



A limited liability corporation with a share capital of €12,000,000
 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, 2005

1.1 KEY CONSOLIDATED FINANCIAL DATA

| (in € thousands) | Year ended December 31, 2005 | Year ended December 31, 2004 |
|--|------------------------------------|------------------------------------|
| STATEMENT OF INCOME | | |
| Revenues | 724,201 | 491,446 |
| Operating expenses, net..... | (616,515) | (435,780) |
| Profit from ordinary activities | 107,686 | 55,666 |
| Other operating income and expense, net..... | 0 | 2,556 |
| Operating profit | 107,686 | 58,222 |
| Financial income and expense, net | (2,795) | 2,677 |
| Corporate income tax | (36,371) | (20,181) |
| Profit from discontinued operations | (378) | 0 |
| Profit for the period | 68,898 | 40,718 |
| Diluted earnings per share (in €) | 1.26 | 0.75 |
| EBITDA | 224,313 | 112,818 |
| BALANCE SHEET | | |
| Non-current assets | 425,945 | 283,501 |
| Current assets | 157,838 | 143,278 |
| <i>Of which cash and cash equivalents.....</i> | <i>51,089</i> | <i>30,485</i> |
| Total assets..... | 583,783 | 426,779 |
| Total equity..... | 248,575 | 178,477 |
| Non-current liabilities..... | 77,162 | 10,916 |
| Current liabilities..... | 258,046 | 237,386 |
| Total equity and liabilities..... | 583,783 | 426,779 |
| CASH FLOWS | | |
| Net cash generated from operating activities.... | 225,817 | 99,826 |
| Net cash used in investing activities..... | (262,205) | (168,518) |
| Net cash generated from financing activities.... | 62,711 | 81,112 |
| Net change in cash and cash equivalents..... | 26,323 | 12,420 |
| Cash and cash equivalents at year-end | 49,416 | 23,093 |

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), hosting services (the Online, BookMyName and Dedibox brands), and Wimax activities (operated by IFW).
- The Traditional Telephony segment, which includes switched 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.

Changes in Group structure during the year concerned the Traditional Telephony segment where Iliad sold a 50% interest in a non-material subsidiary, and the Internet segment where the Group (i) set up Dedibox – which was dormant in 2005 – as well as Total Call and (ii) acquired the entire capital of Altitude Telecom in November 2005 for €57 million. The company was subsequently renamed IFW. IFW owns the only national Wimax licence in France.

The consolidated financial statements of the Iliad Group have been prepared in accordance with IAS/IFRS. A report summarizing the impact of the transition to IFRS is available on the Iliad website.

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. The customer pays France Telecom a connection charge of €0.106 (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, 2005). The amount per minute is calculated by France Telecom and approved by the French Telecommunications Regulatory Authority (ARCEP).
- **The “50-hour” plan.** Under the “50-hour plan”, the subscriber is entitled to 50 hours of dial-up Internet access per month for a flat fee of €14.94 (including tax). The subscriber 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 subscriber 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 subscribers unlimited broadband access for €29.99 per month (including tax), including use of an ADSL modem and without installation fees. This unique offer allows subscribers to access the Internet at a speed of at least 2 MB per second and up to 24 MB (observed) in areas where the local loop is unbundled (which depends on whether a subscriber's line is eligible). Free invoices subscribers by direct debit for their €29.99 monthly subscription. Subscribers 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).

Since January 1, 2004, the portion of television services included in the Freebox subscription – which is taxed at the reduced VAT rate of 5.5% – has been set at 56%.

- **Telephony via ADSL.** Since August 2003 (unbundled areas) and March 2004 (non-unbundled areas), a telephony service has been offered as part of subscriptions to Free Haut Débit broadband access using the Freebox modem. Telephone calls made through the Freebox to another Freebox subscriber or to any standard France Telecom fixed 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.
- **Free's preselection offer.** Since June 2005, Free Haut Débit broadband subscribers have been able to apply for a preselection offering where they have not opted for full unbundling. By signing up with the Free preselection service, the subscriber authorizes the company to make a preselection request to France Telecom so that all calls made from the designated fixed line can be transferred to and billed by Free (excluding special numbers). This enables the subscriber to benefit from Free's rates on all local, national and international calls, as well as on calls to mobile phones.
- **Television via ADSL.** Since December 2003, subscribers to broadband Internet via the Freebox, in unbundled areas, have been offered a television service with more than 222 channels, including 81 free channels as of December 2005. Revenues generated by pay-per-view channels are included within the revenues of the Internet segment. These revenues are also subject to 5.5% VAT. Since November 2004, the Canal+ Group channels have likewise been available via Freebox. These offers are billed directly by the Canal+ Group, which pays a commission to Free.
- **Video on demand via ADSL (VoD).** Since December 2005, subscribers to broadband Internet via the Freebox, in unbundled areas, have been offered a video on demand service operated jointly with the Canal+ Group. This service enables subscribers to access a catalog of movies 24 hours a day, 7 days a week, and view them on their television. The movies – which are ordered using the Freebox remote control – include DVD player features and may be viewed for a period of 24 hours. The price of the movies, which varies between €1.99 and €3.99, is invoiced directly on the subscriber's Free Haut Débit bill. These revenues are subject to 5.5% VAT.
- **Modem offering and migration to the fully unbundled service.** Since June 2004, Free Haut Débit broadband subscribers can request migration from partially to fully unbundled access. Subscribers 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. At the same time, subscribers with a Freebox modem can receive an upgraded

version in return for a €90, €60, or €30 administrative fee depending on the length of time they have held a subscription.

- **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 traffic to the Traditional Telephony segment and the sale of WiFi cards.

1.2.1.1.2 Traditional Telephony revenues

Traditional 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 subscriber authorizes the company to make a preselection request to France Telecom so that all calls made from the designated fixed line can be transferred to and billed by 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. At December 31, 2005, over 89% of customers had signed up for this payment method, compared with 84% at December 31, 2004.
- **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 every other month.

Société.com's e-commerce revenues are generated by online sales of documents or subscriptions and, to a lesser extent, 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 Operating costs for Option 5 ADSL service (subscribers not on an unbundled line) and Option 1 ADSL service (subscribers on an unbundled line)

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 broadband 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, were as follows in 2005:

Operating costs of Option 1 (partial unbundling)

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

Operating costs of Option 1 (full unbundling)

- Rental of the copper pair: €9.50¹
- Copper tie cable (average): €1.32

Under Option 5, for a subscription that is sold at the same price, costs per subscriber and per month are made up of access costs (see table below) and costs of the IP transit service.

Operating costs of Option 5

| | Until February 28, 2005 | From March 1, 2005 |
|---|----------------------------|-----------------------|
| • IP-ADSL CO > 20,000 subscribers (512 Kbps): | €13.00 | €13.00 |
| • IP-ADSL CO < 20,000 subscribers (512 Kbps): | €15.50 | €15.50 |
| • IP-ADSL CO > 20,000 subscribers (1,024 Kbps): | €13.00 | €13.00 |
| • IP-ADSL CO < 20,000 subscribers (1,024 Kbps): | €18.00 | €17.00 |
| • IP-ADSL CO > 20,000 subscribers (2,048 Kbps): | €13.00 | €13.00 |
| • IP-ADSL CO < 20,000 subscribers (2,048 Kbps): | €20.00 | €17.00 |
| • IP-ADSL CO > 20,000 subscribers (Max IP): | - | €13.00 |
| • IP-ADSL CO < 20,000 subscribers (Max IP): | - | €17.00 |

The operating cost structure under Option 5 has been simplified since October 1, 2005 and is no longer directly related to the bit rate concerned or the type of connection node. For the DSL Access offer, the monthly subscription fee is now set at €14.20 per single VC access.

The additional costs of the IP transit service vary depending on the bit rate used by Option 5 subscribers.

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 provisioned under Option 1 by migrating its Option 5 subscribers to Option 1 or, where technically feasible, by directly offering Option 1 to new subscribers living in an area where the local loop has been unbundled.

¹ €10.50 between January and June 2005.

1.2.1.3 Capital expenditures and depreciation

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 terms 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 property, plant and equipment and are depreciated over the life of the contract.

Just as operating costs differ significantly between Option 1 and Option 5, so do levels of capital expenditure. 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 €170 per subscriber in 2005. The cost of access to France Telecom's unbundling services, as well as the Freebox modems and Freebox DSLAMs is depreciated over three years from the date of subscriber installation. Since February 2005, fees invoiced by France Telecom for access to unbundling services have been reduced from €78.7 to €50 per subscriber for full unbundling and to €55 for partial unbundling.

Under Option 5, total capital expenditure is lower, amounting to approximately €125 per subscriber. The cost of access to France Telecom unbundling services and of the ADSL modem or Freebox modem provided to the subscriber is depreciated over three years.

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, 2005 and December 31, 2004

The following comments are based on the consolidated financial statements for the years ended December 31, 2005 and December 31, 2004.

The following section reviews revenues, EBITDA and operating profit 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 Traditional Telephony segment of telecommunications services provided over the network operated by Free, for a total amount of €96.6 million in 2005 and €89.7 million in 2004.

| (in € thousands) | Year ended December 31, 2005 | Year ended December 31, 2004 | % change |
|--|------------------------------------|------------------------------------|-------------|
| Revenues | 724,201 | 491,446 | 47.4 |
| Purchases used in production | (385,886) | (278,843) | 38.4 |
| Payroll costs | (29,811) | (21,756) | 37.0 |
| External charges | (59,940) | (65,550) | (8.6) |
| Taxes other than on income | (5,530) | (3,117) | 77.4 |
| Additions to provisions | (4,463) | (3,068) | 45.5 |
| Other income and expenses from operations, net | (14,258) | (6,294) | 126.5 |
| EBITDA | 224,313 | 112,818 | 98.8 |
| Depreciation and amortization | (116,627) | (57,152) | 104.1 |
| Profit from ordinary activities | 107,686 | 55,666 | 93.5 |
| Other operating income and expense, net | 0 | 2,556 | (100.0) |
| Operating profit | 107,686 | 58,222 | 85.0 |
| Financial income and expense, net | (2,795) | 2,677 | |
| Corporate income tax | (36,371) | (20,181) | |
| Profit from discontinued operations | (378) | 0 | |
| Profit for the period | 68,898 | 40,718 | 69.2 |

Revenues

Revenues for 2005 rose over 47% compared with fiscal 2004. Growth was primarily driven by increased revenues from the Internet segment, particularly from broadband access and optional value-added services available through the Freebox. For the year ended December 31, 2005, these optional services accounted for almost €75 million, versus €13.5 million in 2004.

Operating expenses

Excluding depreciation and amortization, operating expenses climbed 32% in 2005, to €500 million. As mentioned in the Management Report for the year ended December 31, 2004, the Group has crossed the inflection point beyond which the increase in revenues outpaces that in net operating expenses.

Operating profit

Operating profit surged to €107.7 million from €58.2 million. This performance was attributable to the combined impact of:

- Greater profitability in the Internet segment, thanks to an ever-increasing proportion of broadband subscribers on unbundled lines.
- The contribution of value added optional services provided through the Freebox.

In addition, capital expenditure related to equipment for broadband subscribers and measures to extend the network fueled an over 104% rise in depreciation and amortization expense versus 2004, to €116.6 million, representing more than 16% of the Group's 2005 revenues.

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

Group EBITDA totaled €224.3 million in 2005, up 98.8% on 2004. This jump was mainly the result of (i) signing up new ADSL subscribers directly under Option 1, (ii) migrating existing Option 5 subscribers to Option 1, and (iii) the contribution of value added optional services provided through the Freebox. The Group EBITDA margin advanced from 23% in 2004 to 31% in 2005.

Financial income and expense, net

In 2005, net financial expense amounted to €2.8 million, corresponding primarily to interest on borrowings obtained by the Group, as well as foreign exchange losses on purchases of Freebox components denominated in U.S. dollars. The Group does not have any systematic currency hedging policy, including for purchases denominated in US dollars.

Profit for the period

Profit for the period amounted to €68.9 million, up from €40.7 million in 2004, representing a year-on-year increase of over 69%. The income tax charge for 2005 totaled €36.4 million, versus €20.2 million one year earlier.

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, BookMyName and Dédibox brands.
- Call center operations, carried out by Centrapel and Total Call.

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

| (in € thousands) | Year ended December 31, 2005 | Year ended December 31, 2004 | % change |
|--|---------------------------------|---------------------------------|--------------|
| Revenues | 638,923 | 394,052 | 62.1 |
| Purchases used in production | (366,267) | (259,501) | 41.1 |
| Payroll costs | (24,647) | (16,243) | 51.7 |
| External charges | (27,536) | (24,141) | 14.1 |
| Taxes other than on income | (4,707) | (2,105) | 123.7 |
| Additions to provisions | (3,474) | (2,507) | 38.6 |
| Other income and expenses from operations, net | (12,745) | (4,516) | 182.2 |
| EBITDA | 199,547 | 85,039 | 134.7 |
| Depreciation and amortization | (115,472) | (55,093) | 109.6 |
| Profit from ordinary activities | 84,075 | 29,947 | 180.7 |

Revenues

The table below shows the breakdown by category of consolidated revenues for the Internet segment for the years ended December 31, 2005 and December 31, 2004, as well as the percentage change between these two years.

| (in € thousands) | Year ended December 31, 2005 | Year ended December 31, 2004 | % change |
|---|------------------------------------|------------------------------------|-------------|
| ISP revenues (<i>Pay-as-you-go, 50-hour plan, ADSL</i>) | 560,557 | 322,179 | 74.0 |
| Hosting and advertising revenues | 10,449 | 6,294 | 66.0 |
| Inter-segment and other revenues | 67,917 | 65,579 | 3.6 |
| Total revenues | 638,923 | 394,052 | 62.1 |

Internet-segment revenues for 2005 grew by €244.9 million or 62% compared with a year earlier, spurred by the success of Free's ADSL broadband offer.

ISP revenues

| | Year ended December 31, 2003 | Year ended December 31, 2004 | Year ended December 31, 2005 |
|--|------------------------------------|------------------------------------|------------------------------------|
| Total ADSL subscribers | 485,000 | 1,064,000 | 1,595,000 |
| Unbundled subscribers | 163,000 | 566,000 | 1,120,000 |
| Percentage of unbundled subscribers | 33.6% | 53.2% | 70.2% |
| Share of French residential ADSL market ¹ | 15.0% | 17.4% | 17.9% |

ISP revenues (Free, Free Telecom and Free Haut Débit), through both the switched telephone network and ADSL, totaled €560.6 million for the year ended December 31, 2005.

¹ Source: France Telecom (2003) and ARCEP (2004 and 2005)

Revenue growth in the ISP business, totaling 74%, resulted from the following factors:

- **Continuing success of the broadband offer.** At December 31, 2005, total ADSL subscribers numbered 1,595,000, against 1,064,000 at December 31, 2004, reflecting a near-50% increase.
- **The increasing use of optional value-added services provided through the Freebox.** In 2005, revenues related to these services totaled close to €75 million. At December 31, 2005, users of Free's telephony services, via Freebox, numbered 1,304,000, while its pay-per-view television subscribers totaled some 195,000. This take-up rate places Free in the position of European leader in broadband telephony and television services.

The decline in take-up of the "pay-as-you-go" and "50-hour plan" dial-up offers continued during 2005, reflecting the increased popularity of broadband offers.

Hosting and advertising revenues

The marketing of domain names in France, value-added hosting services and the sale of advertising space on Free's portal generated hosting and advertising revenues of almost €10.5 million for the year ended December 31, 2005, up from €6.3 million in 2004.

Inter-segment and other revenues

Inter-segment and other revenues correspond primarily to the resale to the Traditional Telephony segment of call minutes on Free's directly-operated network and proceeds from the sale of WiFi cards. These revenues were on a par with the previous year, due to the combined impacts of a decrease in revenues in the Traditional Telephony segment and an increase in the sale of WiFi cards.

Purchases used in production and external charges

Purchases used in production and external charges were 38.8% higher in 2005 than in 2004. Purchases used in production for the Internet segment are rising at a much 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 subscribers, reaching 70.2% at December 31, 2005, from 53.2% at December 31, 2004.
- 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 to the maximum bandwidth of 10Mbps, thereby raising Free's costs of IP transit.

Payroll costs

The rise in payroll costs in the Internet segment was a result of the recruitments carried out at Centrapel to enhance Free's customer service. Centrapel's payroll costs rose to almost €21.5 million in 2005, reflecting an increase in the company's average number of employees (including part-time workers) from 517 in 2004 to 834 in 2005. This staff increase has enabled Free to markedly improve customer service levels, particularly by significantly reducing Hotline queues. At the same time, however, it caused payroll costs to outstrip revenues generated from incoming calls at the Hotline.

Additions to provisions

Additions to provisions topped €3.4 million in 2005 and primarily corresponded to provisions for doubtful customer accounts.

Other income and expenses from operations, net

This item represented net income of over €12.7 million, up more than 182% on 2004. The total includes royalties, bad debts, expenses relating to audiovisual content, and proceeds from asset disposals.

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

Internet segment EBITDA for 2005 was up almost 135% on the prior-year figure. The EBITDA margin, excluding inter-segment sales, came to 34.5%, compared with 25.7% in 2004. This performance was due to (i) the greater number of France Telecom sites connected with optical fiber, which made it possible to increase the number of subscribers having access to broadband connections through the unbundling of the local loop (Option 1), and (ii) an increase in the average gross margin per user for unbundled subscribers to over €20 a month during the second half of the year.

The rise in EBITDA margin excluding inter-segment sales was particularly significant in the second half of 2005, despite the steady increase in total number of fully unbundled subscribers :

- 31.9% margin in the first half, compared with
- 36.7% in the second half of the year.

During 2005, the number of France Telecom sites connected with optical fiber expanded from over 410 to more than 675. The number of unbundled lines also rose sharply, from 566,000 at December 31, 2004 to 1,120,000 at December 31, 2005.

Profit from ordinary activities

Depreciation and amortization for the Internet segment totaled nearly €115.5 million, up almost 110% on 2004.

Profit from ordinary activities for 2005 came to over €84 million, representing an over €54 million increase compared with the previous year.

1.2.2.1.2 Analysis of results for the Traditional Telephony segment

The Traditional Telephony segment includes the following operations:

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

| (in € thousands) | Year ended December 31, 2005 | Year ended December 31, 2004 | % change |
|--|------------------------------------|------------------------------------|--------------|
| Revenues | 162,250 | 162 976 | (0.4) |
| Purchases used in production | (102,601) | (94,135) | 9.0 |
| Payroll costs | (1,973) | (2,748) | (28.2) |
| External charges | (30,668) | (38,511) | (20.4) |
| Taxes other than on income | (731) | (825) | (11.4) |
| Additions to provisions | (933) | (542) | 72.1 |
| Other income and expenses from operations, net | (486) | (725) | (33.0) |
| EBITDA | 24,858 | 25,491 | (2.5) |
| Depreciation and amortization | (904) | (1,800) | (49.8) |
| Profit from ordinary activities | 23,954 | 23,691 | (1.1) |

Revenues

The table below shows the breakdown by category of consolidated revenues for the Traditional Telephony segment for the years ended December 31, 2005 and December 31, 2004, as well as the percentage change between the two years.

| (in € thousands) | Year ended December 31, 2005 | Year ended December 31, 2004 | % change |
|---|------------------------------------|------------------------------------|--------------|
| Fixed telephony and prepaid phone card revenues | 110,806 | 123,492 | (10.3) |
| Revenues from services to operators and inter-segment sales | 51,444 | 39,484 | 30.3 |
| Total revenues | 162,250 | 162,976 | (0.4) |

Revenues for the Traditional Telephony segment were on an overall par with 2004, coming in at €162.3 million. This total does not, however, reveal the significant change in the revenue mix between 2004 and 2005, corresponding to a decrease in fixed telephony and prepaid phone card revenues, and an increase in revenues from services to operators and inter-segment sales.

Fixed telephony and prepaid phone card revenues

Revenues from fixed telephony and prepaid phone cards, generated primarily by One.Tel and Kertel, amounted to almost €111 million for 2005. The decline in these revenues stemmed primarily from the combination of the following three factors:

- **A decrease in the number of One.Tel customers.** Against a backdrop of contained marketing costs and growing take-up of broadband voice offerings, the number of invoiced customers dropped from 335,000 in December 2004 to 298,000 in December 2005.
- **A 24% decline in average revenue per user (ARPU) between December 2004 and 2005.**

- **A contraction in Kertel's revenue contribution.** During 2005, Kertel sold 7 million prepaid telephone cards and top-ups– 500,000 less than in 2004.
- **The disposal of Endeis Telecom.** The contribution of that activity to the 2004 Traditional Telephony revenues amounted to €2.3 million.

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 for its broadband voice offering.

Purchases used in production and external charges

Purchases used in production and external charges increased 0.5% on 2004, coming in at €133.3 million.

The pace of revenue growth outstripped that for expenses as the rise in traffic costs relating to Kertel and inter-segment sales were offset by a significant decrease in One.Tel's marketing costs.

Payroll costs

The reduction in payroll costs in the Traditional Telephony segment reflects the economies of scale that can be achieved in alternative fixed-line telephony operations. On a constant scope basis, payroll costs are decreasing by 13%.

Earnings before interest, tax, depreciation and amortization (EBITDA) and profit from ordinary activities

The Traditional Telephony segment's EBITDA totaled €24.9 million, down slightly on the 2004 figure. The EBITDA margin, excluding inter-segment sales, came to 18.3% in 2005, compared with 17.3% the previous year.

Profit from ordinary activities advanced to €24 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; and
- Holding structure activities.

| (in € thousands) | Year ended December 31, 2005 | Year ended December 31, 2004 | % change |
|--|---------------------------------|---------------------------------|----------------|
| Revenues | 19,671 | 24,152 | (18.6) |
| Purchases used in production | (90) | (56) | 60.7 |
| Payroll costs | (3,191) | (2,764) | 15.4 |
| External charges | (15,307) | (17,785) | (13.9) |
| Taxes other than on income | (92) | (187) | (50.8) |
| Additions to provisions | (56) | (19) | 194.7 |
| Other income and expenses from operations, net | (1,027) | (1,052) | (2.4) |
| EBITDA | (92) | 2,288 | (104.0) |
| Depreciation and amortization | (251) | (260) | (3.5) |
| Profit/(loss) from ordinary activities | (343) | 2,029 | (116.9) |

Revenues

Other Services revenues contracted by more than 18% in 2005. Directory services revenues decreased by over 30% year on year.

Purchases used in production and external charges

The decrease in purchases used in production and external charges mainly reflected changes in the allocation of headquarters costs and lower marketing expenditure re-invoiced to other Group entities, in particular One.Tel.

Earnings before interest, tax, depreciation and amortization (EBITDA) and profit/(loss) from ordinary activities

Due to the overall decline in revenues for the segment, Other Services reported a negative EBITDA and a €343 thousand loss from ordinary activities.

1.2.3 Liquidity and capital resources

| (in € thousands) | <u>Year ended</u> <u>December 31,</u> <u>2005</u> | <u>Year ended</u> <u>December 31,</u> <u>2004</u> |
|--|---|---|
| CASH FLOWS | | |
| Net cash generated from operating activities | 225,817 | 99,826 |
| Net cash used in investing activities | (262,205) | (168,518) |
| Net cash generated from financing activities | 62,711 | 81,112 |
| Net change in cash and cash equivalents | 26,323 | 12,420 |
| Cash and cash equivalents at year-end..... | 49,416 | 23,093 |

The net change in cash and cash equivalents during the year totaled over €26 million. Based on a constant structure, the Group had a positive free cash flow position in 2005. Net cash generated from operating activities amounted to €226 million, while net cash used in investing activities (excluding changes in Group structure) amounted to approx. €208 million. Altogether, positive free cash flow

came to almost €18 million for the year ended December 31, 2005. This includes € 6 million obtained in a litigation at the end of 2005.

Another factor to be noted in relation to cashflows is that additional DSLAMs had to be manufactured during the year to respond to the extension of unbundled areas, with the number of installed units rising to more than 1,700 ADSL 2+ DSLAMs at December 31, 2005, from 419 at December 31, 2004. Aside from Freebox modems and DSLAMs, optical fiber makes up the bulk of acquisitions of fixed assets, which totaled €214.9 million in 2005, breaking down as follows:

- Capex related to growth operations (including Freebox modems and DSLAMs, and access fees to the France Telecom service), corresponding to €164.9 million.
- Capex relating to the network (including IRU contracts, France Telecom collocation rooms, civil engineering work, and transmission equipment), corresponding to €50.0 million.

On June 9, 2005, Iliad paid out a dividend of €0.04 per share, representing a total payout of €2.2 million. It had previously paid out an interim dividend of €0.075 per share, on December 19, 2004.

On June 30, 2005, Iliad purchased the Free shares issued on the exercise of founders' share subscription warrants (BSPCE) by Free employees, in order to retain full control of its subsidiary. The net outlay for these purchases amounted to almost €0.9 million.

1.2.4 Ownership structure at December 31, 2005

At December 31, 2005, Iliad's capital stock was composed of 54,151,550 ordinary shares, breaking down as follows:

- Executive Management: 41,076,592 shares, or 75.9% of capital stock
- Public: 13,074,958 shares or 24.1% of capital stock

At December 31, 2005 there were three Iliad stock option plans in place, whose main characteristics are as follows:

| | Grant date | Exercise price | Exercise date | Number of shares to be issued on exercise of options |
|---------|-------------------|----------------|-------------------|--|
| Options | January 20, 2004 | €16.30 | January 20, 2008 | 444,132 |
| Options | December 20, 2005 | €48.44 | December 20, 2009 | 270,758 |
| Options | December 20, 2005 | €48.44 | December 20, 2010 | 270,757 |

1.2.5 Off-balance sheet commitments

The table below analyzes the Group's commitments under non-cancelable leases at December 31, 2005 by type of asset and by maturity.

(in € thousands)

| Type of leased assets | 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 | 4,869 | 4,569 | 4,484 | 2,492 | 621 | 1,242 | 18,277 |
| Vehicles | 278 | 160 | 31 | 0 | 0 | 0 | 469 |
| Equipment | 1,044 | 574 | 196 | 0 | 0 | 0 | 1,814 |
| Other | 1,415 | 793 | 700 | 667 | 412 | 1,789 | 5,776 |
| Total | 7,606 | 6,096 | 5,411 | 3,159 | 1,033 | 3,031 | 26,336 |

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 obligations under finance leases totaled €4.5 million at December 31, 2005.

At December 31, 2005, the Group had confirmed credit lines of €120 million, €77 million of which had been drawn down. The longest maturity under these credit lines is until November 2010.

1.3 ADDITIONAL INFORMATION

1.3.1 Subsequent events

No material events have occurred since the balance sheet date.

1.3.2 Glossary

In light of the discrepancies between operators' definitions concerning ADSL, Iliad wishes to reiterate the definitions it has been using since inception of its service.

Total ADSL Subscribers at the end of a period consists of the total number of customers identified by their individual "phone lines" who have signed up for Free's ADSL service excluding those for whom an unsubscription notice has been registered.

Net Adds consist of the difference between Total ADSL Subscribers at the end of two different periods.

Unbundled Subscribers are ADSL subscribers who have signed up for Free's ADSL service on a Central Office unbundled by Free.

Broadband ARPU (Average Revenue per User) includes revenues from the flat-rate package and value-added services but excludes one-time revenues (e.g. migration from one offer to the other or unsubscription fee) divided by the total number of ADSL subscribers invoiced for the period.