IFRS 16 applied to Orange
IFRS 16
A new standard for lease contracts

1st January 2019
Application date
Applied prospectively, with no prior period restatement
No change on lessor side
1st financial communication: Q1 2019

Regulators objectives:
- Integrating all the lease commitments on the balance sheet
- Improving transparency and comparability between companies

Major areas of impacts on Orange:
- Real Estate
- Network
Section one

Accounting impacts
Accounting concept: a refined lease definition

This new standard changes the accounting for leases in the lessee financial statements by replacing the current dual accounting model (finance lease agreements on the balance sheet and operating leases off-balance sheet) by a single model, on balance sheet accounting, for both finance and operating leases.

- **Finance leases**: No change

- **Operating leases**: change *

- **Service agreement relying on an identified asset**: potential change *

* Refer to slide 8 for scope of application
**Impact on Balance sheet: “Pull Up”**

**Before**

No asset nor liability recognized

Off balance sheet commitments only for operating lease

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**Illustrative example:**
Orange signed on 1 January 2019 a commercial lease to rent a shop for a period of 15 years for an annual rent of 300 K € (year end annual payment). The applicable interest rate is 3%.

**Now**

Accounting of a right of use (ROU) asset

Recognition of a debt for the NPV of the future lease payments

* Finance leases: no change

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**One single lease accounting model:** Recognition of a right of use asset and lease liability (representing at contract inception the present value of future lease payments)

**Assets**

<table>
<thead>
<tr>
<th>2019</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goodwill</td>
<td>Share capital</td>
</tr>
<tr>
<td>Other Intangible assets</td>
<td>…</td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td>Total equity</td>
</tr>
<tr>
<td>Right of use assets</td>
<td>Non-current financial liabilities</td>
</tr>
<tr>
<td>Interests in associates and joint ventures</td>
<td>Non-current lease liabilities</td>
</tr>
<tr>
<td>Total non-current assets</td>
<td>3388</td>
</tr>
<tr>
<td>Inventories</td>
<td>Non-current derivatives liabilities</td>
</tr>
<tr>
<td>Trade receivables</td>
<td>…</td>
</tr>
<tr>
<td>Total current assets</td>
<td>Total non-current liabilities</td>
</tr>
<tr>
<td>TOTAL ASSETS</td>
<td>Current financial liabilities</td>
</tr>
</tbody>
</table>

The lease asset and liability calculated and accounted as of January 1st 2019 will be:

$$3,581 \text{ K€} = \sum_{n=1}^{15} \frac{(300)}{(1+3\%)^n}$$
Illustrative example: Orange signed on 1 January 2019 a commercial lease to rent a shop for a period of 15 years for an annual rent of 300 K € (year end annual payment). The applicable interest rate: 3%.

IAS 17
Rent charges are booked above EBITDA
Opex will be replaced by an amortisation of the right of use and an interest expense for the actualization impact.

- Amortization of the right of use € 239K: € 3,581K / 15 years
- Interest expense on the first year: € 107K: € 3,581K * 3% (this interest expense will decrease over the years as the capital portion is repaid)
Impact on Cash Flows: None but a disconnect of cash flows with the P&L

Illustrative example:
Orange signed on 1 January 2019 a commercial lease to rent a shop for a period of 15 years for an annual rent of 300 K€ (year end annual payment). The applicable interest rate: 3%.

- Cash flows are the same under IFRS 16 as under IAS 17
- Over the contract period, the cumulated impact on net result is the same under both standards. A temporary difference will come from the decreasing interest expenses.

Before / Now

<table>
<thead>
<tr>
<th>No change in net cash flows</th>
</tr>
</thead>
<tbody>
<tr>
<td>No change on net result, over the contract period, but a phasing effect</td>
</tr>
</tbody>
</table>

Cash out

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Year 6</th>
<th>Year 7</th>
<th>Year 8</th>
<th>Year 9</th>
<th>Year 10</th>
<th>Year 11</th>
<th>Year 12</th>
<th>Year 13</th>
<th>Year 14</th>
<th>Year 15</th>
</tr>
</thead>
<tbody>
<tr>
<td>-300 K€</td>
<td>-300 K€</td>
<td>-300 K€</td>
<td>...</td>
<td>-300 K€</td>
<td>-300 K€</td>
<td>-300 K€</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

Total cash out:
4 500 K€

Right of use amortisation

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Year 6</th>
<th>Year 7</th>
<th>Year 8</th>
<th>Year 9</th>
<th>Year 10</th>
<th>Year 11</th>
<th>Year 12</th>
<th>Year 13</th>
<th>Year 14</th>
<th>Year 15</th>
</tr>
</thead>
<tbody>
<tr>
<td>-239 K€</td>
<td>-239 K€</td>
<td>-239 K€</td>
<td>...</td>
<td>-239 K€</td>
<td>-239 K€</td>
<td>-239 K€</td>
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</tr>
</tbody>
</table>

Total in P&L:
4 500 K€

Interest charge

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Year 6</th>
<th>Year 7</th>
<th>Year 8</th>
<th>Year 9</th>
<th>Year 10</th>
<th>Year 11</th>
<th>Year 12</th>
<th>Year 13</th>
<th>Year 14</th>
<th>Year 15</th>
</tr>
</thead>
<tbody>
<tr>
<td>-107 K€</td>
<td>-102 K€</td>
<td>-96 K€</td>
<td>...</td>
<td>-26 K€</td>
<td>-17 K€</td>
<td>-9 K€</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>-346 K€</td>
<td>-341 K€</td>
<td>-335 K€</td>
<td>...</td>
<td>-264 K€</td>
<td>-256 K€</td>
<td>-248 K€</td>
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<td></td>
</tr>
</tbody>
</table>

In FY 19, net result lower under IFRS 16 than under IAS 17, with a reversal over the contract period
A change applied to several categories of assets

- **Real Estate**
  - Office buildings / Technical buildings / Points of sale
  - Lands to install pylons / Mobile sites / Mobile site agreement with a third party (Towerco)
- **Mobile Network**
  - Local loop unbundling / Land to install technical equipment
- **Fixed Network**
  - Technical cars and engines / Employees’ cars
- **General Expenses**
- **Other**
  - Routers / Datacenters

**IFRS 16 Scope**
The valuation of the ROU and the lease liability depends on 3 parameters

Lease liability and right of use will depend on 3 estimated inputs, and on the maturity of lease contracts at the transition date…

…thus leading to potential differences with our peers (see example in next slide).
Assumptions made by the Group are key as they have a direct impact on lease valuation.

Example: Impact of the contract duration retained for a rent contract for a shop with a payment of 3 M€ per year.

Contract duration of 3 years with an interest rate of 2%:

- **Balance sheet**
  - **At inception**
    - Assets: 8,7 M€
    - Liabilities: 8,7 M€

- **P&L**
  - **Y1**: 2,9 M€
  - **Y2**: 2,9 M€
  - **Y3**: 2,9 M€
  - **ROU Amortization**: 0,2 M€
  - **Lease interest expense**: 0,06 M€

Contract duration of 9 years with an interest rate of 2%:

- **Balance sheet**
  - **At inception**
    - Assets: 24,5 M€
    - Liabilities: 24,5 M€

- **P&L**
  - **Y1**: 2,7 M€
  - **Y4**: 2,7 M€
  - **Y9**: 2,7 M€
  - **ROU Amortization**: 0,5 M€
  - **Lease interest expense**: 0,06 M€
Section two
A new perspective for our KPIs
An addition to the B/S with necessary insertions of new assets and a “pull-up” move…

Before (IAS 17):
- No BS impact from operating leases
- Off-BS commitments in the notes

Now (IFRS 16):
- All leases on the BS
- ROU asset, and lease liability
...and a change in the Profit & Loss structure that caused adj. EBITDA to be replaced by EBITDAaL...

**Before (IAS17):**
- adj. EBITDA impacted by operating lease

**IFRS 16:**
- adj. EBITDA no longer impacted by operating leases

**IFRS 16 new indicator:**
- EBITDAaL impacted by ALL lease categories
...with EBITDAaL similar (not equal) to adj. EBITDA...

Old EBITDA under IAS17

Revenue

-Other Opex

-Operating lease* Opex

Adj. EBITDA

-Amort. – fin. Leases**

-Interest exp.- fin. Lease**

EBITDAaL similar (not equal) to adj. EBITDA...

New EBITDAaL under IFRS 16

Revenue

-Other Opex

-ROU amort. (Op. Leases*)

-Interest exp. (Op Leases*)

Actualisation impact

recategorisation

-ROU amort. – fin. Leases**

-Interest exp.- fin. Lease**

EBITDAaL

*Operating lease under IAS17 definition

**Finance lease under IAS17 definition
The IFRS 16 lease liability relates to operational items and not to financing transactions: **we will exclude them from net debt.**

Under IFRS 16, **finance and operating leases will be treated the same**

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1st consequence: we exclude the IFRS 16 finance lease liabilities from the net debt indicator.

2nd consequence: Net debt / adjusted EBITDA ratio consistency is maintained as EBITDAaL includes the impact from IFRS 16 finance lease.
Since the implementation of IFRS 15, we have adapted our indicators with a view to keep monitoring our operations in a relevant manner from a *cash and business perspective*.

Regarding Capex, the challenge now is to monitor *asset rotation related to the Fiber business model*.

**Illustrative example:** Orange invests 100 for the Fiber cable from the building connecting point to the client’s premises on year 1. The client churns on year 2, and Orange has to resell this asset. On year 3, Orange wins back the client and has to repay for the asset.

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Total Investment?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash out</td>
<td>Cash in</td>
<td>Cash out</td>
<td></td>
</tr>
<tr>
<td>CAPEX (Current definition)</td>
<td>-100</td>
<td>0</td>
<td>-80</td>
</tr>
<tr>
<td>Cash flows</td>
<td>-100</td>
<td>+90</td>
<td>-80</td>
</tr>
</tbody>
</table>

In a context of asset rotation, **the current definition of Capex no longer reflects the real investment amount**. We have decided to **clear the investment indicator from the proceeds from asset sales** and use a refined indicator: **economic Capex** or **eCapex**.

<table>
<thead>
<tr>
<th>Year 1</th>
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<tbody>
<tr>
<td>Cash out</td>
<td>Cash in</td>
<td>Cash out</td>
<td></td>
</tr>
<tr>
<td>eCAPEX*</td>
<td>-100</td>
<td>+90</td>
<td>-80</td>
</tr>
</tbody>
</table>

* *economic CAPEX*
To keep our Operating Cash Flow indicator (EBITDA<sub>aL</sub> – eCapex*) consistent, as we include the proceeds from sales of assets in our investment indicator, we will exclude the gains and losses from sales of assets from EBITDA<sub>aL</sub>:

**Step 1**
- Adjusted EBITDA excludes
- Opex from Operating lease** includes
- ROU amort. and interest exp. (operating lease** + finance lease***)

**Step 2**
- Excludes Gain/ Loss from sales of assets
- Includes Proceeds from sales of assets

EBITDA<sub>aL</sub> = eCapex*

**Note:**
- *economic CAPEX
- **Operating lease under IAS17 definition
- ***Finance lease under IAS17 definition
Section three

Communication time schedule
Analyst presentation
• IFRS 16 impacts and a new set of KPIs

2018 Full Year results release under IAS 17, and new guidance under IFRS 16
• A range of IFRS 16 opening balance impacts estimates will be disclosed in the notes
• Guidance provided within IFRS 16 with the new indicators

Q1 19 consensus
• Provision of a management FY 18 and Q1 18 non audited comparable basis

Q1 2019 results release under IFRS 16
• First quarterly results under IFRS 16,
• With no Q1 2018 restated accounts, but a management comparative basis in the KPI book
• Results non audited
In a nutshell...

**IFRS 16 accounting impacts**

- BS pull-up
- P&L push-down

No impact on cash

Orange indicators adaptation

- Adjusted EBITDA replaced by EBITDAaL => All leases included
- Finance leases excluded from Net Debt => Net Debt/ EBITDAaL ratio consistent

- Actualization => negative impact on FY19 P&L, reversed over contract period

- Capex becomes eCapex => adapt to asset rotation => Closer to cash
Questions & Answers