



France Telecom

***Initial assessment of IFRS
impact***

December 17th , 2004

Cautionary Statement



This presentation contains forward-looking statements relating to possible changes to France Telecom's financial statements for 2004 (which will be restated in 2005) as a result of restating these statements in accordance with International Financial Reporting Standards (IFRS) endorsed by the European Union by December 31, 2005 for purposes of comparison with France Telecom's financial statements for 2005 and for subsequent reporting periods, and possible impacts on France Telecom's financial statements (including its balance sheet and income statement) of the application of IFRS endorsed by the European Union by December 31, 2005 beginning with the first half of 2005 compared to France Telecom's current financial statements prepared according to French GAAP. These forward-looking statements do not reflect all the possible changes due to IFRS but those identified at this stage. Significant changes and effects could have not been identified at this stage among which certain may have a material impact on net financial debt, equity, assets and liabilities, the 2004 IFRS income and cash-flow statements. These forward-looking statements are based on current expectations, understandings, analysis, forecasts and assumptions that involve risks and uncertainties that could cause actual outcomes and results to differ materially from those projected. These risks and uncertainties include: whether the IFRS standards that will eventually be endorsed by the European Union correspond to those existing as of November 30, 2004 and whether the IFRS standards as adopted will be interpreted by IFRIC and by regulatory bodies in a manner that reflects France Telecom's understanding of the IFRS.

All the changes, effects and figures indicated in this presentation are unaudited

The forward-looking statements contained in this document speak only as of the date of this presentation and France Telecom does not undertake to update any forward-looking statement to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Agenda



Key messages

Equity

Net Debt and Financial result

Income statement

Other impacts

IFRS communication program for 2005

Warning



The purpose of this presentation is to draw a preliminary picture of the various consequences for France Telecom during the transition from French GAAP to IFRS

The forward-looking statements included in this presentation do not reflect all the possible changes due to IFRS but those identified at this stage (Dec. 17th)

The company, through its Investor Relation Department, will be available to comment on some items, but will not discuss IFRS figures/forecasts until IFRS 2004 figures are released mid-April 2005

All figures are preliminary and unaudited

International Financial Reporting Standards at France Telecom: key messages



IFRS are the accounting standards to be implemented by all European listed companies as of January 1st, 2005

France Telecom is on track

A strong “Enterprise Project” started in 2003

- Steering Committee chaired by the CFO
- Dedicated teams in all divisions
- Training program specifically designed

2004 IFRS accounts will be published and presented to the financial community mid-April 2005

International Financial Reporting Standards at France Telecom: key messages



No impact on France Telecom's strategy and business performance

Management decisions are not affected by IFRS transition

No impact on cash-flow

No change on Free Cash Flow commitments for 2003-2005

No impact on return to shareholders potential

Distribution capacity will still be based on parent's company statutory accounts under French GAAP

Main impacts on the IFRS opening balance sheet (January 1st, 2004)

Slight increase in equity

Net Debt increased by cc €6.5 Bn after Equant CVR and minority purchases

Opening balance sheet options



Business combinations	No restatement of business combination accounting as compared to French GAAP (no pooling method accounting was used in FT accounts)
Tangible assets	Historical cost maintained except in very limited circumstances, for which fair value has been used
IAS 32/39 adoption	Implemented as of January 1, 2004 the full version of IAS 32/39 (no use of the carved out version likely to be promulgated in Europe)
Cumulative translation differences	The cumulative translation differences for all foreign operations are deemed to be zero as of January 1, 2004 (reclassification within equity, no impact on total equity)
Employee benefits	All actuarial gains and losses have been reclassified in retained earnings as of January 1, 2004 (as in French GAAP)

Other issues with no impact for France Telecom



Employee benefits

- Pension schemes are not an issue in France and Poland due to the social security regime
- Pension schemes of the group in other countries are defined contribution plans (such as Orange UK) with minor exception of defined benefits plans (however properly funded or provided for).

Scope of consolidation

TP group is fully consolidated, as in French GAAP, since it is controlled

Expected major net impacts on equity ⁽¹⁾



French GAAP equity January 1, 2004

€11.6 Bn⁽²⁾

Reclassification of minority interests

+€5.4 Bn⁽³⁾

TDIRA

+€1.2 Bn

Minority interests commitment

-€0.6 Bn/-€1.2 Bn

Customers' relationship amortization

-€2.5 Bn

Connection fees

-€0.5/1.0 Bn

Overall impact on equity between cc. +€1.5bn and cc. +€2.5bn, including a limited negative impact on goodwill impairment

⁽¹⁾ Deferred tax assets and liabilities will increase with almost no net effect on the total equity (and no effect on prospective cash in/cash out).

⁽²⁾ Including post-employment benefits and Tele-Invests consolidation (« Kulczyk put »)

⁽³⁾ Including Tele-Invests consolidation (« Kulczyk put ») and out of which €1.4 Bn relates to Wanadoo and should thus not remain as of December 31, 2004 after Wanadoo squeeze-out.

Expected Impact on net debt



French GAAP Net debt ⁽¹⁾ January 1, 2004

€47.7 Bn⁽²⁾

TDIRA

€4.1 Bn

Carry back

€1.5 Bn

Equant CVR

€2.0 Bn

Derivatives and associated cash collateral

-€0.8 Bn

Accrued interests

€1.3 Bn

Minority interests commitments

€0.6/1.2 Bn

Of which minority purchases including Orange squeeze-out

€0.6 Bn

IFRS Net debt⁽¹⁾ January 1, 2004

cc.€ 57 Bn

***Remaining negative impact expected cc. € 6.5 Bn
after Equant CVR and minority purchases***

(1) See definition in appendix.

(2) Including securitization and Tele-Invests consolidation (« Kulczyk put »).

Expected Impact on net debt: TDIRA (IAS 32)



French GAAP



IAS/IFRS

- Perpetual bonds redeemable for France Telecom shares are classified in a quasi-equity caption in the balance sheet
- Interest charge is based on the contractual arrangement

- Breakdown between an equity component and a liability component
- Interest charge is computed based on the effective interest rate

Impact on the 2004 IFRS opening balance sheet

- Debt component cc. 3/4 of the nominal value
- Equity component cc.1/4 of the nominal value (subject to deferred tax liability)

Impact on future IFRS financial statements

- *Increased interest charge during the TDIRA fixed interest rate period*
- *Additional interest charges increase the debt amount*

Already priced in by the market

Expected Impact on net debt: Carry back (IAS 32 / IAS 18)



French GAAP	IAS/IFRS
→ The carry back receivable sale is accounted for as a true sale with an usual guarantee (Note 28.2.2 of FT financial statements)	→ Carry-back receivable sale with a guarantee is considered as a secured financing

Impact on the 2004 IFRS opening balance sheet

→ Additional financial debt and carry-back receivable of cc. €1.5 Bn (present value)

Impact on future IFRS financial statements

- *Notional interest charge (no cash out since interest were prepaid at the time the receivable was sold)*
- *Carry back receivable and financing mature in 2007 (net debt reduction), no cash impact*

No future cash out

Expected Impact on net debt: Equant CVR (IAS 39)



French GAAP	IAS/IFRS
→ Equant CVR is accounted for as a provision for risk and contingencies	→ Equant CVR is a derivative instrument → As a derivative instrument: → Any change in the value is recorded through income statement → It is included in the Net Debt

Impact on the 2004 IFRS opening balance sheet
→ Reclassification from provision for risk and contingencies to derivative included in Net Debt

<i>Impact on future IFRS financial statements</i>
→ <i>Impact on IFRS income < €0.1 Bn due to change in fair value between January 1, 2004 and payment in July 2004</i> → <i>Classified as a derivative (included in Net Debt) in the IFRS opening balance sheet, until final settlement in July 2004</i>

Paid on July 8th, 2004

Expected Impact on net debt: derivatives and associated cash collateral (IAS 39)



French GAAP	IAS/IFRS
<p>→ Hedging instruments are presented off balance sheet</p> <ul style="list-style-type: none"> → except currency hedging instruments since French GAAP debt is converted at the hedging rate (debt at hedging rate = debt at closing rate + hedging instrument) 	<p>→ Debt is converted at the closing rate</p> <p>→ Derivatives are accounted for at fair value in the balance sheet</p> <p>→ Changes in the fair value of derivatives are recorded through income statement (except for cash flow hedge accounting)</p>

Impact on the 2004 IFRS opening balance sheet	
→ IFRS Net debt lower by €0.8 Bn	
→ Closing rate conversion instead of hedging rate	-€1.3 Bn
→ Currency and interest rates derivatives evidenced in the balance sheet	+€1.4 Bn
→ Prepayment of derivatives constituted by the cash collateral	-€ 0.9 Bn

Impact on future IFRS financial statements
<p>→ Increased volatility (income statement, shareholders' equity)</p> <ul style="list-style-type: none"> • Expected to be limited since major interest rates derivatives follow the IFRS documentation requirements for hedge accounting qualification

Cash collateral to be included in IFRS Net Debt

Expected Impact on net debt: minority interests commitments (IAS27/IAS32)



French GAAP



IAS/IFRS

→ Minority interests commitments are off balance sheet commitments unless there is a risk of an outflow of resources with no symmetrical economic benefits

→ When minority have a right to sell shares and the entity has obligation to buy these shares, the entity should record a financial liability (present value of the exercise price) and reduce equity for the same amount (no corresponding asset)

• Purchase offers made to minority shareholders enter in this category

Impact on the 2004 IFRS opening balance sheet

→ Total impact for conditional and unconditional put options cc. €0.6/1.2 Bn:

→ Purchase of minority interests as of 1 January 2004: Orange SA, Orange Danemark, Orange Romania: cc. €0.6 Bn

→ Conditional put: Orange Slovensko, Orange Dominicana: cc. €0/0.6 Bn

Impact on future IFRS financial statements

→ Changes in the present value of the put option is recorded through income statement

• Limited impact for purchase of minority interests since they are paid for during 2004
• Potential impact for conditional puts

cc. €0.6/1.2 Bn on debt, of which cc. €0.6 Bn already paid

Income statement: revenue recognition sales of equipment through dealers (IAS 18)



French GAAP	IAS/IFRS
<ul style="list-style-type: none">→ French GAAP accounting based on the contractual relationship and financial flows between FT and the dealers→ handset sales in direct and indirect channels are accounted for differently	<ul style="list-style-type: none">→ Equipment revenue based on the selling price to the end customer→ Distribution remuneration based on the net payment to dealer<ul style="list-style-type: none">→ handset sales in direct and indirect channels are accounted for in the same way

Impact on the 2004 IFRS opening balance sheet

→ No material impact expected

Impact on future IFRS financial statements

→ No impact on net income

→ But impact on revenue presentation (lower handsets sales and lower selling expenses)

• Impact: cc. €0.4 Bn in 2004

No impact on future cash flows – Positive impact on margin ratio

Income statement: revenue recognition connection fees (IAS 18)



French GAAP



IAS/IFRS

→ Generally FT recognises connection fees when connection is effective

→ No specific guidance under IFRS
→ FT decided to have no difference between IFRS and US Gaap accounting on revenue recognition for connection fees
→ Connection fees will be deferred over the average expected customer relationship period
→ Related costs that do not meet the capitalization criteria will be expensed up-front

Impact on the 2004 IFRS opening balance sheet

→ Impact of € -0.5/-1.0 Bn on equity

Impact on future IFRS financial statements

→ *Limited impact expected on revenue stream and net income*

• will reflect connection activity trend and changes in the expected customer relationship period

No impact on Cash Flows

Income statement: amortization of customer relationships (IAS 38)



French GAAP



IAS/IFRS

- Customer relationships accounted for in case of business combinations
- No amortization and no deferred tax

- Deferred tax liability
- Customer relationships amortized over the expected contractual relationship (between 4 and 5 years in most cases)

Impact on the 2004 IFRS opening balance sheet

- Retrospective amortization charge lead to a decrease in total equity of €2.5 Bn

Impact on future IFRS financial statements

- **Decrease in EBIT as long as customer relationships not fully amortized**
 - Negative impact of more than €0.3 Bn for H1 2004
 - Impact should reduce in 2005 and subsequent years

No impact on future cash flows – Negative impact on EBIT

Income statement: share-based compensation (IFRS 2)



French GAAP



IAS/IFRS

- Stock options granted in certain subsidiaries (Orange, Wanadoo, Equant)
- No impact on the accounts until the stock option is exercised
- No compensation expense accounted for (labor OpEx)

- The fair value of stock options is amortized over the vesting period as a compensation expense
- France Telecom position is to apply IFRS 2 to all stock options plans (vs. the option to apply IFRS to plan granted after November 7, 2002)
- Discount offer of shares to employees should be also accounted for as compensation expenses

Impact on the 2004 IFRS opening balance sheet

- A reclassification in subcaptions of equity of € 0.5 Bn will be accounted for
 - Shows the cumulative effect of stock options granted in the past
- No impact on total equity (but reclassification from equity to compensation liability as of March 9, 2004)

Impact on future IFRS financial statements

- The compensation expense relating to stock options for 2004 is not expected to exceed €0.1 Bn
- Discount offers under review
- New plans, if any, could lead to a different impact in the future

Same cash impact as in French GAAP

IFRS impact on income statement: other impacts



SAC's and SRC's

- No difference with French Gaap accounting
- SAC's and SRC's are expensed as incurred

R&D

- Expensed as incurred under French GAAP
- Under IFRS, development costs meeting certain criteria should be capitalized

Goodwill amortization

- Under French GAAP: amortization + impairment testing
- Under IFRS: impairment testing only

Interest capitalization

- Under French GAAP, interest expenses are capitalised on tangible assets in progress
- Under IFRS, FT has chosen not to capitalise interests

IFRS communication program for 2005



Mid February 2005

2004 results in French GAAP

Mid April 2005

Preliminary IFRS 2004 results

End of April 2005

IFRS 1Q revenues

End of July 2005

1H 2005 preliminary results

End of September 2005

1H 2005 final results

Conclusion



No impact on Company strategy
and business performance



Appendix

Financial Statement

IFRS Income Statement

- Presentation by nature
- No more exceptional income



French GAAP

Sales of Services and Products
Cost of services and products sold
Selling, general and administrative expenses
Research and Development expenses
EBITDA
Depreciation and amortization
Amortization of actuarial adjustments in the early retirement plan
Operating income
Interest expenses, net
TDIRA interest expenses
Foreign exchange gain (loss)
Discounting of early retirement plan
Current Income from Integrated companies
Other non operating income/expenses, net
Income taxes
Employees profit sharing
Net Income from Integrated Companies
Equity in net income of affiliates
Goodwill Amortization
Exceptional Goodwill amortization
Net Income (loss) of the consolidated group

IFRS (preliminary)

Revenues
Other operating income
Personnel costs
External purchases
Others operating expenses
EBITDA
Amortization
Impairment of assets
Impairment of goodwill
Disposal of assets
Restructuring costs
Share of the P&L of associates and JV accounted under equity
Impairment of goodwill of affiliates
Operating income
Financial income
Interest expenses
Foreign exchange gain (loss)
Sale/depreciation of financial assets
Discounting
Financial costs
Income taxes
Profit (loss) for the period
Attributed to
Equity holders of the Parent
Minority interest



Definition of Net Debt



French GAAP



IAS/IFRS

Net debt is defined in Note 8 to the financial statements as:

- Total gross borrowing (converted at hedging rate)
- Cash, cash equivalents and marketable securities

Net debt will be defined as:

- Total gross borrowing (converted at closing rate)
- Asset derivatives
- Asset cash collateral
- + Liability derivatives
- + Liability cash collateral
- Cash, cash equivalents and marketable securities
- + Accrued interests