iliad

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 – SIX MONTHS TO JUNE 30, 2004

1.1 KEY CONSOLIDATED FINANCIAL DATA

(in € thousands)	**Six months to June 30**		**Year ended December 31**
	2004	**2003**	**2003**
STATEMENT OF INCOME			
Revenues	221,949	125,269	293,051
Other operating revenues	30,509	15,607	29,566
Total operating revenues	252,458	140,876	322,617
Operating expenses	228,300	125,083	287,650
Operating income	24,158	15,793	34,967
Net interest expense	(264)	(278)	(940)
Operating income after interest	23,894	15,515	34,027
Exceptional items	163	(3,625)	116
Amortization of goodwill	66	104	313
Income before tax	23,991	11,786	33,830
Corporate income tax	8,500	1,179	(45)
Net income	**15,491**	**10,607**	**33,875**
Earnings before interest, tax, depreciation and amortization (EBITDA)	45,607	22,085	53,643
BALANCE SHEET:			
Fixed assets	188,518	83,296	124,344
Operating assets	103,909	80,560	85,202
Cash and marketable securities	61,590	28,248	11,357
Total assets	**354,017**	**192,117**	**220,903**
Shareholders' equity	156,957	31,957	55,227
Provisions for contingencies and charges	4,256	9,773	6,745
Borrowings	22,435	26,508	20,877
Operating liabilities	170,369	123,878	138,054
Total liabilities and shareholders' equity	**354,017**	**192,117**	**220,903**
CASH FLOWS:			
Net cash provided by operating activities	48,966	43,109	91,410
Net cash used by investing activities	(86,582)	(42,024)	(97,300)
Net cash provided by financing activities	80,826	5,492	1,843
Change in cash and cash equivalents	43,210	6,577	(4,047)
Net Cash and cash equivalents at period-end	53,883	21,297	10,673

1.2 FIRST-HALF MANAGEMENT REPORT

1.2.1 Overview

The Group's operations are made up of three main 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), prepaid phone cards (Kertel) and resale of minutes to operators (Kedra);

- Other Services, which now include phone directory services (mainly the ANNU reverse lookup directory accessible by Minitel, phone, 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 the first half of 2004. There were no changes in percentages of control and interest.

Group Management particularly draws the reader's attention to the points of this Management Report listed in the table below, though 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 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 June 30, 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 Télécom. Customers 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 fee passed on to Free by France Télécom. Free invoices France Télécom on a monthly basis and is paid 45 days after receipt of the invoice. The customer pays France Télécom 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 Télécom to Free as the operator of an interconnected network amounts to €0.0231 before tax per minute of use (rate at June 30, 2004). The amount per minute is calculated by France Télécom 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 1 MB per second and up to 5 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). Beginning with the February 2004 direct debits, Free has been applying a VAT rate of 5.5% to all of its subscribers with an unbundled subscription and using a Freebox modem. This VAT rate is applied on a pro rated basis to the portion of the subscription which concerns the distribution of audio-visual content. Following the implementation of this measure, Free filed a request for a confirmatory ruling on this issue from the tax authorities.

- **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 Télécom 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 broadband Internet access via the Freebox, in unbundled areas, have been offered a television service with more than 100 channels, including 35 pay-per-view channels, as of July 2004. Revenues generated by the pay-per-view channels are included within the revenues of the Internet segment. These revenues are also subject to 5.5% VAT.

- **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 Télécom 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 June 30, 2004, over 79 % of customers had signed up for this payment method.

- **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 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 €36.15 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 maximum number of France Télécom exchanges.

Interconnect operating costs

Direct interconnect costs represent the amounts charged by France Télécom 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 Télécom 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 on France Télécom's network in addition to the collection charge.

Since the Group completed the roll-out of its network, the average cost per minute has changed as shown in the table below. The figures shown include France Télécom charges and other direct costs but exclude the impact of the contribution to the Universal Service Fund:

June 30, 2001	Dec. 31, 2001	June 30, 2002	Dec. 31, 2002	Dec. 31, 2003	June 30, 2004
Base = 100	78.8	64.6	58.4	58.4	63.0

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 Télécom group offer marketed by Free.

– Option 1 (subscribers on an unbundled line), corresponding to an offer carried entirely by the Free network.

Under Option 1, direct costs per subscriber and per month, as mentioned in the basic unbundling offer at September 30, 2003, are as follows:

Operating costs of Option 1 (partial unbundling)

- Rental of the copper pair and the ADSL splitter: €2.86
- 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): €20.00

The costs of the IP-ADSL collection 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 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 has been altered accordingly, reducing depreciation expense over the period by €0.5 million.

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 Télécom for access to unbundling services. The cost of these three items came about €200 per customer in the first half of 2004. The cost of access to France Télécom'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 in 2003. The Group's R&D team has been able to design an amended version of the Freebox DSLAM that includes innovative features. The Group is now installing these DSLAMs in France Télécom 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, up 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 is altered accordingly;
- The depreciation period for the amended version DSLAMs was set at 3 years.

Under Option 5, total capital expenditure is lower, amounting to approximately €125 per customer. The cost of access to France Télécom 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 six-month periods ended June 30, 2004 and June 30, 2003

The following comments are based on the consolidated financial statements for the six-month periods ended June 30, 2004 and June 30, 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 €43.9 million in first-half 2004 and €14.1 million in first-half 2003.

Kertel was consolidated as from April 1, 2003. The impact of Kertel on Group results for the first half of 2003 was not material. Taking into account Kertel's revenues for the full six months to June 30, 2003, year-on-year revenue growth would have been 69%.

(in € thousands)	Six months to June 30, 2004	Six months to June 30, 2003	% change
Net revenues	**221,949**	**125,269**	**77.2**
Other operating revenue Purchases used in production and other operating expenses Payroll costs Taxes other than on income Additions to provisions	30,509 191,999 10,621 1,240 2,991	15,607 108,341 6,469 820 3,161	95.5 77.2 64.2 51.2 (5.4)
EBITDA	**45,607**	**22,085**	**106.5**
Depreciation and amortization	21,449	6,292	240.9
Operating income	**24,158**	**15,793**	**53.0**
Net interest expense	(264)	(278)	5.0
Operating income after interest	**23,894**	**15,515**	**54.0**
Exceptional items Goodwill amortization	163 66	(3,625) 104	NM (36.5)
Income before tax	**23,991**	**11,786**	**103.6**
Corporate income tax	8,500	1,179	620.9
Net income before minority interests	**15,491**	**10,607**	**46.0**

Revenues

Revenues for the first half of 2004 rose more than 77% compared to the year-earlier period. 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 the full six months. Other operating revenue also rose in first-half 2004 compared to the year-earlier period, reflecting capitalized production costs for modems and Freebox DSLAMs.

Operating expenses

Operating expenses (net of other operating revenue) were 71% higher for the six months ended June 30, 2004 than in the year-earlier period, amounting to €176.3 million, excluding depreciation and amortization expense. 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 €24.2 million for the six months to June 30, 2004, up from €15.8 million in the year-earlier period. This performance was attributable to the combined impact of:

- Greater profitability in the Internet segment, thanks to the ever-increasing proportion of broadband subscribers on unbundled lines;

- Only partly offset by (i) the temporary decline in the profitability of Telephony operations following the surge in marketing expenditure and (ii) lower margins in the ANNU business.

In addition, capital expenditure on ever-increasing amounts of equipment for broadband customers has caused depreciation and amortization expense to rise threefold between first-half 2003 and first-half 2004. In the six months to June 30, 2004, depreciation and amortization expense totaled €21.4 million, representing 10% of revenues, up from 5% of revenues in first-half 2003.

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

Group EBITDA totaled €45.6 million for the first half of 2004, rising 106.5% compared to first-half 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 accounts.

Net interest expense

In the first half of 2004, net interest expense amounted to €0.3 million, corresponding primarily to interest on borrowings and on lease financing obtained by Free, only partly offset by interest income from investments and exchange rate gains which were lower than in the year-earlier period.

Exceptional items

Exceptional items mainly include revenues from asset disposals, in the form of sales of shared France Télécom 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. Provisions have been booked for receivables related to such invoicing, based on Management estimates of the proportion of bad debts.

Income before tax

Income before tax rose 103.6% compared to first-half 2003, reaching €24 million.

Net income

Net income amounted to €15.5 million in the first half of 2004, up from €10.6 million in first-half 2003. The income tax charge for the six months to June 30, 2004, based on the estimated effective tax rate at June 30, 2004 (35.43%), amounted to €8.5 million, up from €1.2 million for the six months to June 30, 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)	**Six months to June 30, 2004**	**Six months to June 30, 2003**	**% change**
Net revenues	**173,018**	**88,725**	**95.0**
Other operating revenue	29,297	15,286	91.7
Purchases used in production and other operating expenses	156,583	86,545	80.9
Payroll costs	7,955	3,773	110.8
Taxes other than on income	861	443	94.6
Additions to provisions	1,847	2,265	(18.5)
EBITDA	**35,069**	**10,985**	**219.2**
Depreciation and amortization	20,738	5,812	256.8
Operating income	**14,331**	**5,173**	**177.0**

Revenues

The table below shows the breakdown by category of consolidated revenues for the Internet segment for the six-month periods ended June 30, 2004 and June 30, 2003, as well as the percentage change between these two periods.

(in € thousands)	**Six months to June 30, 2004**	**Six months to June 30, 2003**	**% change**
ISP revenues *(Pay-as-you-go, 50-hour plan, ADSL)*	138,343	75,247	83.9
Hosting and advertising revenues	3,157	2,567	23.0
Inter-segment and other revenues	31,517	10,911	188.9
Total revenues	**173,018**	**88,725**	**95.0**

Internet-segment revenues for first-half 2004 grew by €84.3 million or 95% compared to first-half 2003, mainly due to the success of Free's ADSL broadband offer.

ISP revenues

Number of broadband customers	At December 31, 2002	At June 30, 2003	At December 31, 2003	At June 30, 2004
Broadband customers	99,100	275,630	485,000	768,000
of which customers on unbundled lines	3,300	45,850	163,000	355,000
Percentage of unbundled line customers	3.3%	16.6%	33.6%	46.2%
Share of French residential ADSL market	7.2%	13.3%	15.0%	16.9%

ISP revenues (Free, Free Telecom and Free haut débit), through both the switched telephone network and ADSL, totaled €138.3 million for the six months ended June 30, 2004.

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

- **Continuing success of the broadband offer**. At June 30, 2004, broadband customers numbered nearly 768,000, against 485,000 at December 31, 2003, reflecting a 58.4% increase. At June 30, 2004, the success of Free's broadband offer had caused a certain number of delays in (i) cabling within France Telecom facilities and (ii) the current shipping of Freebox modems;

- **Use of the new services available through the Freebox (telephony and television).** In the first half of 2004, revenues related to these services totaled nearly €2.7 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 over 18% to 900 million minutes in first-half 2004 from 1.1 billion in first-half 2003. This decrease was only partly offset by a 6.5% increase in the fees passed on by the incumbent operator, to €0.0231 per minute, from €0.0217. As regards the 50-hour plan, the number of subscribers declined to 175,000 in June 2004, from 211,000 in January 2004.

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 €3.1 million for the six months ended June 30, 2004. The €0.6 million increase compared with the first half of 2003 was driven by a 27.6% growth in hosting revenues and an increase of nearly 20% in advertising revenues, on the back of sustained volume growth in online advertising in France in 2004 (31.5% growth in first-half 2004, according to Enders Analysis).

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 the first half of 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 (net of other operating revenue) were 80% higher in first-half 2004 than in the year-earlier period. 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 46.2% at June 30, 2004, from 33.6% at January 1, 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 from 512 Kbps to 1,024 Kbps, thereby raising Free's costs of IP connection and transit.

In addition, Free's decision to use France Télécom POP and Interlan optical fiber connections had a negative impact on operating expenses in the first half of 2004, because some of these connections, which are being billed to Free as rental expenses, are still in the process of being activated.

Payroll costs

The increase 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 €5.9 million for first-half 2004, from €2.1 million in the year-earlier period. Centrapel had 520 employees at June 30, 2004 (including part-time employees), compared to 165 at June 30, 2003. In first-half 2004, Free's call center was ranked the 14th best call center in France by CAQ (2nd quarter ranking) across all sectors, and 1st in the communications sector.

Additions to provisions

As had been stated in the management reports for the six months ended June 30, 2003 and the year ended December 31, 2003, calculations of contributions to the Universal Service Fund have gone through a number of changes in recent years, for all telecommunications operators, including Free.

In a press release dated June 22, 2004, the ART telecoms regulatory authority issued a statement which it also posted on its website. The following are excerpts of this statement:

"Following the annulment by the Conseil d'Etat (Supreme Administrative Court), in a ruling dated June 18, 2003, of the ministerial order dated July 11, 2002 which stated the forecast cost of universal service for the year 2002 and set operators' contributions, the French authorities were required, to ensure continued financing of universal service, to take the necessary measures in order to provide a legal basis for collecting the forecast contributions for 2002.

Decree 2004-408 concerning methods for evaluating, offsetting and sharing the net forecast cost of universal telecommunications service for the year 2002, published in the Journal Officiel on May 14, 2004 does provide a legal basis for collecting the forecast contributions for 2002, setting out the calculation methods that should be used. These contributions must therefore be calculated again…

Articles L. 36-7 4° and L. 35-3° of the Postal and Telecommunications Code now provide that the ART is responsible for setting the amount of such contributions. Under these conditions, the ART will adopt a new decision assessing the forecast cost of universal service and setting operators' contributions for the year 2002…"

Group Management has adjusted the liability for Universal Service contributions using as a basis a figure equivalent to 0.5% of telecommunications revenues. Based on the information provided by the

ART, the Group considers that the uncertainties surrounding its contributions are now lessened, therefore these amounts are recorded as payables rather than as provisions. This change had no impact on operating income and EBITDA.

EBITDA and operating income

Internet segment EBITDA for the six months ended June 30, 2004 was up 219% on the prior-year period. Excluding inter-segment transactions, the EBITDA margin for the Internet segment rose to 24.8% in first-half 2004 from 14.1% in first-half 2003. This performance was the result of the greater number of France Télécom 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 first-half 2004, the number of connected France Télécom sites rose from over 160 to nearly 300. The number of unbundled lines leapt to 355,000 at June 30, 2004, from 163,000 at December 31, 2003. This high number of Option 1 subscribers confirms the validity's 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 six months to June 30, 2004 came to €14.3 million, representing a €9.1 million increase compared to the first half of 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)	**Six months to June 30, 2004**	**Six months to June 30, 2003**	**% change**
Net revenues	**79,024**	**38,035**	**107.8**
Other operating revenue	1,189	311	282.3
Purchases used in production and other operating expenses	68,701	27,333	151.3
Payroll costs	1,504	1,571	(4.3)
Taxes other than on income	242	246	(1.6)
Additions to provisions	1,139	896	27.1
EBITDA	**8,627**	**8,300**	**3.9**
Depreciation and amortization	568	357	59.1
Operating income	**8,059**	**7,943**	**1.5**

Revenues

The table below shows the breakdown by category of consolidated revenues for the Telephony segment for the six-month periods ended June 30, 2004 and June 30, 2003, as well as the percentage change between these two periods.

(in € thousands)	**Six months to June 30, 2004**	**Six months to June 30, 2003**	**% change**
Fixed telephony and prepaid phone card revenues	60,071	29,685	101.1
Revenues from services to operators and inter-segment sales	18,953	8,170	132.0
Total revenues	**79,024**	**38,035**	**107.7**

Revenues for the Telephony segment for first-half 2004 rose by nearly €41 million, or 107.7%, compared to first-half 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 €60.1 million for the six months ended June 30, 2004.

Revenue growth resulted from the combination of the following three factors:

- **Growth in the number of One.Tel customers in the first half of 2004**. As was stated at the time of the Group's IPO, raising the number of One.Tel subscribers was one of the priorities for Iliad Management. As a result of more extensive and precisely targeted marketing expenditure, the number of invoiced customers rose to 328,000 in June 2004, up almost 53% from the 215,000 at December 31, 2003;

- **Stable average revenue per user (ARPU)**;

- **Contribution from Kertel**. The Group acquired Kertel in March 2003. Not only did Kertel contribute its revenues over the full six months of first-half 2004, as opposed to only three months in first-half 2003, but the company's new sales organization and pricing structure has boosted sales of prepaid phone cards: 3.9 million cards were sold in first-half 2004, compared to 4.9 million for the full year 2003.

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 (net of other operating revenue) increased 136.7% in first-half 2004 compared to the prior-year period, while revenues increased 107.7%.

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 stable payroll costs in the Telephony segment reflect 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 €8.6 million in first-half 2004, up slightly on the prior-year period. Iliad Management had undertaken at the time of the IPO to maintain the EBITDA of the Telephony segment in 2004, despite the forecast increase in the marketing budget. The Group expects to keep this commitment for the year ended December 31, 2004. The EBITDA margin, excluding inter-segment sales, declined to 11.9% as expected.

Operating income remained practically unchanged at €8.0 million for the six months to June 30, 2004.

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)	**Six months to June 30, 2004**	**Six months to June 30, 2003**	**% change**
Net revenues	**13,858**	**12,652**	**9.5**
Other operating revenue	23	10	130.0
Purchases used in production and other operating expenses	10,666	8,606	23.9
Payroll costs	1,162	1,125	3.3
Taxes other than on income	137	131	4.6
Additions to provisions	5	0	nm
EBITDA	**1,911**	**2,800**	**(31.8)**
Depreciation and amortization	143	123	16.3
Operating income	**1,768**	**2,677**	**(34.0)**

Revenues

Revenues from Other Services increased 9.5% in first-half 2004 compared to first-half 2003, as a result of the increased purchases of advertising space by Iliad on behalf of One.Tel and of higher re-invoicing of rental fees.

Conversely to these increases in inter-segment revenues, revenues from sources outside the Iliad Group contracted nearly 28% in first-half 2004 compared to the year-earlier period. Since 1998, use of the Minitel has been experiencing a slow but certain decline in France. Even though directory services have generally held up better than leisure or other non-work-related Minitel services, the Group has clearly felt the impact of this decline since the end of 2001. Growth in e-commerce revenues has not been sufficient to offset these lost revenues.

Purchases used in production and other operating expenses

The increase in purchases used in production was mainly due to 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 €1.9 million and operating income of nearly €1.8 million for the first half of 2004.

1.2.3 Liquidity and capital resources

(in € thousands)	Six months to June 30,	Year ended December 31,		
	2004	2003	2002	2001
CASH FLOWS:				
Cash flows from operating activities.............	48,966	91,410	48,976	14,191
Cash flows from investing activities	(86,582)	(97,300)	(25,097)	(13,597)
Cash flows from financing activities.............	80,826	1,843	(11,991)	3,130
Change in cash and cash equivalents	43,210	(4,047)	11,888	3,725
Net Cash and cash equivalents at period-end ..	53,883	10,673	14,720	(1,245)

The Group's sources of financing mainly include operating cash flow 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 €90 million net of IPO costs.

As regards Group operating cash flow, the negative variation in working capital was €11 million (or 5% of revenues) in first-half 2004, as opposed to €41.2 million (14% of revenues) for the year ended December 31, 2003. Even though Group revenues have risen by more than 77%, working capital generation has fallen to 62 days of sales for the first half of 2004 versus 81 days in 2003, as a direct result of the Group's strategic decision to provide a Freebox modem to every new subscriber. Further, additional DSLAMs had to be manufactured to respond to the extension of unbundled areas, and the number of installed units came to nearly 1,400 at June 30, 2004, up from 575 at December 31, 2003. The Group also constantly holds VAT receivables on the tax authorities, as VAT credits are paid back only every four and a half months, on average. These receivables amounted to some €14 million at June 30, 2004.

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

- Acquisitions of intangible assets (IRU contracts and access fees to the France Telecom service): €47 million.

- Acquisitions of tangible assets (primarily Freebox modems and DSLAMs): €42.7 million.

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

Group Management estimates that total acquisitions of fixed assets for the year 2004 should come to approximately €160 million.

1.2.4 Ownership structure at June 30, 2004

At June 30, 2004, Iliad's capital stock was composed of 53,452,230 ordinary shares, breaking down as follows:

– Executive Management: 43,333,660 shares, or 81.1% of capital stock

– Goldman Sachs Fund: 1,886,670 shares or 3.5% of capital stock

– Public: 8,231,900 shares or 15.4 % of capital stock

In addition, Iliad wishes to inform its shareholders that Messrs. Poidatz, Boukobza and Rosenfeld have informed the Board of Directors of their unilateral decision to forfeit the founder's share subscription warrants (BSPCEs) which had been granted to them. Prior to being forfeited, these warrants had a maximum potential dilutive effect of 3.65%.

1.2.5 Off-balance sheet commitments

The table below analyzes the Group's commitments under non-cancelable leases at June 30, 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 assets	Within 1 year	In 1 to 2 years	In 2 to 3 years	In 3 to 4 years	In 4 to 5 years	Beyond 5 years	TOTAL
Real estate	4,394	4,313	4,186	4,071	4,050	2,048	23,051
Vehicles	163	145	53	-	-	-	360
Equipment	1,018	958	470	-	-	-	2,446
Other	458	242	145	87	61	311	1,305
TOTAL	**6,023**	**5,658**	**4,854**	**4,158**	**4,112**	**2,358**	**27,162**

The IRU agreements described in paragraph 1.2.1.3 represent a total investment of approx. €60 million, of which about 50% have been accounted for as of June 30, 2004.

1.2.6 Group indebtedness

Lender and purpose of loan	Borrower	Annual interest rate	Inception of loan	Total amount (in € thousands)	Due	Hedging instruments	Outstanding principal at June 30, 2004
San Paolo real estate loan: *Real estate acquisition*	Free	Euribor + 1.5%	April 27, 2001	2,287	2013	None	1,683
CEPME 2001 loan: *Acquisition of ADM/Cirpack*	Free	6%	Nov. 29, 2001	1,228	2004	None	205
BFCC 2001 loan: *Acquisition of ADM/Cirpack*	Free	6%	Dec. 3, 2001	1,228	2004	None	307
CEPME 2003 loan: *Completion of local network*	Free	Euribor + 1.5%	Dec. 18, 2002	2,000	2004	None	772
FORTIS 2003 loan: *Completion of local network*	Free	5.5 %	Feb. 10, 2003	3,000	2005	None	781
Ecureuil 2003 loan: *Completion of local network*	Free	Euribor + 1%	April 25, 2003	1,700	2005	None	866
CEPME loan: *Long-distance network*	Free	Euribor + 1.5%	June 10, 2003	4,000	2006	None	3,000
CNCE loan: *Long-distance network*	Free	Euribor + 1.5%	July 3, 2003	4,000	2006	None	3,000

The Group is not subject to any liquidity risk as a result of prepayment clauses undertaken by Group companies nor as a result of non-compliance with financial covenants (ratios, targets, etc.).

Outstanding borrowings and obligations under finance leases totaled €22.4 million at June 30, 2004.

At June 30, 2004, the Group had a confirmed and undrawn credit line of €7.5 million, which can be used until January 31, 2007.

1.3 ADDITIONAL INFORMATION

1.3.1 Subsequent events

At its meeting of July 1, 2004, the Board of Directors of Iliad unanimously voted to make the following changes in the company's executive management: Xavier Niel is now managing director in charge of strategy and Vice-Chairman of the Board, and remains a Director; Cyril Poidatz has become Chairman of the Board and Michael Boukobza has become Chief Executive Officer.

On July 2, 2004, Iliad bought back from the holders of Free founder's share subscription warrants (BSPCEs) the first installment of one-fifth of their warrants, as provided for in paragraph 6.5 (page 165) of the IPO Prospectus recorded on December 15, 2003 under No. I 03-253. The total outlay for the Group amounted to €0.7 million. The holders of BSCPEs are employees of Free SAS, and none are members of Iliad's executive management.

Following the reduction in Option 5 rates on July 26, 2004, Free was the first ISP to offer its subscribers in not-unbundled areas an increase in the available bandwidth (subject to the subscriber's line being eligible) to 2,048 Kbps for €29.99 per month including tax.

On July 29, 2004, France Télévisions Interactive announced that it would be broadcasting free of charge to Freeboxes five channels allowing viewers to follow live feeds on all Olympic events from August 14 to August 29, 2004.

1.3.2 IFRS implementation

The working group which has been studying – and continues to study – the impacts of the changeover to IFRS on the Group's financial statements has already identified the following key points, though this list is not yet complete.

Financial statement presentation

The international standards will alter the presentation

- of the statement of income, by eliminating the concept of exceptional or non-operating revenues and expense,
- of the balance sheet, by requiring a ranking by maturity of assets and liabilities.

Development costs (IAS 38)

IAS 38 should lead to increased capitalization of development costs. Currently, the Group only capitalizes development costs related to new technology, while other development costs are expensed in the year in which they are incurred.
IAS 38 will lead to a capitalization of all development costs meeting certain requirements.

Discontinuing straight-line amortization of goodwill (IAS 22)

Currently, the Group amortizes goodwill over a period which may not exceed ten years. Amortization expense on goodwill amounted to €0.3 million in 2003.
Amortization will be replaced by the requirement to perform impairment tests at least yearly.
Considering the current amount of goodwill carried in the balance sheet and the processes already applied, the Group estimates that it will not need to write down its goodwill as a result of impairment testing.

Rights of use of assets (IAS 17)

As matters currently stand, the Group estimates that the treatment of IRUs, which are capitalized, should not be affected by the implementation of IAS 17. However, with the publication of the final version of the IFRIC D3.6 draft interpretation, there may be a change in the presentation of IRUs, which would no longer be considered as intangible assets but as rentals. This reclassification would have no impact on overall net income, but would lead to an increase in network costs, offset by a decrease in amortization expense.

1.4 STATUTORY AUDITORS' REPORT ON THE LIMITED REVIEW OF THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS FOR THE SIX MONTHS ENDED JUNE 30, 2004

For the six months ended June 30, 2004

This is a free translation into English of the Auditors' review report issued in the French language and is provided solely for the convenience of English speaking readers.

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

ILIAD S.A.

8, rue de La Ville L'Evêque
75008 PARIS

To the shareholders

In our capacity as Statutory Auditors of the Company and as required by article L 232-7 of the French Commercial Code (Code de Commerce), we have performed a limited review of the accompanying interim consolidated financial statements of Iliad S.A. and its subsidiaries for the period from January 1 to June 30, 2004, presented in euros, and of the information contained in the interim report.

These interim consolidated financial statements are the responsibility of the Board of Directors. Our responsibility, based on our limited review, is to report our conclusions concerning these consolidated financial statements.

We conducted our limited review in accordance with the professional standards applied in France. Those standards require that we perform limited procedures to obtain reasonable assurance, below the level resulting from a full audit, that the interim consolidated financial statements do not contain any material errors. A limited review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards applied in France.

Based on our limited review, we are not aware of any material modifications that should be made to the accompanying interim consolidated financial statements, in order to present fairly the consolidated results of operations for the six months ended June 30, 2004 and the consolidated financial position and assets of Iliad S.A. and its subsidiaries at that date in conformity with accounting principles applied in France.

In accordance with professional standards applied in France, we have also reviewed the information given in the interim report accompanying the interim consolidated financial statements that were the subject of our limited review.

We have no matters to report as to its fair presentation and its conformity with the interim consolidated financial statements.

Paris, September 3, 2004

The Statutory Auditors

PricewaterhouseCoopers Audit	Boissière Expertise Audit
Xavier Cauchois	Tita A. Zeïtoun

1.5 INTERIM CONSOLIDATED FINANCIAL STATEMENTS FOR THE SIX MONTHS ENDED JUNE 30, 2004

See Document « Comptes consolidés intermédiaires arrêtés au 30 juin 2004 »