Société anonyme. Share capital: €12,772,554,81

Registered office: 16, rue de la Ville l'Evêque –
75008 Paris

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1. ANALYSIS OF THE GROUP'S BUSINESS AND RESULTS

KEY CONSOLIDATED FINANCIAL DATA

In € millions	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010
INCOME STATEMENT			
Revenues	3,153.3	2,122.1	2,038.3
EBITDA	***921.4***	***833.4***	**798.1**
Profit from ordinary activities	411.7	498.2	477.9
Other operating income and expense, net	(6.4)	(4.6)	61.0
Operating profit	405.3	493.6	538.9
Finance costs, net	(56.8)	(46.8)	(41.7)
Other financial income and expense, net	(34.3)	(34.0)	(7.8)
Corporate income tax	(127.7)	(161.0)	(176.3)
Profit for the period	**186.5**	**251.8**	**273.2**
BALANCE SHEET			
Non-current assets	3,924.4	3,204.0	1,904.4
Current assets	772.6	600.5	516.2
Of which cash and cash equivalents	*384.2*	*357.4*	*347.5*
Assets held for sale	50.0	54.9	71.6
Total assets	**4,747.0**	**3,859.4**	**2,492.2**
Total equity	1,726.7	1,523.9	1,078.3
Non-current liabilities	1,679.8	1,466.3	1,016.0
Current liabilities	1,340.5	869.2	397.9
Total equity and liabilities	**4,747.0**	**3,859.4**	**2,492.2**
CASH FLOWS			
Net cash generated from operating activities	921.5	779.6	874.9
Net cash used in investing activities	(945.2)	(1,156.4)	(793.7)
Net change in cash and cash equivalents (excluding financing activities and dividends)	(38.0)	(391.0)	54.2
Dividends	(21.2)	(21.9)	(21.2)
Cash and cash equivalents at year-end	382.6	350.5	337.5

1.1 OVERVIEW

Fueled by the success of its broadband offering marketed under the Free brand, the Iliad Group (also referred to as the "**Group**") has positioned itself as a major player in the French telecommunications market. In addition, since January 10, 2012 when it launched its mobile offerings, the Group has become an integrated operator present in both the broadband and mobile markets.

At December 31, 2012, the Group had over 5.3 million broadband subscribers and 5.2 million mobile subscribers, representing market shares of over 24% in the ADSL segment and almost 8% in the mobile segment.

Prior to the launch of its mobile offerings in early 2012, the Group's operations were split into two segments – Broadband and Traditional Telephony (with this segment’s contribution to consolidated revenues becoming increasingly lower over time).

Since the launch of its mobile offerings, the Group has redefined its business segments with the creation of a single new segment called Retail Telecom.

As substantially all of its operations are in France, the Group also only has one geographic segment.

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

EBITDA – which corresponds to profit from ordinary activities before share-based payment expense, depreciation, amortization and provisions for impairment of non-current assets – is a key performance indicator for the Group and is used throughout this management report.

1.1.1 Breakdown of revenues

(a) Landline revenues

Offerings and services available under the Free and Alice brands

The Group offers its subscribers the following different Internet access solutions (at prices ranging from €9.99 to €35.98 per month), with a box provided and no installation fees:

- **Unlimited broadband via ADSL.** This offering allows subscribers to access the Internet at a speed of at least 2 Mbps and up to 28 Mbps (observed) in areas where the local loop is unbundled, and 22 Mbps in non-unbundled areas (depending on whether a subscriber’s line is eligible).

- **FTTH very high-speed broadband.** This offering – which is available in selected areas chosen by Free – provides subscribers with very high-speed Internet access (100 Mbps download and 50 Mbps upload).

Through these offerings subscribers are provided with the services described below:

- **Telephony.** All subscribers are provided with a telephone service under which they can make completely free calls through their modem to landline numbers in mainland France (apart from short numbers and special numbers), as well as to 60 or 108 destinations outside mainland France depending on the terms of their offer. In addition, certain of the Group’s offers include free calls or packaged deals for calls to mobile numbers in mainland France.

- Free proposes the broadest **television offering** in the market, comprising over 400 channels (of which some 60 or 185 are included in the basic packages) with 50 high definition channels.

- Free also offers its subscribers **numerous value added services** including catch-up TV, video on demand (VOD or S-VOD), subscription to Canal+ channels and video games.

In line with its image as a pioneer in technological innovation, in December 2010 Free launched the **Freebox Revolution**, which allows subscribers to connect all of their terminals and offers optimal Internet access. The Freebox Revolution also includes many innovative new services, such as the NAS server which has storage capacity of up to 250GB accessible from anywhere at any time, a Blu-ray player, and calls to all mobile numbers in mainland France.

Hosting offers and services available under the Online, Dedibox and Iliad Entreprises brands

The Group's hosting business is structured around three service areas, each of which is represented by a brand:

- **Shared hosting services**, marketed under the Online brand, which correspond to website hosting and the purchase and resale of domain names. These services are invoiced to customers based on an annual subscription and are primarily targeted at private individuals and very small businesses that have relatively low data storage requirements.

- **Dedicated hosting services**, marketed under the Dedibox brand, which correspond to the provision of dedicated servers to private individuals and SMEs that wish to secure their data. This offering is invoiced based on a monthly subscription.

- **Server collocation services**, which consist of providing physical space in fully secure and accessible data centers.

(b) Mobile revenues

Since January 10, 2012, the Group has proposed two simple value-for-money mobile offerings:

- **A €2/month no-contract offering (€0 for Freebox subscribers)** for 120 minutes of voice calls per month in mainland France and to French overseas departments (*départements d'outre-mer* – DOM) and 40 destinations outside mainland France, as well as unlimited SMS messages and unlimited access to FreeWiFi network. This plan – which also includes services such as voice mail, caller display and usage monitoring – was primarily designed for subscribers wanting to make voice calls at competitive prices. Under the plan, subscribers can opt for extra minutes as well as for calls to additional foreign countries and access to Data 3G and MMS option.

- **A €19.99/month no-contract offering (€15.99/month for Freebox subscribers)** with unlimited voice calls, SMS, MMS and Internet (3GB fair usage policy with speeds slowed once 3GB is reached). All subscribers to this plan can make unlimited calls to landlines in 40 destinations outside Mainland France and to mobiles in Canada and the United States (including Alaska and Hawaii) and French overseas departments, and also have unlimited access to the FreeWiFi network.

In tandem, the Group offers a **selection of the best mobile phones in the market**, including top of the range Apple and Samsung phones. With a view to being as transparent as possible, Free sells its phones separately from its subscriptions, which means that subscribers can opt for whichever plan and phone they prefer, or can choose not to purchase a phone at all. Subscribers who do purchase a phone can either pay for it upfront or in several installments (over 4, 12, 24 or 36 months). In both cases, the Group recognizes the corresponding revenue when the phone is sold.

1.1.2 The Group's main operating costs

(a) Free and Alice's ADSL offerings comprise two types of service:

- **Option 1** (subscribers on an unbundled line), whereby the Group markets services entirely on its own network (excluding the local loop).

Under Option 1, direct costs per subscriber and per month, as mentioned in the basic unbundling offer, were as follows at December 31, 2012:

Operating costs (partial unbundling)

- Rental of the copper pair and the ADSL splitter: €1.57
- Other costs (backhaul cables, room rental, optical fiber leasing payments, etc.): €1.86

Operating costs (full unbundling)

- Rental of the copper pair: .... €8.80[1]
- Other costs (backhaul cables, room rental, optical fiber leasing payments, etc.): €1.86

- **Option 5** (subscribers not on an unbundled line), representing a wholesale offer proposed by the incumbent operator that is sold on to subscribers by Free and Alice.

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 the costs of the IP transit service.

The respective monthly fees for the "DSL Access" and "DSL Access Only" services are €4.21 (applicable since January 1, 2012) and €12.55 (since February 1, 2012).

[1] As from May 1, 2013, the monthly subscription cost will be €8.90.

Option 5 costs also include IP transit service costs which vary depending on the bit rate used by all Option 5 subscribers. The price terms applicable in 2012 were as follows:

- Usage fee per Mbps: €12.00
- Access fees: €4.44

Option 1 gross margin and EBITDA margin are significantly higher than Option 5 margins.

The Group'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.

(b) Mobile call termination charges

In its decision dated July 27, 2012, ARCEP (the French electronic communications regulatory authority) set the following mobile call termination rates for the period from July 1, 2012 through December 31, 2013:

(in euro cents)	**Second-half 2012**	**First-half 2013**	**Second-half 2013**
Orange	1.0	0.8	0.8
SFR	1.0	0.8	0.8
Bouygues	1.0	0.8	0.8
Free Mobile	**1.6**	**1.1**	**0.8**

(c) Roaming charges

The Group has to pay roaming charges for areas that are not directly covered by Free Mobile's own network. The roaming services provided to the Group are defined in a roaming agreement signed with France's incumbent operator during the first half of 2011. This agreement has a six-year term commencing from the commercial launch of the Group's mobile offerings and applies to 2G and 3G technologies. It was amended in 2012 – notably in relation to interconnection capacity – to take into account the increase in mobile subscriber numbers.

The charges provided for in the roaming agreement include (i) a fixed portion corresponding to the purchase of a right of use for the period (which is recognized as capital expenditure in accordance with IFRS), and (ii) a variable portion based on volumes (minutes, SMS, MMS, Internet etc.). The volume-based variable portion represents the majority of the roaming charges paid by the Group.

As both gross margin and EBITDA margin are significantly higher for Free Mobile's own-network traffic than for roaming traffic, the Group's objective is to maximize the proportion of traffic carried directly on its own network by pursuing the rollout targets described in section 1.1.3.c. below.

1.1.3 Capital expenditure and depreciation

(a) Broadband

Since the early 2000s, the Group has focused on rolling out its telecommunications network in mainland France, choosing to build a single network based on an 802.3 physical layer (Ethernet) using the various available speeds (100 Mbps, then 1 gigabit, 10 gigabits and 100 gigabits per second).
In less than 15 years, having laid over 68,000 km of fiber, it has rolled out one of the largest IP networks in France, both in terms of coverage and traffic volumes.

A portion of the underlying optical fiber for this network is operated under IRU (Indefeasible Right of Use) contracts with terms ranging from 10 to 27 years that involve a single upfront payment when the fiber is made available. These IRUs are recognized as property, plant and equipment in the Group's balance sheet 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 or AliceBox modems and Freebox DSLAMs and to pay fees to the incumbent operator for access to unbundling services (which are also known as cabling costs or access fees). In addition, it incurs logistics and modem shipping costs:

- Since December 14, 2010, subscribers have been supplied with either the Freebox HD under the traditional offering or the latest-generation Freebox under the Freebox Revolution offer. The Freebox Revolution incorporates state-of-the-art technologies such as PLC (Power Line Communication), a Blu-ray™ player, a gyroscopic remote control, a gamepad and loud speakers. In 2012, the cost of a Freebox Revolution was around €275.

- Fees invoiced by the incumbent operator for access to unbundling services are €56 per subscriber for full unbundling and €66 for partial unbundling.

All of the above-described items (Freebox modems, access fees and logistics costs) are depreciated over a period of five years.

Under Option 5, total capital expenditure is lower as the majority of new subscribers are provided with Freebox version 5 modems, which are already in the process of being depreciated. The main capitalized costs therefore correspond to access fees billed by the incumbent operator, breaking down as follows:

- Fees for access to the DSL Access service: €56.00
- Fees for access to the DSL Access Only service: €61.00
- Fees for access to the DSL Access Only service (where operator access was already in place): €17.00

Capitalized access fees are also depreciated over five years as from when the related services are provided.

(b) 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, IRE and Immobilière Iliad.

In very densely populated areas, as defined by ARCEP, this network is being rolled out in four phases:

- acquiring premises to house optical nodes (ONs);
- laying fiber optic cable between the ONs and buildings ("horizontal rollout");
- "vertical rollout", which consists of:
  - laying optical fiber within buildings up to the front doors of each household or business for which Free Infrastructure holds the connection agreement, or
  - connecting buildings made available by third-party operators under rollout pooling agreements;
- connecting subscribers to the network.

The majority of the Group's ON acquisitions are financed through twelve-year leases, with only certain sites purchased in Iliad's own name. At December 31, 2012 the Group had 229 such sites. These ONs represent potential coverage of approximately 3.4 million FTTH plugs.

The horizontal rollouts are undertaken either by the Group's own teams or by subcontractors. In 2012, the Group completed its rollouts in those areas where work had already started in 2011.

Following ARCEP's finalization in 2011 of the regulatory framework for "very densely populated" areas, the Group set up a dedicated organizational structure and specific industrial production processes for connecting up buildings made available by third-party operators through rollout pooling agreements. As a result, the pace of building connections picked up in 2012 in areas where the horizontal rollout process was already completed. Consequently, the number of homes eligible for an FTTH offering is growing, which will in turn push up the level of subscriber connections.

In August 2012, the Iliad Group was the first operator to take up France Telecom's third-party operator access offer for its FTTH network outside very densely populated areas and therefore the first operator to commit to co-financing the FTTH network in certain urban areas proposed by the incumbent operator. This offer enables each operator to co-finance the rollout only to the extent of the lines required to serve its subscribers in the local area concerned. This pooling of resources to introduce a single network shared among the fiber optic providers and subscribers is aimed at expanding the service to a wider population.

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(c) Rollout of a network of mobile masts

On January 12, 2010, Iliad's subsidiary Free Mobile was authorized to use frequencies in the 2.1 GHz and 900 MHz bands to set up and operate a third-generation mobile communications network in mainland France.

Since this license was acquired, Free Mobile has put in place a specific organizational structure to manage and oversee its network rollout process, which notably involves:

- seeking out sites, which entails site identification and reporting on each site's mobile coverage potential;
- undertaking discussions with all types of lessors, including private individuals, condominium owners, housing associations, corporate and institutional lessors, mobile operators and companies with substantial real estate portfolios such as hotel chains;
- carrying out administrative and regulatory procedures to obtain the necessary authorizations to perform works (such as preliminary planning statements, building permits etc.);
- organizing, planning and managing projects as well as coordinating the work of the various people and entities involved in both the validation process and subsequent site construction work, notably via a collaborative information system;
- ensuring a full understanding of and compliance with safety rules related to performing installation works at height and the use of mobile communications equipment;
- monitoring the operation and maintenance of radio equipment at sites where it has been installed.

By putting in place this structure, the Group has been able to achieve direct coverage of more than 27% of the French population in less than two years. On December 13, 2011, having verified Free Mobile's coverage, ARCEP confirmed that the Group had complied with the coverage obligation contained in its 3G license. This meant that Free Mobile was permitted to launch its first commercial offerings.

During 2012, the Group intensified its rollout measures, focusing wherever possible in densely populated areas. Consequently, by December 31, 2012 the Group had deployed almost 2,200 sites, giving it a population coverage level of over 40% (according to ARCEP"s definition).

In view of the progress of its rollouts, the Group is standing by the objectives set in connection with Free Mobile's commitments to ARCEP, namely to achieve coverage levels of 75% of the French population by 2015 and 90% by 2018.

The Group continued to proactively invest in its mobile business throughout the course of 2012. The main outlay during the year related to the deployment and connection of some 1,500 new sites, rollout of the core and backhaul networks and information systems, and payment of the fixed portion of the charges due for the year under the roaming agreement.

Following the commercial launch of its mobile business, the Group began to depreciate/amortize the various assets brought into service in 2012 (license, radio equipment, etc.) The depreciation/amortization periods applied are as follows:

- 3G license: 18 years
- Network equipment: 4 years
- Other equipment and assets: 6 years

1.2 SIGNIFICANT EVENTS OF THE YEAR

In € millions	**2012**	**2011**	**% change**
Consolidated revenues	**3,153.3**	**2,122.1**	**48.6%**
- *Landline*	2,321.4	2,122.1	9.4%
- *Mobile*	843.9		
- *Inter-segment sales*	(12.0)		
Consolidated EBITDA	**921.4**	**833.4**	**10.6%**
- *Landline*	967.5	833.4	16.1%
- *Mobile*	(46.1)		
Profit from ordinary activities	**411.7**	**498.2**	**-17.4%**
Profit for the period	**186.5**	**251.8**	**-25.9%**
Free Cash Flow from ADSL operations	**508.8**	**307.0**	**65.7%**
Leverage ratio	**1.16x**	**1.16x**	**-**

The year 2012 was marked by the Group's transformation from a landline operator to an integrated (landline and mobile) player, thanks to the launch of its mobile offerings. This change was accompanied by very strong growth, driven by (i) the commercial success of our mobile offerings, with 5.2 million subscribers in less than a year, (ii) an outstanding showing from the landline business, with net adds coming in at 515,000, and (iii) another robust financial performance which enabled us to maintain a solid balance sheet structure.

- **A successful debut for the Group's mobile offerings**, with over 5.2 million subscribers in less than a year – representing a near-8% market share – and over €840 million in revenues.

- **Continuation and acceleration of the landline business's virtuous circle of profitable growth.** In line with Group objectives, 2012 saw our landline business step up its pace of growth, with revenue climbing 9.4% versus 4.1% in 2011. At the same time, the Group boosted its profitability by continuing to focus on unbundling and optimizing the fixed cost base. As a result, EBITDA margin for the landline business came in at a record 41.7%.

- **Solid financial structure and performance.** At over €921 million, consolidated EBITDA was up 11% on 2011, with sharp growth in the landline business enabling the Group to offset the adverse impact of the negative EBITDA contribution from its mobile business.

  Profit from ordinary activities amounted to €412 million in 2012, down 17% year on year. The decrease was primarily due to the beginning of depreciation/amortization for the Group's mobile assets (network, license, roaming charges etc.) and, to a lesser extent, depreciation/amortization related to optical fiber and the Freebox Revolution.

  In view of the above, profit for the period stood at €187 million versus €252 million in 2011.

  At a negative €38 million, consolidated Free Cash Flow (excluding financing activities and dividends) was more or less at breakeven and reflected the combined impacts of the following:

  - a 28% rise in operating Free Cash Flow, which topped €1.1 billion in 2012, including a €131 million change in working capital requirement;

  - total capital outlay of €945 million during the year due to an ongoing proactive capital expenditure policy;

  - a sharp 66% jump in Free Cash Flow from ADSL operations to €509 million. This brought the aggregate figure for the 2010-2012 period to €1.25 billion, in excess of the Group's original target of at least €1.1 billion;

  - payment of the 2011 dividend amounting to €21 million.

1.3 COMPARISON OF RESULTS FOR 2012 AND 2011

In € millions	2012	2011	% change
Revenues	**3,153.3**	**2,122.1**	**48.6%**
Purchases used in production	(1,668.4)	(951.7)	75.3%
Gross profit	**1,484.9**	**1,170.4**	**26.9%**
as a % of revenues	***47.1%***	***55.2%***	
Payroll costs	(170.2)	(129.0)	31.9%
External charges	(192.3)	(147.3)	30.5%
Taxes other than on income	(29.8)	(17.3)	72.3%
Additions to provisions	(148.1)	(29.6)	-
Other income and expenses from operations, net	(23.1)	(13.8)	67.4%
EBITDA	**921.4**	**833.4**	**10.6%**
as a % of revenues	***29.2%***	***39.3%***	-
Share-based payment expense	(10.4)	(10.0)	4.0%
Depreciation, amortization and provisions for impairment of non-current assets	(499.3)	(325.2)	53.5%
Profit from ordinary activities	**411.7**	**498.2**	**-17.4%**
Other operating income and expense, net	(6.4)	(4.6)	39.1%
OPERATING PROFIT	**405.3**	**493.6**	**-17.9%**
Finance costs, net	(56.8)	(46.8)	21.4%
Other financial income and expense, net	(34.3)	(34.0)	0.9%
Corporate income tax	(127.7)	(161.0)	-20.7%
PROFIT FOR THE PERIOD	**186.5**	**251.8**	**-25.9%**

1.3.1 Analysis of consolidated results

(a) Key indicators

	Dec. 31, 2012	Dec. 31, 2011	Dec. 31, 2010
Total mobile subscribers	**5,205,000**	**-**	**-**
Total broadband subscribers	**5,364,000**	**4,849,000**	**4,534,000**
- Free	5,173,000	4,461,000	3,969,000
of which migrations from Alice to Free	*140,000*	*85,000*	-
- Alice	191,000	388,000	565,000
Percentage of unbundled subscribers	**94.10%**	**92.20%**	**89.20%**

In €	Dec. 31, 2012	Dec. 31, 2011	Dec. 31, 2010
Broadband ARPU	**36.0**	**35.5**	**36.1**
Freebox Revolution ARPU	*> 38.0*	*> 38.0*	-

(b) Revenues

Consolidated revenues for the year ended December 31, 2012 topped €3 billion, up by almost 50% on 2011. This very strong increase is attributable to the outstanding sales performance turned in by the landline business as well as the success of the Group's mobile offerings since their launch on January 10, 2012.

The table below shows the breakdown of revenues by business and category for 2012 and 2011 as well as the percentage change between the two years.

In € millions	2012	2011	% change
Landline	**2,321.4**	**2,122.1**	**9.4%**
Mobile	**843.9**	**-**	**-**
Telecom services	*719.5*		
Terminals	*124.4*		
Intra-group sales	(12.0)	-	**-**
Total consolidated revenues	**3,153.3**	**2,122.1**	**48.6%**

Landline revenues

Landline revenues advanced from €2,122 million in 2011 to €2,321 million in 2012, representing growth of more than 9% for the year as a whole and driven by an increase of over 10% in the second half alone. The year-on-year rise primarily reflects the impacts of the following:

- **An outstanding sales performance in 2012.** The Group's landline business delivered a record showing, with 515,000 new subscribers during the year (net of terminations and excluding migrations from Alice) and a market share of net adds at close to 50%. This achievement demonstrates the strong reputation of the Free brand, the appeal of the Freebox Revolution offering and the significant revenue synergies leveraged between our landline and mobile businesses. At December 31, 2012, the Group had a total 5,364,000 broadband subscribers.

- **Solid broadband ARPU at end-December 2012**, up by nearly €0.50 year on year to €36. After two years of flat ARPU this rise was achieved thanks to the success of the Freebox Revolution offering and despite revenue pressure triggered by lower call termination charges and an increase in VAT.

- **Acceleration of the loyalty and retention program for Alice subscribers.** In early 2011 the Group launched a program offering Alice subscribers the possibility of migrating to Free's offers (including the Freebox Revolution). Some 140,000 Alice subscribers took up this option during 2012, compared with 85,000 in 2011.

Mobile revenues

The year 2012 saw the commercial success of the Group's mobile offerings. The mobile business generated €844 million in revenues in less than a year, including €124 million from sales of terminals. This performance was propelled by the following factors:

- **The commercial success of the innovative mobile offerings proposed by Free**, which enabled the Group to attract 5,205,000 subscribers – representing a near-8% share of the French mobile market – in less than a year.

- **An even distribution of subscriptions** between the two available plans, between the Free community and newcomers, and between subscriptions with mobile number portability and those with a new phone number assigned.

Inter-segment sales

Inter-segment sales correspond to sales between companies from the Group's two different businesses and mainly consist of billings of interconnection operations. They are eliminated in consolidation.

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(c) Gross profit

Consolidated gross profit came to €1,485 million in 2012, up 27% on 2011. As a percentage of revenues, however, it decreased by nearly 8 points due mainly to the dilutive impact of the mobile business. The main factors affecting gross profit during the year were:

- **The positive effects of lower operating costs and a rise in the unbundling rate.** The Group continued its drive to extend its ADSL network in 2012 and opened over 700 new connection nodes, pushing up its unbundling rate by almost 2 points to over 94% at the year-end.

- **Higher gross profit on Freebox Revolution subscriptions.** Following on from the slight reduction in gross profit for the Group's landline business in 2011 – due to the considerable success of the Freebox Revolution offering and the high number of calls made to mobiles – gross profit on Freebox Revolution subscriptions increased in 2012 as a result of the reductions in mobile call termination charges introduced in January and July 2012.

- **Dilutive impact of the mobile business on gross margin.** As the Group expected, its mobile business had a dilutive impact on gross margin.

- **Synergies leveraged between the landline and mobile businesses.** The rapid development of the Group's mobile business has enabled it to fully leverage its new status as an integrated operator, especially concerning interconnection charges for intra-group calls.

(d) Payroll costs

Subscriber relations are a key priority for the Group, which is why it opted from the very beginning to develop its own call centers, which are mainly based in France. A major recruitment campaign was carried out in mainland France in 2012 to support both the rapid development of the mobile business and sustained growth in the landline business.

In addition, with a view to strengthening its local subscriber service, the Group has begun to roll out a distribution network based on physical sales outlets. At end-2012 it had 15 stores (Free Centers) located in France's major towns and cities, with the flagship store based in Paris.

Some 900 employees were recruited and trained during the year, raising the Group's total headcount to 6,506 at December 31, 2012.

Consequently, payroll costs (excluding employee benefits and capitalized costs) increased by 32% to €170 million.

All of these efforts to enhance our subscriber relations were recompensed by the high rankings and prizes awarded to the Group in numerous surveys carried out in 2012, including:

- a survey published in May 2012 by France's largest consumer association (UFC – *Que Choisir*), which ranked Free no .1 for consumer satisfaction (with a rate of 92.3%);
- a TNS Sofres/Bearing Point survey, which awarded Free first prize in the Podium 2012 customer relationship management awards for mobile telephony[2];

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[2] *This survey was carried out between March 30 and April 9, 2012 among customers choosing Free mobile call plans taken from a sample of 4,000 individuals.*

- a KPAM survey, which ranked Free the best hotline experience for French consumers in the ISP/telecommunications operator category (June 2012);
- a customer satisfaction survey published by the consumer association 60 millions de consommateurs in September 2012, in which Free came number one with a subscriber satisfaction rate of over 94%;
- a TestnTrust survey issued in December 2012, which put Free in first place for subscriber satisfaction in the ISP/telecommunications operator category for the third quarter in a row.

(e) External charges

The Group's external charges came to €192 million in 2012 versus €147 million in 2011. This item mainly includes the costs of network maintenance, equipment hosting, insurance, advertising and sub-contracting.

(f) Taxes other than on income

Taxes other than on income rose by some €13 million year on year to €30 million.

(g) Additions to provisions

Additions to provisions – which include provisions for bad debts, impairment of inventories and contingencies and charges – totaled €148 million in 2012. This reflects the strict policy put in place when the Group's mobile operations were launched concerning the recognition of provisions for certain expenses, claims and litigation, and bad debts, because the mobile business is in its start-up phase and is growing rapidly.

(h) Other income and expenses from operations, net

This item represented a net expense of €23 million (€14 million in 2011), corresponding to 0.7% of consolidated revenues.

(i) EBITDA

Consolidated EBITDA rose 11% year on year to over €921 million, with the strong performance from the landline business more than offsetting the negative EBITDA contribution from the mobile business, which is in its start-up phase.

However, as a percentage of revenue, EBITDA losses caused by the mobile launch caused the consolidated EBITDA margin to narrow by 10 points to 29.2%.

Landline

EBITDA from the landline business totaled €968 million, up by more than 16% on 2011. In addition, thanks to the increase in gross profit on Freebox Revolution subscriptions, the ongoing rise in the percentage of unbundled subscribers and the economies of scale achieved in relation to the fixed cost base during the year, the landline business posted a 2.4-point year-on-year increase in its EBITDA margin to 41.7%. For the second half alone the EBITDA margin for this business was a record 42.3%.

Mobile

Despite the resounding commercial success and high growth rate of the mobile business in 2012, the Group managed to restrict its start-up EBITDA loss to just €46 million due to (i) major synergies leveraged between the mobile and landline businesses and (ii) the rise in the coverage rate of Free Mobile's network for voice, SMS and data traffic throughout the course of the year.

(j) Profit from ordinary activities

Profit from ordinary activities contracted 17% year on year, coming in at €412 million. The decrease was primarily due to the beginning of depreciation/amortization for the Group's mobile assets (network, license, roaming charges etc.) and, to a lesser extent, depreciation/amortization related to optical fiber and the Freebox Revolution.

(k) Profit for the period

In view of the above, profit for the period retreated 26% to €187 million in 2012 from €252 million the previous year.

1.3.2 Cash flows and capital expenditure

In € millions	**2012**	**2011**	**% change**
Consolidated cash flow	**987.2**	**828.9**	**19.1%**
Change in working capital requirement	130.8	47.9	173.1%
Operating Free Cash Flow	**1,118.0**	**876.8**	**27.5%**
Net cash used in investing activities	(945.2)	(1,154.5)	-18.1%
Income tax paid	(196.5)	(97.1)	102.4%
Other	(14.3)	(16.2)	-11.7%
Consolidated Free Cash Flow (excluding financing activities and dividends)	**(38.0)**	**(391.0)**	**-**
Free Cash Flow from ADSL operations	**508.8**	**307.1**	**65.7%**
Dividends	(21.2)	(21.9)	-3.2%
Cash and cash equivalents at year-end	**382.6**	**350.5**	**9.2%**

Consolidated Free Cash Flow

Consolidated Free Cash Flow was almost breakeven in 2012, representing a negative €38 million versus a negative €413 million in 2011. This year-on-year change mainly reflects the following:

- a 28% rise in operating Free Cash Flow, which topped €1.1 billion in 2012, including a €131 million change in working capital requirement;
- total capital outlay of €945 million during the year due to an ongoing proactive capital expenditure policy;
- a sharp 66% jump in Free Cash Flow from ADSL operations to €509 million; this brought the aggregate figure for the 2010-2012 period to €1.25 billion, in excess of the Group's original target of at least €1.1 billion;
- payment of the remaining tax due for 2011 and all of the tax due for 2012, representing a combined amount of €197 million.

Net change in cash and cash equivalents

The Group ended 2012 with €383 million in available cash and cash equivalents. Excluding the operating items presented above, the main changes in cash and cash equivalents during the year related to:

- the redemption on January 2, 2012 of the unconverted portion of the Group's convertible bond issue, representing €128 million;
- the start-up of a commercial paper program, of which €191 million had been used at December 31, 2012;
- a new loan granted by the EIB (€200 million) on August 27, 2012, of which €100 million had been drawn down at December 31, 2012.

1.3.3 Consolidated debt

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

At December 31, 2012, the Group had gross debt of €1,448 million and net debt of €1,064 million. Despite the launch of its mobile business during the year and the commercial success of its ADSL offerings, the Group maintained a solid financial structure and kept its leverage ratio stable at 1.16x at December 31, 2012. This very prudent level enabled Iliad to retain its position as one of the European telecom operators with the least amount of debt.

The Group's gross debt primarily comprised the following at December 31, 2012:

A €500 million short-term commercial paper program

During the first half of 2012, the Iliad Group set up a €500 million commercial paper program in order to diversify the sources and maturities of its financing. This program had been used in an amount of €191 million at December 31, 2012.

A €1,400 million syndicated credit facility

On June 9, 2010 the Group set up a €1,400 million syndicated credit facility with a pool of 11 international banks. This facility comprises two tranches:

- A €600 million loan tranche to refinance the Group's net debt, of which €350 million had been drawn down at December 31, 2012;

- A revolving tranche of €800 million expiring in June 2015. None of this tranche had been drawn down at December 31, 2012.

The applicable interest rate is based on Euribor plus a margin of between 2.05% and 1.10% per year depending on the Group's leverage ratio.

A €150 million loan granted by the European Investment Bank (EIB) in 2010

The EIB granted Iliad a €150 million loan in order to help finance the rollout of the Group's ADSL and FTTH networks between 2010 and 2012. This loan – which is repayable in installments with a final maturity in July 2020 – had been fully drawn down at December 31, 2012.

A €200 million loan granted by the European Investment Bank (EIB) in 2012

Following on from the loan granted in 2010, the EIB extended its partnership with Iliad in 2012 by granting it another loan (€200 million) to help finance the Group's capital expenditure between 2012 and 2014. This loan – which is also repayable in installments and matures in July 2022 – had been drawn down in an amount of €100 million at December 31, 2012.

At December 31, 2012 all of the covenants on the Group's credit facilities were respected.

Finance lease commitments

The Group uses finance leases to finance (i) the purchase of premises required to roll out its FTTH network and (ii) a portion of its technical equipment.

At December 31, 2012, the Group's total obligations under finance leases amounted to €95 million.

A €500 million bond issue

On May 26, 2011, the Group issued €500 million worth of bonds paying interest at 4.875% per year.

The bonds will be redeemed at face value at maturity on June 1, 2016.

1.3.4 Ownership structure at December 31, 2012

At December 31, 2012, Iliad's share capital was made up of 57,637,805 ordinary shares, held by the following shareholders:

- Executive Management: 36,022,725 shares, representing 62.5% of the share capital;
- Public: 21,615,080 shares, representing 37.5% of the share capital.

At December 31, 2012, there were seven Iliad stock option plans in place with a total of 1,830,306 shares under option.

1.4 ADDITIONAL INFORMATION

1.4.1 Strategic objectives

With a view to continuing to implement its strategy of achieving profitable growth, the Group has set itself the following objectives:

- Landline:
  - Achieve a 25% share of the landline broadband market in the long term
  - Pursue horizontal FTTH rollouts and co-financing arrangements
  - Grow revenues by more than 5% in 2013
- Mobile:
  - Continue and intensify site rollouts;
  - Reach obligatory coverage rate of 75% of the French population by end-2014
  - Achieve a 15% market share in the medium term with a long-term goal of 25%
- Group:
  - Generate revenues of over €4 billion by 2015

1.4.2 Events after the reporting period

1.4.3 Glossary

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

Broadband ARPU (Average Revenue Per User): Includes revenues from the flat-rate package and value-added services but excludes one-time revenues (e.g. fees for migration from one offer to another or subscription and cancellation fees), divided by the total number of broadband subscribers invoiced for the period.

Broadband subscribers: Subscribers who have signed up for the Group's ADSL or FTTH offerings.

Free cash flow from ADSL operations: Represents EBITDA plus or minus changes in working capital and minus investments made in connection with property, plant and equipment and intangible assets acquired for the Group's ADSL operations.

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

Gross profit: Corresponds to revenues less purchases used in production.

Leverage ratio: Represents the ratio between net debt (short- and long-term financial liabilities less cash and cash equivalents) and EBITDA.

Net adds: Represents the difference between total broadband subscribers at the end of two different periods.

Total broadband subscribers: Represents, at the end of a period, the total number of subscribers identified by their telephone lines who have signed up for Free's or Alice's broadband service, excluding those recorded as having requested the termination of their subscription.

Total mobile subscribers: Represents, at the end of a period, the total number of subscribers, identified by their telephone lines, who have subscribed to a Free mobile offering, excluding those recorded as having requested the termination of their subscription.

Unbundled subscribers: Subscribers who have signed up for the Group's ADSL or FTTH offerings through a telephone exchange unbundled by Free.