



*Société anonyme*. Share capital: €12,000,000

Registered office: 8, rue de la Ville l'Evêque – 75008 Paris

Registered in Paris. Registration no. 342 376 332

## MANAGEMENT REPORT – YEAR ENDED DECEMBER 31, 2007

### 1.1 KEY CONSOLIDATED FINANCIAL DATA

(in € millions)	Year ended December 31, 2007	Year ended December 31, 2006*	Year ended December 31, 2006
<b>INCOME STATEMENT</b>			
Revenues .....	1,212.4	935.1	950.3
Operating income and expense, net.....	998.6	754.6	765.1
Profit from ordinary activities .....	213.8	180.5	185.2
Other operating income and expense, net.....	(2.0)	(3.0)	(3.0)
Operating profit .....	211.8	177.5	182.2
Financial income and expense, net.....	(3.5)	(4.2)	(3.9)
Corporate income tax .....	(72.0)	(60.0)	(61.7)
Profit from discontinued operations .....	13.9	7.3	7.3
<b>Profit for the period .....</b>	<b>150.2</b>	<b>120.6</b>	<b>123.9</b>
Earnings before interest, tax, depreciation and amortization (EBITDA) .....	443.6	328.5	331.6
<b>BALANCE SHEET</b>			
Non-current assets .....	771.2	632.1	
Current assets .....	375.9	405.5	
<i>O/w cash and cash equivalents.....</i>	<i>234.8</i>	<i>279.5</i>	
Assets held for sale	8.1	-	
<b>Total assets.....</b>	<b>1,155.2</b>	<b>1,037.6</b>	
Total equity.....	516.7	382.7	
Non-current liabilities.....	362.5	345.0	
Current liabilities .....	276.0	309.9	
<b>Total equity and liabilities .....</b>	<b>1,155.2</b>	<b>1,037.6</b>	
<b>CASH FLOWS</b>			
Net cash generated from operating activities....	317.1	281.2	
Net cash used in investing activities.....	(351.8)	(286.5)	
Net cash (used in) generated from financing activities	(18.6)	232.1	
Net change in cash and cash equivalents.....	(53.2)	226.9	
Cash and cash equivalents at year-end .....	223.1	276.3	

\* The 2006 income statement items presented in this column have been adjusted to exclude Kertel SA, sold in February 2007, and Société SA, sold in August 2006.

## 1.2 MANAGEMENT REPORT

### 1.2.1 Overview

The Group's operations are made up of two business segments defined based on operating criteria:

- The Broadband segment, which includes Internet service provider operations (marketed under Free and related brands), hosting services (the Online, BookMyName and Dedibox brands), call center operations (Centrapel and Total Call), Wimax activities (operated by IFW), and operations related to the rollout of the FTTH (fiber-to-the-home) optical fiber network (Free Infrastructure, IRE, Immobilière Iliad and Citéfibre).
- The Traditional Telephony segment, which includes switched fixed-line telephony (One.Tel and Iliad Telecom), resale of airtime to operators (Kedra), directory services (mainly the ANNU reverse look-up directory accessible by Minitel, telephone, Internet and SMS text messaging) and e-commerce operations (Assunet.com).

ADSL broadband and optional value-added services, combined within the Broadband segment, represent the dominant source of revenue, while revenues from the Group's other offerings, combined within the Traditional Telephony segment, are declining as planned. In 2007 the Broadband segment accounted for almost 98% of the Group's total revenues excluding inter-segment sales.

These business segments may change in the future, depending on operating criteria and the development of the Group's operations.

There were no significant changes in Group structure during 2007. On February 7, 2007 Iliad sold its entire interest in Kertel SA to Proximania. Kertel was no longer considered a strategic business in light of the Group's operating focus on broadband and high speed broadband.

The consolidated financial statements of the Iliad Group have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted for use in the European Union at the balance sheet date.

#### 1.2.1.1 Breakdown of revenues

##### 1.2.1.1.1 Broadband revenues

- **Unlimited ADSL broadband offer.** Since October 2002, Free has offered its subscribers unlimited broadband access for €29.99 per month (including VAT). An ADSL modem is supplied free of charge and no charge is made for installation. This unique offer allows subscribers to access the Internet at a speed of at least 2 MB per second and up to 28 MB (observed) in areas where the local loop is unbundled (which depends on whether a subscriber's line is eligible). Subscribers are billed by Free and pay by monthly direct debit. Subscribers who cancel their subscription are charged a termination fee, also paid by direct debit. The fee amounts to €96 (including VAT) less €3 for every month of their prior subscription period, and covers the cost of activating their line.

Television services, which are taxed at the reduced VAT rate of 5.5%, represented 56% of the Freebox subscription fee until 2007. Since January 1, 2008, this proportion has been reduced to 50% in accordance with new tax regulations.

- **Telephony via ADSL.** Since August 2003 (unbundled areas) and March 2004 (non-unbundled areas), subscribers to the Free Haut Débit broadband service who are equipped with a Freebox modem have also been offered a telephony service. Under this service, telephone calls made through the Freebox to another Freebox subscriber or to any number in mainland France (excluding short numbers and special numbers), the Reunion islands, Guadeloupe, and 70 foreign countries are completely free. Revenues generated by calls to French mobile phones and to international numbers not included in the package, as well as revenues generated by incoming calls to Freebox subscribers, are included within the revenues of the Broadband 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 Télécom 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 and subject to line eligibility) have been offered a television service with more than 257 channels, including 144 free channels as of December 2007. Revenues generated by pay TV channels are included within the revenues of the Broadband segment. Since November 2004, Canal+ Group channels can also be accessed, and the French national channels TF1 and M6 have been available since 2007. Subscribers to Canal+ Group channels are billed directly by the Canal+ Group, which pays a commission to Free. Since July 31, 2007 all Free Haut Débit broadband subscribers (in unbundled and non-unbundled areas and subject to line eligibility) can access a selection of TV channels from Free's portal.
- **Video on demand (VoD) via ADSL.** Since December 2005, subscribers to broadband Internet via the Freebox (in unbundled areas and subject to line eligibility) have been offered a video on demand service operated jointly with the Canal+ Group, TF1 and M6. 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 starts from €0.99, is invoiced directly on the subscriber's Free Haut Débit bill.
- **Subscription-based video on demand (S-VoD) via ADSL.** Since June 2007, subscribers to broadband Internet via the Freebox (in unbundled areas and subject to line eligibility) have been offered a subscription-based video on demand service. For €5.99 a month, subscribers with the basic Free Home Vidéo package have unlimited 24/7 access to a selection of more than 50 films and 100 TV series episodes that are renewed each week. In January 2008, this offering was rounded out to include Free Home Vidéo Intégrale, a new service giving subscribers unlimited access to a full range of content including movies, TV series, music programs, family shows and HD broadcasts.

- **Migration to the fully unbundled service and modem replacement offering.** Since June 2004, Free Haut Débit broadband subscribers can request migration from partially to fully unbundled access. The migration fee is €90 (including VAT), less a discount per month of the prior subscription period. 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, while 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. Since October 2007 subscribers to the Free IP ADSL service can request migration to the Freebox Only offering. The fee is €90 (including VAT), less a discount of €3 per month of the prior subscription period.
- **"Pay-as-you-go" access.** For this no-subscription dial-up offer, the customer pays the price of the phone call invoiced by France Télécom. Subscribers dial the Free access number (08 60 92 20 00) from any fixed line in France, and the call is charged by France Télécom 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 revenue-share passed on to Free by France Télécom. Free invoices France Télécom on a monthly basis. The customer pays France Télécom a connection charge of €0.106 (including VAT) and a flat rate of €0.02 per minute (including VAT), applicable 24/7, excluding special offers. The share of airtime revenue passed on by France Télécom to Free as the operator of an interconnected network amounts to €0.0227 before VAT per minute of use (rate at December 31, 2007). The amount per minute is calculated by France Télécom and is approved by the French telecommunications and postal regulator (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 VAT). 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 revenues for the current month.
- **Hosting services.** Revenues for this business are generated through the sale of both dedicated and non-dedicated hosting solutions. Non-dedicated hosting services are invoiced at a flat annual rate by domain name or by site. The dedicated server offering, which is targeted at SMEs and individuals, provides broadband Internet access for multimedia applications at a flat fee of €29.99 per month, excluding VAT.
- **Marketing of domain names and selling of advertising space** on Free's portal.
- **Other Broadband** revenues corresponding mainly to the sale of switched traffic to the Traditional Telephony segment and the sale of WiFi cards and related equipment.

#### ***1.2.1.1.2 Traditional Telephony revenues***

Traditional Telephony segment revenues break down as follows:

- **Revenues generated by One.Tel.** One.Tel's offer is a no-subscription carrier preselection service. By signing up with One.Tel, the subscriber authorizes the company to make a preselection request to France Télécom 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

- **Revenues 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 Télécom on the user's telephone bill, and part of the fee is passed on by France Télécom to the company running the service. For ANNU, the fee passed on by France Télécom amounts to €36.93 per hour. Fee payments are received every other month.
- **Revenues generated by Assunet** – an online insurance broker – from sales of insurance policies to private individuals and Group companies.
- **Revenues from Iliad Telecom's** carrier preselection service for companies.

#### **1.2.1.2 *Operating costs for the Option 5 ADSL service (subscribers not on an unbundled line) and Option 1 ADSL (subscribers on an unbundled line)***

Free's ADSL offer involves two types of service:

- 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 Télécom and can still make and receive telephone calls through France Télécom. Where subscribers opt for the fully unbundled service, they have no commercial ties with France Télécom and do not therefore pay a telephone line rental charge. In this case, all telephone calls transit through the broadband connection.
- Option 5 (subscribers not on an unbundled line), representing a France Télécom wholesale offer marketed by Free.

Under Option 1, direct costs per subscriber and per month, as mentioned in the basic unbundling offer, were as follows at December 31, 2007:

##### *Operating costs under Option 1 (partial unbundling)*

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

##### *Operating costs under Option 1 (full unbundling)*

- |                               |       |
|-------------------------------|-------|
| • Rental of the copper pair:  | €9.30 |
| • Copper tie cable (average): | €1.32 |

Since April 2007, Free has used France Télécom's optical fiber leasing offering to unbundle dispatchers. The lease payments are not set as part of the unbundling offering but are negotiated between France Télécom and Free. This additional expense is not included in the operating costs set out above.

Under Option 5, for a subscription sold at the same price, monthly costs per subscriber are made up of access costs and IP transit service costs.

The access 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. The monthly subscription fee

for the DSL Access offer was set at €13.30 from September 1, 2006 through December 31, 2007 and reduced to €12.90 as from January 1, 2008. The monthly fee for France Télécom's DSL Access Only service available since September 1, 2006 went down from €21.50 to €20 on January 1, 2008.

IP transit service costs vary depending on the bit rate used by all Option 5 subscribers. The service's price structure was changed on June 7, 2007. The new price terms are as follows:

- Usage fee per Mbps €75.10
- Access fee €3.90

These fees have been applied retroactively from January 1, 2007.

Option 1 gross margin and EBITDA margin are significantly higher than Option 5 margins. Free's objective is therefore to maximize the proportion of Option 1 subscribers 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.

### **1.2.1.3 Capital expenditure and depreciation**

#### *1.2.1.3.1 Broadband*

The Group has rolled out a telecommunications network in mainland 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.

Under Option 1, the Group is required to provide Freebox modems and Freebox DSLAMs and to pay fees to France Télécom for access to unbundling services (which are also known as cabling costs or access fees). In addition, it incurs logistics and modem shipping costs. The cost of these four items, which came to about €270 per subscriber in first-half 2007, decreased to €240 per subscriber at the year-end reflecting a reduction to around €180 in the price of Freebox HD modems, which now include power line communication (PLC) technology. The costs (logistics and shipping, access to France Télécom's unbundling services, and the Freebox modems and DSLAMs) are depreciated over three years from the date of subscriber installation. Fees invoiced by France Télécom for access to unbundling services are €50 per subscriber for full unbundling and €55 for partial unbundling.

Under Option 5, total capital expenditure is lower. Only the cost of access to France Télécom's unbundling services is capitalized and depreciated over three years as the ADSL modems provided under this option are Freebox version 4, which are already in the process of being depreciated. Since January 1, 2008, the fees billed by France Télécom for access to the DSL Access Only service have been €54 per subscriber without Internet access and €17 per subscriber with access through an existing operator, compared with the previous fees of €66 and €24 respectively. Fees billed by France Télécom for the DSL Access service are €49 per subscriber without Internet access.

#### *1.2.1.3.2 Rollout of an FTTH network*

To support the rollout of its FTTH (fiber-to-the-home) optical fiber network, the Group is making fresh investments in network infrastructure through its subsidiaries Free Infrastructure and Immobilière Iliad.

The network is being rolled out in four phases:

- Acquiring premises to house optical nodes (ONs);
- Laying fiber optic cable between the ONs and buildings;
- Installing optical fiber within those buildings, up to the front door of each business or household;
- Connecting the subscriber to the network.

The Group acquires its ONs through its two subsidiaries IRE and Immobilière Iliad. Most of the premises purchased are held by IRE and a large proportion are financed through 12-year leases. Immobilière Iliad has, however, acquired a number of sites in its own name.

The Group is currently focusing on phase two, which is handled by its own teams (mainly in Paris), or by subcontractors under fixed price contracts (rest of France).

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

EBITDA is one of the Group's key performance indicators. It is an earnings measure that corresponds to profit from ordinary activities before depreciation, amortization and employee benefits expense (corresponding to stock option expense).

### **1.2.2 Comparison of results for 2007 and 2006**

The comments below are based on the consolidated financial statements for the years ended December 31, 2007 and December 31, 2006. The 2006 income statement figures have been restated to exclude Kertel SA, sold in February 2007, and Société SA, sold in August 2006.

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 set out below, due to the elimination of inter-segment transactions, corresponding to transactions between Group companies belonging to different segments. The bulk of inter-segment transactions consist of billings to the Traditional Telephony segment of telecommunications services provided over the Free network. In all, inter-segment transactions amounted to €29.5 million in 2007 and €82.6 million in 2006.

(in € millions)	2007	2006	% change
<b>Revenues</b>	<b>1,212.4</b>	<b>935.1</b>	<b>29.7%</b>
Purchases used in production	(612.5)	(484.5)	26.4%
Payroll costs	(47.5)	(38.5)	23.2%
External charges	(68.4)	(55.0)	24.4%
Taxes other than on income	(12.1)	(8.5)	42.9%
Additions to provisions	(8.7)	(4.6)	86.6%
Other income and expenses from operations, net	(19.6)	(15.4)	27.4%
<b>EBITDA</b>	<b>443.6</b>	<b>328.5</b>	<b>35.0%</b>
Employee benefits expense	(3.2)	(1.8)	74.5%
Depreciation and amortization	(226.7)	(146.4)	54.8%
<b>Profit from ordinary activities</b>	<b>213.8</b>	<b>180.5</b>	<b>20.4%</b>
Other operating income and expense, net	(2.0)	(3.0)	-
<b>Operating profit</b>	<b>211.8</b>	<b>177.5</b>	<b>19.3%</b>
Financial income and expense, net	(3.5)	(4.2)	(17.4%)
Corporate income tax	(72.0)	(60.0)	20.1%
Profit from discontinued operations	13.9	7.3	91.5%
<b>Profit for the period</b>	<b>150.2</b>	<b>120.6</b>	<b>24.4%</b>

### ***Revenues***

Revenues for 2007 rose by over 29.7% compared with 2006. The increase was mainly attributable to the Broadband segment, led by Internet access and optional value-added services available through the Freebox. For the year ended December 31, 2007 these optional services represented consolidated revenues of €263.4 million, up by more than 61% compared with 2006.

### ***Operating expenses***

Excluding depreciation, amortization and employee benefits expense, operating expenses climbed 26.7% in 2007, to €760 million. However, they declined in relative terms, to 62.7% of consolidated revenues from 64.4%, reflecting the higher proportion of subscribers on unbundled lines during the year, the impact of operating efficiency measures, and the lower cost of IP transit services.

## ***EBITDA***

EBITDA increased by 35% to €443.6 million in 2007, reflecting (i) new ADSL subscribers signed up directly under Option 1; (ii) migration of subscribers from non-unbundled to unbundled lines; and (iii) the contribution of optional value-added services. EBITDA margin rose from 35.1% to 36.6%.

## ***Profit from ordinary activities***

Profit from ordinary activities surged 20.4% to €213.8 million from €177.5 million in 2006. This performance reflects the combined impact of:

- Greater profitability in the Broadband segment, spurred by the ever-increasing proportion of broadband subscribers on unbundled lines.
- The contribution of optional value-added services.

Depreciation and amortization was 55% higher than in 2006. This significant rise was primarily attributable to higher capital expenditure incurred as a result of the increased Broadband subscriber base, chiefly relating to (i) the provision of Freebox HD modems; (ii) access fees paid to France Télécom; and (iii) to a lesser degree, network extensions.

## ***Financial income and expense, net***

In 2007, net financial expense amounted to €3.5 million, corresponding mainly to interest paid on the Group's borrowings, partially offset by U.S. dollar foreign exchange gains and income from short-term investments.

Interest paid during the year on the “Océane” convertible bonds totaled €7.3 million, and the aggregate expense recognized under IFRS – reflecting the effective interest rate – came to €13.8 million.

## ***Profit for the period***

Including the €13.9 million net-of-tax gain on the sale of Kertel SA, profit for the period amounted to €150.2 million, up 24.4% on the €120.6 million recorded for 2006. Income tax expense totaled €72 million, compared with €60 million in 2006.

### 1.2.2.1.1 Analysis of results for the Broadband segment

The Broadband 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 Télécom and Freebox brands.
- Hosting and domain-name creation services, operated under the Online and Dedibox brands.
- Call center operations, carried out by Centrapel and Total Call.
- Optical fiber operations.
- Wimax activities operated by IFW.

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

(in € millions)	2007	2006	% change
<b>Revenues</b>	<b>1,189.0</b>	<b>881.6</b>	<b>34.9%</b>
Purchases used in production	(608.6)	(462.5)	31.6%
Payroll costs	(43.2)	(34.8)	24.1%
External charges	(62.9)	(47.4)	32.7%
Taxes other than on income	(11.6)	(7.9)	46.8%
Additions to provisions	(8.6)	(5.1)	68.6%
Other income and expenses from operations, net	(19.1)	(14.7)	29.9%
<b>EBITDA</b>	<b>435.0</b>	<b>309.2</b>	<b>40.7%</b>
Employee benefits expense	(2.4)	(1.3)	84.6%
Depreciation and amortization	(226.4)	(145.0)	56.1%
<b>Profit from ordinary activities</b>	<b>206.2</b>	<b>163.0</b>	<b>26.5%</b>

## Revenues

The table below shows the breakdown by category of Broadband revenues for the years ended December 31, 2006 and 2007, as well as the percentage change between the two years.

(in € millions)	2007	2006	% change
Broadband revenues (excluding inter-segment sales)	1,178.4	865.1	36.2%
- <i>ISP revenues (ADSL, Pay-as-you-go, 50-hour plan)</i>	1,149.9	819.0	40.4%
- <i>Hosting and advertising revenues</i>	19.3	14.3	35.0%
- <i>Other revenues</i>	9.2	31.8	(71.1%)
Inter-segment sales	10.6	16.5	(35.7%)
<b>Total revenues</b>	<b>1,189.0</b>	<b>881.6</b>	<b>34.9%</b>

Broadband revenues for 2007 (excluding inter-segment sales) climbed €313.3 million to €1,178.4 million, up 36.2% compared with a year earlier, boosted by the development of Free's ADSL broadband offer.

### *ISP revenues*

	2005	2006	2007
Total ADSL subscribers	1,595,000	2,278,000	2,904,000
Unbundled subscribers	1,120,000	1,730,000	2,366,000
Percentage of unbundled subscribers	70.2%	75.9%	81.5%
Share of French residential ADSL market <sup>1</sup>	18.0%	19.0%	19.7%

ISP revenues (Free, Free Télécom and Free Haut Débit), through both the switched telephone network and ADSL, totaled €1,149.9 million for 2007, an increase of 40.4% over 2006. The main growth factors were as follows:

- **The continuing success of the Broadband offer.** The number of ADSL subscribers rose to 2,904,000 at December 31, 2007 from 2,278,000 one year earlier. Subscriber acquisition remained strong in 2007, with Free signing up 22.3% of total new ADSL subscribers in France, representing 626,000 net adds for the year. At December 31, 2007 Free's share of the French ADSL market was over 19.7%, versus 19.0% at end-2006.
- **Free's continuing drive to increase the proportion of unbundled subscribers.** At December 31, 2007 the unbundled subscriber rate was 81.57% versus 75.9% at end-2006.
- **The growing use of optional value-added services provided through the Freebox.** In 2007, revenues generated from these services totaled €263.4 million versus €163.4 million in 2006. At December 31, 2007 optional value-added services represented approximately 22.4% of total Group revenues compared with 3.4% at December 31, 2004.

<sup>1</sup> Source: Iliad and France Télécom for 2005, 2006 and 2007.

(in € millions)	2004	2005	2006	2007
Revenues from optional value-added services	13.5	75.0	163.4	263.4
Broadband revenues	394.1	638.9	865.1	1,178.4
% of Broadband revenues	3.4%	11.7%	18.9%	22.4%

Take-up of the "Pay-as-you-go" and "50-hour plan" dial-up offers continued to decline in favor of Broadband offerings during 2007, with the related revenues representing €13 million against €23 million in 2006.

### *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 €19.3 million in 2007, up from €14.3 million in 2006.

### *Inter-segment sales and other revenues*

Inter-segment sales and other revenues correspond to airtime on Free's directly-operated network billed to the Traditional Telephony segment, and to sales of WiFi cards and related items. These revenues were lower than in 2006 due to the contraction in Traditional Telephony business volumes.

### **Purchases used in production and external charges**

Purchases used in production and external charges rose 31.7% in 2007 to €671.5 million. Broadband gross profit (defined as revenues less purchases used in production and external charges) came to €517.5 million, representing 43.9% of revenues, excluding inter-segment sales, compared with 43.0% in 2006.

The slight increase in gross margin reflects the combined effect of the following factors:

- The **positive impact** of (i) the greater number of France Télécom sites connected with optical fiber, providing scope to increase the number of subscribers with access to broadband connections through the unbundling of the local loop (Option 1); and (ii) the fact that average gross profit per unbundled subscriber held firm at over €20 per month.
- The **negative financial impact** of higher external charges, attributable to optical fiber leasing costs (see paragraph 1.2.12) and increased marketing expenditure. **These factors had a positive effect from an operating perspective, however.**

Free spent 29% more on marketing in 2007 compared to 2006, intensifying its advertising presence in the first half of the year to step up the pace of subscriber acquisition in a market where competitors' churn rates are high.

### **Payroll costs**

Excluding employee benefits expense, payroll costs represented 3.7% of revenues (not including inter-segment sales), down 0.3 points on 2006. During 2007 the Group increased its drive to improve its handling of technical problems experienced by subscribers, by recruiting over 700 employees at its call centers. The number of call center employees (including part-time workers) totaled 2,275 in December 2007 compared with 1,581 one year earlier.

Despite an increase of more than 1,300,000 subscribers over the past two years, average queuing time in 2007 was less than 1 minute 30 seconds for fully unbundled subscribers, and less than 2 minutes for subscribers on non-unbundled lines.

As a result of this focus on customer service, payroll costs outstripped revenues from incoming calls.

### **Additions to provisions**

Additions to provisions amounted to €8.6 million in 2006, and primarily corresponded to provisions for doubtful customer accounts. As a percentage of revenues, the net cost of customer credit risks remained low, reflecting the constant collection drive carried out by the Group's debt recovery department.

### **Other income and expenses from operations, net**

This item represented a net expense of €19.1 million, versus €14.7 million for 2006. The total includes royalties, bad debt write-offs (net of provision reversals), and gains and losses on asset disposals.

### **EBITDA**

Broadband EBITDA surged by 40.7% in 2007, to €435 million. The EBITDA margin, excluding inter-segment sales, came to 36.9%, versus 35.7% in 2006. This performance was due to (i) the greater number of France Télécom sites connected with optical fiber, which made it possible to increase the number of subscribers with access to broadband connections through the unbundling of the local loop (Option 1); and (ii) the fact that average gross profit per user for unbundled subscribers held firm at over €20 per month.

During 2007, the number of France Télécom sites connected with optical fiber expanded from 908 to over 1,500 and the number of unbundled lines rose significantly from 1,730,000 to 2,366,000, of which approximately 72% were fully unbundled.

### **Profit from ordinary activities**

Depreciation and amortization for the Broadband segment totaled €226.4 million, up 56.1% on 2006. Several factors explain this increase:

- **The sharp rise in the number of subscribers on unbundled lines.** In the space of two years, the number of Free subscribers has almost doubled, rising from 1,595,000 at December 31, 2005 to 2,904,000 at December 31, 2007.
- **Higher access fees paid to France Télécom** as a result of (i) the increased unbundled subscriber rate (81.5% at December 31, 2007); and (ii) internal subscriber transfers, such as switching from non-unbundled to unbundled lines, from IP ADSL to IP Only, from partial unbundling to full unbundling, house moves, and portability requests.
- **The introduction of the Freebox HD at the end of April 2006.** The Freebox HD costs over twice as much as the previous version, the Freebox v4.

Profit from ordinary activities rose by €43.2 million to €206.2 million, representing 17.5% of 2007 revenues (excluding inter-segment sales) versus 18.8% in 2006. This lower margin was due to the factors described above.

### 1.2.2.1.2 *Key figures for the Traditional Telephony segment*

The Traditional Telephony segment now represents only 2.8% of the Iliad Group's consolidated revenues excluding inter-segment sales, due to:

- the sale of Kertel in February 2007;
- the decrease in revenues generated by Kedra as a result of the end of indirect interconnections; and
- to a lesser extent, the lower number of Onetel subscribers.

(in € millions)	2007	2006	% change
<b>Revenues</b>	<b>53.0</b>	<b>111.5</b>	<b>(52.5%)</b>
Purchases used in production	(12.2)	(60.3)	(79.8%)
Payroll costs	(4.3)	(3.7)	16.2%
External charges	(26.8)	(27.3)	(1.8%)
Taxes other than on income	(0.5)	(0.6)	(16.7%)
Additions to provisions	(0.1)	0.5	N/A
Other income and expenses from operations, net	(0.5)	(0.7)	(28.6%)
<b>EBITDA</b>	<b>8.6</b>	<b>19.3</b>	<b>(55.4%)</b>
Employee benefits expense	(0.7)	(0.6)	16.7%
Depreciation and amortization	(0.3)	(1.2)	(75.0%)
<b>Profit from ordinary activities</b>	<b>7.6</b>	<b>17.5</b>	<b>(56.6%)</b>

The table below shows the breakdown by category of Traditional Telephony revenues for the years ended December 31, 2006 and 2007, as well as the percentage change between the two years.

(in € millions)	2007	2006	% change
Traditional Telephony revenues (excluding inter-segment sales)	34.0	69.9	(51.4)
- <i>Telephony services</i>	25.1	37.5	(33.1)
- <i>Operator services</i>	4.4	25.9	(83.0)
- <i>Other revenues</i>	4.5	6.5	(30.8)
Inter-segment sales	19.0	41.6	(54.3)
<b>Total revenues</b>	<b>53.0</b>	<b>111.5</b>	<b>(52.5)</b>

### 1.2.3 Liquidity and capital resources

(in € millions)	2007	2006
Net cash generated from operating activities.....	317.1	281.2
Net cash used in investing activities.....	(351.8)	(286.5)
Net cash (used in) generated from financing activities.....	(18.6)	232.1
Net change in cash and cash equivalents.....	(53.2)	226.9
Cash and cash equivalents at year-end.....	223.1	276.3

Net cash generated from operating activities amounted to €317 million, 12.8% higher than in 2006. The total includes payment of the balance of 2006 income tax and 2007 income tax prepayments for some €87 million, as well as a €38.5 million unfavorable change in working capital requirement due to the non-recurring impact of faster settlement of amounts due to France Télécom.

Acquisitions of property, plant and equipment and intangible assets (net of disposal proceeds) came to €366.5 million in 2007, breaking down as follows:

- €280.9 million worth of development expenditure and subscriber base management costs (including Freebox modems and DSLAMs, access fees to the France Télécom service and portability service fees). This figure was higher than in 2006, reflecting both the greater cost of the Freebox HD launched in April 2006 and a record number of new subscribers signed up in first-half 2007. The total also includes €87.1 million in access fees paid to France Télécom, of which a portion is attributable to new subscribers and the rest to the above-described internal subscriber transfers.
- €52.4 million in network expenditure (including IRU contracts, France Télécom co-location rooms, civil engineering work and transmission equipment).
- €33.3 million in FTTH optical fiber network expenditure. The majority of premises used to house optical nodes (ONs) have been acquired under finance leases with Genefim, a subsidiary of Société Générale, and some network equipment has been acquired under leases with Cisco Capital (see section 1.2.5). These leases are not reflected in the above-described €33.3 million expenditure.

### 1.2.4 Ownership structure at December 31, 2007

At December 31, 2007, Iliad's share capital was composed of 54,151,550 ordinary shares, breaking down as follows:

- Executive Management: 39,116,276 shares, representing 72.2% of the share capital
- Public: 15,035,274 shares, representing 27.8% of the share capital

At December 31, 2007 there were five Iliad stock option plans in place. The plans' 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	409,434
Options	December 20, 2005	€48.44	December 20, 2009	219 601
Options	December 20, 2005	€48.44	December 20, 2010	219 602
Options	June 14, 2007	€74.62	June 13, 2012	162,455
Options	August 30, 2007	€68.17	August 30, 2012	703,960
			Total	1 715 052

### **1.2.5 Group indebtedness**

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

At December 31, 2007 the Group had a confirmed syndicated credit line of a maximum of €220 million, none of which had been drawn down. This facility is available until June 2011.

At December 31, 2007 the obligations under the finance leases set up with Genefim to acquire ONs totaled €12.6 million and obligations under the FTTH equipment lease contracts signed with Cisco Capital represented over €7.1 million.

## **1.3 ADDITIONAL INFORMATION**

### **1.3.1 The Group's main objectives for 2008**

- 3.25 million Broadband subscribers by December 31, 2008 and 4 million subscribers in 2010.
- An unbundled subscriber rate of 84% by end-2008.
- Over €20 average gross margin per unbundled subscriber per month.
- Free cash flow significantly higher than €100 million for the Group's ADSL business (excluding FTTH CapEx)
- 70% of Paris laid with FTTH cable by mid-2009.

### **1.3.2 Subsequent events**

No significant events have occurred between the balance sheet date and the date of authorization of the consolidated financial statements.

### **1.3.3 Glossary**

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

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 customers recorded as having requested the termination of their subscription.

Net adds consists 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) represents revenues from the flat-rate package and value-added services (excluding one-time revenues, e.g. migration from one offer to another or subscription start-up or termination fees), divided by the total number of ADSL subscribers invoiced for the period.

FTTH (Fiber-to-the-home): data delivery technology that directly connects subscribers' homes to an optical node.