



A limited liability corporation with a share capital of €1,200,000
Registered office: 8, rue de la Ville l'Evêque – 75008 Paris, France
Companies and Trade Register of Paris No. 342 376 332

MANAGEMENT REPORT (EXTRACT) – SIX MONTHS TO JUNE 30, 2006

1.1 KEY CONSOLIDATED FINANCIAL DATA

| (in €thousands) | Six months to June 30, 2006 | Six months to June 30, 2005 | Year ended December 31, 2005 |
|--|--------------------------------|--------------------------------|------------------------------------|
| INCOME STATEMENT | | | |
| Revenues | 447,938 | 337,832 | 724,201 |
| Operating expenses, net..... | (358,410) | (298,622) | (616,515) |
| Profit from ordinary activities | 89,528 | 39,210 | 107,686 |
| Other operating income and expense, net..... | 0 | 0 | 0 |
| Operating profit | 89,528 | 39,210 | 107,686 |
| Financial income and expense, net | (152) | (2,278) | (2,795) |
| Corporate income tax | (30,772) | (12,805) | (36,371) |
| Profit from discontinued operations | - | - | 378 |
| Profit for the period | 58,604 | 24,127 | 68,898 |
| Earnings before interest, tax, depreciation and amortization (EBITDA) | 152,952 | 94,916 | 224,313 |
| BALANCE SHEET | | | |
| Non-current assets | 510,026 | 346,104 | 425,945 |
| Current assets | 481,927 | 137,748 | 157,838 |
| <i>Of which cash and cash equivalents</i> | <i>366,441</i> | <i>21,293</i> | <i>51,089</i> |
| Total assets | 991,953 | 483,852 | 583,783 |
| Total equity..... | 319,661 | 203,499 | 248,575 |
| Non-current liabilities..... | 320,311 | 10,673 | 77,162 |
| Current liabilities..... | 351,981 | 269,680 | 258,046 |
| Total equity and liabilities | 991,953 | 483,852 | 583,783 |
| CASH FLOWS | | | |
| Net cash generated from operating activities.... | 124,372 | 96,822 | 225,817 |
| Net cash used in investing activities..... | (123,806) | (128,440) | (262,205) |
| Net cash generated from financing activities.... | 310,585 | 20,637 | 62,711 |
| Net change in cash and cash equivalents | 311,150 | (10,981) | 26,323 |
| Net Cash and cash equivalents at period-end ... | 360,566 | 12,112 | 49,416 |

1.2 MANAGEMENT REPORT

1.2.1 Overview

The Group's operations were reorganized in the first half of 2006 and are now made up of two business segments:

- The Broadband segment, which includes Internet service provider operations (under Free and related brands), hosting services (the Online, BookMyName and Dedibox brands), call center operations (Centrapel and Total Call) 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), the resale of minutes 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 (Société.com and Assunet.com).

The former Internet segment has been renamed Broadband in order to reflect the dominant proportion of revenues generated by ADSL broadband and optional value-added services. All of the Group's other offerings – which now account for a much less significant proportion of revenues – have been brought together within the Traditional Telephony segment.

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

There were no significant changes in Group structure in first-half 2006.

The condensed interim financial statements of the Iliad Group have been prepared in accordance with IAS 34, Interim Financial Reporting.

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 tax), with 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 €6 (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, to any standard France Telecom fixed line in mainland France (excluding short numbers and special numbers) and to 28 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 in 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 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 and subject to line eligibility) have been offered a television service with more than 222 channels, including 81 free channels as of June 2006. Revenues generated by pay-per-view channels are included within the revenues of the Broadband 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 and subject to line eligibility) 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 €0.99 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 €0 (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 €0, €60, or €30 administrative fee depending on the length of time they have held a subscription.
- **“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.
- **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.
- **Marketing of domain names and selling of advertising space** on Free’s portal.
- **Other Broadband-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 break down as follows:

- **Revenues generated by One.Tel.** 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.
- **Revenues generated by Kertel,** through the use of telephone services. These revenues are recognized as 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.
- **Revenues from ANNU,** the reverse look-up directory accessible by Minitel, telephone, Internet and SMS text messaging. Minitel access to this service is invoiced 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.
- **E-commerce revenues** generated by (i) **Société.com** through online sales of documents or subscriptions and, to a lesser extent, advertising, and (ii) **Assunet**, an online insurance broker, via 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 (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. When 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 the first half of 2006:

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: €0.30¹
- 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 and costs of the IP transit service.

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.

1.2.1.3 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 expenditure 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 (which are also known as cabling costs or access fees). The cost of these three items came to about €150 per subscriber between January and April 2006, when the new Freebox HD was launched. The cost per subscriber equipped with the new Freebox HD will amount to about €280 for the remainder of 2006. The cost of access to France Telecom's unbundling services, as well as the Freebox modems and Freebox DSLAMs is depreciated

¹ Since February 2006.

over three years from the date of subscriber installation. Fees invoiced by France Telecom for access to unbundling services are €50 per subscriber for full unbundling and €5 for partial unbundling.

Under Option 5, total capital expenditure is lower, amounting to approximately €25 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 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, 2006 and June 30, 2005

The following comments are based on the consolidated financial statements for the six-month periods ended June 30, 2006 and June 30, 2005.

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 €40.9 million in first-half 2006 and €47.3 million in the first six months of 2005.

| (in €thousands) | Six months to June 30, 2006 | Six months to June 30, 2005 | % change |
|--|--------------------------------|--------------------------------|--------------|
| Revenues | 447,938 | 337,832 | 32.6 |
| Purchases used in production | (233,807) | (187,632) | 24.6 |
| Payroll costs | (18,444) | (14,673) | 25.7 |
| External charges | (29,440) | (30,947) | (4.9) |
| Taxes other than on income | (4,165) | (2,740) | 52.0 |
| Additions to provisions | (2,215) | (3,729) | (40.6) |
| Other income and expenses from operations, net | (6,915) | (3,195) | 116.4 |
| EBITDA | 152,952 | 94,916 | 61.1 |
| Depreciation and amortization | (63,424) | (55,706) | 13.9 |
| Profit from ordinary activities | 89,528 | 39,210 | 128.3 |
| Other operating income and expense, net | 0 | 0 | - |
| Operating profit | 89,528 | 39,210 | 128.3 |
| Financial income and expense, net | (152) | (2,278) | (93.3) |
| Corporate income tax | (30,772) | (12,805) | 140.3 |
| Profit for the period | 58,604 | 24,127 | 142.9 |

Revenues

Revenues for first-half 2006 rose almost 33% compared with the same period in 2005. Growth was primarily driven by increased revenues from the Broadband segment, particularly from internet access and optional value-added services available through the Freebox. For the six months to June 30, 2006, these optional services accounted for €73.5 million, more than double the revenues generated in 2005.

Operating expenses

Excluding depreciation and amortization, operating expenses were 21% higher than in first-half 2005, coming in at €95 million. However, as a percentage of consolidated revenues they decreased from 72% to 66%, reflecting the higher ratio of subscribers on unbundled lines during the period.

Operating profit

Operating profit surged to €89.5 million in the first six months of 2006 from €39.2 million in first-half 2005, representing a 128% increase. This performance was attributable to the combined impact of:

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

- Improved margins reported by the Traditional Telephony segment, particularly at Kertel.

In addition, capital expenditure related to equipment for broadband customers and measures to extend the network fueled a 14% rise in depreciation and amortization expense versus first-half 2005.

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

Group EBITDA totaled €153 million in the first half of 2006, up 61% on the comparable prior-year period. 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 optional value-added services provided through the Freebox. The Group EBITDA margin climbed from 28% in first-half 2005 to 34% in the first six months of 2006.

Financial income and expense, net

In the first half of 2006, net financial expense amounted to €152,000, corresponding primarily to interest on borrowings obtained by the Group, partially offset by foreign exchange gains 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 U.S. dollars.

Profit for the period

Profit for the period came to €8.6 million, up from €4.2 million in first-half 2005, representing a year-on-year increase of 143%. The income tax charge totaled €0.7 million, compared with €2.8 million in the first six months of 2005.

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 Telecom and Freebox brands.
- Hosting and domain-name creation services, marketed under the Online, BookMyName and Dedibox brands.
- Call center operations, carried out by Centrapel and Total Call.
- The Wimax activities under IFW. Additional analysis have led Iliad's management to affect the goodwill to the national 3.5 Ghz License included in the assets acquired.

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

| (in €thousands) | Six months to June 30, 2006 | Six months to June 30, 2005 | % change |
|--|--------------------------------|--------------------------------|--------------|
| Revenues | 410,790 | 292,742 | 40.3 |
| Purchases used in production | (222,719) | (177,207) | 25.7 |
| Payroll costs | (15,686) | (11,807) | 32.9 |
| External charges | (19,407) | (12,644) | 53.5 |
| Taxes other than on income | (3,648) | (2,235) | 63.2 |
| Additions to provisions | (2,616) | (3,045) | (14.1) |
| Other income and expenses from operations, net | (6,449) | (2,882) | 123.8 |
| EBITDA | 140,265 | 82,923 | 69.2 |
| Depreciation and amortization | (62,888) | (55,169) | 14.0 |
| Profit from ordinary activities | 77,377 | 27,754 | 178.8 |

Revenues

The table below shows the breakdown by category of consolidated revenues for the Broadband segment for the six-month periods ended June 30, 2006 and June 30, 2005, as well as the percentage change between these two periods.

| (in €thousands) | Six months to June 30, 2006 | Six months to June 30, 2005 | % change |
|---|--------------------------------|--------------------------------|-------------|
| ISP revenues (<i>ADSL, Pay-as-you-go, 50-hour plan</i>) | 377,394 | 251,409 | 50.1 |
| Hosting and advertising revenues | 6,174 | 5,809 | 6.3 |
| Inter-segment and other revenues | 27,222 | 35,524 | (23.4) |
| Total revenues | 410,790 | 292,742 | 40.3 |

Broadband revenues for first-half 2006 grew by €18 million or 40% compared with the same period one year earlier, boosted by the development of Free's ADSL broadband offer.

ISP revenues

| | Six months to June 30, 2005 | Year ended Dec. 31, 2005 | Six months to June 30, 2006 |
|--|--------------------------------|-----------------------------|--------------------------------|
| Total ADSL subscribers | 1,316,000 | 1,595,000 | 1,905,000 |
| Unbundled subscribers | 883,000 | 1,120,000 | 1,377,000 |
| Percentage of unbundled subscribers | 67.1% | 70.2% | 72.3% |
| Share of French residential ADSL market ¹ | 17.8% | 17.9% | 18.2% |

ISP revenues (Free, Free Telecom and Free Haut Débit), through both the switched telephone network and ADSL, totaled €377.4 million for the six months ended June 30, 2006.

Revenue growth in the ISP business, totaling 50%, resulted from the following factors:

- **Continuing success of the broadband offer.** At June 30, 2006, total ADSL subscribers numbered 1,905,000, against 1,595,000 at December 31, 2005, reflecting a near 19.5% increase.
- **The increasing use of optional value-added services provided through the Freebox.** In first-half 2006, revenues related to these services totaled €73.5 million, up from €27.5 million in the first six months of 2005. At June 30, 2006, users of Free's telephony services, via Freebox, numbered 1,650,000, while subscribers using at least one paying audiovisual service totaled some 273,000. This take-up rate places Free in the position of European leader in broadband telephony and television services. In the first six months of 2006, Free launched France's first full VoD (Video on Demand) offering. During the period approximately 802,800 films were downloaded from Free's three video downloading services – Canalplay, Canalplay Kids and i-Concerts – out of a total of 2 million downloads sold in France (Source: NPA and GfK).

The decline in take-up of the “pay-as-you-go” and “50-hour plan” dial-up offers continued during the first half of 2006, with related revenues coming in 40% lower than in the same period of 2005.

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 €6.2 million for the six months ended June 30, 2006, up from €5.8 million in the comparable prior-year period.

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 lower than in the prior-year period due to the contraction in Traditional Telephony business volumes.

¹ Source: Iliad, and ARCEP for 2005 market share and France Telecom for 2006

Purchases used in production and external charges

Purchases used in production and external charges totaled €242 million – 27.5% higher than in first-half 2005. Gross profit recorded by the Broadband segment (defined as revenues less purchases used in production and external charges) came to €168.6 million, representing 43.4% of total revenues, excluding inter-segment sales, compared with 39.6% in the first half of 2005 .

The gross margin increase is partially mitigated by the following elements during the first half 2006:

- New logistics costs related to Freebox modems, eg. Kiala.
- A more or less unchanged proportion of Option 1 ADSL subscribers (72.3% at June 30, 2006) compared with the second half of 2005.
- 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 of 10Mbps, thereby raising Free's costs of IP transit.

In first-half 2006, Free's marketing costs remained stable as a percentage of revenues, excluding inter-segment sales, but increased in absolute value terms. This rise reflects the reallocation of marketing budgets within the Group between the Traditional Telephony and Broadband segments.

Payroll costs

Payroll costs represented 4% of revenues, excluding inter-segment sales, versus 4.5% in first-half 2005, reflecting the economies of scale achieved in terms of the Group's personnel, particularly for the Broadband segment's hotline. The management of technical problems experienced by Free's subscribers was significantly improved during first-half 2006, with average queuing time amounting to 9 seconds for fully unbundled subscribers and 2 minutes for other subscribers. The rise in payroll costs in absolute value terms was once again due to recruitments carried out at the Group's call centers, with Centrapel and Total Call's payroll costs climbing to above €13 million in the six months ended June 30, 2006. The average number of employees in the call centers totaled 1,171 (including part-time workers) compared with 834 in 2005. As a result of this focus on customer service, payroll costs outstripped revenues generated from incoming calls.

In addition, during the six months to June 30, 2006, payroll costs included the impact of stock options granted at the end of 2005 to Group employees (see paragraph 1.2.4).

Additions to provisions

Additions to provisions topped €2.6 million in first-half 2006 and primarily corresponded to provisions for doubtful customer accounts. The net amount of costs related to customer risks decreased, in % of revenues, compared with the second half of 2005. This decline reflects the collection drive launched by the debt recovery department, which led to an overall drop in the number of bad debts.

Other income and expenses from operations, net

This item represented a net expense of €6.4 million versus €2.9 million in first-half 2005. The total includes royalties, bad debts (net of provision reversals), and gains and losses on asset disposals.

The higher net expense compared with the first half of 2005 was due to the combination of the following factors:

- A twofold increase in royalties paid.
- A more than 50% decrease in proceeds from asset disposals.
- The first-time recognition of ARCEP fees paid for the use of the WiMax license, representing €0.5 million over the period under review.

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

Broadband segment EBITDA surged by approximately 69.2% to €140.3 million in first-half 2006. The EBITDA margin, excluding inter-segment sales, increased to 36.1% from 31.9% in the same period of 2005. 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 with access to broadband connections through the unbundling of the local loop (Option 1), and (ii) the average gross margin per user for unbundled subscribers holding firm at over €20 a month.

During the first half of 2006, the number of France Telecom sites connected with optical fiber expanded from around 675 to 724. The number of unbundled lines also rose sharply, from 1,120,000 at December 31, 2005 to 1,377,000 at June 30, 2006 of which approximately 50% were fully unbundled.

Profit from ordinary activities

Depreciation and amortization for the Broadband segment totaled close to €2.9 million, up some 14% on first-half 2005.

Profit from ordinary activities for the first half of 2006 came to over €77 million, a €50 million increase on the comparable prior-year period. It represented 20% of revenues (excluding inter-segment sales) versus 10.7% in the first half of 2005.

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.
- Reverse look-up directory services, one of Iliad's historic businesses, marketed under the 3617 ANNU and Annu.com names, 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.
- Holding structure activities.

| (in €thousands) | Six months to June 30, 2006 | Six months to June 30, 2005 | % change |
|--|--------------------------------|--------------------------------|---------------|
| Revenues | 78,043 | 92,438 | (15.6) |
| Purchases used in production | (44,457) | (52,144) | (14.7) |
| Payroll costs | (2,758) | (2,866) | (3.8) |
| External charges | (17,559) | (23,933) | (26.6) |
| Taxes other than on income | (517) | (505) | 2.4 |
| Additions to provisions | 401 | (684) | (158.6) |
| Other income and expenses from operations, net | (466) | (313) | 48.9 |
| EBITDA | 12,687 | 11,993 | 5.8 |
| Depreciation and amortization | (536) | (537) | (0.2) |
| Profit from ordinary activities | 12,151 | 11,456 | 6.1 |

Revenues

The table below shows the breakdown by category of consolidated revenues for the Traditional Telephony segment for the six-month periods ended June 30, 2006 and June 30, 2005, as well as the percentage change between the two periods.

| (in €thousands) | Six months to June 30, 2006 | Six months to June 30, 2005 | % change |
|---|--------------------------------|--------------------------------|---------------|
| Fixed telephony and prepaid phone card revenues | 42,057 | 59,981 | (29.9) |
| Inter-segment and other revenues | 35,986 | 32,457 | 10.9 |
| Total revenues | 78,043 | 92,438 | (15.6) |

First-half 2006 revenues for the Traditional Telephony segment decreased to €78 million, reflecting the significant decline in the Group's fixed telephony and prepaid phone card businesses.

Fixed telephony and prepaid phone card revenues

Revenues from fixed telephony and prepaid phone cards, generated primarily by One.Tel and Kertel, fell to €42 million for the six months ended June 30, 2006.

The year-on-year decrease stemmed primarily from the combination of the following three factors:

- **A reduction in the number of One.Tel customers in the first half of 2006.** Against a backdrop of contained marketing costs and growing take-up of ADSL voice offerings, the number of invoiced customers edged back from 298,000 in December 2005 to 258,000 in June 2006.

- **An 8% decline in average revenue per user (ARPU) between December 2005 and June 2006.**
- **A contraction in Kertel's revenue contribution.** During the first half of 2006, Kertel sold 2.7 million prepaid telephone cards and top-ups. Since January 2006, Group Management has rebalanced the prices of Kertel cards in order to focus on profitability rather than sales.
- **The disposal of Endeis Telecom.** This company's contribution to Traditional Telephony revenues amounted to €1.2 million in the first half of 2005.

Inter-segment and other revenues

Inter-segment and other revenues increased to €36 million. This increase corresponds to additional marketing expenses billed to the other segment partially compensated by a 34% year-on-year drop in fees received in connection with the ANNU reverse look-up directory service and the flat sales to third-party operators reported by Kedra.

Purchases used in production and external charges

Purchases used in production and external charges decreased 18.5% to €62 million, primarily due to the termination of One.Tel marketing costs and the fact that the prices of Kertel cards were rebalanced.

Payroll costs

The reduction in payroll costs in the Traditional Telephony is partially compensated by the new stock options granted to employees in December 2005 (see paragraph 1.2.4).

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

The Traditional Telephony segment's EBITDA advanced to €12.7 million in first-half 2006. The EBITDA margin, excluding inter-segment sales, came to 21.4%, compared with 15.4% in first-half 2005.

Profit from ordinary activities totaled €12.2 million.

1.2.3 Cash flow statement

| (in €thousands) | Six months to June 30, 2006 | Year ended Dec. 31, 2005 | Six months to June 30, 2005 |
|---|--|---|--|
| Net cash generated from operating activities..... | 124,372 | 225,817 | 96,822 |
| Net cash used in investing activities..... | (123,806) | (262,205) | (128,440) |
| Net cash generated from financing activities..... | 310,585 | 62,711 | 20,637 |
| Net change in cash and cash equivalents | 311,150 | 26,323 | (10,981) |
| Net cash and cash equivalents at period-end | 360,566 | 49,416 | 12,112 |

Net cash and cash equivalents increased by €311 million in the first half of 2006, primarily as a result of the financing received following Iliad's issue of convertible/exchangeable bonds in June 2006.

Net cash generated from operating activities amounted to €124.4 million, 28.5% higher than in the first half of 2005. Cash flows for first-half 2006 included settlement of the balance due in relation to 2005 corporate income tax as well as two advance payments on the corporate income tax due for 2006, representing an aggregate of almost €39 million. In addition, at June 30, 2006, the Group was awaiting recovery of a €10.5 million VAT credit.

Acquisitions of property, plant and equipment and intangible assets (net of asset disposals) came to €22 million in the first half of 2006, breaking down as follows:

- €90 million worth of expenditure related to growth operations (including Freebox modems and DSLAMs, France Telecom service access fees, portability service fees, etc.) This figure also includes the impact of the launch of the new Freebox HD and measures undertaken by Iliad’s management team to rebuild a sufficient buffer inventory for this new type of Freebox. At June 30, 2006, the value of new Freebox HD ready for shipping represented over €10 million.
- Acquisitions relating to the network (including IRU agreements, France Telecom collocation rooms, civil engineering work, and transmission equipment), corresponding to €6 million.
- €9.9 million relating to other investments (Dedibox, IFW, computer equipment, etc.).

In January 2006, 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 €2 million.

On June 21, 2006, Iliad carried out an issue of “Oceane” bonds which are convertible into new shares or exchangeable for existing shares. The net proceeds raised from the issue amounted to €26 million. The bonds mature in January 2012 and carry interest of 2.2%. A total of 3,754,968 bonds were issued at a unit price of €88.05, with a conversion ratio of one bond for one share.

Also during the first half of 2006, the Group repaid €4.7 million in borrowings.

1.2.4 Ownership structure at June 30, 2006

At June 30, 2006, Iliad’s share capital was composed of 54,151,550 ordinary shares, breaking down as follows:

- Executive Management: 40,656,249 shares, or 75.1% of the share capital
- Public: 13,495,301 shares, or 24.9% of the share capital

At June 30, 2006, 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 | €6.30 | January 20, 2008 | 423,313 |
| Options | December 20, 2005 | €8.44 | December 20, 2009 | 270,758 |
| Options | December 20, 2005 | €8.44 | December 20, 2010 | 270,757 |

1.2.5 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 €3.6 million at June 30, 2006.

On June 21, 2006, Iliad carried out an issue of “Oceane” bonds which are convertible into new shares or exchangeable for existing shares. The net proceeds raised from the issue amounted to €26 million.

At June 30, 2006, the Group had confirmed credit lines of a maximum of €245 million, of which €66 million had been drawn down. The longest maturity under these credit lines is until June 2011.

1.3 ADDITIONAL INFORMATION

1.3.1 Events after the balance sheet date

On August 2, 2006 Iliad sold its entire interest in Société SA (Société.com) for €7.8 million. Formed in 1999, this company provides legal and financial information on companies, as well as brand data, via both free and paying services. Société SA was part of the Group's Traditional Telephony segment.

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 the 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 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 unsubscription fees), divided by the total number of ADSL subscribers invoiced for the period.