



A limited liability corporation with a share capital of €10,000,000
Registered office: 8, rue de la Ville l'Evêque – 75008 Paris, France
Companies and Trade Register of Paris No. 342 376 332

MANAGEMENT REPORT – YEAR ENDED DECEMBER 31, 2004

1.1 KEY CONSOLIDATED FINANCIAL DATA

(in € thousands)	Year ended December 31,		
	<u>2004</u>	<u>2003</u>	<u>2002</u>
STATEMENT OF INCOME			
Revenues.....	491,446	293,051	160,263
Other operating revenue.....	3,899	1,834	380
Total operating revenues.....	495,345	294,885	160,643
Operating expenses.....	442,255	259,918	125,546
Operating income.....	53,090	34,967	35,097
Net interest income/(expense).....	2,735	(940)	(2,447)
Operating income after interest.....	55,825	34,027	32,650
Exceptional items.....	5,168	116	(2,747)
Amortization of goodwill.....	254	313	95
Income before tax.....	60,739	33,830	29,808
Corporate income tax.....	19,907	(45)	5,980
Net income.....	40,832	33,875	23,828
Diluted earnings per share.....	0.75	0.67	0.46
Earnings before interest, tax, depreciation and amortization (EBITDA).....	108,672	53,643	43,249
BALANCE SHEET:			
Fixed assets.....	278,204	124,344	39,871
Operating assets.....	117,789	85,202	61,755
Cash and marketable securities.....	30,548	11,357	15,756
Total assets.....	426,541	220,903	117,382
Shareholders' equity.....	178,285	55,227	25,638
Provisions for contingencies and charges.....	1,492	6,745	5,470
Borrowings.....	29,354	20,877	15,023
Operating liabilities.....	217,410	138,054	71,251
Total liabilities and shareholders' equity....	426,541	220,903	117,382
CASH FLOWS:			
Net cash provided by operating activities.....	139,131	91,410	48,976
Net cash used by investing activities.....	(210,700)	(97,300)	(25,097)
Net cash provided by financing activities.....	84,054	1,843	(11,991)
Change in cash and cash equivalents.....	12,485	(4,047)	11,888
Net cash and cash equivalents at year-end.....	23,158	10,673	14,720

1.2 MANAGEMENT REPORT

1.2.1 Overview

The Group's operations are made up of three business segments:

- The Internet segment, which includes Internet service provider operations (under Free and related brands) and hosting services (the brands Online and BookMyName);
- The Telephony segment, which includes fixed-line telephony (One.Tel and Iliad Telecom), prepaid phone cards (Kertel) and resale of minutes to operators (Kedra);
- Other Services, which include directory services (mainly the ANNU reverse look-up directory accessible by Minitel, telephone, Internet and SMS text messaging) and e-commerce operations (Société.com and Assunet.com).

These business segments may change in the future, based on the development of Group operations and according to operating criteria.

The Group's scope of operations remained unchanged in 2004. There were no notable changes in percentages of control and interest.

Group Management particularly draws the reader's attention to the points of this Management Report presented in the table below, although this list is by no means exhaustive. The Management invites the reader to read this Management Report in its entirety and make his or her own assessment of which points are of particular importance.

Paragraph	Description
1.2.1.1.1	Application of the 5.5% VAT rate for revenues concerning audio-visual content
1.2.1.2	Change in rates for Option 5 ADSL
1.2.1.3	Change in depreciation/amortization periods for LDCOM IRUs and Freebox DSLAMs
1.2.2.1.1	Change in provision for the contribution to the Universal Service Fund
1.2.3	Issuance of shares related to the Iliad Group IPO Change in working capital
1.2.4	Iliad ownership structure at December 31, 2004

1.2.1.1 Breakdown of revenues

1.2.1.1.1 Internet revenues

- **“Pay-as-you-go” access.** For this no-subscription dial-up offer, the customer pays the price of the phone call invoiced by France Telecom. Customers dial the Free access number (08 60 92 20 00) from any fixed line in France, and the call is charged by France Telecom at the local Internet rate. Revenues from the “Pay-as-you-go” offer are therefore directly related to the time customers spend online and to the fee passed on to Free by France Telecom. Free invoices France Telecom on a monthly basis and is paid 45 days after receipt of the invoice. The customer pays France Telecom a connection charge of €0.10 (including tax) and a flat rate of €0.02 per minute (including tax), excluding special offers, 24 hours per day, seven days per week. The fee passed on by France Telecom to Free as the operator of an interconnected network amounts to €0.0231 before tax per minute of use (rate at December 31, 2004). The amount per minute is calculated by France Telecom and approved by the French Telecommunications Regulatory Authority (ART).
- **The “50-hour” plan.** Under the “50-hour plan” launched in April 2001, the customer is entitled to 50 hours of dial-up Internet access per month for a flat fee of €14.94 (including tax). The customer connects to the Internet by dialing a toll-free number (08 68 92 20 00). The subscription fee is paid directly to Free by direct debit at the beginning of each month. Any additional dial-up time and charges for incomplete months are invoiced by Free at the local Internet rate. They are debited to the customer at the beginning of the following month but are recognized in revenue for the current month.
- **Unlimited ADSL broadband offer.** Since October 2002, Free has been offering its customers unlimited broadband access for €29.99 per month (including tax), including use of an ADSL modem and without installation fees. This unique offer allows customers to access the Internet at a speed of at least 2 MB per second and up to 20 MB (observed) in areas where the local loop is unbundled (which depends on whether a subscriber’s line is eligible). Free invoices customers by direct debit for their €29.99 monthly subscription. Customers who cancel their subscription are invoiced and charged a termination fee that decreases by €3 for every month of their subscription period, from a maximum of €96 (including tax).

Free lodged an official request with the French Tax Legislation Department asking for detailed information on the VAT rates applicable to subscriptions for television services using the Freebox modem, as well as on breakdowns of revenues by different tax rates. Following this request, based on data provided by Group Management, the French Budget and Budgetary Reform Minister estimated that the portion of television services in the Freebox subscription – the only portion that is eligible for the reduced VAT rate – amounted to 56%. This reduced rate applies for four years as from January 1, 2004. Iliad is required to inform the Ministry of any changes resulting from technological developments or operating procedures, subsequent to which the proportion of revenues taxed at the reduced VAT rate may have to be amended.

- **Telephony via ADSL.** Since August 2003 (unbundled areas) and March 2004 (bundled areas), a telephony service has been offered as part of subscriptions to high speed broadband access using the Freebox modem. Telephone calls made through the Freebox to another Freebox subscriber or to any standard France Telecom line in mainland France (excluding short numbers and special numbers) are completely free. Revenues generated by calls to French mobile phones and to international numbers, as well as revenues generated by incoming calls to Freebox subscribers, are included within the revenues of the Internet segment.

- **Television via ADSL.** Since December 2003, subscribers to very high-speed broadband Internet access via the Freebox, in unbundled areas, have been offered a television service with more than 140 channels, including 53 pay-per-view channels, as of December 2004. Revenues generated by the pay-per-view channels are included within the revenues of the Internet segment. These revenues are subject to 5.5% VAT. Since November 2004, the Canal+ Group channels are also available via Freebox. These channels are billed directly by the Canal+ Group, which pays a commission to Free.
- **Modem offering and migration to the fully unbundled service.** Since June 2004, Free Haut Débit subscribers can request migration from partially to fully unbundled access. Customers are invoiced a fee for this migration that decreases in line with the duration of their subscription period, from a maximum of €90 (including tax). In addition, since September 2004, subscribers who have Sagem modems can receive a Freebox modem in return for a €60 administrative fee for people who have held a subscription for less than one year and €30 for those who have been subscribers for between 12 and 24 months.
- **Hosting services.** Revenues from the hosting of websites are invoiced at a flat annual rate by domain name or by site.
- **Marketing of domain names and selling of advertising space** on Free’s portal.
- **Other Internet-based revenues** corresponding mainly to the sale of switched time to the Telephony segment.

1.2.1.1.2 Telephony revenues

Telephony segment revenues are mainly attributable to One.Tel and Kertel and break down as follows:

- **One.Tel’s** offer is a no-subscription carrier preselection offer. By signing up with One.Tel, the customer authorizes the company to make a preselection request to France Telecom so that all calls made from the designated fixed line are transferred to One.Tel (excluding special numbers). This enables the customer to benefit from One.Tel’s rates on all local, national and international calls, as well as on calls to mobile phones, including the €0.01 per minute offer for all local and national calls. At the end of each month, the total cost of calls is calculated for each customer and invoiced for payment within two weeks. Since Iliad took over One.Tel, customers have been strongly encouraged to pay by direct debit in order to reduce the risk of non-payment. As of December 31, 2004, over 84% of customers had signed up for this payment method, compared with 73% at December 31, 2003.
- **Kertel’s** revenues are generated by the use of telephone services. They are recognized as the phone cards are used, but also include what is known as “breakage”, i.e. the unused amount remaining on cards when they reach their expiration date.

1.2.1.1.3 Revenues from Other Services

Revenues from the “Other Services” segment mainly come from ANNU, the reverse look-up directory accessible by Minitel, telephone, Internet and SMS text messaging. Minitel access to this service is billed directly by France Telecom on the user’s telephone bill, and part of the fee is passed on by France Telecom to the company running the service. For ANNU, the fee passed on by France Telecom amounts to €36.15 per hour. Fee payments are received on a bi-monthly basis.

Société.com’s e-commerce revenues come from online sales of documents or subscriptions and, to a lesser extent, from advertising. Assunet, an online insurance broker, derives its revenues from commissions on sales of insurance policies to private individuals and to Group companies.

1.2.1.2 Interconnect costs for Option 5 ADSL service (subscribers not on an unbundled line) and Option 1 ADSL (subscribers on an unbundled line)

The Group had three clear financial goals for the roll-out of its network, in addition to the goal of maximizing service quality:

- Increase revenues from “pay-as-you-go” access fees, leveraging Free’s status as an operator;
- Minimize interconnect costs for Free’s “pay-as-you-go” and “50-hour plan” offers and for One.Tel and Kertel telephony services;
- Guarantee high margins for the broadband offer, on the one hand by enrolling new subscribers directly under Option 1, and on the other by migrating Option 5 subscribers (not unbundled) to Option 1 (unbundled) by ensuring that the Group’s network has points of presence at a large number of France Telecom exchanges.

Interconnect operating costs

Direct interconnect costs represent the amounts charged by France Telecom to Free as an operator, as follows:

- Fixed costs corresponding to the rental cost of primary digital blocks and main switching units in the France Telecom network;
- Variable costs calculated based on actual connection time in minutes.

Fixed and variable costs are different depending on whether traffic goes through the digital local exchange or the digital main switching unit. The cost per minute is the same for Free’s “pay-as-you-go” and “50-hour plan” offers, as both involve only a single call collection charge. For local and national calls through One.Tel and Kertel, however, the cost per minute is doubled because there is a call termination charge in addition to the collection charge.

Operating costs of broadband offers

Free’s ADSL offer involves two types of services:

- Option 5 (subscribers not on an unbundled line), representing a France Telecom wholesale offer marketed by Free.
- Option 1 (subscribers on an unbundled line), corresponding to an offer carried entirely by the Free network. Since June 2004, Free Haut Débit subscribers can choose between a partially or fully unbundled service. In the case of the partially unbundled service, users subscribe to the Free Haut Débit broadband offering but continue to pay the telephone line rental to France Telecom and can still make and receive telephone calls through the incumbent operator. Where subscribers opt for the fully unbundled service, they have no commercial link with France Telecom and do not therefore pay a telephone line rental charge. In this case, all telephone calls transit through the broadband connection.

Under Option 1, direct costs per subscriber and per month, as mentioned in the basic unbundling offer, are as follows at December 31, 2004:

Operating costs of Option 1 (partial unbundling)

- Rental of the copper pair and the ADSL splitter: €2.90
- Copper tie cable: €1.32

Operating costs of Option 1 (full unbundling)

- Rental of the copper pair: €10.50
- Copper tie cable: €1.32

Under Option 5, for a subscription that is sold at the same price, costs per subscriber and per month are as follows:

Operating costs of Option 5

- IP-ADSL CO > 20,000 subscribers (512 Kbps): €13.00
- IP-ADSL CO < 20,000 subscribers (512 Kbps): €15.50
- IP-ADSL CO > 20,000 subscribers (1,024 Kbps): €13.00
- IP-ADSL CO < 20,000 subscribers (1,024 Kbps): €18.00
- IP-ADSL CO > 20,000 subscribers (2,048 Kbps): €13.00
- IP-ADSL CO < 20,000 subscribers (2,048 Kbps): €20.00

The costs of the IP-ADSL collection service vary depending on the bit rate used by Option 5 subscribers. These costs have been changed following the decision of the ART on February 8, 2005.

Option 1 gross margin and EBITDA margin are significantly higher than Option 5 margins. Free's objective is therefore to maximize the proportion of its subscribers registered under Option 1 by encouraging its Option 5 subscribers to migrate to Option 1 or, when technically feasible, by directly making an Option 1 offer available to new customers living in an area where the local loop has been unbundled.

1.2.1.3 Capital expenditures and depreciation/amortization expense

The Group has rolled out a telecommunications network in metropolitan France. Most of the underlying optical fiber for this network was obtained under IRU (Indefeasible Right of Use) contracts with an initial term ranging from 10 to 25 years, that involve a single up-front payment when the fiber is made available. These IRU contracts are recognized as intangible assets and are amortized over the life of the contract. In the first half of 2004, the Iliad Group signed a memorandum of understanding with Neuf Telecom, under which Iliad has the option of extending all IRU agreements between Free and Neuf Telecom, up to December 31, 2030. The amortization period relating to these agreements has been altered accordingly, as Group Management considers that the option will be exercised.

Just as operating costs differ significantly between Option 1 and Option 5, so do levels of capital expenditure on tangible and intangible assets.

In addition to capital expenditures on optical fiber during the network roll-out phase, under Option 1 the Group is required to make available a Freebox modem and a Freebox DSLAM and to pay fees to France Telecom for access to unbundling services. The cost of these three items came to about €200 per customer in 2004. The cost of access to France Telecom's unbundling services is amortized over three years from the date of customer installation. The cost of the Freebox modem is depreciated over the same period, while the Freebox DSLAM, like all other network equipment, was depreciated over six years until June 30, 2004. The Group's R&D team has designed an amended version of the Freebox DSLAM that includes ADSL 2+ technology. The Group is now installing these DSLAMs in France Telecom sites. To provide a consistent quality of service to all of its subscribers, the Group has decided to gradually replace older-version Freebox DSLAMs over a period of 18 months, from July 2004 to December 31, 2005.

As a result of these decisions:

- The final date of use of the older version Freebox DSLAMs has been set at December 31, 2005 and their depreciation period has been altered accordingly;
- The depreciation period for the amended version DSLAMs has been set at 3 years.

Under Option 5, total capital expenditure is lower, amounting to approximately €125 per customer. The cost of access to France Telecom unbundling services is amortized over three years, the same period used for the depreciation of the ADSL modem or Freebox modem provided to the customer.

1.2.1.4 Earnings before interest, tax, depreciation and amortization (EBITDA)

EBITDA (earnings before interest, tax, depreciation and amortization) is one of the key performance indicators used throughout this Management Report.

1.2.2 Comparison of results for the years ended December 31, 2004 and December 31, 2003

The following comments are based on the consolidated financial statements for the years ended December 31, 2004 and December 31, 2003.

The following section reviews revenues, EBITDA and operating income for the Group as a whole and by business segment.

Consolidated revenues and operating expenses disclosed in the financial statements do not match the sum of the segment revenues and expenses in the section below, due to adjustments for inter-segment transactions. The bulk of these inter-segment transactions corresponds to the resale to the Telephony segment of telecommunications services provided over the network operated by Free, for a total amount of €43.4 million in 2003 and €89.7 million in 2004.

Kertel was consolidated as from April 1, 2003. The impact on Group results of consolidating Kertel for the first quarter of 2003 would not have been material.

For ease of reference, in this Management Report operating expenses are presented for the first time net of capitalized production costs (Other operating revenues). These costs correspond to the production cost of the Freebox modems and DSLAMs that are manufactured within the Group and recorded under tangible assets or inventories. This new presentation is deemed to better reflect the economic reality of the Group's business. Other operating revenue now only includes reversals of provisions, as well as expense transfers and miscellaneous revenues.

(in € thousands)	Year ended December 31, 2004	Year ended December 31, 2003	% change
Net revenues	491,446	293,051	67.7
Other operating revenue	3,899	1,834	112.6
Purchases used in production and other operating expenses	355,214	220,053	61.4
Payroll costs	22,064	14,421	53.0
Taxes other than on income	3,822	1,623	135.5
Additions to provisions	5,573	5,145	8.3
EBITDA	108,672	53,643	102.6
Depreciation and amortization	55,582	18,676	197.6
Operating income	53,090	34,967	51.8
Net interest income/(expense)	2,735	(940)	NM
Operating income after interest	55,825	34,027	64.1
Exceptional items	5,168	116	NM
Goodwill amortization	254	313	(18.8)
Income before tax	60,739	33,830	79.5
Corporate income tax	19,907	(45)	NM
Net income	40,832	33,875	20.5

Revenues

Revenues for 2004 rose nearly 68% compared to fiscal 2003. Growth was driven by: (i) increased revenues from Internet access, particularly ADSL broadband access, (ii) higher revenues in the Telephony segment thanks to significantly stronger marketing for the One.Tel brand, (iii) the new sales momentum enjoyed by Kertel's teams since their integration into a telecommunications group, as well as the consolidation of Kertel's revenues over a full year.

Operating expenses

Operating expenses, excluding depreciation and amortization expense, increased 60% in 2004, to €386.7 million. Against a backdrop of rapid revenue growth, the Group has crossed the inflection point beyond which the increase in revenues outpaces that in net operating expenses.

Operating income

Operating income rose significantly, to €53.1 million in 2004, up from €35.0 million one year ago. This growth reflected the combined impact of greater profitability in the Internet segment, thanks to the ever-increasing proportion of broadband subscribers on unbundled lines, and improved operating

income in the Telephony segment. It was, however, partly offset by lower margins in the ANNU directory business.

In addition, capital expenditure on equipment for broadband customers fueled a threefold rise in depreciation and amortization expense between 2003 and 2004, to €55.6 million. This represents over 11% of revenues, compared with just over 6% in 2003.

Earnings before interest, tax, depreciation and amortization (EBITDA)

Group EBITDA totaled €108.7 million in 2004, rising 102.6% compared to 2003. This jump was mainly the result of signing up new ADSL subscribers directly under Option 1, in addition to migrating existing Option 5 subscribers to Option 1. The Group EBITDA margin also improved from 18.3% in 2003 to 22.1% in 2004.

Net interest income

Net interest income totaled €2.7 million in 2004. This total includes interest income from cash investments relating to proceeds from the IPO, as well as exchange-rate gains on purchases of Freebox components and reversals of provisions for investments, offset by interest expense on borrowings and on lease financing obtained by Free.

Exceptional items

Exceptional items mainly include revenues from asset disposals, in the form of sales of shared France Telecom collocation rooms, and of Free's invoicing, in accordance with the general terms of sale, of Sagem and Freebox modems not returned by customers following the canceling of their subscription.

The Group recorded the following as exceptional income in 2004: (i) a gain of €1.6 million from the sale of an office building; (ii) a gain of €2.6 million on the waiver by Siris of a One.Tel receivable as part of the memorandum of understanding signed in December 2004 with the Neuf Telecom Group; and (iii) two reversals of provisions for contingencies and charges in One.Tel's accounts, amounting to €2.0 million. The Group recorded an exceptional expense of some €730,000, corresponding to the withdrawal of the Kertel billing platform.

Income before tax

Income before tax rose 79.5% compared to 2003, reaching €60.7 million.

Net income

Net income amounted to €40.8 million in 2004, up from €33.9 million in 2003. The income tax charge for 2004 was €19.9 million, versus no tax charge for 2003.

1.2.2.1.1 Analysis of results for the Internet segment

The Internet segment includes the following operations:

- Internet Service Provider (ISP) operations, both through the switched telephone network and via ADSL, marketed under the Free, Free haut débit, Free Telecom and Freebox brands;
- Hosting and domain-name creation services, marketed under the Online and BookMyName brands.

Free is the Group subsidiary responsible for operating the Group's telecommunications network.

(in € thousands)	Year ended December 31, 2004	Year ended December 31, 2003	% change
Net revenues	394,052	215,042	83.2
Other operating revenue	2,778	1,139	143.9
Purchases used in production and other operating expenses	291,573	173,485	68.1
Payroll costs	16,773	9,170	82.9
Taxes other than on income	2,731	1,027	165.9
Additions to provisions	3,268	3,333	(2.0)
EBITDA	82,485	29,166	182.9
Depreciation and amortization	54,226	17,423	211.2
Operating income	28,259	11,743	140.6

Revenues

The table below shows the breakdown by category of consolidated revenues for the Internet segment for the years ended December 31, 2004 and December 31, 2003, as well as the percentage change between these two years.

(in € thousands)	Year ended December 31, 2004	Year ended December 31, 2003	% change
ISP revenues (<i>Pay-as-you-go, 50-hour plan, ADSL</i>)	322,179	177,118	81.9
Hosting and advertising revenues	6,294	4,743	32.7
Inter-segment and other revenues	65,579	33,181	97.6
Total revenues	394,052	215,042	83.2

Internet segment revenues for fiscal 2004 grew by €179.0 million or 83% compared to fiscal 2003, mainly due to the success of Free's ADSL broadband offer.

ISP revenues

	At December 31, 2002	At December 31, 2003	At June 30, 2004	At December 31, 2004
ADSL subscribers	99,100	485,000	768,000	1,064,000
Of which customers on unbundled lines	3,300	163,000	355,000	566,000
Percentage of unbundled line customers	3.3%	33.6%	46.2%	53.2%
Share of residential market¹	7.2%	15.0%	16.8%	17.4%

ISP revenues (Free, Free Telecom and Free haut débit), through both the switched telephone network and ADSL, totaled €322.2 million for the year ended December 31, 2004.

Revenue growth in the ISP business resulted from the following factors:

- **Continuing success of the broadband offer.** At December 31, 2004, broadband customers numbered nearly 1,064,000, against 485,000 at December 31, 2003. This 119.4% increase was achieved despite a reduction in market share in the fourth quarter of the year, primarily caused by an advertising campaign launched by France Telecom which was subsequently held by the French courts to be parasitic advertising;
- **Use of the new paying services available through the Freebox (telephony and television).** In 2004, revenues related to these services totaled nearly €13.5 million;
- **Decline in the "pay-as-you-go" and "50-hour plan" dial-up offers.** Call minutes generated by the pay-as-you-go offer declined almost 24% to around 1.6 billion minutes in 2004 from some 2.1 billion in 2003. As regards the 50-hour plan, the number of subscribers declined from 211,000 in January 2004 to 143,500 by the end of the year.

Hosting and advertising revenues

The marketing of domain names in France, value-added hosting services and the sale of advertising space (including the sale of sponsored links as part of a partnership with Google) on Free's portal generated hosting and advertising revenues of €6.3 million in 2004. The €1.6 million increase compared with 2003 was driven by a 21% rise in hosting revenues and an increase of nearly 40% in advertising revenues on the back of sustained volume growth in online advertising in France during the year.

Inter-segment and other revenues

Inter-segment and other revenues correspond primarily to the resale to the Telephony segment of call minutes on Free's directly-operated network. Growth in these revenues in 2004 mainly reflected higher revenues in the Telephony segment.

Purchases used in production and other operating expenses

Purchases used in production and other operating expenses were 68% higher in 2004 than in 2003. Operating expenses for the Internet segment are rising at a slower pace than revenues, as a result of the unbundling strategy adopted by the Group. The key factors causing operating expenses to fall as a proportion of revenues are as follows:

- The rising proportion of Option 1 ADSL subscribers among total broadband customers, reaching 53.2% at December 31, 2004, up from 33.6% at January 1, 2004.

¹ Source: France Telecom

- The overall decline in costs of Option 5 subscriptions (see paragraph 1.2.1.2), offset by the opportunity offered to subscribers of increasing their available bandwidth from 512 Kbps to 1,024 Kbps and subsequently 2,048 Kbps, thereby raising Free's costs of IP connection and transit.

In addition, Free's decision to use France Telecom POP and Interlan optical fiber connections had a negative impact on operating expenses in 2004, because some of these connections, which are being billed to Free as rental expenses, were not used during the year.

Payroll costs

The rise in payroll costs in the Internet segment was a direct result of the recruitments carried out at Centrapel to handle the surge in demand for the ADSL broadband offer. Centrapel's payroll costs rose to €12.9 million from €5.7 million in 2003, reflecting an increase in the company's average number of employees (including part-time employees) from 239 in 2003 to 517 in 2004.

Additions to provisions

Additions to provisions amounted to €3.3 million in 2004, and primarily corresponded to provisions for doubtful customer accounts. In percentage of revenue terms, this figure was on a par with 2003, when total additions to provisions came to €3.3 million, including €1.7 million set aside for contributions to the French Universal Service Fund.

As stated in the management report for the year ended December 31, 2003, calculations of contributions to the Universal Service Fund have undergone a number of changes in recent years, for all telecommunications operators, including Free. The situation was clarified in 2004, following a Decree dated November 17, 2004, published in the *Journal Officiel* on November 19, 2004, which set out the definitive calculation rules. This Decree approved the use of a percentage of revenues as the basis for calculating contributions to the Fund and also confirmed the powers of the French Telecommunications Regulatory Authority (ART) in relation to determining the costs of the Universal Service. By way of a decision dated December 19, 2004, published in the *Journal Officiel* on December 21, 2004, the ART set the final amount of the Universal Service Fund at €124.9 million for 2002 and the contribution rate at 0.42% of telecommunications revenues. For 2003 and subsequent years, Iliad's Management has adjusted the Group's liability for Universal Service contributions using 0.43% of telecommunications revenues as the calculation base. This led to a €2.6 million reversal from the related provision in 2004, which represented the majority of the amount recorded under other operating revenue for the Internet segment during the year. The amount payable for the Universal Service contributions in 2004 represented an operating expense of €1.1 million.

EBITDA and operating income

Internet segment EBITDA for 2004 was up almost 183% on the prior-year figure. Excluding inter-segment transactions, the EBITDA margin for the Internet segment rose to 24.9% from 16.0% in 2003. This performance was the result of the greater number of France Telecom sites connected with optical fiber or rented lines, which made it possible to increase the number of subscribers having access to broadband connections through the unbundling of the local loop (Option 1).

In 2004, the number of connected France Telecom sites rose from over 160 to nearly 410. The number of unbundled lines leapt to 566,000 at December 31, 2004, from 163,000 at December 31, 2003. This high number of Option 1 subscribers demonstrates the validity of the Group's strategy of encouraging migration from Option 5 to Option 1, as well as Management forecasts of EBITDA trends.

Operating income for the year ended December 31, 2004 came to €28.3 million, representing a €16.5 million increase compared to 2003.

1.2.2.1.2 Analysis of results for the Telephony segment

The Telephony segment includes the following operations:

- Fixed-line telephony and prepaid phone card operations under the One.Tel and Kertel brands;
- Telephony services provided to operators by Kedra.

(in € thousands)	Year ended December 31, 2004	Year ended December 31, 2003	% change
Net revenues	162,976	96,366	69.1
Other operating revenue	979	664	47.4
Purchases used in production and other operating expenses	134,304	73,823	81.9
Payroll costs	2,737	3,033	(9.8)
Taxes other than on income	819	347	136.0
Additions to provisions	2,286	1,810	26.3
EBITDA	23,808	18,017	32.1
Depreciation and amortization	1,069	957	11.7
Operating income	22,739	17,060	33.3

Revenues

The table below shows the breakdown by category of consolidated revenues for the Telephony segment for the years ended December 31, 2004 and December 31, 2003, as well as the percentage change between the two years.

(in € thousands)	Year ended December 31, 2004	Year ended December 31, 2003	% change
Fixed telephony and prepaid phone card revenues	123,492	75,269	64.1
Revenues from services to operators and inter-segment sales	39,484	21,097	87.1
Total revenues	162,976	96,366	69.1

Revenues for the Telephony segment for fiscal 2004 rose by nearly €66.6 million, or 69.1%, compared to fiscal 2003.

Fixed telephony and prepaid phone card revenues

Revenues from fixed telephony and prepaid phone cards, generated primarily by One.Tel and Kertel, amounted to €123.5 million for the year ended December 31, 2004.

Revenue growth stemmed primarily from the combination of the following three factors:

- **Growth in the number of One.Tel customers in 2004.** As stated at the time of the Group's IPO, raising the number of One.Tel subscribers was one of the priorities for Management. As a result of more extensive and precisely targeted marketing expenditure, the number of invoiced customers rose to 335,000 in December 2004, up almost 56% from the 215,000 at December 31, 2003;
- **A slight contraction (9%) in average revenue per user (ARPU);**
- **Contribution from Kertel.** Further to the Group's acquisition of Kertel in March 2003, the company's new sales organization and pricing structure has boosted sales of prepaid phone cards, with 7.5 million sold in 2004, compared to 4.9 million the previous year.

Revenues from services to operators and inter-segment sales

The increase in revenues from services to operators and inter-segment sales was mainly attributable to a greater volume of transactions with the Internet segment, and with Free in particular, which centralizes all purchases of minutes by the Group.

Purchases used in production and other operating expenses

Purchases used in production and other operating expenses rose 81.9% in 2004 compared to the prior year, while revenues increased 69.1%.

This outpacing of growth in revenues by operating expenses was mainly due to rising interconnect costs related to greater traffic from One.Tel customers and users of Kertel cards, as well as the significant increase in marketing expenses for One.Tel, as had been announced at the time of Iliad's IPO.

Payroll costs

The reduction in payroll costs in the Telephony segment reflects the economies of scale that can be achieved in alternative fixed-line telephony operations.

EBITDA and operating income

The Telephony segment's EBITDA came to €23.8 million in 2004, €5.8 million up on the 2003 figure. At the time of the IPO, Iliad's Management had undertaken to maintain the EBITDA of the Telephony segment or achieve a slight increase, despite the forecast rise in the marketing budget. The EBITDA margin, excluding inter-segment sales, came to 16.2%.

2004 operating income for the Telephony segment climbed to €22.7 million.

1.2.2.1.3 Analysis of results for the Other Services segment

The Other Services segment includes:

- Reverse look-up directory services, one of Iliad's historic businesses, marketed under the names 3617 ANNU and Annu.com, accessible via Minitel, telephone, Internet and SMS text messaging;
- E-commerce operations, including Assunet.com, an online insurance broker, and Société.com, an online provider of financial information.

(in € thousands)	Year ended December 31, 2004	Year ended December 31, 2003	% change
Net revenues	24,152	25,026	(3.5)
Other operating revenue	142	35	NM
Purchases used in production and other operating expenses	19,071	16,132	18.2
Payroll costs	2,553	2,218	15.1
Taxes other than on income	272	249	9.2
Additions to provisions	19	2	NM
EBITDA	2,379	6,460	(63.2)
Depreciation and amortization	287	296	(3.0)
Operating income	2,092	6,164	(66.1)

Revenues

Overall revenues from Other Services contracted by 3.5% in 2004.

Directory services revenues contracted by almost 30% in 2004, reflecting the slow but sure fall-off in use of the Minitel in France since 1998. Even though directory services have generally held up better than leisure or other non-work-related Minitel services, the Group has markedly felt the impact of this decline since the end of 2001, which could not be offset by growth in e-commerce revenues.

Purchases used in production and other operating expenses

The increase in purchases used in production mainly reflected higher headquarters costs and marketing expenditure re-invoiced to other Group entities, in particular One.Tel.

EBITDA and operating income

Despite decreasing revenues, the Group's reverse look-up directory services remain profitable, contributing to the Other Services segment's EBITDA of €2.4 million and operating income of nearly €2.1 million for fiscal 2004.

1.2.3 Liquidity and capital resources

(in € thousands)	Year ended December 31,		
	<u>2004</u>	<u>2003</u>	<u>2002</u>
CASH FLOWS:			
Cash flows provided by operating activities	139,131	91,410	48,976
Cash flows used by investing activities	(210,700)	(97,300)	(25,097)
Cash flows provided by financing activities	84,054	1,843	(11,991)
Change in cash and cash equivalents	12,485	(4,047)	11,888
Net cash and cash equivalents at year-end	23,158	10,673	14,720

The Group's sources of financing include operating cash flows on a recurrent basis. In addition, cash proceeds from the issue of shares at the time of Iliad's IPO of January 30, 2004, with the greenshoe clause, allowed Iliad to raise approximately €91.6 million net of IPO costs.

As regards Group operating cash flow, the contribution to working capital amounted to nearly €39 million (or 7.9% of revenues) in 2004, as opposed to €41.2 million (14% of revenues) for 2003. Although Group revenues rose by more than 68%, working capital generation fell to 77 days of sales in 2004 versus 81 in 2003, as a direct result of the Group's strategic decision to provide a Freebox modem to every new subscriber.

In the consolidated financial statements, amounts due to fixed asset suppliers are not accounted for separately from amounts due to suppliers of goods and services. The average payment period for Iliad Group suppliers improved slightly in 2004, corresponding to 90 days.

Another factor to be noted in relation to cashflows is that DSLAMs had to be manufactured in 2004 to respond to the extension of unbundled areas, with the number of installed units rising from 575 at December 31, 2003 to nearly 1,342, including 419 ADSL 2+ DSLAMs. Further, the Group is constantly in a credit position with the tax authorities in terms of VAT, as on average, VAT credits are only repaid every four and a half months. The related VAT receivables amounted to some €13.5 million at December 31, 2004.

Aside from Freebox modems and DSLAMs, network optical fiber makes up the bulk of acquisitions of fixed assets, which broke down as follows in 2004:

- Acquisitions of intangible assets (including IRU contracts, France Telecom collocation rooms and access fees to the France Telecom service): €102.6 million;
- Acquisitions of tangible assets (including Freebox modems and DSLAMs, transmission equipment, etc.): €112.2 million.

On June 11, 2004, Iliad paid out a dividend of €0.10 per share (excluding the *avoir fiscal* tax credit), representing a total payout of €5.3 million.

On December 19, 2004, Iliad paid out an interim dividend of €0.075 per share (excluding the *avoir fiscal* tax credit), representing a total payout of €4.0 million.

In the second half of 2004, Iliad purchased the Free shares issued on the exercise of founders' share subscription warrants (BSPCE) by Free employees, for a net amount of €1.6 million. These share purchases were in line with the Group's decision to retain full control of its subsidiary, Free, in 2004.

1.2.4 Ownership structure at December 31, 2004

At December 31, 2004, Iliad's capital stock was composed of 53,452,230 ordinary shares, breaking down as follows:

- Executive Management: 42,051,013 shares, or 78.6% of capital stock
- Goldman Sachs Fund: 936,670 shares or 1.8% of capital stock
- Public: 10,464,547 shares or 19.6% of capital stock

At December 31, 2004, outstanding options exercisable for Iliad shares broke down as follows: founders' share subscription warrants (BSPCE) exercisable at any time for a total of 699,320 shares and Iliad share subscription options exercisable as from February 2008 for a total of 444,132 shares.

1.2.5 Off-balance sheet commitments

The table below analyzes the Group's commitments under non-cancelable leases at December 31, 2004 by type of asset and by maturity. See also the information provided in the notes to the consolidated financial statements.

(in € thousands)

Type of leased asset	Within 1 year	1 to 2 years	2 to 3 years	3 to 4 years	4 to 5 years	Beyond 5 years	TOTAL
Real estate	4 387	4 302	4 076	4 072	2 307	1 755	20 899
Vehicles	182	132	23	/	/	/	337
Equipment	681	542	72	/	/	/	1 295
Other	414	313	199	160	129	859	2 074
TOTAL	5 664	5 289	4 370	4 232	2 436	2 614	24 605

1.2.6 Group indebtedness

As far as Iliad is aware, the Group is not subject to any liquidity risk as a result of prepayment clauses entered into by Group companies or as a result of non-compliance with financial covenants (ratios, targets, etc.).

Outstanding borrowings and obligations under finance leases totaled €21.8 million at December 31, 2004.

At December 31, 2004, the Group had confirmed credit lines of €70 million, available until November 2008, €10 million of which had been drawn down.

1.3 ADDITIONAL INFORMATION

1.3.1 Subsequent events

No material events have occurred since the balance sheet date.

1.3.2 IFRS Transition

A working group has been established to assess the impact of IFRS transition. Pursuant to the AMF recommendation, full IFRS comparative information will be released at the latest with 1st Half 2005 results.

[En attente du rapport CAC]