

# IFRS 16 applied to Orange



**Orange Group**  
Investor relations

6<sup>th</sup> February 2019



# 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

1<sup>st</sup> financial

<sup>2</sup> 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** \*

# Impact on Balance sheet : “Pull Up”

## Before\*

No asset nor liability recognized

Off balance sheet commitments only for operating lease

## Now\*

Accounting of a right of use (ROU) asset

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

### 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%.

### IAS 17

Nothing on the balance sheet  
Estimates in the off balance sheet commitment note

**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)

	2019
<b>Assets</b>	
Goodwill	
Other Intangible assets	
Property, plant and equipment	
Right of use assets	3581
Interests in associates and joint ventures	
....	
<b>Total non-current assets</b>	
Inventories	
Trade receivables	
.....	
<b>Total current assets</b>	
<b>TOTAL ASSETS</b>	

	2019
<b>Liabilities</b>	
Share capital	
...	
<b>Total equity</b>	
Non-current financial liabilities	
Non-current lease liabilities	3388
Non-current derivatives liabilities	
...	
<b>Total non-current liabilities</b>	
Current financial liabilities	
Current lease liabilities	193
...	
<b>Total current liabilities</b>	
<b>TOTAL EQUITY and LIABILITIES</b>	

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

$$3,581 \text{ K€} = \sum_{n=1}^{15} \frac{(300)}{(1+3\%)^n}$$

IFRS 16

\* Finance leases : no change

# Impact on Profit & Loss : “Push Down”

**Before\***

**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.**

**Operating expense**

**Above EBITDA**

**Now\***

**ROU amortization,**

**Interest expense**

**Below EBITDA**

	2019
<b>Revenues</b>	
External purchases	<del>300</del>
Other operating income	
Other operating expense	
Labour expenses	
Operating taxes and levies	
<b>EBITDA</b>	
Depreciation and amortization	239
....	
<b>EBIT</b>	
Cost of gross financial debt	
Lease interest expense	107
....	
<b>Finance costs, net</b>	
Income tax	
<b>Consolidated net income after tax</b>	

- 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)

**IFRS 16**

\* Finance leases : no change

# Impact on Cash Flows : None

## but a disconnect of cash flows with the P&L

**Before /  
Now**

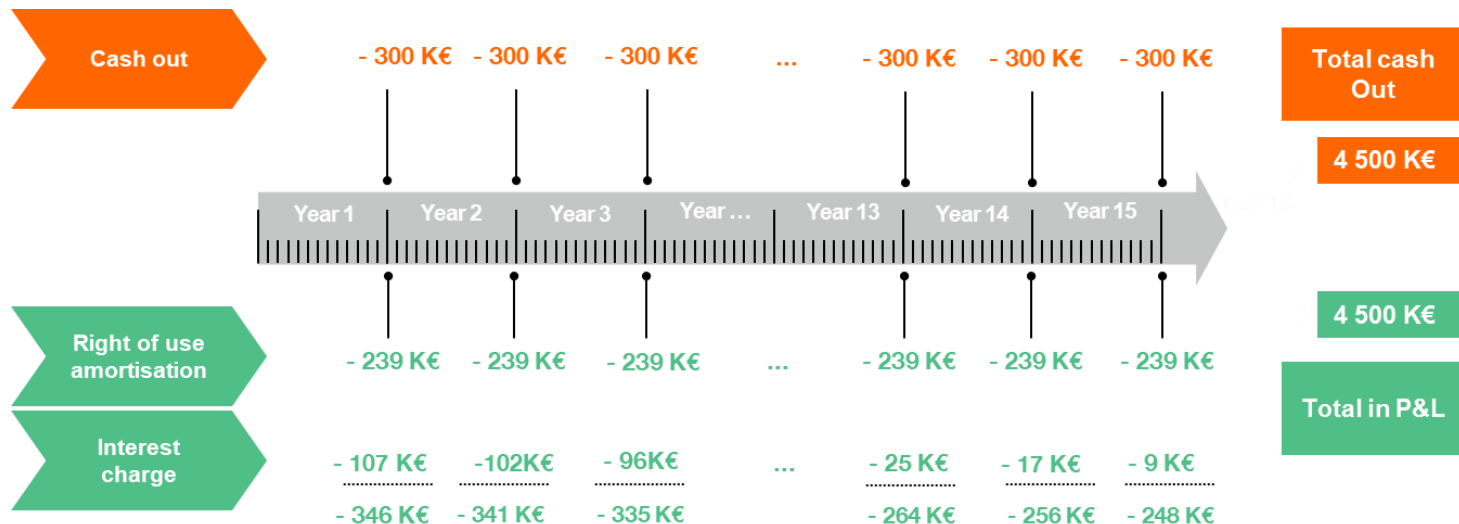
**No change in net  
cash flows**

**No change on net  
result, over the  
contract period,  
but a phasing  
effect**

### Illustrative example:

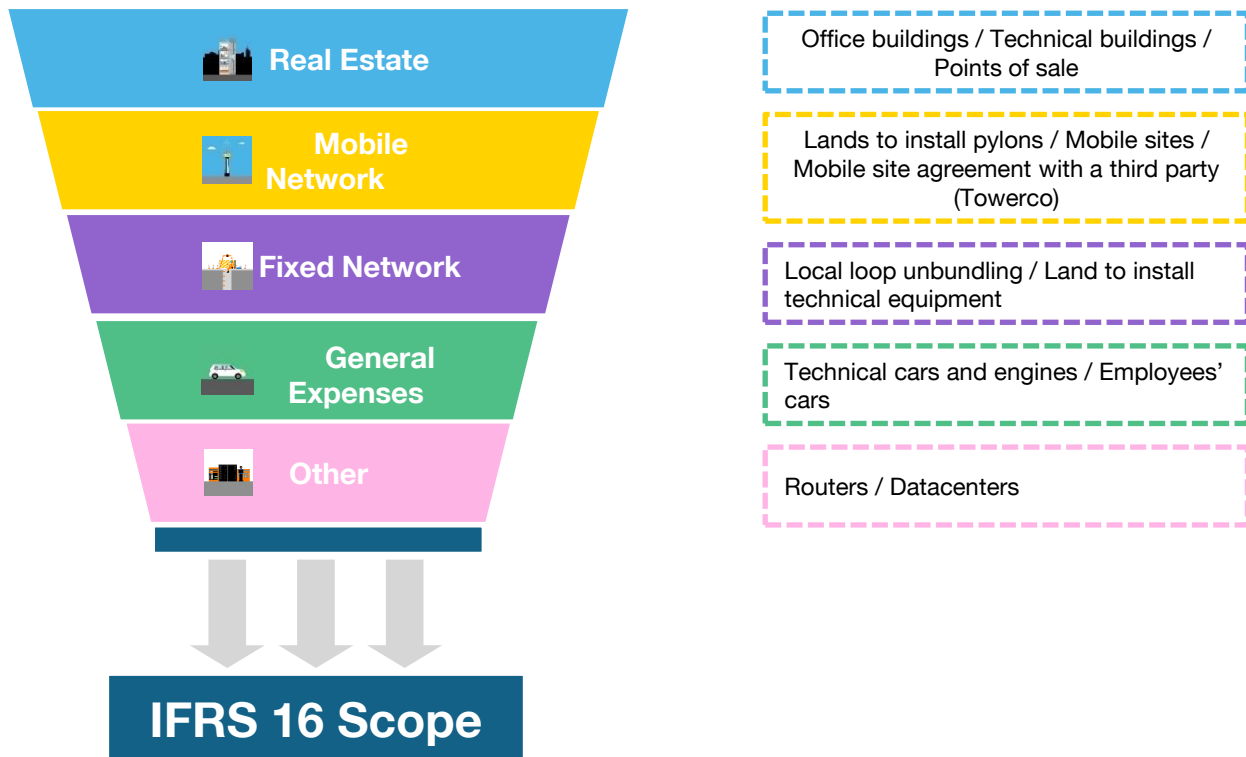
Orange signed on 1 January 2019 a commercial lease to rent a shop for a period of 15 years for an annual rent of 300 K € (year end annual payment). The applicable interest rate: 3%.

- 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.



**In FY 19, net result lower under IFRS 16 than under IAS17, with a reversal over the contract period**

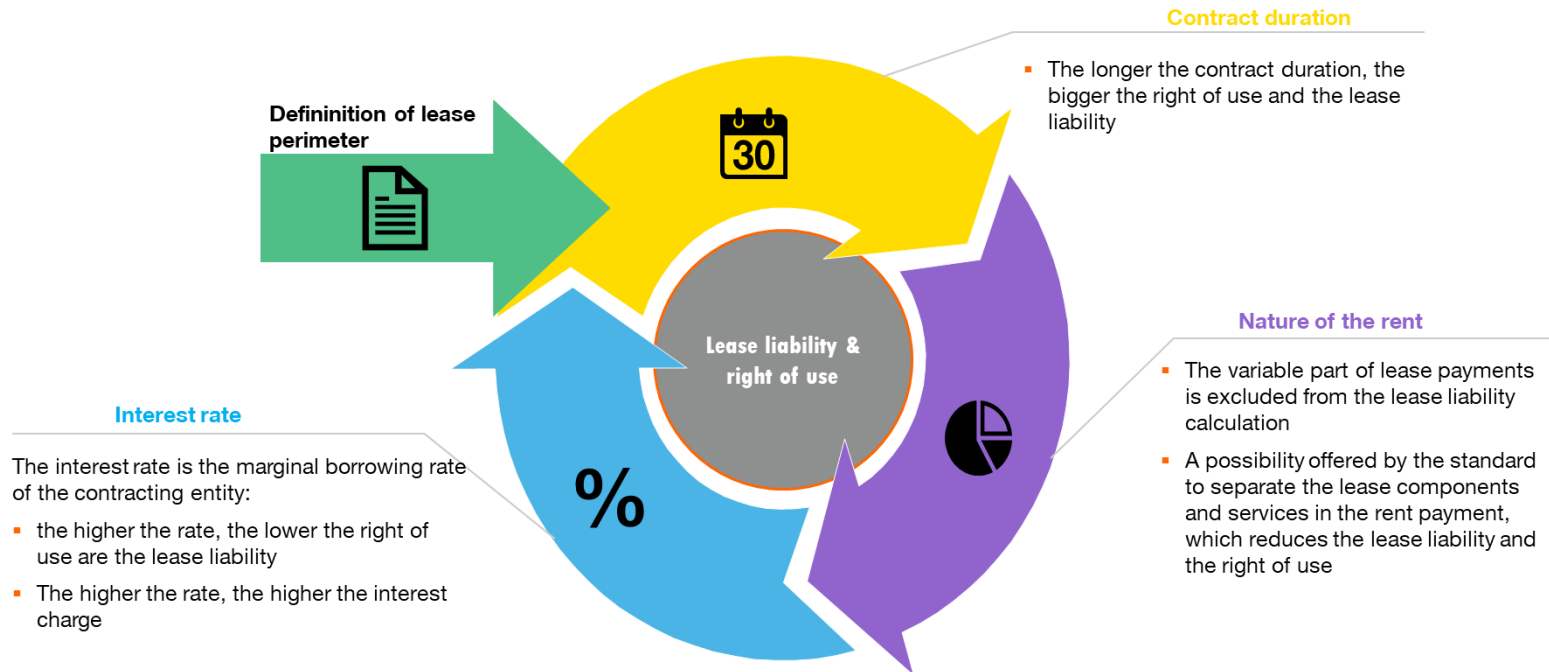
# A change applied to several categories of assets





# 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%

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

## Balance sheet

At inception

8,7 M€

Assets

8,7 M€

Liabilities

At inception

24,5 M€

Assets

24,5 M€

Liabilities

## P&L

0,2 M€

2,9 M€

Y1

0,1 M€

2,9 M€

Y2

0,06 M€

2,9 M€

Y3

0,5 M€

2,7 M€

Y1

0,3 M€

2,7 M€

Y4

0,06 M€

2,7 M€

Y9

# 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...

	2019
<b>Assets</b>	
Goodwill	
Property, plant and equipment	
<b>Total non-current assets</b>	
.....	
<b>Total current assets</b>	
<b>TOTAL ASSETS</b>	

	2019
<b>Liabilities</b>	
...	
<b>Total equity</b>	
Non-current financial liabilities	
...	
<b>Total non-current liabilities</b>	
Current financial liabilities	
...	
<b>Total current liability</b>	
<b>TOTAL EQUITY and LIABILITIES</b>	

**Before (IAS 17) :**

- No BS impact from operating leases
- Off-BS commitments in the notes

	2019
<b>Assets</b>	
Goodwill	
Property, plant and equipment	
<b>Right of use assets</b>	
<b>Total non-current assets</b>	
.....	
<b>Total current assets</b>	
<b>TOTAL ASSETS</b>	

	2019
<b>Liabilities</b>	
...	
<b>Total equity</b>	
Non-current financial liabilities	
<b>Non-current lease liabilities</b>	
...	
<b>Total non-current liabilities</b>	
Current financial liabilities	
<b>Current lease liabilities</b>	
...	
<b>Total current liabilities</b>	
<b>TOTAL EQUITY and LIABILITIES</b>	

**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

### Revenues

External purchases

...

**adj. EBITDA**

Depreciation and amortization

....

### EBIT

Cost of gross financial debt

....

**Finance costs, net**

Income tax

**Consolidated net income after tax**

## IFRS 16 :

adj. EBITDA no longer impacted by operating leases

### Revenues

External purchases

...

**adj. EBITDA**

Depreciation and amortization

....

### EBIT

Cost of gross financial debt

....

**Lease interest expense**

....

**Finance costs, net**

Income tax

**Consolidated net income after tax**

## IFRS 16 new indicator :

EBITDAaL impacted by ALL lease categories

### Revenues

External purchases

...

ROU amortization

Lease interest expense

**EBITDAaL**

Depreciation and amortization

....

### EBIT

Cost of gross financial debt

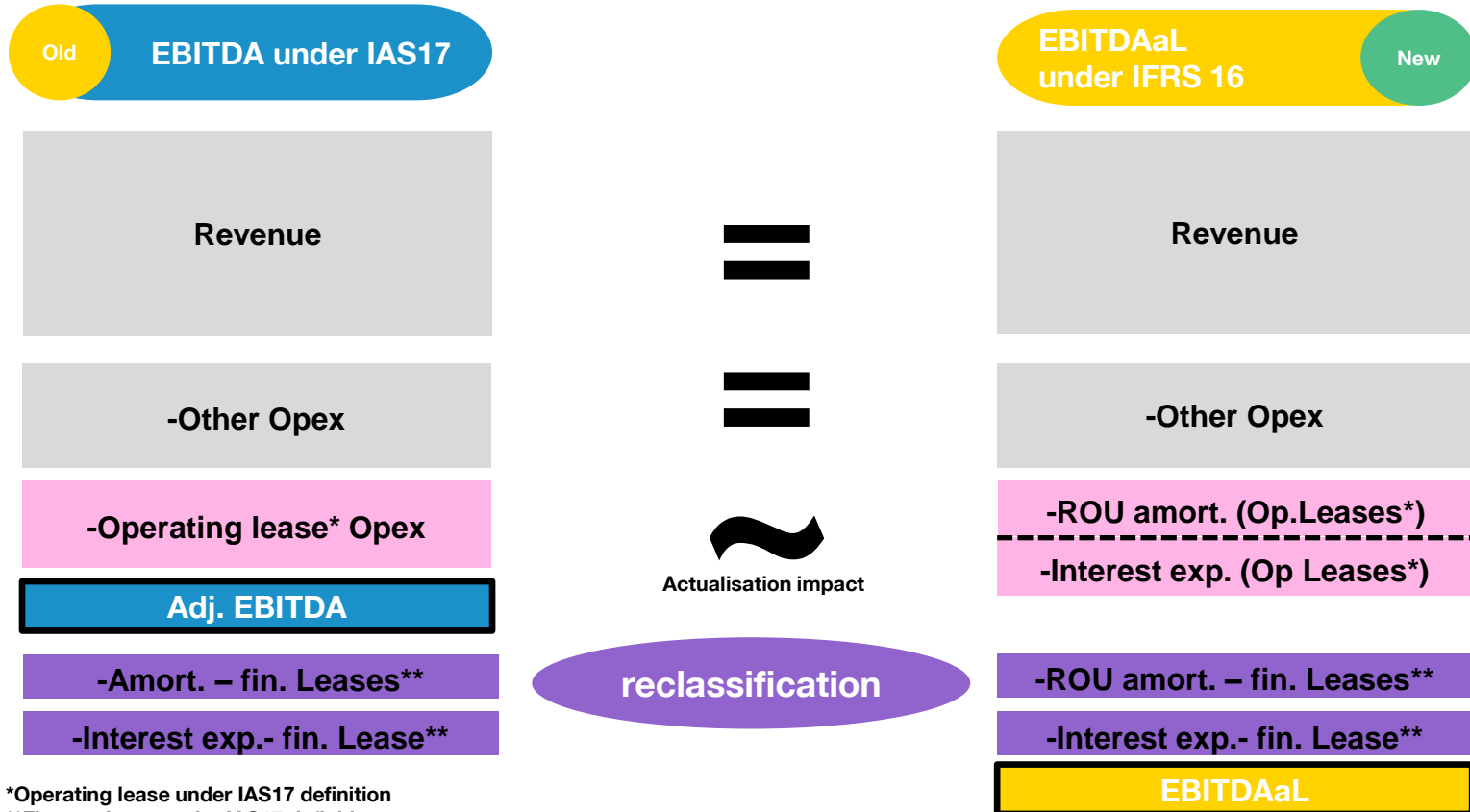
....

**Finance costs, net**

Income tax

**Consolidated net income after tax**

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

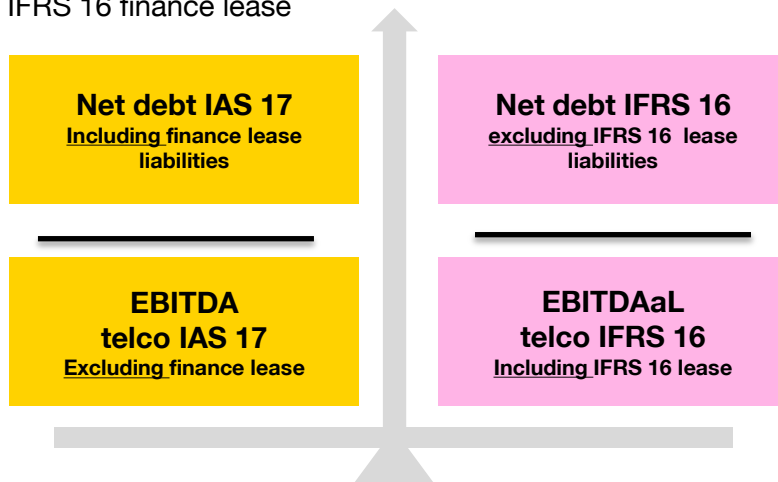


# ...with the adaptation of the Net Debt definition to keep the Net Debt ratio consistent...

- 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**

↳ **1<sup>st</sup> consequence:** we exclude the IFRS 16 finance lease liabilities from the net debt indicator

↳ **2<sup>nd</sup> consequence:** Net debt / adjusted EBITDA ratio consistency is maintained as EBITDAaL includes the impact from IFRS 16 finance lease



# ...with an investment indicator consistent with asset rotation and closer to cash : eCapex\*...



- 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.

	Year 1 Cash out	Year 2 Cash in	Year 3 Cash out	Total Investment ?
<b>CAPEX</b> <i>Current definition</i>	-100	0	-80	-180
<b>Cash flows</b>	-100	+90	-80	-90



↳ 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\***

	Year 1 Cash out	Year 2 Cash in	Year 3 Cash out	Total Investment
<b>eCAPEX*</b>	-100	+90	-80	-90





# ...that triggers a 2<sup>nd</sup> adjustment to EBITDAaL for operating cash measurement consistency

## Before

Adjusted EBITDA includes gain/loss from asset sales

Capex excludes proceeds from asset sales effect

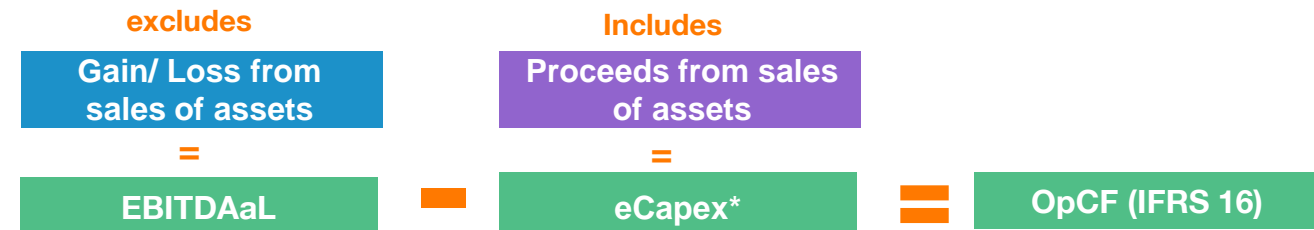


To keep our **Operating Cash Flow indicator (EBITDAaL – eCapex\*) consistent**, as we include the proceeds from sales of assets in our **investment indicator**, we will exclude the gains and losses from sales of assets from **EBITDAaL**:

**Step 1**  
(refer to slide 14)



**Step 2**



## Now

EBITDAaL excludes gain/loss from asset sales

eCapex\* adjusted from proceeds from asset sales

\*economic CAPEX

\*\*Operating lease under IAS17 definition

\*\*\*Finance lease under IAS17 definition

# Section three

## Communication time schedule

6<sup>th</sup> February  
2019

### Analyst presentation

- IFRS 16 impacts and a new set of KPIs

21<sup>st</sup> February  
2019

### 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

April 2019

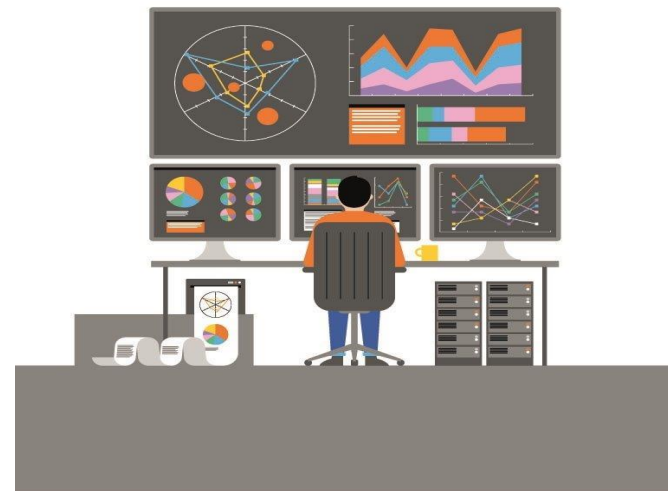
### Q1 19 consensus

- Provision of a management FY 18 and Q1 18 non audited comparable basis

30<sup>th</sup> April 2019

### 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



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

## Orange indicators adaptation



Adjusted EBITDA  
replaced by EBITDAaL  
=> All leases included



Finance leases excluded  
from Net Debt  
=> Net Debt/ EBITDAaL  
ratio consistent



Capex becomes eCapex  
=> adapt to asset rotation  
=> Closer to cash

# Questions & Answers

