ensure that operating units take environmental issues into consideration more systematically. A convergence plan, defined and monitored by the central environmental management organisation, has been introduced with the following objectives:

- ensure compliance of installations and operational processes with regulatory and technical
- manage consumption of energy and natural resources, and manage risks related to emissions and waste
- conduct environmental audits to quantify each activity's environmental impact and take any action needed
- establish an Environmental Management System taking the specific characteristics of each activity into account to maintain regulatory and technical compliance, manage risks, and monitor progress on improvement programmes.

The Environmental Management Systems is applied in various ways depending on the type of site:

- ISO 14001 certification is obligatory for sites with significant industrial activity.
- ISO 14001 certification is recommended for sites with mixed, service, integration or testing activities. Even if the site is not certified, the main provisions of the ISO standard apply.
- Sites with exclusively service-related activities apply strict waste, energy and water management plans.

This approach has been adopted in almost all the countries where Thales has significant operational activities: Australia, Germany, Italy, the Netherlands, South Africa and the United Kingdom. At end-2003, 46 units throughout the world had obtained ISO 14001 certification.

Training and communication about environmental risk

The **Thales Environment Guide**, first published in 1998, was updated in 2002. This guide is issued to all French subsidiaries. It discusses the main problems that site correspondents may face and provides regulatory information, details about working methods and other guidelines.

An **Environment Portal** has also been available on the intranet since 2002 and was substantially improved in 2003. This collaborative workspace for environmental correspondents provides all Group employees with information about environmental management tools developed in-house, regulations, Group directives, contact details, etc.

In addition, **internal training sessions** by Thales University have been available since 1998 in France and the United Kingdom. Training includes specific courses for environmental managers as well as awareness modules integrated in other training programmes. In the Netherlands, each site has its own training plan on environmental topics. In the United States, a conference on risk management was held in 2003 for all the Group's North American units.

MONITORING OF ENVIRONMENTAL RISK

Although most Group activities present relatively little environmental risk, all units face the same issues and requirements in terms of waste treatment, consumption of energy and natural resources, and emissions.

The Environmental Management System ensures that each unit complies with local regulations. Each unit has specific contingency plans for accidental pollution, fire, etc. A crisis management unit under corporate responsibility can be activated as soon as an environmental risk is identified.

At the same time, an **environmental risk mapping** programme has been launched, initially to address administrative or technical non-compliances and potential pollution risks related to asbestos and legionella. This programme was developed first in France and is being finalised in the United Kingdom. It is due to be introduced in the Group's other countries of operation from 2004.

FINANCIAL AND LEGAL INFORMATION

Claims and litigation

To the Group's knowledge, Thales was not liable in 2003 for payment of compensation in relation to an environmental matter in any of the countries covered by this report.

Guarantees

Specific environmental provisions are made with respect to disposals or acquisitions of assets. The provisions cover regulatory compliance, operating permits, the absence of injunctions, complaints or claims, pre-existing pollution and potential liability for pollution.

Acquirers increasingly require environmental guarantees: most countries have adopted stricter legislation affecting operators and owners, and sensitivity on this topic is growing as a result. Acquirers therefore seek to protect themselves as far as possible from civil action by employees or third parties.

The guarantees required are usually based on existing laws, but may also refer to "good practice", laws under discussion, or possible changes in the use of the land and buildings sold. Thales' approach makes it possible to limit the type, value and duration of the guarantees accorded.

In general, environmental compensation is a provision of the sales contract. The total value of environment-related guarantees accorded by Thales since 1998 stood at €286 million at 31 December 2003.

Budget and provisions

For the first time in 2003, Thales included a section on the environment in the procedures for producing its three-year and annual budget plans. Each site was required to disclose actual or budgeted expenditure, investment and non-recurring costs that might be associated with pollution removal for 2003, 2004, 2005 and 2006.

Nevertheless, total provisions in 2003 for environmental risk were the same as in 2002 (€7.5 million) [1].

(1) See Page 16 of this annual report

ENVIRONMENTAL DATA

Since the Group's activities have little impact on the environment, the only relevant indicators of its environmental performance are consumption of energy and natural resources, waste, air and water emissions, and chemicals.

Qualitative and quantitative assessments of the Group's environmental performance are based on the improvements made since 2002 in the quality and global coverage of the information collected about industrial and similar activities. In 2003, the countries covered employed 96% of Thales employees worldwide, and information was collected for all units with environmental significance in each country. These units accounted for 77% of the Group's global workforce.

Since the scope of these assessments changed from 2002 to 2003, any comparison of the two years' data is of limited value. The data for 2002 given below are for information only. Information was also collected for more countries in 2003 than in 2002.

Energy and natural resources

Water

The indicator measures quantities of water taken from water supply networks, ground and surface water. Globally, 33.9% of the water consumed is taken from groundwater and 0.1% from surface water.

Thales businesses as defined above consumed the following quantities of water in 2003 (in cubic metres):

	2003	***2002 for information***
France	1,714,132	*1,742,844*
Australia	1,041,050	*959,980*
United Kingdom	156,100	*195,373*
Germany	138,165	
South Korea	73,737	
Netherlands	57,812	
Singapore	48,939	
North America	32,354	
Italy	25,837	
South Africa	5,290	
Belgium	2,583	
Greece	1,000	

Measures introduced in France since 2000, including replacement or modification of equipment, use of closed circuits and metering, have cut consumption by 14.7%. The largest consumers of water have also been required to take specific measures to reduce consumption.

The relatively high water consumption in Australia is due to the type of businesses involved (shipbuilding and pyrotechnics in particular) and the size of sites. A multi-year water-saving plan has been adopted.

Energy

Electricity, gas and fuel oil are the energy sources used by Thales for lighting, office equipment, heating and process equipment. Occasionally, steam and coal (in Australia) are used for heating but only represent a tiny proportion of energy use and are not recorded separately. No renewable energy sources are used.

Energy consumption in tonnes of oil equivalent (toe):

	2003	***2002 for information***
France	83,361	*83,327*
North America	30,562	
Australia	26,165	*26,186*
United Kingdom	21,053	*21,459*
Netherlands	7,717	*8,730*
Germany	2,592	
Singapore	2,223	
South Korea	1,950	
Italy	869	
South Africa	416	
Belgium	385	
Greece	177	

Energy consumption remained virtually stable from 2002 to 2003 in France, Australia and the United Kingdom. France continued to deploy its multi-year plan to stop fuel oil usage. Australia has negotiated an energy consumption reduction plan with the local authorities.

Waste

Non-hazardous industrial waste (NHIW) figures refer to total waste production by both industrial and service-related activities.

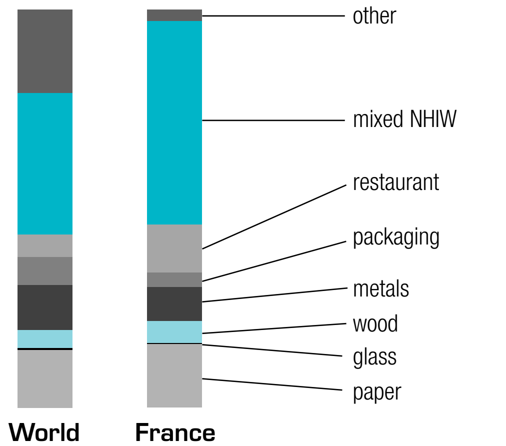
Thales businesses as defined above produced the following amount of non-hazardous industrial waste (in tonnes):

	2003	***2002 for information***
France	6,655	*6,547*
Australia	5,174	*5,703*
United Kingdom	2,801	*3,054*
North America	1,235	
Singapore	1,235	
Netherlands	1,011	
Germany	531	
South Africa	516	
Italy	90	
South Korea	74	
Greece	24	
Belgium	22	

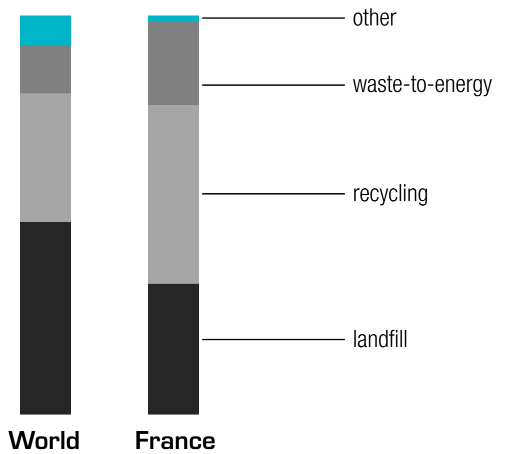
In France, the average rate of waste recycling or reuse stood at 68% (compared with 52% globally). This has been achieved by providing specific waste collection areas and organising staff awareness campaigns to improve waste sorting. Similar programmes are being introduced or are planned in other countries.

Closer monitoring of waste management contractors and the use of waste management scorecards have led to more effective management of the waste disposal processes.

Breakdown by type of waste in 2003
(excluding Singapore and North America: data unavailable)



Breakdown by waste treatment process in 2003
(excluding Singapore and North America: data unavailable)



Hazardous waste is generally generated by industrial processes.

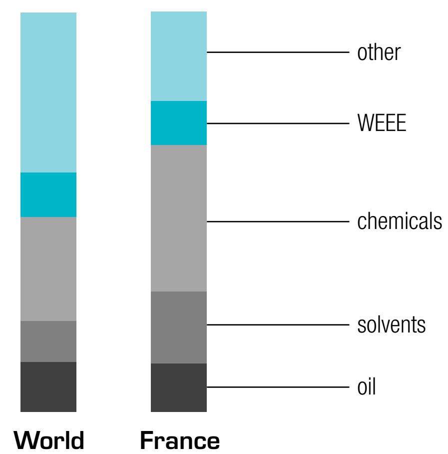
Production of hazardous industrial waste (in tonnes):

	2003	*2002 for information*
France	1,430	*1,457*
Australia	1,014	*776*
Netherlands	368	*380*
United Kingdom	333	*329*
Germany	70	
Singapore	37	
Italy	7,6	
North America	4,4	
South Korea	4,1	
Belgium	2	
South Africa	0.012	
Greece	0	

As for non-hazardous waste, the use of appropriate waste collection systems, staff information and awareness programmes, and performance monitoring tools have led to more effective management of hazardous waste in France. Only a small proportion of the hazardous waste produced is now sent to landfills.

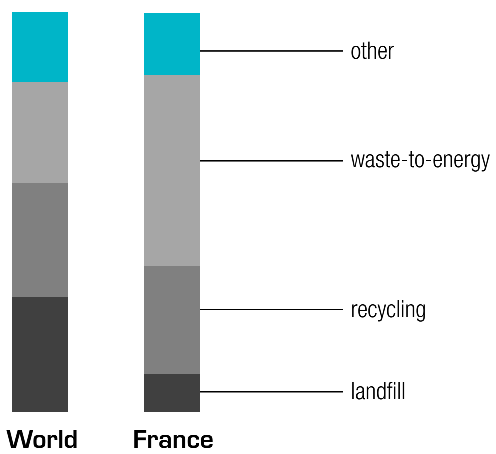
Globally, all waste is given to duly approved subcontractors with guaranteed traceability.

Breakdown by type of hazardous waste

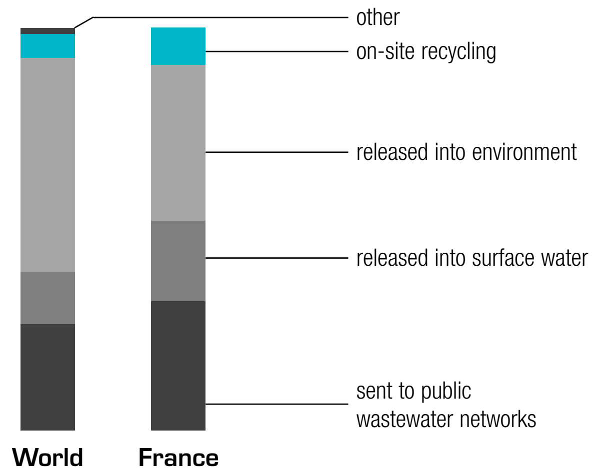


The proportion of waste electric and electronic equipment (WEEE) continues to grow (+24% since 2002), as steps are taken to increase on-site sorting and collection of this type of waste.

Breakdown by waste treatment process



Breakdown of wastewater disposal solutions in 2003



Emissions

Atmospheric emissions

Atmospheric emissions are of two sorts:

- emissions from site installations (boilers and generators, which are subject to regulatory controls and adjustments)
- so-called industrial emissions from the specific activity, mainly related to metals and solvents.

Thales operations in five countries produce solvent emissions: France, Australia, and to a lesser extent, the United Kingdom, Germany and the Netherlands. Only a few units have continuous emissions (mainly connected with surface treatment processes). Emission volumes are low.

Metals emissions are negligible, i.e., less than 10 kg in total.

CO_2, CO, NO_x and SO_x emissions are also measured. Results show that these emissions are primarily from boilers and generators. Action plans (installing closed-loop systems, solvent replacement) are underway at French and Australian sites and will reduce this type of atmospheric emission as from 2004.

Industrial wastewater

Industrial wastewater emission is fairly significant in four countries: France, Australia, the Netherlands and the United Kingdom. This effluent consists mainly of cooling water and process water, which is treated, if necessary, before being discharged into wastewater treatment systems. In recent years, all sites generating industrial wastewater have taken steps to improve their environmental performance in this area: containerisation for easier treatment, improvements to existing treatment equipment, upgrading of inadequate wastewater networks.

Only two sites, one in France and the other in Australia, located at considerable distances from public wastewater networks, release their wastewater directly into the environment. Both sites are being upgraded to raise wastewater quality. Three sites release their wastewater into the surface water network: two of these are in Australia, and the owner (Commonwealth) has installed treatment plants; and one is in France, and has a treatment plant that ensures that the wastewater complies with regulations. Site improvements and effluent quality have been approved by local authorities in all cases.

Chemicals

A new indicator was introduced in 2003 to identify substances purchased during the year that are known to be carcinogenic or to cause gene mutations, toxic effects on reproduction, or eutrophication. At this stage, the method does not provide relevant indications of environmental performance with respect to these substances. The units involved will be equipped with suitable measurement tools in 2004.

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The Group brochure is available from Thales Corporate Communication at Thales head office.

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