BELLSOUTH®

2005 Annual Report

This is not a phone line...

Financial Highlights
BellSouth Corporation

at or for the year ended December 31, dollars in millions, except per share data	2003	2004	2005
Reported Operating Revenues	$ 20,341	$ 20,300	**$ 20,547**
Plus 40% of Cingular Wireless Revenues [(1)]	$ 6,060	$ 7,611	**$ 13,484**
Plus Other Revenue Adjustments [(2)]		$ 50	**$ (47)**
Normalized Operating Revenues	$ 26,401	$ 27,961	**$ 33,984**
Net Income from Continuing Operations	$ 3,488	$ 3,394	**$ 2,913**
Net Income	$ 3,904	$ 4,758	**$ 3,294**
Diluted Earnings Per Share from Continuing Operations	$ 1.88	$ 1.85	**$ 1.59**
Diluted Earnings Per Share	$ 2.11	$ 2.59	**$ 1.80**
Normalized Diluted Earnings Per Share [(3)]	$ 1.95	$ 1.87	**$ 2.00**
Weighted Average Shares Outstanding	1,852	1,836	**1,829**
Declared Dividends Per Share	$ 0.92	$ 1.06	**$ 1.14**
Total Assets	$ 49,622	$ 59,339	**$ 56,553**
Capital Expenditures	$ 2,926	$ 3,193	**$ 3,457**
Total Debt	$ 14,980	$ 20,583	**$ 17,188**
DSL Customers (000)	1,462	2,096	**2,882**
Long Distance Customers (000)	3,960	6,015	**7,179**
Access Lines (000)	22,263	21,356	**20,037**
Employees	75,743	62,564	**63,066**
Closing Stock Price	$ 28.30	$ 27.79	**$ 27.10**
Cingular Wireless: [(4)]			
Operating Revenues	$ 15,577	$ 19,565	**$ 34,433**
Net Income	$ 977	$ 201	**$ 333**
Capital Expenditures	$ 2,734	$ 3,449	**$ 7,475**
Customers (000)	24,027	49,132	**54,144**

(1) *40 percent proportional share of Cingular Wireless, net of intercompany eliminations.*

(2) *Deferred revenue adjustment of $47 million in 2005 and regulatory settlement of $50 million in 2004.*

(3) *See reconciliation on page 24.*

(4) *Cingular results shown at 100 percent. BellSouth has joint control and 40 percent ownership of Cingular Wireless.*

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It's an entrance to
a world of possibilities
from BellSouth.


SMALL BUSINESS
FastAccess® Business DSL
Speed up the pace
you do business - Online!

It's the answer **to the need** for speed.

Consumers, corporations, small businesses – when it comes to communications, all have an insatiable demand for speed. And BellSouth makes it simple. We continue to evolve from a narrowband voice company to a broadband services company. As we accelerate from dial-up speed to DSL Internet service with speeds of six megabits per second[1] and beyond, we are converging on a profitable and expansive marketplace.

But our story is not just about speed, it's also about our communications network. BellSouth is channeling more capital and assets toward expanding our broadband IP (Internet protocol) network – one with the capability, bandwidth and speed needed to compete against cable. We are not starting anew in this endeavor. Rather, we are building upon the strong foundation of our existing network and operating processes.

At BellSouth, we're pushing fiber penetration deeper into our already fiber-rich network. Presently, approximately 50 percent of the households we serve are connected via fiber optic cable and short copper loops. Ultimately, this combination of fiber and copper will enable us to deliver bandwidth at speeds of 12 to 24 megabits per second and higher throughout our network.

In addition to expanding our fiber network, BellSouth is developing broadband products and services that meet customers' network needs. More than just providing high-speed Internet, we offer convenient solutions like wireless networking and Internet security for the home; voice, e-mail and web hosting packages for small businesses; and data networking and voice over Internet protocol (VoIP) solutions for large businesses. Clearly, BellSouth is moving fast.

BELLSOUTH® FASTACCESS® DSL

FastAccess DSL Lite, Ultra, Xtreme and Xtreme 6.0. There are four BellSouth FastAccess DSL services with simple pricing. Download e-mail attachments, photos and music at your convenience. No more dial-up hassles or waiting to connect to the Internet. Just click and go!

FASTACCESS DSL ADD-ON FEATURES

Consumers and businesses can add convenience and security. Home networking offers wireless connections, file and printer sharing and 24x7 technical support. BellSouth Internet Security Products protect your computer. Small businesses can add custom e-mail addresses, hot spot service and priority technical support on their FastAccess DSL service.

MANAGED NETWORK VPN SERVICE

Run voice, video and data on a single network – across the city, across the country. BellSouth® Virtual Private Network is a cost-effective way for businesses to connect various locations and telecommuters to critical information.

[1] *Maximum downstream speed*

It's information you won't find in books.

Living rooms, school rooms, hospital rooms – BellSouth is bringing a world of communications to all three. Not just phone systems, but complete voice and data, high-speed fiber optic networks. Take St. John the Baptist Public Schools in Louisiana, for instance. BellSouth developed a solution using BellSouth® Metro Ethernet Service for its educational excellence agenda. This service links 12 parish schools at speeds of up to 100 megabits per second, providing students, their parents and teachers with access to technology-driven tools such as streaming video. With its focus on education, the BellSouth Foundation is funding e-Learning initiatives. The Foundation is working with state-led virtual high schools to bring online instruction to students with the goal of narrowing the growing achievement gap and increasing graduation rates.

Hospitals rely on BellSouth's network expertise, too. Florida Hospital, in Central Florida, worked closely with BellSouth to develop a network solution to link together its seven hospitals and 16 primary care centers. This network provides voice service, high-bandwidth Internet connections, wireless phones and wireless PC connectivity, and file sharing between locations including electronic x-rays. Andy Crowder, CTO of Florida Hospital says, "By ensuring our voice and data networks operate at maximum efficiency, BellSouth has a direct impact on our patient care."

BellSouth has consistently provided schools and hospitals in our markets with cost-efficient, flexible, scalable networks. We are committed to providing all of our business customers with secure, reliable communications solutions to best meet their specific business needs. Something else you won't find in books.

image courtesy of Georgia Aquarium

VOICE SERVICES

Local and unlimited long distance, business voice lines, voice mail, call forwarding, call waiting. If there's a voice on the line, BellSouth will help you hear it.

DATA SERVICES

Robust and flexible solutions for constant, secure Internet connections for e-mail, data networking or high-bandwidth applications. Data products include BellSouth® MegaLink® T1 Service, BellSouth® Dedicated Internet Access Service (DIA) and BellSouth® Metro Ethernet Service.

YELLOW PAGES

First The Real Yellow Pages® and now YELLOWPAGES.COM™ from BellSouth – the fastest-growing online national search and yellow pages directory in the nation. Both powerful advertising tools for connecting businesses with consumers.

It's all you need from one source.

The spectacular new Georgia Aquarium is the largest, most advanced aquarium in the world. So who provided the advanced communications infrastructure? Not surprisingly, BellSouth. Our large business team designed an innovative voice and data solution that includes cabling infrastructure to support the local area network, a VoIP call center solution, long distance voice service, dedicated Internet access and a high-speed connection to the off-site animal receiving warehouse. The aquarium's network connects data-sensing devices to monitor the animals and their environment and a security system that ensures the safety of the animals, employees and visitors with surveillance cameras and card readers. We also promoted the Georgia Aquarium by featuring it on the cover of The Real Yellow Pages® from BellSouth.

BellSouth serves residential and small business customers in much the same way – bundling together the services they need. It's called the BellSouth Answers® package, a powerful marketing tool that drives product penetration and strengthens customer loyalty.

Consumers like the simplicity and value of the BellSouth Answers® package. They can choose any distance voice service, Internet service, Cingular Wireless® and DIRECTV® service. BellSouth also simplified the pricing for high-speed DSL Internet access so that all customers can take advantage of the new lower pricing no matter how many products they buy from BellSouth.

Small businesses find value in packages like the Combined Answers℠ Bundle. With this bundle, businesses can combine BellSouth® FastAccess® Business DSL with unlimited local and long distance and Cingular Wireless service. Businesses can connect with potential customers at the most important time – right before they make their buying decision – by advertising with The Real Yellow Pages® and YELLOWPAGES.COM™ from BellSouth.

One source is a good reason to stay with BellSouth.

This is not just a cell phone...

It is your any time, any where conne

The Cingular Wireless® logo. You se it practically everywhere. And with good reason. It belongs to the nation's larges wireless voice and data provider, creat through the 2004 merger of Cingular Wireless and AT&T Wireless.

Post merger, Cingular leads the indu with more than 54 million customers. Cing network also has more cell sites and de cellular/PCS spectrum than any other wi provider. To strengthen that network even Cingular is adding efficiency by elimina redundant cell sites and deploying new in strategic locations.

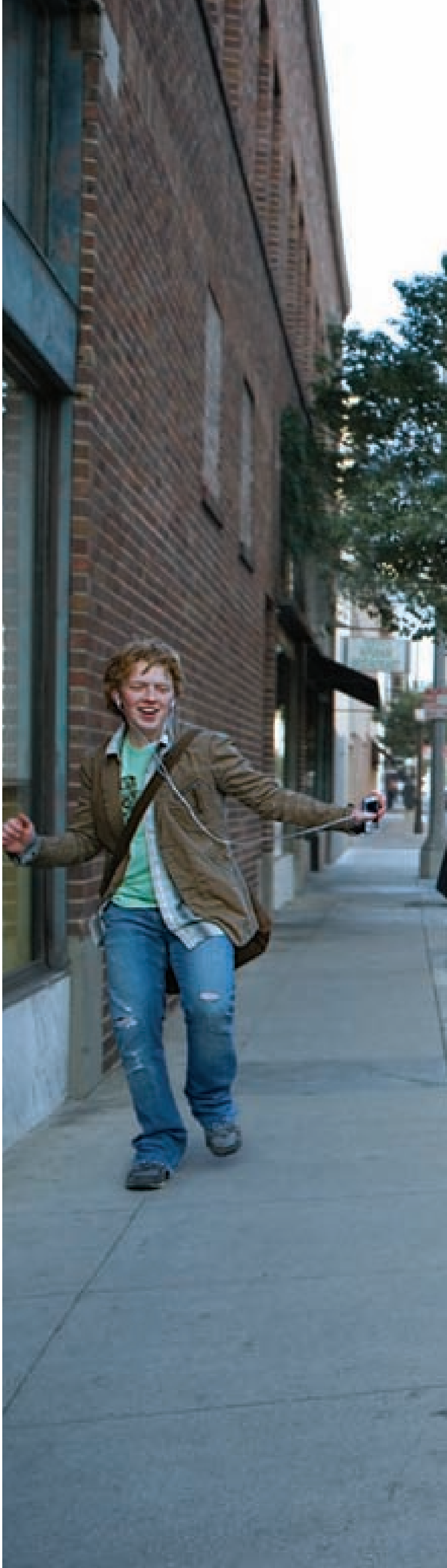
From the standpoint of lowering co and adding efficiencies, the integration Cingular and AT&T Wireless is progressi at an impressive pace. Even more impre sive, however, is Cingular's contribution BellSouth. In 2005, Cingular provided m than 40 percent of BellSouth's normalize revenues and more than 19 percent of BellSouth's full year normalized earning per share.

It's the wave of **the future with your** own soundtrack.

The wireless market is dynamic – driven by a never-ending search for the next cool thing, whether it's ringtones, games or handsets. Cingular keeps one step ahead of that demand. In 2005, Cingular introduced a stream of new, exclusive phones, features, payment plans and wireless devices. The Motorola® ROKR and the Motorola® SLVR, the first phones to come with Apple iTunes® software, made their debut exclusively with Cingular. So, too, did the sleek, black Motorola® RAZR phone. Cingular now offers wireless customers Cingular® Push to Talk and the Cingular® GoPhone®, a popular prepaid calling plan, both launched last year.

During 2005, Cingular optimized its sales locations by closing redundant stores and opening new retail channels. Beginning in 2006, Cingular is selling its service through RadioShack. With thousands of nationwide locations, RadioShack is Cingular's newest and largest single distribution outlet.

Staying ahead of competition also requires that Cingular provide great customer service. And it is doing just that with a Web site that provides easy access for customers to purchase new calling plans, to upgrade their handsets or to change existing service. Cingular also offers Star Services, which provide personal account information delivered by text message to customers' cell phones.



It's information **where you need it** whenever you need it.

GSM. EDGE. UMTS. HSDPA. You don't have to know what these acronyms mean to understand the opportunities they present. They mark the evolution of a third-generation (3G) global mobile communications system – one that transfers voice and data at incredible speeds.

Cingular is a leader in wireless technology building a next-generation network with higher data speeds and capacity. Cingular already uses the GSM standard, along with almost 80 percent of the world's subscribers, and uses EDGE technology for data. With the introduction of UMTS (Universal Mobile Telecommunications System) with High Speed Downlink Packet Access (HSDPA), Cingular customers will be able to subscribe to broadband data access using either a compatible Cingular handset or a PC with a data card. UMTS provides access to simultaneous voice and data applications – everything from e-mail and work collaboration to video, gaming and music downloads. So you can be traveling on business and you can have a video conversation with your family that lets you see and hear each other in real time while you chat.

CINGULAR® LAPTOP CONNECT

Cingular's EDGE and BroadbandConnect for laptops offer the best combination of coverage and speed, allowing you to stay productive while you are away from home. Access the Internet, using Cingular's Wireless network or Wi-Fi hot spots. E-mail, browse the Internet, or access your company's intranet, all wirelessly.

BLACKBERRY® 8700C PDA

With the 8700c or any Blackberry device from Cingular, if you are on the go, you can read e-mail and attachments — all without lugging around a laptop or hunting for a phone jack. BlackBerry combines Web browsing, e-mail, calendar, contacts and phone calls in one handheld device. Cingular's exclusive BlackBerry 8700c works on GSM/GPRS/EDGE wireless networks in over 100 countries.

CINGULAR® PUSH TO TALK

Cingular Push to Talk (PTT) is more than a walkie-talkie. It's a new way of connecting to your family or business colleagues. Any Cingular user with PTT can contact any other Cingular user with PTT – instantly. Customers can view contact list availability and set up group calls. If the call gets more involved, just convert to a regular cellular call.


This is not a
phone company...
BELLSOUTH

It's a sound **investment.**

BellSouth is a Fortune 100 company with normalized revenues totaling $34 billion in 2005. We have a strong portfolio of assets directed toward wireless and broadband complemented by a thriving yellow pages business. Our cash flow is strong. We repurchased $1 billion of our stock in 2005, and we paid our 87th consecutive quarterly dividend.

The changing dynamics in our industry lead us to balance vision with fundamentals and investment in new technology with financial discipline. What makes BellSouth a sound investment is that we are mapping a better future with new profitable revenue streams, including wireless, DSL and long distance, as the market moves away from traditional access lines.

At every level and in every business unit, our employees are focused on delivering strong financial results, providing excellent customer service and fostering a diverse and inclusive environment. We have the right assets, the right people and the right balance.

ASHLEY CARR
Network Operations

CHARLES DAVIS
Customer Care, Advertising & Publishing

JARNICE ANDERSON
Internal Auditing

WENDY THOMAS
Finance

SANDY DE LA TORRE
Small Business Sales

Dear Shareholders:

Duane Ackerman
Chairman and Chief Executive Officer

Five years into the new millennium, the communications industry is a world in progress. Today, BellSouth's direction is clear. BellSouth is continuing to take significant steps toward growth by repositioning our assets. In 2004, we sold our Latin America operations and, through Cingular, acquired AT&T Wireless. In 2005, the new Cingular completed its first full year of operation with good results, and we stepped up efforts to transform the narrowband infrastructure in our wireline company to broadband. And we're moving forward with the right assets and the right balance.

Our financial results reflect our balanced approach. In 2005, we generated $3.3 billion in operating free cash flow and paid down $3.4 billion in debt. Over the last three years, we have increased our dividend by 45 percent to 29 cents per quarter, annualized to $1.16 per year.

AN INDUSTRY IN TRANSITION

Over the last decade, we have seen dramatic shifts in wireline and wireless technology, industry consolidation and regulatory progress. All of these forces have combined to create a new, highly competitive communications world where companies are migrating their wireline networks from narrowband to broadband, and more customers are migrating from wireline to wireless.

- Today, more residential subscribers access the Internet with a broadband connection than with a narrowband dial-up connection.
- Consumers are demanding broadband speeds reaching six megabits of data per second and beyond.
- In the United States, 65 to 70 percent of people have at least one wireless device, and this number is growing.

As customers and technology reshape the industry, communications players are consolidating. BellSouth participated in this consolidation through Cingular's acquisition of AT&T Wireless in 2004. In 2005, SBC Communications acquired AT&T, Verizon acquired MCI, and Sprint acquired Nextel. We know that as we look forward the competitive landscape will change, and BellSouth must rapidly adapt.

As the industry changes, we will continue to push for regulatory reform that acknowledges the new realities. In 2005, the industry made progress toward market-based competition. The FCC reduced broadband DSL regulation so that DSL providers can compete on even ground with cable modem service. Federal legislation on the horizon could significantly reduce U.S. government regulation of telecom services. A new policy debate is heating up in 2006 over the best way to ensure that consumers have an enhanced quality experience with high-bandwidth content. BellSouth believes that consumers should shape a market-based business model for enhanced quality content, not government regulation.

Technology, the competitive landscape and regulation are bringing about a new communications world. In the face of these changes, BellSouth is approaching our business with greater clarity.

A STRONG ASSET MIX

We have simplified our portfolio to focus on three assets: Wireless, Wireline and Advertising & Publishing. In 2005, our reported revenues (from Wireline and Advertising & Publishing) were $20.5 billion. Our normalized revenues, including $13.5 billion from BellSouth's proportionate share of Cingular, were $34 billion.

Wireless Forty percent of BellSouth's normalized revenues come from Cingular Wireless, the nation's largest wireless company, providing voice and data services to more than 54 million subscribers. Cingular acquired AT&T Wireless in 2004. The integration of the two companies is on track and, in fact, it has exceeded everyone's expectations. In 2005, Cingular added more than 5 million subscribers during a year when many expected the company to be distracted by the integration activities. The company grew revenues 6.6 percent compared to pro forma 2004 revenues. Cingular significantly improved its margin in four short quarters by reducing customer churn, eliminating duplicate stores, improving customer service and beginning the process of modernizing its network.

As the largest wireless player, Cingular is well-positioned to meet the growing demand for next-generation data services. The company is accelerating the build-out of its network and deploying advanced wireless technology in major markets across the country. The company has recently launched its new wireless broadband service in 16 markets, and plans to serve the majority of the top 100 U.S. markets by the end of 2006.

Cingular's goals for the end of 2007 are clear: attain industry-leading results in customer growth, profitability, and reputation with customers. Achieving these goals will have a compounding effect on BellSouth's margin and earnings per share.

Wireline In our wireline business, we have put our core business on a clear path to a broadband future.

Network – We are increasing the speed of our wireline network by building on the investments we have made over the past two decades. Our goal is to deliver more bandwidth, better security and quality of service to our consumer and business customers. Throughout the year, customers have migrated to higher speeds of service and, in 2005, we initiated faster DSL Internet service with speeds up to six megabits per second [1] in certain markets. We also began testing speeds of up to 12 megabits per second [1] on our network. Our test results are positive, and we are upgrading the network so that 50 percent of our households will have access to speeds of 12 to 24 megabits[1] by the end of 2007. This translates into 70 percent of the households in our top 30 markets. Greater speeds open up possibilities for BellSouth to offer new higher bandwidth applications over our network such as voice over Internet protocol (VoIP), integrated wireless and wireline products, and video entertainment services.

Consumer – Our consumer unit operates in an extremely competitive environment and has lost access line customers for the past few years due to wireless substitution and, to a lesser extent, competition from cable companies offering telephony and broadband Internet services. Consumer average revenue per customer grew as our customers bought more of their communication services from BellSouth, and BellSouth's consumer operations contributed to more than a 2 percent increase in revenues despite the decline in consumer access lines. At the same time, we are balancing our losses to wireless substitution with our stake in Cingular. In 2005, we added more wireless customers than we lost wireline customers.

[1] *Maximum downstream speed*

BellSouth competes effectively in this market by offering our customers competitively priced BellSouth Answers® packages that offer any distance voice, broadband DSL Internet service and video services from DIRECTV. DSL is one of the most important components of this package, and we have 2.9 million DSL subscribers, a 15 percent penetration of our retail access lines. Our goal is to increase DSL penetration to position BellSouth as the primary provider of high-speed Internet connection to the home. BellSouth remains committed to providing best-in-class customer service and a strong product portfolio to meet customer needs.

Business – BellSouth serves businesses ranging from sole proprietor small businesses to large multi-national enterprises. In 2005, our small business segment gained access lines and grew revenues more than 6 percent by offering the right products, covering the market with strong channels and providing customers a valuable service proposition. Across the industry, the large business market has been under pressure for several years. In the latter half of 2005, we were encouraged by signs of volume stability and revenue improvement. We have strong customer relationships, and BellSouth is well-positioned to win in market segments such as healthcare, education, financial services and government.

Advertising & Publishing Our yellow pages business connects the customer with the advertiser through both print and online products. A&P is an important cash and profit contributor that needs minimal capital. This group represents 6 percent of BellSouth's normalized revenues, 16 percent of our earnings and less than 1 percent of our capital expenditures. We expect continued growth as we reinforce the value of the print product while bringing more advertisers to our online products.

MOVING FORWARD

Communications is a world in transition – full of opportunity and uncertainty. BellSouth manages through the risk in our business every day … from emerging and disruptive technology to large traditional and new competitors … from outdated regulation to the next hurricane season. We balance this risk with a measured response to the market and technology changes. By realigning our assets toward the promise of industry growth, 75 percent of our revenue streams grew revenues year-over-year during 2005. As a result, we enter 2006 with a strong balance sheet, strong cash flow, improving metrics, a competitive dividend and a share repurchase program.

We continue to take great care to operate our business with integrity and in compliance with the law. During 2005, as required by the Sarbanes-Oxley Act, we conducted a thorough assessment of the company's internal controls over financial reporting. We are pleased to confirm that these internal controls were effective at year-end. Also in 2005, we updated our code of conduct, "Our Values in Action." Our company is committed to our tradition of ethics and values a diverse and inclusive work environment.

Before closing, I want to recognize the 2005 retirement of BellSouth's Chief Financial Officer Ron Dykes. Ron worked for BellSouth for 34 years and most notably served our company as CFO for the past 10 years. BellSouth's employees, customers and shareholders benefited from Ron's unwavering integrity and, most of all, his dedication to the company's financial return. We appreciate Ron's contributions and look forward to this continuing leadership from our new CFO, Pat Shannon.

The 2005 hurricane season reminded us that communications services are not a luxury, but a lifeline. The worst hurricane season on record challenged BellSouth on every front. But the people of BellSouth answered that challenge with extraordinary commitment in 2005, and we remain committed to do so in the future.

As I reflect on BellSouth, our direction is clear. We will continue to move your company into a broadband and wireless future with the right assets and the right balance.

Duane Ackerman

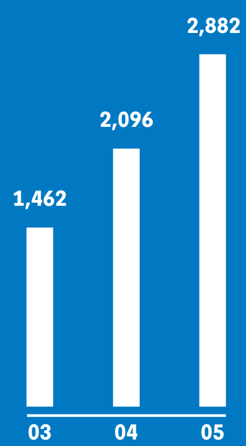
Duane Ackerman
Chairman and Chief Executive Officer

Communications Group Revenues
dollars in billions

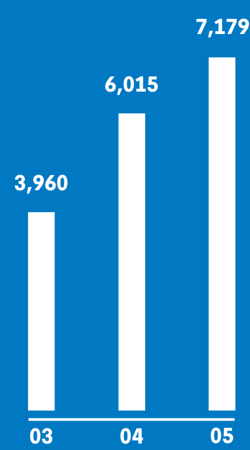
As the market moves away from traditional access line services, BellSouth is delivering a stable topline with new revenues from broadband DSL and long distance.

Access Lines
in thousands

Broadband DSL Customers
in thousands

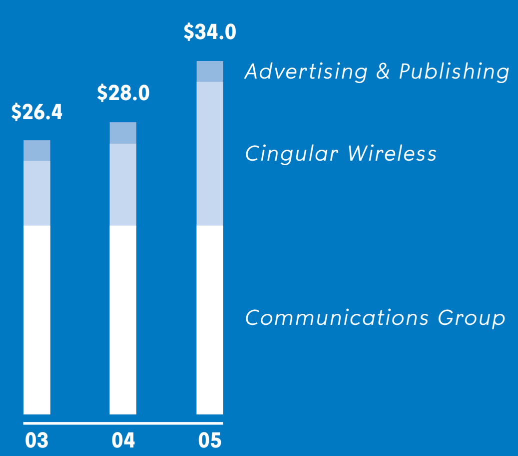


Long Distance Customers
in thousands



BellSouth Normalized Revenues*
dollars in billions

We have a strong portfolio focused on three assets: Wireline, Wireless and Advertising & Publishing.



** See reconciliation to reported operating revenues on inside front cover.*

It's all about **what we do for** our customers.

A single sentence defines BellSouth's customer service commitment: The Customer Rules![SM] It refers to five "rules" that guide every customer interaction. The first is "Take Ownership and Show We Care." The fifth is "Meet Our Commitments." In between are the steps that drive our service culture: "Be Responsive and Deliver," "Do it Right" and "Make it Seamless."

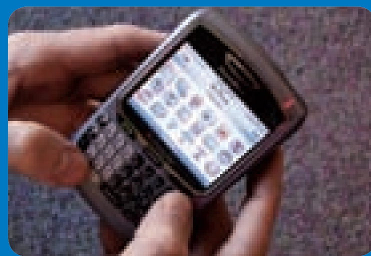
In the aftermath of Hurricane Katrina's devastating fury, those rules underwent a supreme test. BellSouth's monumental task was to rebuild the network and restore service to more than 1.5 million Gulf Coast customers. As soon as the storm passed, BellSouth began restoration – prioritizing hospitals, E911 centers, and law enforcement while restoring wireless providers' interconnection services. Our employees worked around the clock for several months. And with the exception of the hardest-hit areas, where much work remains, service has been restored.

A few days after Katrina, BellSouth employees raised the American flag on top of the New Orleans main switching office. The flag, lighted by generator power, served as a beacon of hope for the downtown New Orleans area. BellSouth was there for our customers and our employees after hurricanes Katrina, Rita, Wilma and many other storms during 2005. We will be there again to keep our customers connected and our employees safe and on the job.

Portfolio of Services

BUNDLES AND PACKAGES

Through BellSouth Answers®, residential and small business customers can bundle their local and long distance service with dial-up and high-speed DSL Internet access, DIRECTV® service and Cingular® Wireless. More services bundled means more money saved.



WIRELESS DATA

Cingular® Wireless data lets your phone be more than just a phone. Through Cingular s MEdia Net packages, you can send messages, share photos, surf the Web, download ringtones and more. Cingular offers international wireless data roaming in over 100 countries for laptops, PDAs and other data services.

BUSINESS SOLUTIONS

BellSouth offers a comprehensive package of secure and reliable technology solutions for all your business needs. Services include local and long distance voice, data net working and VoIP.

HIGH-SPEED INTERNET ACCESS

BellSouth® FastAccess® DSL customers can safely surf the Internet, e-mail, download music and pictures, and instant chat with friends at high speeds. BellSouth offers four speeds of service so that customers can choose the price and broadband speed that best suits their demands.

ONLINE DIRECTORIES

As the fastest growing online yellow pages and search directory in the nation, YELLOWPAGES.COM™ from BellSouth offers searchable directory listings for connecting consumers to businesses. YELLOWPAGES.COM™ from BellSouth is your trusted online source for information.

ANY DISTANCE VOICE

BellSouths local and long distance calling plans offer flexibility, reliability and value. Make unlimited calls anywhere in the United States at any time for one low monthly price with the BellSouth® Advantage Unlimited Plan and the BellSouth® Complete Choice® Unlimited Plan.

WIRELESS VOICE

Cingular has the country s largest digital voice and data network, the ALLOVER™ network, and the largest mobile-to-mobile calling community. While traveling abroad, Cingular customers can make calls in more than 180 countries, more places than any other U.S. carrier.

PRINT DIRECTORIES

For more than a century, The Real Yellow Pages® from BellSouth has been connecting buyers and sellers. No other advertising media can deliver as much value, influence and return on a business's advertising dollar as The Real Yellow Pages® from BellSouth.

VIDEO ENTERTAINMENT

DIRECTV® service features enhanced capabilities including interactive television, digital video recording and HD video – all with access to more than 250 digital quality channels, including movies, music, sports and international programming. BellSouth offers video through an agency agreement with DIRECTV.

Board of Directors

Left to right:

F. DUANE ACKERMAN, 63
Chairman of the Board
and Chief Executive Officer,
BellSouth Corporation
Atlanta, GA
Director since 1993.

LEO F. MULLIN, 63
Retired Chairman of the Board
and Chief Executive Officer,
Delta Air Lines, Inc.
Atlanta, GA
Director since 1998.

WILLIAM S. STAVROPOULOS, 66
Chairman of the Board,
The Dow Chemical Company
Midland, MI
Director since 1997.

KATHLEEN F. FELDSTEIN, 65
President,
Economic Studies, Inc.
Belmont, MA
– economics consulting firm
Director since 1998.

JAMES P. KELLY, 62
Retired Chairman of the Board
and Chief Executive Officer,
United Parcel Service, Inc.
Atlanta, GA
Director since 2000.

Left to right:

ROBIN B. SMITH, 66
Chairman of the Board,
Publishers Clearing House
Port Washington, NY
– direct marketing company
Director since 1994.

J. HYATT BROWN, 68
Chairman of the Board
and Chief Executive Officer,
Brown & Brown, Inc.
Daytona Beach, FL
– insurance services company
Director since 1994.

ARMANDO M. CODINA, 59
Chairman of the Board and
Chief Executive Officer,
Codina Group, Inc.
Coral Gables, FL
– real estate development company
Director since 1992.

JAMES H. BLANCHARD, 64
Chairman of the Board,
Synovus Financial Corp.
Columbus, GA
– financial services holding company
Director since 1994.

REUBEN V. ANDERSON, 63
Partner,
Phelps Dunbar, LLP
Jackson, MS
– law firm
Director since 1994.

MARK L. FEIDLER, 49
President and Chief Operating Officer,
BellSouth Corporation
Atlanta, GA
Director since 2005.

BellSouth Management

F. DUANE ACKERMAN
Chairman of the Board and Chief Executive Officer

MARK L. FEIDLER
President and Chief Operating Officer

RICHARD A. ANDERSON
Vice Chairman and President Business Markets

BARRY L. BONIFACE
Chief Strategy and Development Officer

FRANCIS A. DRAMIS, JR.
Chief Information, eCommerce and Security Officer

MARC GARY
General Counsel

ISAIAH HARRIS, JR.
President – Advertising & Publishing

W. PATRICK SHANNON
Chief Financial Officer

HERSCHEL L. ABBOTT, JR.
Vice President – Governmental Affairs

REX M. ADAMS
Web Development Officer

VALENCIA I. ADAMS
Vice President – Chief Diversity Officer

PAULINO R. BARROS, JR.
Chief Product Officer – Retail Markets

RICHARD E. BURNS
Chief Integration Officer Broadband

KEITH O. COWAN
Chief Field Operations Officer

MARSHALL M. CRISER III
State President – Florida

MARTY G. DICKENS
State President – Tennessee

MARK E. DROEGE
Vice President and Treasurer

REBECCA M. DUNN
Senior Vice President – Corporate Compliance and Corporate Secretary

RONALD E. FRIESON
State President – Georgia

MARGARET H. GREENE
President – Regulatory and External Affairs

DON G. HALLACY
Chief Information Officer Communications Group

THOMAS L. HAMBY
State President – Alabama

PHIL S. JACOBS
President – BellSouth Community Technologies

DONNA A. LEE
Chief Marketing Officer – Business Markets

HARRY M. LIGHTSEY, III
State President – South Carolina

JOHN M. MCCULLOUCH
State President – Mississippi

RODERICK D. ODOM, JR.
President – Network Services

WILLIAM A. OLIVER
State President – Louisiana

WILLIAM C. PATE
Chief Marketing Officer – Retail Markets

EDDY C. ROBERTS, JR.
State President – Kentucky

DAVID W. SCOBEY, JR.
President – Retail Markets

RICHARD D. SIBBERNSEN
Vice President – Human Resources

WILLIAM L. SMITH
Chief Technology Officer

KRISTA S. TILLMAN
State President – North Carolina

LYNN A. WENTWORTH
Vice President and CFO Communications Group

BellSouth At-a-Glance

Communications Group

BellSouth's Communications Group offers wireline voice and data communications services to residential, wholesale and small and large business customers. Residential and small business customers can bundle their local and long distance service with dial-up and high-speed DSL Internet access, Cingular Wireless cellular phone service, and satellite television. For large businesses, BellSouth provides secure, reliable voice and data networking solutions.

BellSouth's voice and mass market broadband Internet access services face competition from wireless substitution and cable modem service. Over the last few years, revenues in the segment have held steady in the face of competition. In 2005, Communications Group grew revenues $100 million compared to 2004 as growth from DSL and long distance offset the revenue lost from declining access lines.

Communications Group's strategy is to position BellSouth as the leading provider of wireline services in the Southeast by offering flexible packages, providing excellent service, deploying new broadband platforms and reducing costs.

Wireless

BellSouth owns a 40 percent interest in Cingular Wireless, a joint venture that provides a wide array of nationwide wireless voice and data services. Our Wireless segment is based on our 40 percent proportionate share of Cingular's financial results.

Cingular Wireless is the nation's largest wireless company with more than 54 million customers. Cingular has the largest digital voice and data network in the nation, owns spectrum licenses covering a total population of 294 million (approximately 99 percent of the U.S. population), and serves all of the nation's top 100 metropolitan areas. Through roaming agreements with foreign carriers, Cingular Wireless provides its customers equipped with multi-band devices the largest global coverage of any U.S. wireless carrier, with service available in over 180 countries.

Cingular Wireless intends to be the pre-eminent wireless communications company in the nation. Its business strategies are to build the best network, deliver exceptional customer service, rationalize distribution channels and offer compelling products and services.

Advertising & Publishing Group

BellSouth's Advertising & Publishing Group, one of the leading publishers of telephone directories in the United States, publishes more than 500 directories and distributes approximately 65 million copies to residences, businesses and government agencies annually. The published advertising is also made available through YELLOWPAGES.COM™ from BellSouth and through partnerships with multiple search engines.

Advertising & Publishing seeks to expand by marketing to customers with unique directory services and products including the Companion directory, a smaller, more portable version of the traditional print directory, and electronic search engine advertising.

Advertisers are increasingly including online advertising with their print media buys. We have the goal of becoming the market leader in Internet yellow pages and local Internet search through our joint venture YELLOWPAGES.COM™ from BellSouth.

Normalized Earnings Per Share Reconciliation

Earnings Per Share from Continuing Operations
dollars per share

dollars per share	2003	2004	**2005**
Reported Diluted Earnings Per Share from Continuing Operations	$ 1.88	$ 1.85	**$ 1.59**
Severance-Related Items	0.05	0.01	**0.03**
Asset Impairments	0.02	–	**–**
Gain from Sale of Sonofon	–	(0.16)	**–**
Regulatory Settlement Costs	–	0.02	**–**
Hurricane-Related Expenses	–	0.05	**0.19**
Wireless Merger:			
Integration Costs/ FV Adjustment	–	0.06	**0.11**
Intangible Amortization	–	0.04	**0.20**
Debt Extinguishment Costs	–	–	**0.01**
Gain from Sale of Cellcom	–	–	**(0.12)**
Deferred Revenue Adjustment	–	–	**(0.02)**
Normalized Diluted Earnings Per Share [1],[2]	$ 1.95	$ 1.87	**$ 2.00**

Normalized Earnings Per Share [2]
dollars per share

[1] May not sum due to rounding.

[2] So that investors can better evaluate BellSouths performance, BellSouth excludes from its Normalized EPS calcuation items that it believes may not be indicative of core operating results. These calculations are shown in the table above.

MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED SHAREHOLDER MATTERS

The principal market for trading in BellSouth common stock is the New York Stock Exchange, Inc. (NYSE). BellSouth common stock is also listed on the London, Amsterdam and Swiss exchanges. The ticker symbol for BellSouth common stock is BLS. At January 31, 2006, there were 649,248 holders of record of BellSouth common stock. Market price data was obtained from the NYSE Composite Tape, which encompasses trading on the principal United States stock exchanges as well as off-board trading. High and low prices represent the highest and lowest sales prices for the periods indicated.

	Market Prices		Per Share Dividends
	High	Low	Declared
2004			
First Quarter	$31.00	$26.13	$ .25
Second Quarter	27.86	24.46	.27
Third Quarter	27.94	25.08	.27
Fourth Quarter	28.96	25.65	.27

	Market Prices		Per Share Dividends
	High	Low	Declared
2005			
First Quarter	**$28.12**	**$24.85**	**$ .27**
Second Quarter	**27.36**	**25.38**	**.29**
Third Quarter	**27.90**	**25.51**	**.29**
Fourth Quarter	**28.03**	**24.32**	**.29**

CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

No change in accountants or disagreements on the adoption of appropriate accounting standards or financial disclosure has occurred during the periods included in this report.

CEO AND CFO CERTIFICATIONS

In 2005, as required by the listing standards of the New York Stock Exchange (NYSE), BellSouth's chief executive officer (CEO) provided a certificate to the NYSE certifying that he is not aware of any violation by the Company of the New York Stock Exchange's corporate governance listing standards. In addition, BellSouth's CEO and chief financial officer filed with the Securities and Exchange Commission all required certifications regarding the quality of BellSouth's public disclosures in its reports for 2005.

SELECTED FINANCIAL AND OPERATING DATA

DOLLARS ARE IN MILLIONS, EXCEPT PER SHARE AMOUNTS

The comparability of the following Selected Financial and Operating Data is significantly impacted by various changes in accounting principle and merger, acquisition and disposition activity. The more significant items include the adoption of Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets", effective January 1, 2002, which resulted in the cessation of amortization of goodwill; and the adoption of SFAS No. 143, "Accounting for Asset Retirement Obligations", effective January 1, 2003, which resulted in a reduction in depreciation expense.

At December 31 or for the year ended	2001	2002	2003	2004	**2005**
Income Statement Data:					
Operating revenues	$21,211	$20,207	$20,341	$20,300	**$20,547**
Operating expenses	15,339	15,753	14,784	15,011	**15,877**
Operating income	5,872	4,454	5,557	5,289	**4,670**
Income from continuing operations	2,786	3,475	3,488	3,394	**2,913**
Income (loss) from discontinued operations, net of tax	(339)	(867)	101	1,364	**381**
Income before cumulative effect of changes in accounting principle	2,447	2,608	3,589	4,758	**3,294**
Cumulative effect of changes in accounting principle, net of tax	–	(1,285)	315	–	**–**
Net income	$ 2,447	$ 1,323	$ 3,904	$ 4,758	**$ 3,294**
Operating income margin	27.7%	22.0%	27.3%	26.1%	**22.7%**
Diluted earnings per share of common stock:					
Income before discontinued operations and cumulative effect of changes in accounting principle	$ 1.48	$ 1.85	$ 1.88	$ 1.85	**$ 1.59**
Income before cumulative effect of changes in accounting principle	$ 1.30	$ 1.39	$ 1.94	$ 2.59	**$ 1.80**
Net income	$ 1.30	$ 0.71	$ 2.11	$ 2.59	**$ 1.80**
Other Financial Data:					
Diluted weighted-average shares of common stock outstanding (millions)	1,888	1,876	1,852	1,836	**1,829**
Dividends declared per share of common stock	$ 0.76	$ 0.79	$ 0.92	$ 1.06	**$ 1.14**
Total assets	$51,912	$49,368	$49,622	$59,339	**$56,553**
Total debt	$20,125	$17,397	$14,980	$20,583	**$17,188**
Shareholders' equity	$18,758	$17,906	$19,712	$23,066	**$23,534**
Construction and capital expenditures	$ 5,495	$ 3,536	$ 2,926	$ 3,193	**$ 3,457**
Book value per common share	$ 9.99	$ 9.63	$ 10.77	$ 12.60	**$ 13.09**
Ratio of earnings to fixed charges	3.98	5.03	5.68	6.00	**4.33**
Debt to total capitalization ratio	51.8	49.3	43.2	47.2	**42.2**
Operating Data:					
Access lines in service (in thousands)	23,824	23,005	22,263	21,356	**20,037**
Retail long distance customers (in thousands)	–	1,002	3,960	6,015	**7,179**
DSL customers (in thousands)	621	1,021	1,462	2,096	**2,882**
Cingular Wireless customers (in thousands)	21,596	21,925	24,027	49,132	**54,144**
Number of employees	87,875	77,020	75,743	62,564	**63,066**

See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Consolidated Results of Operations" for a discussion of unusual items affecting the results for 2003, 2004 and 2005.

Overview

We are a Fortune 100 company with annual revenues of over $20 billion. Our core businesses are wireline and wireless communications and our largest customer segment is the retail consumer. We have interests in wireless communications through our ownership of 40 percent of Cingular Wireless, the nation's largest wireless company based on number of customers and revenue. We also operate one of the largest directory advertising businesses in the United States. The great majority of our revenues are generated based on monthly recurring services.

We operate much of our wireline business in one of the country's strongest regional economies, where the population is increasing, real income growth is outpacing the national average and a diverse mix of businesses require advanced information and communication technology solutions. The Southeast is a positive net migration region, with net migration averaging almost 500,000 annually. The region's real income growth is expected to exceed the national average over the next five years.

INDUSTRY DYNAMICS

Demand in the traditional voice business has been negatively impacted by the proliferation of wireless services led by one-rate pricing plans that include a large bucket of minutes and free roaming and long-distance, the popularity of e-mail and instant messaging, and technological advances such as broadband. After a period of significant growth in the 1990s, access lines, a key driver of our business, have declined steadily since 2001.

While the last mile connectivity to the customer remains essential, the communications industry is beginning a transition from a network-centric circuit-based infrastructure to an applications-centric IP infrastructure, which could create uncertainty around traditional business models. Further, industry consolidation, such as the recent combinations of SBC and AT&T, Verizon and MCI, and Sprint and Nextel, are creating large competitors with global reach and economies of scale.

Based on comparisons to penetration rates in other parts of the world, there is still significant growth potential in the wireless market in the United States. There are currently four national wireless companies engaging in aggressive competition in a growing market. The intense competition has driven down pricing, increased costs due to customer churn and increased wireless usage as companies attempt to differentiate their service plans. Meanwhile, significant capital is being invested in networks to meet increasing demand and to upgrade capabilities in anticipation of the development of new data applications.

REGULATION AND COMPETITION

Our wireless and wireline businesses are subject to vigorous competition, and both are subject to regulation.

Changes to federal law in the early 1990s generally preempted states from regulating the market entry or rates of a wireless carrier, while allowing states to regulate other terms and conditions of wireless service. Wireless carriers are also subject to regulation by the Federal Communications Commission (FCC), which allocates and enforces the spectrum used by wireless carriers, and adopts and enforces other policies relating to wireless services.

Our wireline business is subject to dual state and federal regulation. The FCC has historically engaged in heavy regulation of our interstate services. In recent years, it has granted increasing pricing flexibility for our interstate telecommunications services because of the additional competition to which those services are subject, though nearly all of the services remain subject to tariffing requirements. Separately, in response to the Telecommunications Act of 1996, the FCC initially required us to share our network extensively with local service competitors, and prescribed a pricing policy (TELRIC) that has not permitted fair cost recovery. These sharing (unbundling) rules were invalidated by the courts on three separate occasions, but not before the invalid policies had been generally implemented in our contracts with competitors. In February 2005, the FCC issued rules that cut back significantly on some of the anticompetitive sharing requirements. The new rules essentially eliminated the unbundled network platform, or UNE-P, a combination of unbundled elements that replicate local service at unfairly low prices.

During 2005, we transitioned many former UNE-P customers to a similar platform service provided at commercially negotiated terms and prices. The FCC-ordered transition phase out of UNE-P is scheduled to be complete on March 11, 2006, though the conduct of state commission litigation concerning the UNE-P terms of earlier contracts may cause some delay in our implementation of the phase-out.

The FCC provided additional relief when it released new broadband rules effective in November 2005 that responded to a recent US Supreme Court decision. The new rules are designed to provide our high speed Internet access services with regulation equivalent to that of our competition, particularly cable modem providers. The new rules are scheduled to be fully phased in by the third quarter of 2006, although the FCC reserved the right to extend the transition.

The states in our region continue to exert economic regulation over much of the revenue generated by our traditional narrowband wireline telecommunications services, though that regulation has been lessening. During the past two years, state legislatures and state regulatory commissions have taken action that moved regulation toward equivalence with our telecommunications competitors by prohibiting state regulation of broadband services, rebalancing rates, and reducing regulation of service bundles.

Despite these successes, our wireline business remains more regulated than competing businesses that use cable, wireless or non-facilities based technologies. While we welcome the reforms, the transition of our wireline business regulation from the comprehensive, utility-like regulation of previous years to standard business regulation is not complete, and adjusting to each individual change requires significant management attention. We will accordingly continue to encourage regulatory reform in every appropriate forum.

ACQUISITIONS AND DISPOSITIONS

Over the last 18 to 24 months, we completed the exit of our international operations and increased our investment in the domestic wireless market through Cingular Wireless' acquisition of AT&T Wireless. The addition of AT&T Wireless filled in Cingular Wireless' national coverage footprint, added depth to its licensed spectrum position, and added size and scale to compete more effectively. Cingular Wireless' new advertising campaigns combined with improvements in customer service and network coverage are driving customer loyalty and growth. Customer churn has reduced appreciably, integration efforts are well underway and cost synergies are contributing to margin expansion. This acquisition substantially increases BellSouth's participation in the domestic wireless industry, bringing wireless to over 40 percent of our proportional revenues including Cingular Wireless. As Cingular completes its integration of AT&T Wireless and executes its strategy, we expect its contribution to BellSouth's earnings to increase over the next two years.

HIGHLIGHTS AND OUTLOOK

On August 29, 2005, Hurricane Katrina caused catastrophic damage in areas of Louisiana, Mississippi and Alabama, causing significant incremental expense for network restoration and customer dislocation. Despite the challenges of Hurricane Katrina, BellSouth maintained focus on the key growth areas of its business, delivering continued customer growth from broadband and long distance services. Consolidated revenues, which do not include our share of Cingular Wireless, increased slightly in 2005 as growth in long distance, DSL and small business services effectively offset revenue declines from residential access line loss and large business services. We added more than 1.1 million mass market long distance customers in 2005 to total nearly 7.2 million at December 31, 2005, while DSL net subscriber additions of 786,000 brought our total to nearly 2.9 million at December 31, 2005.

Wireless substitution continued to drive access line losses in 2005. Retail access lines were down 579,000, which included positive retail business line growth of 64,000. Wholesale access lines were down 740,000 compared to year-end 2004 influenced by the change in regulatory position towards UNE-P.

Our cost structure is heavily weighted towards labor and fixed asset related costs. In order to sustain margins, we have to adjust our workforce as market share of access lines shifts. Since the beginning of 2001, we have reduced our domestic workforce by slightly more than 17,000 employees, or 22 percent. Further, in December 2005, we announced a reduction of 1,500 management employees. Maintaining current operating margin levels going forward will be challenging as competition intensifies, pressuring revenue. We must achieve continued increases in productivity to manage our costs. While there have been some encouraging developments on the regulatory front, there will be other events such as increasing healthcare costs, continued loss of lines to wireless substitution and the rollout of VoIP telephony by cable providers that are likely to continue to put pressure on margins. Further, operating cash flow was relatively flat in 2005 but is expected to decline over the next two years due primarily to higher income tax payments.

Cingular Wireless

Cingular Wireless added more than 5 million customers in 2005, bringing its nationwide customer base to 54.1 million customers. Customer churn of 2.2 percent in 2005 decreased 50 basis points compared to the prior year. Year over year, revenue growth exceeded 6 percent on a pro forma basis driven by customer growth partially offset by a decline in average revenue per user (ARPU). Operating margin has been improving due to revenue growth and operating efficiencies from an improved customer acquisition cost structure, headcount reductions and systems rationalization.

Consolidated Results of Operations

Key financial and operating data for the three years ended December 31, 2003, 2004 and 2005 are set forth below. All references to earnings per share are on a diluted basis. The following consolidated Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with results by segment directly following this section.

Following generally accepted accounting principles (GAAP), we use the equity method of accounting for our investment in Cingular Wireless. We record and present our proportionate share of Cingular Wireless' earnings as net earnings of equity affiliates in our consolidated income statements. Additionally, our financial statements reflect results for the Latin American operations as Discontinued Operations. The operational results and other activity associated with the Latin American segment have been presented on one line item in the income statement separate from Continuing Operations.

	For the Year Ended December 31,			Percent Change	
	2003	2004	**2005**	2004 vs. 2003	**2005 vs. 2004**
Results of operations:					
Operating revenues	$20,341	$20,300	**$20,547**	(0.2)	**1.2**
Operating expenses					
Cost of services and products	6,991	7,520	**8,067**	7.6	**7.3**
Selling, general, and administrative expenses	3,777	3,816	**3,873**	1.0	**1.5**
Depreciation and amortization	3,811	3,636	**3,661**	(4.6)	**0.7**
Provision for restructuring and asset impairments	205	39	**276**	*	*
Total operating expenses	14,784	15,011	**15,877**	1.5	**5.8**
Operating income	5,557	5,289	**4,670**	(4.8)	**(11.7)**
Interest expense	947	916	**1,124**	(3.3)	**22.7**
Net earnings of equity affiliates	452	68	**165**	*	**142.6**
Gain on sale of operations	–	462	**351**	*	**(24.0)**
Other income (expense), net	362	283	**240**	(21.8)	**(15.2)**
Income from continuing operations before income taxes	5,424	5,186	**4,302**	(4.4)	**(17.0)**
Provision for income taxes	1,936	1,792	**1,389**	(7.4)	**(22.5)**
Income from continuing operations	3,488	3,394	**2,913**	(2.7)	**(14.2)**
Income from discontinued operations, net of tax	101	1,364	**381**	*	*
Income before cumulative effect of changes in accounting principle	3,589	4,758	**3,294**	32.6	*
Cumulative effect of changes in accounting principle, net of tax	315	–	**–**	*	**–**
Net income	$ 3,904	$ 4,758	**$ 3,294**	21.9	*
Summary results of discontinued operations:					
Operating revenues	$ 2,294	$ 2,459	**$ 66**	7.2	*
Operating income (loss)	$ 349	$ 647	**$ (5)**	85.4	*
Income (loss) from discontinued operations	$ 101	$ 1,364	**$ 381**	*	*

* Not meaningful

2005 compared to 2004

Hurricane Katrina negatively impacted our operating income for 2005, causing both reduced revenues and increased expenses. Revenues were impacted by $99 in proactive billing credits that we issued in order to address service outages and significant customer dislocation in the hardest-hit areas. We incurred expenses of $360 including network restoration costs, an increase in our allowance for uncollectibles to cover the estimated incremental uncollectible accounts receivable due to customer displacement, and other recovery costs. We also recognized an asset impairment charge of $166 for hurricane damage to the Company's property, plant and equipment. In addition to the operating income impacts, we incurred an incremental $211 of capital expenditures for network restoration.

The Company estimates approximately 100,000 access lines have been disconnected as a result of the hurricane. While we have seen some above trend inward movement in other wire centers, presumably from customers relocating within our markets and from businesses migrating to New Orleans to participate in reconstruction, it is difficult to estimate the extent of this impact.

For the year, incremental expenditures for wireline network restoration and capital were approximately $500. On January 25, 2006, the Company estimated the total cost for network restoration, including capital and expense, to be $700 to $900. We expect a portion of the cost associated with the Hurricane Katrina recovery effort to be covered by insurance. While the exact amount has not been determined, our current estimate of the amount of covered losses, net of our deductible, is approximately $250. The actual recovery will vary depending on the outcome of the insurance loss adjustment effort.

DOLLARS ARE IN MILLIONS, EXCEPT PER SHARE AMOUNTS AND AS OTHERWISE INDICATED

OPERATING REVENUES

Consolidated operating revenues increased $247 in 2005 as compared to 2004 reflecting growth in DSL and long distance products. Combined revenues from DSL and long distance increased $673 in 2005 compared to 2004. These increases were substantially offset by the impact of revenue declines associated with competitive access line losses in the retail and wholesale sectors along with related pricing pressures. Additionally, $97 of the year-over-year increase is attributable to one-time revenue adjustments in the Communications Group — a $50 reduction in 2004 related to a regulatory settlement and a $47 increase in 2005 related to the current recognition of previously deferred revenue. Advertising & Publishing revenues continued to grow in 2005 driven by higher core print revenues, growing sales of electronic media products and higher sales agency commissions.

Revenue trends are discussed in more detail in the Communications Group and Advertising & Publishing Group segment results sections.

OPERATING EXPENSES

Total operating expenses increased $866 in 2005 as compared to 2004. A major driver was $447 of incremental increase in hurricane-related expense as Hurricanes Katrina, Wilma and Rita eclipsed the expense associated with the four major hurricanes of the 2004 season. Another primary driver was a $260 increase in labor driven by overtime associated with higher DSL volumes and network maintenance, severance-related costs, expansion and growth in the advertising and publishing business and higher expenses associated with pension and postretirement benefit plans.

Specifically, retiree medical expense increased by $150 primarily as a result of the full year impact of calculating the obligation for non-management retiree medical costs as if there were no caps, partially offset by reductions in other retiree benefits. The change in accounting for non-management caps was effective with ratification of our contract with the CWA in the third quarter of 2004. Partially offsetting this increase was $48 higher pension income primarily due to lower interest rates.

Other factors driving the 2005 increase include volume-driven increases of $112 primarily for the provision of long distance services associated with the growth of subscribers and $109 of incremental expense for Universal Service Fund contributions due to increases in fund contribution rates and a higher assessment base driven by growth in DSL and long distance. These increases were partially offset by a $72 decline in uncollectible expense associated with improved economic conditions.

Trends in operating expenses are discussed in more detail in the Communications Group and Advertising & Publishing Group segment results sections.

INTEREST EXPENSE

	For the Year Ended December 31,		
	2004	**2005**	Change
Interest expense – debt	$ 864	**$ 1,021**	$ 157
Interest expense – other	52	**103**	51
Total interest	$ 916	**$ 1,124**	$ 208
Average debt balances(1)	$15,523	**$18,163**	$2,640
Effective rate	5.6%	**5.6%**	0 bps

(1) Average debt balances exclude amounts related to discontinued operations.

Interest expense associated with interest-bearing debt was up $157 in 2005 compared to 2004 reflecting the higher average debt balances due to the incremental borrowings associated with our equity contributions to Cingular Wireless to fund its acquisition of AT&T Wireless. The effective interest rate remained flat year-over-year as a result of increasing commercial paper rates offset by the refinancing of higher-rate long-term debt with lower-rate long-term debt. The increase in interest expense-other relates primarily to the reversal of interest accruals in the prior year related to tax contingencies based on audit settlements.

NET EARNINGS OF EQUITY AFFILIATES

	For the Year Ended December 31,		
	2004	**2005**	Change
Cingular Wireless	$ 24	**$ 135**	$ 111
Other equity investees	44	**30**	(14)
Total	$ 68	**$ 165**	$ 97

The increase in earnings from Cingular Wireless in 2005 was attributable to the contribution from the AT&T Wireless operations acquired in October 2004 and growth in the customer base in 2005. Cingular Wireless' earnings have steadily grown since the acquisition as merger synergies associated with its increased scale and integration of the former AT&T Wireless operations have been realized. Partially offsetting the growth in earnings are integration costs, higher expenses associated with significant customer growth, and an increase in depreciation and amortization expense driven by increased capital investment, a reduction in the remaining useful life of TDMA network assets, and amortization of the acquired intangible assets. Integration costs were incurred as Cingular Wireless began to execute plans to fully integrate the acquired operations, exit certain activities, and dispose of certain assets of AT&T Wireless, including redundant facilities and interests in certain foreign operations. These plans affect many areas of the combined company, including sales and marketing, network, information technology, customer care, supply chain and general and administrative functions.

The decline in other earnings from equity investees relates to the sale of our interest in Cellcom.

GAIN ON SALE OF OPERATIONS

The gain on sale of operations in 2005 related to the sale of our 34.75 percent interest in Cellcom, a cellular communications operator in Israel, for $625 in gross proceeds. As a result of the sale, we recorded a gain of $351, or $228 net of tax, which included the recognition of cumulative foreign currency translation losses of $10.

OTHER INCOME (EXPENSE), NET

	For the Year Ended December 31,		
	2004	**2005**	Change
Interest income	$ 70	**$ 34**	$ (36)
Interest on advances to Cingular Wireless	230	**204**	(26)
Loss on early extinguishment of debt	(14)	**(42)**	(28)
Gain (loss) on sale of assets	(5)	**32**	37
Other, net	2	**12**	10
Total other income (expense), net	$ 283	**$ 240**	$ (43)

The decline in interest income in 2005 as compared to the same period in 2004 is primarily due to lower invested cash balances. The decline in interest on advances to Cingular Wireless is due to principal repayments during 2005. Interest on advances to Cingular Wireless is offset by a like amount of interest expense recorded by Cingular Wireless and reported in our financial statements in the caption "Net earnings of equity affiliates." The gain (loss) on sale of assets for both years is primarily due to sales of land and buildings. Other, net in 2005 is primarily dividend income on investments.

PROVISION FOR INCOME TAXES

	For the Year Ended December 31,		
	2004	**2005**	Change
Provision for income taxes	$1,792	**$1,389**	$ (403)
Effective tax rate	34.6%	**32.3%**	(230) bps

The lower rate in 2005 was primarily due to the release of a valuation allowance recorded due to capital gains associated with the sale of Cellcom. Additionally, we recognized a cumulative benefit related to a reduction in state income tax rates. The tax rate was also positively impacted by a change in assumptions regarding the Medicare Part D subsidy, which is non-taxable, associated with retiree medical expense. Other benefits during 2005 included a permanent tax benefit realized for a dividends received deduction related to our investment in Cingular Wireless and lower projected taxable income in 2005 due primarily to Hurricane Katrina costs. These benefits were partially offset by recognition of tax liabilities for the excess of book basis over tax basis in Cellcom and the sale of BellSouth shares by our grantor trust.

INCOME FROM DISCONTINUED OPERATIONS, NET OF TAX

In 2005, we sold the final two of the ten Latin American properties, which resulted in a $390 gain, net of tax. In 2004, we sold the first eight of the ten properties, which resulted in an $850 gain, net of tax. In addition to the sale, 2004 included a $336 tax benefit related to excess tax over book basis in our Latin America investments.

2004 compared to 2003

OPERATING REVENUES

Consolidated revenues declined $41 in 2004 as compared to 2003. Communications Group revenues decreased $13 compared to 2003 reflecting the impact of revenue declines associated with competitive line losses and related pricing pressures substantially offset by growth in DSL and long distance products. Revenues from DSL and long distance combined increased $863 in 2004 compared to 2003. In addition, 2004 was negatively affected by a $50 customer refund accrual associated with a settlement agreement with the South Carolina Consumer Advocate. A decline in revenue for the exit of the payphone business was offset by higher revenues from the sale of wholesale long distance. Advertising & Publishing Group revenues were down $28 in 2004 compared to 2003 because of a reduction in print revenues due to lower overall spending by our advertisers.

OPERATING EXPENSES

Total operating expenses increased $227 in 2004 as compared to the prior year. The most significant expense change driver was increased labor costs of $463, which includes incremental overtime related to service restoration and network repairs due to the four major hurricanes that hit during the third quarter of 2004, higher expense associated with pension and postretirement benefit plans (pension and retiree medical costs) driven by changes associated with the contract agreement with the CWA. The most significant changes were the change in the calculation of the obligation for non-management retiree medical costs as if there were no caps and lower contractual limits on life insurance coverage, increases in annual salary and wage rates, higher incentive compensation and adjustments to workers compensation and long-term disability accruals partially offset by lower average employees due to continued workforce reductions. In addition to higher labor costs, costs of goods sold increased $207 primarily for the provision of long distance services associated with the growth in subscribers, information technology expenses and contract services increased $51 in connection with more project-related spending and materials and supplies increased $55 attributable to increased utilities usage and weather-related restorations.

DOLLARS ARE IN MILLIONS, EXCEPT PER SHARE AMOUNTS AND AS OTHERWISE INDICATED

These increases were partially offset by lower depreciation and amortization expense of $175 attributable to lower depreciation rates, lower uncollectible expense of $139 driven by improved economic conditions and improved collection processes and lower access fees of $96 driven by CLEC interconnect volume declines. The $166 decline in restructuring charges and asset impairments is attributable to incrementally smaller workforce reductions and a $52 asset impairment charge related to an abandoned software project in 2003.

INTEREST EXPENSE

	For the Year Ended December 31,		
	2003	**2004**	Change
Interest expense – debt	$ 836	**$ 864**	$ 28
Interest expense – other	111	**52**	(59)
Total interest	$ 947	**$ 916**	$ (31)
Average debt balances[(1)]	$14,193	**$15,523**	$1,330
Effective rate	5.9%	**5.6%**	(30) bps

(1) Average debt balances exclude amounts related to discontinued operations.

Interest expense decreased $31 in 2004 compared to 2003. Interest expense associated with interest-bearing debt was up $28 for 2004 compared to 2003 reflecting higher average debt balances impacted by higher incremental borrowings associated with our equity contributions to Cingular Wireless to fund its acquisition of AT&T Wireless. The lower effective interest rate is due to our interest rate swap program and refinancing higher-rate debt with lower-rate debt, offset partially by an increase in short-term interest rates. The change in interest expense-other relates primarily to the reversal of interest accruals related to tax contingencies based on audit settlements.

NET EARNINGS OF EQUITY AFFILIATES

	For the Year Ended December 31,		
	2003	**2004**	Change
Cingular Wireless	$ 408	**$ 24**	$ (384)
Other equity investees	44	**44**	–
Total	$ 452	**$ 68**	$ (384)

Earnings from Cingular Wireless in 2004 were lower compared to 2003 primarily due to impacts of the AT&T Wireless acquisition, which included integration costs and higher depreciation expense associated with increased capital investments and a reduction in the useful life of TDMA assets.

GAIN ON SALE OF OPERATIONS

The gain on sale of operations in 2004 related to the sale of our interest in Danish wireless provider, Sonofon, for 3.68 billion Danish Kroner to Telenor ASA. As a result of the sale, we recorded a gain of $462, or $295 net of tax, which included the recognition of cumulative foreign currency translation gains of $13.

OTHER INCOME (EXPENSE), NET

	For the Year Ended December 31,		
	2003	**2004**	Change
Interest income	$ 60	**$ 70**	$ 10
Interest on advances to Cingular Wireless	256	**230**	(26)
Foreign currency transaction gains (losses)	39	**(1)**	(40)
Loss on early extinguishment of debt	(18)	**(14)**	4
Other, net	25	**(2)**	(27)
Total other income (expense), net	$ 362	**$ 283**	$ (79)

The increase in interest income is due to higher invested cash balances, partially offset by the loss of income on an advance to Dutch telecommunications provider Royal KPN N.V. (KPN) due to early repayment in 2003. The decrease in interest on advances to Cingular Wireless is due to a lower rate in 2004. Foreign currency transaction gains in 2003 relate primarily to the advance to KPN.

During 2003, we recognized $33 in gains related to the sale of our interests in two real estate partnerships and the sale of a building. In addition, we recognized a $9 loss on the sales and impairments of cost-method investments.

PROVISION FOR INCOME TAXES

	For the Year Ended December 31,		
	2003	**2004**	Change
Provision for income taxes	$1,936	**$1,792**	$ (144)
Effective tax rate	35.7%	**34.6%**	(110) bps

The effective tax rates in 2004 were reduced by a favorable permanent difference for the Medicare Part D subsidy, which is non-taxable, associated with retiree medical expense, and an adjustment to taxes payable associated with divested operations.

INCOME FROM DISCONTINUED OPERATIONS, NET OF TAX

Income from discontinued operations, net of tax, increased $1,263 in 2004 compared to the same period in 2003 primarily due to the sale of eight of the ten Latin American properties, which resulted in a $850 gain, net of tax. Other net income increases included a $336 tax benefit related to excess tax basis over book basis in our Latin America investments, $177 for the cessation of depreciation beginning in the second quarter of 2004, a $234 loss on the sale of our interests in two Brazilian wireless companies in 2003, and higher revenues. Partially offsetting the increases to net income were the $190 charge related to the settlement of arbitration in Venezuela, foreign exchange gain decreases of $99, and a $33 loss in the second quarter of 2004 related to the purchase of additional ownership share in Argentina.

From an operational perspective, the Latin America business generated strong growth in both customers and revenue. Despite the October 2004 sale of eight properties, which resulted in only ten months of revenues in 2004 for these properties, operating revenue in the Latin America operations for 2004 increased $165, or 7.2 percent, over 2003 due to growth in customers and traffic throughout the portfolio. Excluding the decrease in operating expenses for the cessation of depreciation beginning in the second quarter of 2004, operating income was $76 higher than the prior year.

CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLE

Asset retirement obligations

Effective January 1, 2003, we adopted SFAS No. 143, ''Accounting for Asset Retirement Obligations'' (SFAS No. 143). In connection with the adoption of this standard, we recorded the cumulative effect of accounting change that increased 2003 net income by $816.

Revenue recognition for publishing revenues

Effective January 1, 2003, we changed our method for recognizing revenues and expenses related to our directory publishing business from the publication and delivery method to the deferral method. The cumulative effect of the change in accounting method is reflected in the income statement as a decrease to 2003 net income of $501.

Results by Segment

Our reportable segments reflect strategic business units that offer similar products and services and/or serve similar customers. We have three reportable operating segments:

- Communications Group;
- Wireless; and
- Advertising & Publishing Group.

The Company's chief decision makers evaluate the performance of each business unit based on net income, exclusive of internal charges for use of intellectual property and adjustments for unusual items that may arise. Unusual items are transactions or events that are included in reported consolidated results but are excluded from segment results due to their nonrecurring or nonoperational nature. Such items are listed in the table of summary results for each segment. In addition, when changes in our business affect the comparability of current versus historical results, we adjust historical operating information to reflect the current business structure. See Note P to our consolidated financial statements for a reconciliation of segment results to the consolidated financial information.

The following discussion highlights our performance in the context of these segments. For a more complete understanding of our industry, the drivers of our business, and our current period results, you should read this discussion in conjunction with our consolidated financial statements, including the related notes.

COMMUNICATIONS GROUP

The Communications Group includes our core domestic businesses including: all domestic wireline voice, data, broadband, long distance, Internet services and advanced voice features. The group provides these services to an array of customers, including consumer, small business, large business and wholesale.

In the first quarter of 2005, BellSouth began to include various corporate entities, the largest of which is BellSouth Technologies Group, Inc., in the Communications Group segment for financial reporting purposes. These entities previously billed substantially all of their costs to the Communications Group. This change aligns financial reporting with management's current view of the business, is principally timing in nature and does not affect the consolidated financial statements. Prior period segment operating results were recast to reflect the reporting change.

Our marketing strategy has been to further penetrate our existing base of customers with new products such as interLATA long distance and BellSouth® FastAccess® DSL, encouraging customers to purchase packages containing multiple communications services. We continue to experience retail access line market share loss due to competition and technology substitution, and we expect these trends to continue into 2006.

At December 31 or for the Year Ended December 31	2003	2004	**2005**	Percent Change 2004 vs. 2003	**2005 vs. 2004**
Segment operating revenues:					
Voice	$12,701	$12,609	**$12,576**	(0.7)	**(0.3)**
Data	4,353	4,513	**4,743**	3.7	**5.1**
Other	1,353	1,291	**1,193**	(4.6)	**(7.6)**
Total segment operating revenues	18,407	18,413	**18,512**	0.0	**0.5**
Segment operating expenses:					
Cost of services and products	6,744	7,089	**7,471**	5.1	**5.4**
Selling, general, and administrative expenses	3,063	3,118	**3,153**	1.8	**1.1**
Depreciation and amortization	3,787	3,609	**3,633**	(4.7)	**0.7**
Total segment operating expenses	13,594	13,816	**14,257**	1.6	**3.2**
Segment operating income	4,813	4,597	**4,255**	(4.5)	**(7.4)**
Segment net income	$ 2,829	$ 2,727	**$ 2,543**	(3.6)	**(6.7)**
Unusual items excluded from segment net income:					
Accounting change (FAS143)	816	–	**–**	*	*
Gains on grantor trust transactions	–	5	**44**	*	*
Loss on early extinguishment of debt	(11)	–	**(26)**	*	*
Deferred revenue adjustment	–	–	**29**	*	*
Asset impairment and lease termination cost	(32)	(7)	**–**	*	*
South Carolina regulatory settlement	–	(33)	**–**	*	*
Severance-related items	(97)	(25)	**(59)**	*	*
Hurricane-related expenses	–	(100)	**(315)**	*	*
Segment net income including unusual items	$ 3,505	$ 2,567	**$ 2,216**	(26.8)	**(13.7)**
Key Indicators (000s except where noted)					
Switched access lines[1]:					
Residence retail:					
Primary	12,463	11,770	**11,319**	(5.6)	**(3.8)**
Additional	1,601	1,346	**1,163**	(15.9)	**(13.6)**
Total retail residence	14,064	13,116	**12,482**	(6.7)	**(4.8)**
Residential wholesale:					
Resale	178	117	**182**	(34.3)	**55.6**
Commercial agreements/UNE-P	1,698	1,972	**1,306**	16.1	**(33.8)**
Total wholesale residence	1,876	2,089	**1,488**	11.4	**(28.8)**
Total residence	15,940	15,205	**13,970**	(4.6)	**(8.1)**
Business retail	5,413	5,242	**5,306**	(3.2)	**1.2**
Business wholesale:					
Resale	77	60	**54**	(22.1)	**(10.0)**
Commercial agreements/UNE-P	686	751	**614**	9.5	**(18.2)**
Total wholesale business	763	811	**668**	6.3	**(17.6)**
Total business	6,176	6,053	**5,974**	(2.0)	**(1.3)**
Other retail/wholesale (primarily payphones)	147	98	**93**	(33.3)	**(5.1)**
Total switched access lines in service	22,263	21,356	**20,037**	(4.1)	**(6.2)**
DSL customers (retail and wholesale)	1,462	2,096	**2,882**	43.4	**37.5**
Retail long distance customers	3,960	6,015	**7,179**	51.9	**19.4**
Switched access and local minutes of use (millions)	82,101	70,061	**62,589**	(14.7)	**(10.7)**
Retail long distance minutes of use(millions)	10,039	21,109	**25,511**	110.3	**20.9**
Total access minutes of use (millions)	92,141	91,170	**88,100**	(1.1)	**(3.4)**
Capital expenditures	$ 2,898	$ 3,164	**$ 3,429**	9.0	**8.6**

* *Not meaningful*

(1) *Prior period operating data are often revised at later dates to reflect updated information. The above information reflects the latest data available for the periods indicated.*

2005 compared to 2004

SEGMENT OPERATING REVENUES

Revenue growth for 2005 in both the consumer and small business units was driven by increased penetration of long distance and DSL and customer reacquisition and retention programs. Revenue for our large business unit declined 2.1 percent as growth in complex long distance services was overshadowed by competitive pricing pressure. Wholesale revenue declined 1.4 percent due to revenue declines in transport services sold to inter-exchange carriers, UNE-P and switched access were nearly offset by growth in wireless transport revenue. Also contributing was a decrease in revenue from declines in dial-up Internet service provider (ISP) traffic. Billing credits associated with service outages during Hurricane Katrina reduced revenue by approximately $76.

Voice

Voice revenues were relatively flat, declining $33 during 2005 compared to 2004 driven by diverging factors. Access line-related revenues declined $417 when compared to the same periods in 2004. Total switched access lines declined 1,319,000, or 6.2 percent, year-over-year. The access line decline was the result of continued share loss, driven primarily by volume declines to wireless and broadband technology substitution and, to a much lesser extent, access line losses to VoIP providers. Wholesale lines were down 740,000 lines year-over-year. Wholesale lines consist primarily of the grandfathered service provided under invalidated FCC rules (UNE-P) and services provided under successor commercial contracts at negotiated rates. Commercial contracts covered 74 percent of the wholesale lines at December 31, 2005. The amortization of deferred installation and activation revenues declined $81 in 2005 when compared to 2004. Revenues subject to deferral have declined over the past two years as a result of higher promotional activity.

In efforts to combat share loss, we continue to grow our package services. BellSouth Answers® is our signature residential package offering, which combines various wireline, wireless, Internet services and/or DIRECTV® digital satellite television services. The primary package combines the Complete Choice® calling plan of local service and multiple convenience calling features with BellSouth Long Distance, BellSouth® FastAccess® DSL or dial-up Internet, and Cingular Wireless services. We also offer DIRECTV® digital satellite television service through all sales channels as part of our BellSouth Answers® portfolio. This agency relationship with DIRECTV® provides us with a key competitive product with insignificant cost or capital requirements. We ended 2005 with more than 4.9 million residential packages, representing a 44 percent penetration of our retail primary line residence base. As of December 31, 2005, 86 percent of Answers customers have long distance in their package and almost 47 percent have either FastAccess DSL or BellSouth® dial-up Internet.

Long distance voice revenue increased $435 in 2005 when compared to 2004, driven primarily by growth in interLATA retail services and includes $53 of wholesale long distance services provided to Cingular Wireless driven by wireless customer growth. InterLATA retail revenues increased $372 year-to-date reflecting continued market share gains driven by marketing efforts and the BellSouth® Unlimited Long Distance Plans. Included in this increase is $31 related to growth in our long distance offerings in complex business. At December 31, 2005, we had nearly 7.2 million retail long distance customers and a mass-market penetration rate of almost 58 percent of our retail customer base.

Switched access revenue was essentially flat in 2005 when compared to 2004. Switched access and local minutes of use declined 10.7 percent in 2005 due to access line losses and alternative communications services, primarily wireless and e-mail. This volume decline was principally offset by increased usage.

Data

Data revenues increased $230 in 2005 when compared to 2004. Data revenues were driven by growth from the sale of BellSouth®FastAccess® DSL service partially offset by decreases in revenue from other data products. Combined wholesale and retail DSL revenues of $1,238 in 2005 were up $253 when compared to the same periods in 2004 due primarily to a larger customer base partially offset by lower average revenue per user (ARPU). As of December 31, 2005, we had nearly 2.9 million DSL customers, an increase of 786,000 customers compared to December 31, 2004 driven by simplified pricing and promotional activity. In July 2005, BellSouth announced more straightforward consumer broadband pricing which reduced the number of FastAccess DSL® price points from 21 to 3. During 2005, net subscriber additions to BellSouth's three highest-speed DSL products made up 69 percent of total DSL net customer additions.

Revenue from other retail data products increased $27 in 2005 when compared to 2004. Revenue from our long distance offerings in complex business increased $65 year-to-date when compared to the same periods in 2004. These increases were offset by declines of $38 for 2005 in our large business segment due to continued price pressures.

Revenues from the sale of wholesale data transport services, including sales to long distance companies and CLECs, declined 2.6 percent in 2005 when compared to 2004. The decreases were due to declines in data transport sold to interexchange carriers as they continue to reduce their network costs in response to declining volumes. Additional lower revenue related to dial-up ISP traffic partially offset by revenue growth in transport sold to wireless carriers as wireless subscribers and volumes continue to expand.

Other

Other revenues decreased $98 in 2005 when compared to 2004 reflecting $80 wholesale long distance volume declines and reduced revenues for billing and collections and late payments of $10, customer premise equipment of $22 and payphone service providers of $18, partially offset by wireless sales agency fee growth of $13.

SEGMENT OPERATING EXPENSES

Cost of services and products

Cost of services and products increased $382 in 2005 when compared to 2004. The increase includes: $146 related to labor costs due primarily to increases in retiree medical costs and overtime costs associated with restoration of service after damage from severe weather and increased technician dispatches for DSL volumes; the impact of annual wage increases and workforce additions. Additionally, the increase includes $112 in costs of goods sold principally driven by higher volumes in long distance services; $109 in Universal Service Fund contributions due to higher fund contribution rates and a larger assessment base driven by growth in DSL and long distance revenues; and $45 in materials and supplies driven primarily by both DSL modem cost associated with customer growth and increased fleet fuel costs. These increases were partially offset by a $41 decline in access fees due to lower volumes, and a $39 decline in penalties associated with CLEC service parity requirements.

Selling, general, and administrative expenses

Selling, general, and administrative expenses increased $35 in 2005 when compared to 2004. The increase reflects an increase of $73 in labor costs driven by incremental retiree medical benefit costs, and annual wage increases, and a $70 increase in contract services related to information technology platform development. These increases were partially offset by $31 lower advertising expense due to specific 2004 campaigns and a $47 decline in uncollectible expense driven by lower write-offs associated with improved economic conditions.

Depreciation and amortization

Depreciation and amortization expense increased $24 during 2005 when compared to 2004 reflecting increased capital spending partially offset by reduced depreciation rates under the group life method of depreciation.

2004 compared to 2003

SEGMENT OPERATING REVENUES

Growth in consumer long distance and DSL revenue was offset by retail residential access line losses, resulting in flat consumer revenue in 2004 compared to 2003. Revenue for our small business unit increased 4.3 percent in 2004 compared to 2003 driven by increased penetration of long distance and DSL and customer reacquisition and retention programs. Revenue for our large business segment decreased 2.6 percent in 2004 compared to 2003 reflecting competitive pricing pressure and weak demand for access lines. Wholesale revenue was stable in 2004 compared to 2003 as revenue as declines in switched access revenue were offset by growth in wireless transport and UNE-P revenue.

Voice

Voice revenues decreased $92 during 2004 compared to 2003 driven primarily by continued access line loss offset by the growth in interLATA long distance. Total switched access lines declined 907,000, or 4.1 percent, for the period with retail line losses being slightly offset by increases in wholesale lines. The access line decline was the result of continued share loss and technology substitution, primarily wireless.

Wholesale lines, which consist primarily of unbundled network element – platform (UNE-P) lines, totaled almost 3.0 million at December 31, 2004, up 273,000 lines year over year. The vast majority of the UNE-P additions were residential. When lines over which we provide retail services are converted to UNE-P, we lose revenue and margin. On average, the revenue from our provision of UNE-P does not permit us to recover the fully allocated costs we incur to provide it. To mitigate this loss, we have been actively seeking reform of the pricing rules that regulators use to set UNE-P prices. As previously discussed under the heading "Overview," a judicial decision that became effective in June 2004 invalidated certain FCC rules that governed the provision of wholesale access to our network by local service competitors. We believe this change in the regulatory environment influenced the loss in UNE-P lines that we experienced in the second half of 2004.

In efforts to combat share loss, we continued to grow our package services. BellSouth Answers® is our signature residential package offering, which combines various wireline, wireless, Internet services and/or DIRECTV® digital satellite television services. The primary package combines the Complete Choice calling plan of local service and multiple convenience calling features with BellSouth Long Distance, BellSouth® FastAccess® DSL or dial-up Internet, and Cingular Wireless services. During 2004, we began offering DIRECTV® digital satellite television service through all sales channels as part of the BellSouth Answers® portfolio. This agency relationship with DIRECTV® provides us with a key competitive product with insignificant cost or capital requirements. With the addition of video, the BellSouth Answers® package is one of the most comprehensive and competitively priced bundles in our markets today. We ended 2004 with almost 4.4 million residential packages, representing a 37 percent penetration of our retail primary line residence base. Almost 84 percent of Answers customers have long distance in their package and almost 45 percent have either FastAccess DSL or BellSouth dial-up Internet service.

Long distance voice revenue increased $578 in 2004 when compared to 2003, driven primarily by growth in interLATA and wireless long distance. InterLATA revenues increased $640 reflecting continued large market share gains driven by marketing efforts and the BellSouth Unlimited Long Distance Plans. At December 31, 2004, we had 6.0 million retail long distance customers and a mass-market penetration rate of approximately 48 percent of our customer base. We also continued to grow our long distance offerings in complex business. We recorded $209 in complex long distance revenue in 2004 compared to $71 in 2003. Through December 31, 2004, the complex long distance backlog stood at $624. This backlog represents an estimated value of the complex long distance business sold but not yet booked as revenue. Revenue from wholesale long distance services provided to Cingular Wireless increased $55 when compared to 2003. This increase was caused by higher volumes associated with the proliferation of wireless package plans that include long distance partially offset by slightly lower rates.

Switched access revenues declined $62 in 2004 when compared to 2003 due to volume and rate decreases. Our entry into interLATA long distance shifted switched access minutes from other carriers to our service resulting in a transfer from wholesale switched access revenues to retail long distance revenue. Switched access and local minutes of use decreased 14.7 percent compared to 2003. The decrease is due to the impact of our entry into interLATA long distance, access line losses including the shift to UNE-P lines and alternative communications services, primarily wireless and e-mail. Switched access rates were slightly lower in 2004 due to the July 1, 2003 rate reduction of the CALLs program, an FCC access reform initiative. The decline in rates, however, is substantially offset by higher subscriber line charges that are also included in voice revenues.

Data

Data revenues increased $160 in 2004 when compared to 2003. Data revenues were driven by strong growth from the sale of BellSouth® FastAccess® DSL service partially offset by decreases in revenue from other data products. Combined wholesale and retail DSL revenues were up $241 in 2004 when compared to 2003 due primarily to a larger customer base. As of December 31, 2004, we had almost 2.1 million DSL customers, an increase of 634 thousand customers compared to December 31, 2003.

Retail data services grew 11.5 percent in 2004 when compared to 2003 driven primarily by the growth from the sale of FastAccess DSL service. During 2004, we added 653 thousand net retail customers. We offer three broadband downstream connection speeds to meet the varying needs of our mass-market customers. The original version – BellSouth FastAccess DSL Ultra – runs at downstream connection speeds of up to 1.5 megabits. Since mid-2003, we have offered a lower speed version – BellSouth® FastAccess® DSL Lite – running at downstream connection speeds of up to 256 kilobits. FastAccess DSL Lite accounted for approximately one-fourth of DSL customers as of December 31, 2004. In April 2004, we began offering BellSouth® FastAccess® DSL Xtreme, delivering downstream connection speeds of up to 3.0 megabits and upstream connection speeds of up to 384 kilobits. We believe our broadband offers are among the most competitively priced in our markets. In late September 2004, we launched additional incentives and introduced new pricing for FastAccess® DSL Ultra service designed to increase long-term market penetration. Retail FastAccess customer additions were offset somewhat by wholesale DSL disconnects as we continue to see a shift in customer mix to retail. Revenue from other retail data products was flat for 2004 when compared to 2003.

Revenues from the sale of wholesale data transport services and wholesale DSL to other communications providers, including long distance companies and CLECs, declined 3.5 percent in 2004 when compared to 2003, primarily due to the lingering impacts of soft enterprise market segment demand and continued network grooming and consolidation by large inter-exchange carriers.

Other

Other revenues decreased $62 in 2004 when compared to 2003. This decrease reflects decreases in revenues from the payphone business of $77 and billing and late payment fees of $29, partially offset by increases in equipment revenues of $33 and increases in wholesale long distance revenues of $12. Increases in equipment revenues reflect increased demand due to improved economic conditions and customer upgrades to newer technology.

SEGMENT OPERATING EXPENSES

Cost of services and products

Cost of services and products increased $345 in 2004 when compared to 2003. The cost of services increase was impacted by: increases of $207 in costs of goods sold principally driven by increases in the provision of long distance service volumes; increases of $104 in labor costs impacted by pay increases driven by union contract raises and higher costs from retiree and medical benefits slightly offset by lower average workforce; increases of $49 in contract services related to network planning projects and equipment installations; and increases in materials and supplies of $39 associated with increased utilities usage, partially offset by decreases of $96 in access fees due to volume declines, settlements and significant reductions in charges associated with access to other carriers customer name databases.

Selling, general, and administrative expenses

Selling, general, and administrative expenses increased $55 in 2004 when compared to 2003. The selling, general, and administrative expense reflected represents an increase of

$209 in labor costs driven by higher costs from retiree and medical benefits, incentive awards, reduced use of contractors and pay increases partially offset by lower headcount. Also included in the labor increase was a $40 increase in an annual adjustment to the workers compensation and long-term disability accruals.

This increase was partially offset by a decrease in uncollectibles expense of $90 driven by continued improvements in the collection process and improved economic conditions, a decrease in contract services of $26 and a decrease in outside sales commissions of $16.

Depreciation and amortization

Depreciation and amortization expense decreased $178 in 2004 when compared to 2003. The primary driver of the decline in depreciation expense relates to lower depreciation rates under the group life method of depreciation. The lower depreciation rates were precipitated primarily by the reductions in capital expenditures over the past several years. Amortization expense increased due to higher levels of capitalized software.

WIRELESS

We own a 40 percent economic interest in Cingular Wireless, a joint venture with AT&T. Because we exercise influence over the financial and operating policies of Cingular Wireless, we use the equity method of accounting for this investment. Under the equity method of accounting, we record our proportionate share of Cingular Wireless' earnings in our consolidated statements of income. These earnings are included in the caption ''Net earnings of equity affiliates''. For management purposes, we evaluate our Wireless segment based on our proportionate share of Cingular Wireless' results. Accordingly, results for our Wireless segment reflect the proportional consolidation of 40 percent of Cingular Wireless' financial results.

On October 26, 2004, Cingular Wireless completed the acquisition of AT&T Wireless, creating the largest wireless carrier in the United States based on number of customers and revenue. Data revenue played an increasingly important role in revenue composition and its growth is expected to accelerate in 2006 with the launch of a new high speed data network. Despite industry consolidation, competition continues to be intense. Cingular Wireless' competitors are principally the other national providers of wireless communications services as well as regional carriers, niche carriers and resellers.

				Percent Change	
At December 31 or for the Year Ended December 31	2003	2004	**2005**	2004 vs. 2003	**2005 vs. 2004**
Segment operating revenues:					
Service revenues	$ 5,727	$ 7,041	**$12,255**	22.9	**74.1**
Equipment revenues	504	785	**1,518**	55.8	**93.4**
Total segment operating revenues	6,231	7,826	**13,773**	25.6	**76.0**
Segment operating expenses:					
Cost of services and products	2,311	3,032	**5,638**	31.2	**85.9**
Selling, general, and administrative expenses	2,170	2,826	**4,546**	30.2	**60.9**
Depreciation and amortization	835	1,073	**1,778**	28.5	**65.7**
Total segment operating expenses	5,316	6,931	**11,962**	30.4	**72.6**
Segment operating income	915	895	**1,811**	(2.2)	**102.3**
Segment net income	$ 261	$ 209	**$ 701**	(19.9)	**235.4**
Unusual items excluded from segment net income:					
Merger integration costs	–	(59)	**(197)**	*	*
Fair value adjustment and lease accounting adjustment	–	(50)	**–**	*	*
Wireless merger intangible amortization	–	(80)	**(374)**	*	*
Hurricane-related expenses	–	–	**(27)**	*	*
Segment net income including unusual items	$ 261	$ 20	**$ 103**	(92.3)	*
Key Indicators (100% Cingular Wireless):					
Cellular/PCS customers (000s)	24,027	49,132	**54,144**	104.5	**10.2**
Average monthly cellular/PCS revenue per user[(a)]	$ 51.67	$ 49.68	**$ 49.65**	(3.9)	**(0.1)**
Capital expenditures	$ 2,734	$ 3,449	**$ 7,475**	26.2	**116.7**

(a) Management uses average revenue per user (ARPU) as an indicator of operating performance of the business. Average monthly cellular/PCS revenue per user is defined as cellular/PCS service revenues during the period divided by average cellular/PCS customers during the period. This metric is used to compare the recurring revenue amounts being generated on Cingular Wireless' network to prior periods and internal targets. We believe that this metric provides useful information concerning the performance of Cingular Wireless' initiatives to attract and retain high value customers and the use of its network.

* *Not meaningful*

2005 compared to 2004

SEGMENT OPERATING REVENUES

Cingular Wireless had 54.1 million cellular/PCS customers at December 31, 2005, representing a growth of approximately 5.0 million in its cellular/PCS customer base from a year ago. Additionally, Cingular Wireless' cellular/PCS customer net additions were 5.0 million in 2005, up from 3.3 million in 2004. Strong customer gross additions during 2005 of 18.5 million, up 5.8 million from 2004, were driven by the larger distribution network of the combined Cingular Wireless and AT&T Wireless company, attractive service offerings, including the popularity of Cingular Wireless' FAMILYTALK® plans and Cingular Wireless' ROLLOVER® plan feature, and continued high levels of advertising of the combined company. Offsetting these increases was a decrease in Cingular Wireless' reported reseller gross additions primarily due to the change in methodology for calculating its reseller churn implemented in the first quarter of 2005.

The monthly cellular/PCS churn rate was 2.2% in 2005, down from 2.7% in the prior year. The decline in Cingular Wireless' churn resulted primarily from a lower churn rate in its postpaid customer base and the change in its methodology for calculating churn related to its reseller customers. Offsetting these declines was an increase in the churn rate among its legacy prepaid customers. Postpaid churn for 2005 was 1.9%, down from 2.3% in the prior year. Cingular Wireless believes that the decline in its postpaid churn resulted from the combined company providing a more compelling value proposition than Cingular Wireless was able to provide before the acquisition, including more affordable rate plans, broader network coverage, higher network quality, exclusive devices and mobile-to-mobile calling to over 54.1 million Cingular Wireless customers. The change in methodology for the calculation of reseller churn resulted in an improvement to its reported churn for 2005 of 32 basis points.

Total operating revenues increased $5,947 to $13,773 in 2005 compared to 2004. The primary driver behind the year-over-year increase was Cingular Wireless' acquisition of AT&T Wireless in October 2004. Additionally, total operating revenues continue to be favorably impacted by growth in service revenue as a result of a higher average cellular/PCS customer base, the continued growth of data revenues and higher regulatory fee revenues. Equipment sales contributed $733 to the increase in total operating revenue in 2005 compared to 2004.

Service revenues

Service revenues increased $5,214 in 2005 compared to 2004. The local service component of total service revenues includes recurring monthly access charges, airtime usage, including prepaid service, and charges for optional features and services, such as voice mail, mobile-to-mobile calling, roadside assistance, caller ID and handset insurance. It also includes billings to Cingular Wireless' customers for the USF and other regulatory fees and pass-through taxes. The primary driver of the increase of $4,088 in local service revenues for 2005 was an increase of 75.8 percent in the average number of cellular/PCS customers, including the nearly 22 million customers acquired in the AT&T Wireless transaction. The increase in local service revenues was partially offset by a decline in Cingular Wireless' monthly access charges and airtime usage due to an increase in the number of its customers on its ROLLOVER® plans, which allow customers to carry over unused minutes for up to one year, and its free mobile-to-mobile minutes, which allow Cingular Wireless customers to call other Cingular Wireless customers at no charge.

Data revenue growth also favorably impacted total service revenues. The $714 increase in data revenues for 2005 compared to 2004 was driven by increased data service penetration and usage of SMS short messaging and other data services by Cingular Wireless' cellular/PCS customers, including those data customers assumed with the AT&T Wireless acquisition. Partially offsetting these increases was the loss of revenues from its Mobitex data business, which Cingular Wireless sold during the fourth quarter of 2004.

Roaming revenues, including both incollect and outcollect revenues, increased $262 for 2005 when compared with the prior year. These increases resulted as higher roaming revenues from the acquired AT&T Wireless customer base more than offset the elimination of the intracompany roaming between former AT&T Wireless and Cingular Wireless markets and a reduction in roaming rates.

Long distance revenues increased $100 from the prior year due to the revenue associated with the acquired AT&T Wireless customers and an increase in international long distance revenues from the traditional Cingular Wireless customer base as more customers continue to migrate to its GSM network, which allows for more access to international calling than the TDMA technology.

Cellular/PCS ARPU for 2005 was $49.65, relatively flat when compared to ARPU of $49.68 in 2004. Continued increases in ARPU related to higher customer usage, data and regulatory fee revenue and higher ARPU from former AT&T Wireless customers were offset by the impact of a larger embedded customer base of postpaid customers on lower ARPU FamilyTalk® rate plans and on all-inclusive rate plans that include more "free" minutes, thereby reducing overages and other chargeable airtime. Also exerting downward pressure is a change in the mix of the cellular/PCS customer base to include a higher percentage of lower ARPU reseller customers, former AT&T Wireless customers migrating to popular ROLLOVER® rate plans, and decreases in roaming ARPU, largely as a result of the acquisition of AT&T Wireless.

Equipment revenues

Equipment sales increased $733 in 2005 compared to 2004. The increase was driven primarily by incremental revenues from new customers in former AT&T Wireless markets, higher volumes of equipment sales in traditional Cingular Wireless markets, and increased equipment sales from former AT&T Wireless customers migrating to Cingular

Wireless common service offerings. Additionally, equipment revenues increased due to the shift to more advanced handsets following the GSM/GPRS/EDGE network overlay.

SEGMENT OPERATING EXPENSES

Cost of services and products

Cost of services and products increased $2,606 in 2005 when compared with 2004 resulting primarily from the increase in costs of a larger business attributable to the AT&T Wireless acquisition, increased network usage and a higher cost of sales for customer handsets.

The local network systems costs and interconnect costs increase of $514 and $322, respectively, over the prior period resulted primarily from the incremental network activity due to the acquisition of AT&T Wireless. Additionally, interconnect expenses increased year-over-year due to slight increases in minutes of use per customer.

Third-party network systems costs, which include reseller services, incollect roaming, long distance and USF fees, increased by $839. Reseller services increased $348 primarily from the incremental amount from the acquisition and from increased costs associated with the California/Nevada network sold to T-Mobile in the first quarter of 2005. USF fees increased $207 primarily due to the incremental activity from the acquisition. Incollect roaming and long distance grew $149 and $135, respectively, from year-to-year. Both increases were driven by higher volumes of minutes, including those minutes associated with the acquired AT&T Wireless customers, which more than offset rate decreases from both incollect minutes and long distance minutes, and the elimination of intracompany roaming between former AT&T Wireless customers and Cingular Wireless.

Equipment sales expenses increased $878 from the prior year driven primarily by higher unit sales. Higher unit sales resulted both from the 46.1 percent increase in gross customer additions as well as increased upgrade activity due to the migration of former AT&T Wireless customers to Cingular Wireless common service offerings and the shift to more advanced handsets following Cingular Wireless' GSM/GPRS/EDGE network overlay.

Selling, general and administrative

Selling, general and administrative expenses for 2005 increased $1,720 compared with the prior year, driven primarily by the AT&T Wireless acquisition. Selling expenses, which include sales, marketing, advertising and commission expenses increased when compared to the prior year due to selling expenses related to increased sales personnel costs associated with the acquired AT&T Wireless sales force, higher advertising and promotions expenses and increased commissions expenses related to the 46.1 percent increase in gross customers year-over-year. Costs for maintaining and supporting Cingular Wireless' customer base in 2005 increased due to higher customer service expenses, an increase in upgrade commissions and an increase in billing and bad debt expenses. Customer service expenses increased due to increased headcount and employee-related expenses acquired from AT&T Wireless to support Cingular Wireless' larger customer base, as well as customer retention and customer service improvement initiatives. Increases in upgrade commissions were primarily driven by an increase in handset upgrade activity and higher commission incentives related to the migration of Cingular Wireless' AT&T Wireless customers to Cingular Wireless common service offerings. Since the acquisition of AT&T Wireless, Cingular Wireless has successfully migrated approximately 7 million former AT&T Wireless customers to Cingular Wireless service offerings, including approximately 5 million during 2005. Other maintenance cost increases include higher billing and bad debt related expenses related to the growth in Cingular Wireless' customer base. Other administrative costs increased as a result of incremental expenses associated with the acquired AT&T Wireless administrative personnel.

Depreciation and amortization

Depreciation expense of $1,758 increased $738 compared to the prior year primarily due to incremental depreciation associated with the property, plant and equipment acquired in the AT&T Wireless acquisition and depreciation related to Cingular Wireless' ongoing capital spending associated with its GSM and UMTS network. Additionally, depreciation expense increased over the prior year as a result of a reduction of the estimated useful lives of certain legacy Cingular Wireless TDMA assets. Amortization expense for 2005 decreased by $33, primarily due to amortization associated with intangible assets that became fully amortized during 2004.

2004 compared to 2003

SEGMENT OPERATING REVENUES

Cingular Wireless had 49.1 million cellular/PCS customers at December 31, 2004, representing growth of 25.1 million in its cellular/PCS customer base from a year ago. This growth was primarily due to a 21.7 million cellular/PCS customer base increase, related to Cingular Wireless' acquisition of AT&T Wireless in October 2004. Additionally, for 2004, Cingular Wireless' cellular/PCS customer net additions were 3.3 million, up from 2.1 million a year ago, with 1.7 million of the current year's cellular/PCS customer net additions occurring in the fourth quarter of the year. This fourth quarter increase represented the highest cellular/PCS customer net additions total ever when compared with the combined historical results of Cingular Wireless and AT&T Wireless. The strong performance in cellular/PCS customer net additions during the fourth quarter was driven by the re-launch of the Cingular Wireless brand, the offering of new common rate plans and the larger distribution network of the newly combined Cingular Wireless/ AT&T Wireless company subsequent to the acquisition. Also favorably impacting customer net additions throughout

2004 were the promotion and success of Cingular Wireless' new GSM service offerings and the continued promotion of its FamilyTalk® service offering and its Rollover® rate plans. Excluding the impact to the prepaid customer base due to the AT&T Wireless acquisition, the prepaid customer count was reduced from the prior year, in part due to the successful promotion of the postpaid FamilyTalk® plan, which competes for customers at a similar price point but with enhanced services. The increase in reseller customer net additions compared with the prior year can be attributed to continued growth by Cingular Wireless' primary reseller.

The monthly cellular/PCS churn rate of 2.7% in 2004, which included the results of AT&T Wireless since its acquisition, was flat compared with the churn rate in the prior year as a lower churn rate in Cingular Wireless' postpaid customer base was offset by higher churn rates in the prepaid and reseller customer bases. During the fourth quarter of 2004, Cingular Wireless experienced a significant improvement in its postpaid customer base churn rate compared with prior periods, as customers responded positively to the launch of the new Cingular Wireless, its broad network coverage and its attractive GSM service offerings. Also, during the fourth quarter of 2004, conformity issues related to the calculation of churn for Cingular Wireless and AT&T Wireless reduced churn subsequent to the acquisition by 13 basis points. To date, Cingular Wireless does not believe that wireless local number portability has materially impacted the customer churn rate.

Total operating revenues, consisting of service revenue and equipment sales, increased $1,595 in 2004. The primary driver behind the year-over-year increases in almost every component of total operating revenues was Cingular Wireless' acquisition of AT&T Wireless in late October 2004 and the inclusion of 67 days of AT&T Wireless operating results. Additionally, total operating revenues continue to be favorably impacted by growth in service revenue as a result of a higher average cellular/PCS customer base and the continued growth in data revenues. Equipment sales contributed $281 to the increase in total operating revenues, driven by both strong customer growth and handset upgrade activity.

Service revenues

Service revenue, comprised of local voice and data services, roaming, long distance and other revenue, increased $1,314 in 2004 compared to 2003. The local service component of total service revenue includes recurring monthly access charges, airtime usage, including prepaid service, and charges for optional features and services, such as voice mail, mobile-to-mobile calling, roadside assistance, caller ID, handset insurance and data services. It also includes billings to customers for the Universal Service Fund (USF) and other regulatory fees. The primary driver of the increase in local service revenue for 2004 was the inclusion of the former AT&T Wireless operating results as a result of Cingular Wireless' acquisition in late October 2004. Aside from this impact, increases in local service revenue are a function of the higher average customer base partially offset by the impact of a lower Average Revenue Per User (ARPU). Strong growth in data revenue, including the impact of the AT&T wireless acquisition, continues to favorably impact local service revenue driven primarily by increased data service penetration and usage of text messaging and other data services by cellular/PCS customers. Incollect and outcollect roaming revenues were essentially flat, when compared with the corresponding prior year. Roaming revenue continues to be unfavorably impacted by the bundling of "free" roaming minutes with all-inclusive regional and national rate plans and lower negotiated rates with Cingular Wireless' roaming partners. Prior to the acquisition, AT&T Wireless was Cingular Wireless' largest national roaming partner. Effective with the acquisition, Cingular Wireless' consolidated outcollect revenue reflects elimination of roaming revenue between the now combined Cingular Wireless and former AT&T Wireless properties along with a corresponding elimination of incollect roaming costs. Although net income neutral, this elimination will significantly reduce the new combined company outcollect revenue when compared to the combination of prior historical stand-alone results. The increase in long distance revenue compared with 2003 was primarily related to the incremental impact of the additional long distance revenue contributed as a result of the AT&T Wireless acquisition. Higher international long distance revenue in 2004 also contributed, to a lesser extent, to the overall increase compared with the prior year.

Cellular/PCS ARPU for 2004 was $49.68, a decrease of $1.99, or 3.9 percent, compared with $51.67 for 2003. Although the contribution of a higher ARPU for the AT&T Wireless customer base for the last 67 days of 2004 had a slightly positive impact on overall 2004 ARPU when compared with 2003, the main drivers of the changes in ARPU remained consistent with prior periods. Continued increases in ARPU related to higher customer usage and increased data revenue and regulatory fee revenue were more than offset by the impact of a larger embedded customer base of postpaid customers on lower ARPU FamilyTalk® rate plans and on all-inclusive rate plans that include more "free" minutes, thereby reducing overages and other chargeable airtime. Also exerting downward pressure on ARPU compared with the prior year is a change in the mix of the cellular/PCS customer base to include a higher percentage of lower ARPU reseller customers and decreases in roaming revenue, largely as a result of the acquisition of AT&T Wireless.

Equipment revenues

For 2004, equipment sales increased $281 in 2004 compared to 2003, primarily driven by overall higher handset sales including the impact of a significant increase in customer gross additions due to the acquisition of AT&T Wireless. Customer migrations to new Cingular Wireless rate plans as a result of the merger also favorably impacted handset upgrade revenue.

SEGMENT OPERATING EXPENSES

Cost of services and products

The cost of services and products increase of $721 for 2004 compared to 2003 was due to increases in local network system costs and in third party system costs (*i.e.*, roaming and long distance costs).

Over half of the increase in local network system costs can be attributed to the incremental costs related to the acquired AT&T Wireless network. Excluding this impact, the overall drivers of increased local network costs are primarily related to increased network system usage and associated network system expansion costs. Increased local network system costs in 2004 versus the prior year attributable to historical pre-merger Cingular Wireless activities included increased costs billed to its customers related to payments into the USF and certain other regulatory funds and higher costs related to its handset insurance program due to increased claims.

For 2004, third-party network system costs were lower as continued decreases in incollect roaming costs were partially offset by higher long distance costs. Lower incollect roaming costs were a result of lower negotiated roaming rates with Cingular Wireless' roaming partners, which more than offset increased volumes of roaming minutes. Also, as a result of the AT&T Wireless acquisition, Cingular Wireless' consolidated incollect expenses reflect elimination of intra-company incollect roaming costs between the now combined Cingular Wireless and former AT&T Wireless properties along with a corresponding elimination of outcollect revenue. Although net income neutral, this elimination will significantly reduce the new combined company incollect roaming expenses when compared to the combination of prior historical stand-alone results. The increase in long distance costs was primarily volume driven, impacted by the inclusion of "free long distance" in many of Cingular Wireless' regional and national rate plan offerings. In addition, approximately one-third of the increase in long distance costs versus 2003 was related to the incremental long distance expenses incurred as a result of the AT&T Wireless acquisition.

For 2004, the cost of equipment sales increased, primarily driven by overall higher handset sales including the impact of a significant increase in customer gross additions and customer migration to Cingular Wireless rate plans due to the acquisition of AT&T Wireless.

Selling, general, and administrative expenses

Selling, general, and administrative expenses for 2004 increased $656 when compared with the prior year, primarily due to the incremental expense impact resulting from the addition of the AT&T Wireless selling, general, and administrative expenses during the fourth quarter of 2004. Selling, general, and administrative expenses in 2004 also included cost increases associated with increased customer gross additions and other customer service and support initiatives. Selling expenses, which include sales, marketing, advertising and commission expenses, increased for 2004 compared with the prior year primarily due to the addition of the incremental AT&T Wireless selling expenses during the fourth quarter of 2004. Higher sales, advertising and promotion costs and commissions expenses were also a function of the increased customer gross additions in 2004. Costs for maintaining and supporting the customer base also increased for 2004 compared with the prior year primarily due to the addition of the AT&T Wireless expenses in the fourth quarter. Costs for maintaining and supporting the customer base were also impacted by higher bad debt expense, customer service expenses to support on-going customer retention and other service improvement initiatives and higher commission expenses associated with handset upgrades. Bad debt expense increased primarily due to higher customer net write-offs as a result of prior relaxed credit policies in selected areas, which have been subsequently changed, as well as residual impacts related to the implementation of wireless local number portability in late 2003. Additionally, 2003 included a net recovery of prior MCI write-offs. Upgrade commission expenses were impacted by over one million customer migrations to new rate plans as a result of the merger.

Depreciation and amortization

Depreciation expense increased by $249 in 2004, compared to 2003, and included an incremental $130 related to assets acquired from AT&T Wireless. Other increases in depreciation expense were primarily due to on-going capital spending, including the GSM/GPRS/EDGE network overlay, in addition to increased depreciation on TDMA assets in 2004 as a result of a further review of estimated service lives. Amortization expense decreased by $12 in 2004 compared to 2003 due to certain historical Cingular Wireless finite-lived intangible assets becoming fully amortized during 2004.

ADVERTISING & PUBLISHING GROUP

Our Advertising & Publishing Group is comprised of companies that publish, print, sell advertising in and perform related services concerning alphabetical and classified telephone directories and electronic product offerings. In November 2004, BellSouth and AT&T (formerly SBC) entered into a joint venture that purchased yellowpages.com®. In late 2005, we launched YELLOWPAGES.COM™ from BellSouth. This electronic product offering enables us to expand our national advertising base and diversify our traffic relationships.

As discussed more fully in Note C to our consolidated financial statements, effective January 1, 2003, we changed our method for recognizing revenues and expenses related to our directory publishing business from the publication and delivery method (issue basis) to the deferral method (deferral basis). Under the issue basis, we recognized 100 percent of revenues and direct expenses at the time the directories were published and delivered. Under the deferral basis, we amortize, or recognize ratably, revenues and direct expenses over the life of the related print directory, generally 12 months. When compared to the issue basis method, the deferral method causes trends in current-period operating results to be recognized in the income statement over a longer period of time and to cross fiscal years.

In 2003 and early 2004, our Advertising & Publishing Group was negatively affected by weak economic conditions and competition. An improving economy, combined with the execution of our business strategies, resulted in moderate revenue growth in 2005. We expect this trend to continue in 2006.

	For the Year Ended December 31,			Percent Change	
	2003	2004	**2005**	2004 vs. 2003	**2005 vs. 2004**
Segment operating revenues					
Advertising & Publishing revenues	$1,906	1,878	**$1,908**	(1.5)	**1.6**
Commission revenues	144	141	**152**	(2.1)	**7.8**
Total segment operating revenues	2,050	2,019	**2,060**	(1.5)	**2.0**
Segment operating expenses:					
Cost of services and products	345	353	**374**	2.3	**5.9**
Selling, general, and administrative expenses	706	684	**704**	(3.1)	**2.9**
Depreciation and amortization	26	28	**28**	7.7	**–**
Total segment operating expenses	1,077	1,065	**1,106**	(1.1)	**3.8**
Segment operating income	973	954	**954**	(2.0)	**–**
Segment net income	$ 600	$ 583	**$ 595**	(2.8)	**2.1**
Unusual items excluded from segment net income:					
Accounting change	(501)	–	**–**	*	**–**
Severance-related items	(3)	–	**–**	*	**–**
Hurricane-related expenses	–	–	**(7)**	–	*****
Segment net income including unusual items	$ 96	$ 583	**$ 588**	*	**0.9**
Capital expenditures	$ 28	$ 29	**$ 28**	3.6	**(3.4)**

* *Not meaningful*

2005 compared to 2004

SEGMENT OPERATING REVENUES

Operating revenues in 2005 grew $41, or 2 percent, compared to 2004. However, print and Internet revenues were negatively affected by billing credits of $22 and $1, respectively, given to customers in the areas devastated by Hurricane Katrina. Excluding the hurricane impacts, total operating revenue would have increased $64, or 3.2 percent, in 2005 compared to 2004. The increase includes a $24 increase in print revenues and a $29 increase in electronic media revenue. Sales agency commission revenue increased $11.

The print revenue increase was driven by growth in directory sales in 2004 and 2005. This positive growth was the result of a continuation of product offering expansion and successful marketing programs and sales execution, as well as a stable economy. Internet revenue was driven by a significant increase in issue sales, in particular the RealSearch℠ product for which issue sales grew over 120 percent during 2005. Sales agency commission revenue grew as a result of a new contract with an out-of-region telecom company.

SEGMENT OPERATING EXPENSES

Cost of services increased $21 in 2005 compared to 2004 driven by the manufacturing and distribution costs for the print product expansion, as well as distribution costs resulting from growth in the Internet business. Selling, general, and administrative expenses increased $20 in 2005 compared to 2004 driven primarily by higher variable selling costs associated with the increased sales revenue. Employee benefits, particularly postretirement benefits, also increased during 2005. Partially offsetting these increases was a decline in uncollectible expense associated with decreased write-offs resulting from an improved collections process and stable economic conditions.

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2004 compared to 2003

SEGMENT OPERATING REVENUES

Segment operating revenues decreased $31 in 2004 compared to 2003. The decreases include a reduction in print revenues, partially offset by an increase in electronic media revenues. Sales agency commission revenues declined $3 in 2004 compared to 2003.

The print revenue decline between periods was primarily driven by the amortization of revenues from directories issued in the latter half of 2003. The decline in revenues from 2003 directories was attributable to the lingering effects of weak economic conditions in 2003 that affected the directory advertising environment, and the continued impact of online and offline media competition. These factors also caused revenues from directories issued in the first half of 2004 to be flat when compared to their 2003 issues. Revenues from directories issued in the second half of 2004, however, achieved positive growth as a result of expanded product offerings, increased distribution, growth in Internet sales, and an improving economy. The $3 decline in sales agency commission revenues was the result of the discontinuance of a line of business, partially offset by growth in core sales.

SEGMENT OPERATING EXPENSES

Cost of services and products increased $8 in 2004 compared to 2003 driven by the impact of increased distribution. Selling, general, and administrative expenses decreased $22 in 2004 compared to 2003 driven primarily by a $49 decrease in uncollectible expense, the result of improved collection performance between periods. Variable costs associated with selling also decreased as a result of the reduction in revenues. Partially offsetting these decreases were increases in employee healthcare, pension and postretirement medical costs, as well as increased spending for advertising in response to a more competitive environment. Depreciation and amortization expense increased $2 during 2004 reflecting an increase in capitalized software.

Liquidity and Financial Condition

BellSouth's cash generation and financial position enable it to reinvest in its business while distributing substantial cash to its shareholders. BellSouth's priorities for the use of cash are to fund investment opportunities, maintain a capital structure that balances a low weighted average cost of capital against an appropriate level of financial flexibility, and distribute cash to shareholders in the form of dividends and share repurchases.

SOURCES AND USES OF CASH

Our primary source of cash flow is dividends from our consolidated operating subsidiaries. Our subsidiaries generate sufficient cash flow to fund their capital expenditures. Generally, we do not permit these subsidiaries to accumulate cash, but require them to distribute cash to us in the form of dividends. Our subsidiaries no longer issue external debt and they redeem existing debt as it matures. Any subsidiary financing needs are provided by BellSouth, either through available cash or through external financing. In addition, after funding capital expenditures and redeeming maturing debt, Cingular Wireless distributes 40 percent of its remaining cash, reflecting our ownership percentage, to BellSouth.

Our sources of funds — primarily from operations and, to the extent necessary, from readily available external financing arrangements — are sufficient to meet all current obligations on a timely basis. We believe that these sources of funds will be sufficient to meet the operating needs of our business for at least the next twelve months. Information about the Company's cash flows, by category, is presented in the consolidated statement of cash flows.

				Percent Change	
Net cash provided by (used for):	2003	2004	**2005**	2004 vs. 2003	**2005 vs. 2004**
Continuing Operations					
Operating activities	$ 7,883	$ 6,801	**$ 6,708**	(13.7)	**(1.4)**
Investing activities	$(2,706)	$(13,560)	**$ (483)**	*	*
Financing activities	$(4,679)	$ 5,071	**$(6,363)**	*	*
Discontinued Operations	$ 428	$ (579)	**$ (115)**	*	*

* *Not meaningful*

Cash generated by operations decreased $93 in 2005 compared to the prior year due primarily to higher incremental cash expenses associated with network restoration from hurricane damage and higher interest payments associated with increases in average debt balances, partially offset by a decline in income tax payments.

For 2004, cash generated by operations decreased $1,082 compared to the prior year due primarily to a $601 increase in income tax payments in 2004, a previously accrued payment of approximately $81 to MCI related to its bankruptcy settlement, a $77 payment associated with the ratification of our contract with CWA, and $160 of cash expenses associated with network restoration from hurricane damage in 2004. Partially offsetting these increased payments were decreases over the prior year of $141 in other postretirement benefit funding and $45 in severance payments.

Operating cash flows in the next few years will be negatively impacted by higher federal income tax payments as the timing of accelerated tax deprecation in recent years begins to reverse.

CAPITAL EXPENDITURES

Capital expenditures consist primarily of (a) gross additions to property, plant and equipment having an estimated service life of one year or more, plus the incidental costs of preparing the asset for its intended use, and (b) gross additions to capitalized software.

Our capital expenditures for continuing operations for 2001 through 2005 were as follows:

	Millions	% of Revenue
2001	$5,495	25.9
2002	$3,536	17.5
2003	$2,926	14.4
2004	$3,193	15.7
2005	**$3,457**	**16.8**

The trend in capital spending levels over the past five years reflects targeted capital deployment and better unit pricing due to technological advances. Capitalized software purchases have increased over the periods driven by system enhancements to increase efficiencies and introduce new products. The 2005 expenditures also included $211 of incremental spending as a result of damages by Hurricane Katrina. Excluding the effects of Hurricane Katrina in both periods, we expect spending levels in 2006 to be similar to 2005. We expect to continue to focus capital expenditures toward broadband and other next-generation technologies, such as fiber optics and DSL.

We expect expenditures for 2006 to be financed substantially through internal sources and, to the extent necessary, from external financing sources.

WIRELESS

In general, Cingular Wireless funds its capital and operating cash requirements from operations. To the extent additional funding is required, BellSouth and AT&T provide unsubordinated short-term financing on a pro rata basis. As of December 31, 2005, BellSouth had outstanding advances under the line of credit of $204. During 2006, we expect Cingular to utilize its operating cash flow after capital expenditures primarily to pay their maturing third-party debt.

DISTRIBUTIONS TO SHAREHOLDERS

Dividends

Our Board of Directors considers the cash dividend on a quarterly basis. Their objective is to maintain a competitive dividend while giving consideration to our cash flow projections and other potential uses of cash that would increase shareholder value. BellSouth has paid a dividend each quarter since it began operations in 1984. Over the last three years, BellSouth increased its quarterly dividend 45 percent from 20 cents per common share to 29 cents per common share.

Share repurchases

BellSouth uses share repurchases to help manage cash distributions to shareholders. In October 2005, BellSouth's board of directors authorized the repurchase of up to $2 billion of BellSouth's common shares through 2007. We repurchased nearly $1 billion through December 31, 2005.

EXTERNAL FINANCING

Credit ratings

At December 31, 2005, our long-term debt rating was A2 from Moody's Investor Service and A from Standard and Poor's. Our short-term debt rating at December 31, 2005 was P-1 from Moody's and A-1 from Standard and Poor's. Moody's maintains a negative outlook on both our short- and long-term debt ratings. The negative ratings outlook reflects Moody's concern that significant and expanded competitive challenges, especially in the wireline business, may erode BellSouth's ability to reduce debt levels and restore balance sheet strength to sufficiently offset increasing business risk. In January 2006, Standard and Poor's placed BellSouth's short- and long-term credit ratings on CreditWatch with negative implications. Standard and Poor's indicated that its action resulted from its concern over the increasing uncertainty of the business prospects of the local wireline business.

Financing arrangements

As of December 31, 2005, our authorized commercial paper program was $10.5 billion, with $1.4 billion outstanding. We believe that we have ready access to the commercial paper market in the event we need funding in excess of our operating cash flows. We also have an effective registration statement on file with the Securities and Exchange Commission under which we could issue $3.1 billion of long-term debt securities.

BellSouth and BellSouth Telecommunications currently have debt outstanding under various indentures that we have entered into over the past twelve years. None of these indentures contain any financial covenants. They do contain limitations that restrict the Company's (or the affiliate of the company that is a party to the indenture) ability to create liens on their properties or assets (but not the properties or assets of their subsidiaries) except in specified circumstances. None of these indentures contains any provisions that are tied to the ratings assigned to the Company or its affiliates by an external debt rating agency. Further, none of these indentures contains cross-default provisions.

DOLLARS ARE IN MILLIONS, EXCEPT PER SHARE AMOUNTS AND AS OTHERWISE INDICATED

Effective April 29, 2005, we entered into a syndicated line of credit in the amount of $3.0 billion. This line of credit serves as a backup facility for our commercial paper program and will expire on April 29, 2008. We do not have any balances outstanding under the line of credit.

Except as described in this paragraph, the line of credit contains no financial covenants or requirements for compensating balances. Further, the line of credit does not contain any provisions that are tied to the ratings assigned to us or our affiliates by an external debt rating agency. The line of credit limits the debt of the Company and its consolidated subsidiaries to 300 percent of consolidated earnings before interest, taxes, depreciation and amortization for the preceding four quarters. During 2005, this debt to earnings ratio was approximately 210 percent. In addition, the line of credit prohibits the Company and its significant subsidiaries from permitting liens to be placed on their properties or assets except in specified circumstances. If BellSouth or any of our subsidiaries defaults on any outstanding debt in excess of $200, an event of default will occur under the line of credit.

Off-Balance Sheet Arrangements and Aggregate Contractual Obligations

OFF-BALANCE SHEET ARRANGEMENTS

We do not have transactions, arrangements or relationships with ''special purpose'' entities, and we do not have any off-balance sheet debt.

In most of our sale and divestiture transactions we indemnify the purchaser for various items including labor and general litigation as well as certain tax matters. Generally, the terms last one to five years for general and specific indemnities and for the statutory review periods for tax matters. The events or circumstances that would require us to perform under the indemnity are transaction and circumstance specific. We regularly evaluate the probability of having to incur costs associated with these indemnifications and have accrued for expected losses that are probable. In addition, in the normal course of business, we indemnify counter parties in certain agreements. The nature and terms of these indemnities vary by transaction. Historically, we have not incurred significant costs related to performance under these types of indemnities.

CONTRACTUAL OBLIGATIONS

The following table discloses aggregate information about our contractual obligations as of December 31, 2005 and the periods in which payments are due:

	Payments Due by Period				
	Total	Less than 1 year	2007-2009	2010-2012	After 2012
Debt maturing within 1 year	$ 4,109	$4,109	$ –	$ –	$ –
Long-term debt(1)	$13,392	$ –	$2,992	$2,822	$ 7,578
Interest on long-term debt	$19,666	$ 882	$2,382	$1,769	$14,633
Operating leases	$ 582	$ 114	$ 215	$ 76	$ 177
Unconditional purchase obligations(2)	$ 2,633	$ 936	$1,482	$ 215	$ –
Interest rate swaps(3)	$ 49	$ 14	$ 34	$ 1	$ –
Total contractual cash obligations	$40,431	$6,055	$7,105	$4,883	$22,388

(1) The long-term debt amount above excludes $(61) of unamortized discounts and premiums included in long-term debt on the balance sheet as of December 31, 2005. Payments after the year 2012 include the final principal amount of $500 for the Zero-to-Full Debentures due in 2095, which have a carrying value of $248 as of December 31, 2005.

(2) We have contracts in place to outsource certain services, principally information technology. We also have various commitments with vendors to purchase telecommunications equipment, software, and services. The unconditional purchase obligations include annual estimated expenditures based on anticipated volumes.

(3) The amounts due for the interest rate swaps and forward contracts are based on market valuations at December 31, 2005. Actual payments, if any, may differ at settlement date.

Putable obligations

Two issues of long-term debt included in the less than one year column in the table above contain embedded options, which may require us to repurchase the debt or which may alter the interest rate associated with that debt. Please refer to Note H to our consolidated financial statements for further information on these instruments.

Those issues, their amounts and the date of the related options, are as follows:

Issue	Amount	Date of Put Option
20-put-1 remarketable securities	$1,000	Annually in April
Putable debentures	$ 281	November 2006

Other potential obligations

As of December 31, 2005, our qualified defined benefit pension plans were fully funded. Therefore, we do not currently anticipate any cash funding needs to meet minimum required funding thresholds. Over the past three years, funding for other retiree benefits was $563 in 2003, $422 in 2004, and $401 in 2005. We currently expect funding in 2006 to be in the range of $350 to $400.

RELATED PARTY TRANSACTIONS

We own a 40 percent interest in Cingular Wireless. See Note E to our consolidated financial statements for a description of our relationship with Cingular Wireless.

Quantitative and Qualitative Disclosure About Market Risk

DESCRIPTION OF RISK

We are exposed to various types of market risk in the normal course of business, including the impact of interest rate changes and changes in equity investment prices. We employ risk management strategies including the use of derivatives, such as interest rate swap agreements, and diversification of our equity investment portfolio. We do not hold derivatives for trading purposes.

Interest rate risk

Our objective in managing interest rate risk is to maintain a balance of fixed and variable rate debt that will lower our overall borrowing costs within reasonable risk parameters. Interest rate swaps have been traditionally used to convert a portion of our debt portfolio from a variable rate to a fixed rate or from a fixed rate to a variable rate.

Risk sensitivity

Our use of derivative financial instruments is designed to mitigate foreign currency and interest rate risks, although to some extent they expose us to credit risks. The credit risks associated with these instruments are controlled through the evaluation and continual monitoring of the creditworthiness of the counter parties. In the event that a counterparty fails to meet the terms of a contract or agreement, our exposure is limited to the current value at that time of the currency rate or interest rate differential and not the full notional or contract amount. Such contracts and agreements have been executed with credit worthy financial institutions, and as such, we consider the risk of nonperformance to be remote.

Summary of 2004 market risk

As of December 31, 2004, our long-term debt was $17,357 and had a fair value of $18,394. In addition, the fair value of our interest rate derivatives was carried as a liability of $24. These derivatives had a notional amount of $2,400.

The following table provides information, by maturity date, about our interest rate sensitive financial instruments, which consist of fixed and variable rate debt obligations and related interest rate derivatives. Fair values for the majority of our long-term debt obligations and interest rate swaps are based on quotes from dealers.

	Expected Maturity Date							
	2006	2007	2008	2009	2010	Thereafter	Total	Fair Value[1]
Liabilities								
Long-term debt:								
Fixed Rate	$2,299	$ 19	$621	$1,872	$1,023	$9,126	$14,961	$15,513
Average interest rate	4.8%	6.3%	5.7%	4.5%	7.7%	6.2%	5.9%	
Variable Rate	$ 410	$500	$ –	$ –	$ –	$ –	$ 910	$ 910
Average interest rate	4.4%	4.9%					4.6%	
Interest Rate Derivatives								
Interest Rate Swaps:								
Fixed to Variable	$ –	$ –	$600	$ 800	$ 400	$ –	$ 1,800	$ (44)
Average pay rate			6.6%	5.7%	8.8%		6.7%	
Average receive rate			5.8%	4.8%	7.8%		5.8%	

(1) Fair value amounts do not include accrued interest; accrued interest is classified as an other current liability in our balance sheet.

DOLLARS ARE IN MILLIONS, EXCEPT PER SHARE AMOUNTS AND AS OTHERWISE INDICATED

PROPORTIONAL DEBT

We own a 40 percent interest in Cingular Wireless, and share joint control of the venture with AT&T and, therefore, do not consolidate these operations. Our proportional debt, including our share of the face value of Cingular Wireless' non-affiliate debt and capitalized leases at December 31, 2005, is shown in the table below.

Consolidated debt	$17,188
Plus: 40% of Cingular Wireless debt	4,967
Proportional debt	$22,155

Operating Environment

DOMESTIC ECONOMIC TRENDS

Real gross domestic product (GDP) increased at a growth rate of 3.5 percent for 2005. Consumer prices rose 3.4 percent in 2005, with energy costs accounting for much of the rise. The economy is expected to continue its expansion in 2006, but at a slower pace.

On average, the economy of BellSouth's nine-state region has tended to closely track the cycles of the US economy. However, Hurricanes Katrina and Rita significantly disrupted the economies of the Gulf coast states in late 2005. Through November, Louisiana's payroll employment was 10.7 percent below a year ago, with more than 200,000 lost jobs. As a consequence, the region's employment growth through November was 0.8 percent, about half the rate that would have been achieved without the storms. The region's unemployment rate was 5.3 percent near the end of 2005.

The region has experienced strong net migration for several years, a trend that is likely to be sustained. Residential construction activity has been strong as a result. The home building pace accelerated to an annual rate of more than 615,000 through the first three quarters of 2005. The region posted 599,000 housing starts in 2004. Rebuilding from the hurricane damage is expected to keep residential construction in the Gulf region strong in 2006. The economy of the nine-state region overall is expected to expand at a moderate pace in 2006, but subject to a risk of a slowdown in the US economy.

WIRELINE REGULATORY ENVIRONMENT

The FCC regulates rates and other aspects of our provision of interstate telecommunications services, including international rates and interstate access charges. The FCC also defines network elements and establishes other telecommunications policies, including policies related to broadband services. State regulatory commissions have jurisdiction over our provision of intrastate telecommunications services (including traditional local voice service, and intrastate long distance and intrastate access services) to the extent defined by state law. Access charges are designed to compensate our wireline subsidiary for the use of its networks by other carriers. Our future operations and financial results will be substantially influenced by developments in a number of federal and state regulatory proceedings. Adverse results in these proceedings could materially affect our revenues, expenses and ability to compete effectively against other telecommunications carriers.

Regulatory reform

Because traditional telecommunications providers such as BellSouth are subject to significantly more regulatory requirements than our competitors, we encourage reform efforts before legislatures and regulatory agencies. As competition increases, our need for regulatory requirements whose burdens more nearly equal those of our competitors increases. We encourage state and federal legislators and regulators to adopt reforms that prevent greater rate and service quality regulation of our services than is imposed on our competitors.

We expect significant regulatory reform debate will continue in the jurisdictions where we provide traditional telecommunications service. We cannot predict the outcome of reform efforts. The continued imposition of unequal regulatory burdens could have an adverse affect on our results of operations.

Federal regulatory matters

The FCC regulates rates and other aspects of our provision of interstate telecommunications services. In addition, pursuant to the Telecommunications Act of 1996, the FCC has authority to establish policies for pricing and terms of interconnection between local exchange carriers and incumbent local exchange carriers such as BellSouth. Prior to 1996, this activity had been mostly the exclusive jurisdiction of the state regulatory commissions. States now set the rates and establish the terms for interconnection within the policy framework ordered by the FCC. We expect the FCC to continue policies that promote local service competition.

In various dockets before the FCC, we have urged it to accord our broadband and Internet protocol offerings a regulatory treatment more nearly like that it accords broadband offerings by the cable industry, and to forbear from old requirements that assume our telecommunications business is a monopoly. We also have asked the FCC to forbear from applying affiliate transactions rules, cost allocation and assignment rules, and other accounting requirements that apply to only BellSouth and a handful of other telecommunications providers.

In September 2005, the FCC adopted rules designed to provide regulatory treatment of our high-speed Internet access services that use digital subscriber line (DSL) technology that is equivalent to the regulatory treatment provided for high-speed Internet access provided by cable modems. The new rules apply the same regulatory definition to our service as to cable modems, and they effectively remove earlier requirements that caused us to tariff and offer separately the underlying telecommunications transport associated with our service. In addition, the new rules prescribed equivalent treatment between our service and cable modems with respect to contribution to the FCC's universal service fund. The universal service fund change will be phased in during 2006 and is subject to further FCC review.

FCC INTERCONNECTION, UNBUNDLING AND PRICING RULES

Under the 1996 Act, the FCC is required to consider the extent to which we must make elements of our network available to other providers of local service. The FCC can require access to proprietary network elements only when ''necessary''. For non-proprietary network elements, the FCC can order access only when failure to do so will impair the ability of the requesting carrier to provide services. The elements provided under these requirements are known as unbundled network elements or ''UNEs''. The FCC also establishes pricing policy for elements. The policy currently in effect is TELRIC (an acronym for total element long run incremental cost), which assumes a hypothetical lowest cost, most efficient network for purposes of establishing prices for elements. States have set prices for elements under this policy since 1996. The FCC's unbundling and pricing requirements have caused us to provide service to competitors at deeply discounted artificial prices, often below actual costs. The FCC adopted UNE rules in 1996, 1999 and 2003. On each occasion, the rules required significant unbundling of our loop, switching and transmission facilities. Although we implemented the unbundling requirements as they were adopted, we also participated in appeals that challenged their validity and the courts generally invalidated the unbundling requirements on each occasion.

Because we implemented the rules before the courts found them invalid, we still have contracts under which we continue to provide UNEs, and some of those contracts include the unbundled network element platforms or UNE-P. As the rules were invalidated, we pursued options provided by law and options provided by our contracts to reform our UNE offers. We have recently also offered competitors commercial and tariff services that would replace the services required by the invalidated rules. These offerings have commercially negotiated prices and require longer term commitments. We currently have approximately 190 commercial agreements with CLEC customers through which our former UNE-P service is replaced with a mutually acceptable commercial offering.

The most recent invalidation of the FCC rules became effective on June 16, 2004. The FCC later issued rules that effectively relieved us of the obligation to accept new UNE-P orders after March 10, 2005. The order also provided for a 12-month transition period to phase out UNE-P service existing before March 10, 2005. The FCC order also generally requires us to offer as UNEs certain high capacity loop and transport services that competitors use to serve business customers. The obligation to provide the services as UNEs does not apply to wire centers that meet certain thresholds. Only a small percentage of wire centers in our region meet the thresholds. Finally, the order permits competitors to convert qualifying higher-priced special access tariff services to lower-priced UNE services under certain conditions.

Depending on the extent to which competitors can and do choose to order UNEs or convert existing tariff services to UNEs, we could experience a material adverse effect on operations.

We believe the action requiring unbundling of high capacity loop and transport services is a violation of earlier court orders, and we, along with other incumbent carriers, have challenged the action in the DC Circuit Court of Appeals. Other parties have challenged the order, contending that the FCC was required to maintain UNE-P and provide additional unbundling. We expect a decision from the DC circuit court during the second or third quarter of 2006. If the outcome of the appeal requires us to increase the number or scope of UNEs we must provide to competitors, or permits competitors greater ability to substitute UNEs for special access services, we could face a material adverse effect on revenues and results of operations.

The FCC has a pending proceeding to consider modifications to its TELRIC pricing policy. We are participating in the proceeding and encouraging the adoption of a methodology that allows appropriate recovery of the cost of operating an actual network. To the extent the rules resulting from the proceeding fail to permit recovery of the costs of operating an actual network, we will continue to experience an adverse effect on revenues and the results of operations.

The FCC also has pending a rulemaking addressing its special access pricing flexibility rules and its general regulation of special access services under federal price cap regulation. Potential revenue loss from an adverse decision could be material.

PRICE REGULATION

The FCC regulates interstate prices using a price regulation plan, which limits aggregate price changes to the rate of inflation, minus a productivity offset, plus or minus other cost changes recognized by the FCC. The productivity factor can vary among services. Interstate prices have been decreasing over the last few years as a result of low inflation in the US economy.

ACCESS CHARGE REFORM

Access charge reform refers to the process through which the historical subsidy for residential local service contained in network access charges paid by long distance carriers is funded instead by end-users, universal service funds, or some combination of the two. For the past five years, we have implemented an FCC order that reduced interstate network access charges on long distance carriers and increased interstate subscriber line charges paid by end-users. These rate changes have better aligned our cost recovery with the way in which we incur costs.

We continue to participate in FCC examinations of further access reform. The FCC has an ongoing comprehensive examination of intercarrier compensation — that is, payments among telecommunications carriers resulting from use of their respective interconnecting networks. In general, there are three classes of intercarrier compensation: (1) reciprocal compensation that applies to local calls; (2) access charges that apply to long distance calls; and (3) compensation for transit calls wherein we convey a call from the originating carrier to the terminating carrier. The FCC's examination could lead to permanent changes in the methods carriers use to compensate one another and in the way carriers receive compensation from their end-user customers. The FCC has multiple policy models under consideration, each of which would significantly reform current intercarrier compensation methods. We expect any new methodology to address rates for reciprocal compensation. There are other aspects of access charges and universal service fund contribution requirements that continue to be considered by state and federal regulators that could result in greater expense levels or reduced revenues.

UNIVERSAL SERVICE

The FCC has established a Universal Service Fund. Telecommunications companies are required to pay a specific percentage of their interstate and international revenues into the fund to support programs established by the FCC. We began contributing to the fund in 1998. During 2005, our wireline operations contributed $430 to the Universal Service Fund. The FCC does not require contributing companies to recover their contributions directly from customers. Like many other companies, however, BellSouth has chosen to recover Universal Service Fund costs directly from end-users.

The FCC's universal service mechanism for non-rural carriers serving high-cost, low-income areas is designed to ensure that customers in those areas receive telephone service at affordable rates. BellSouth receives high-cost support for service to residents in Alabama, Kentucky and Mississippi. The Universal Service Fund also establishes significant discounts for services to be provided to eligible schools and libraries for telecommunications services, internal connections and Internet access. In addition, it provides support for rural health care providers so that they may pay rates comparable to those paid by urban health care providers. Industry-wide annual costs of the entire universal service program, estimated at approximately $7 billion, are funded from the federal Universal Service Fund.

IP-ENABLED SERVICES REGULATION

The FCC has pending dockets in which it continues to consider the regulatory classification of various IP-enabled services. The FCC and various state public service commissions also are considering the rules and regulations that should apply to various voice over Internet protocol (VoIP) services. We are unable to predict the outcome of these proceedings. Because wireline telephony is transitioning toward broadband services, the materiality of the outcome of these proceedings to us is increasing over time.

State regulatory matters

We are subject to regulation of our local and intrastate long distance services and intrastate access services by a state authority in each state where we provide intrastate telecommunications services. That regulation covers prices, services, competition and other issues.

In recent years, various states, either through action by their legislatures or their commissions, have reformed regulations under which we operate or have taken action to exempt modern services from regulation. Broadband services have been removed from state commission jurisdiction in Alabama, Florida, Kentucky, Mississippi, North Carolina and South Carolina. Alabama, South Carolina, and Tennessee have removed service bundles from state commission jurisdiction, and commissions in Georgia and North Carolina have removed tariffing requirements for service bundles. Alabama's legislature has removed state commission jurisdiction over all telecommunications service except basic services and features, and the Kentucky and Mississippi legislatures are considering similar legislation. Even with the reforms enacted, we have greater regulatory burdens on our provision of telecommunications services than do our competitors, and the continuing imposition of these burdens or the imposition of new burdens could have a material adverse effect on the results of operations.

PRICE REGULATION

We currently operate under price regulation plans in all states in our wireline territory. Under these plans, the state regulatory commissions or state legislatures have established maximum prices that can be charged for certain telecommunications services. While the plans limit the amount of increases in prices for specific services, they enhance our ability to adjust prices and service options to respond more effectively to changing market conditions and competition. Price regulation also provides an opportunity to benefit more fully from productivity enhancements. While some plans are not subject to either review or renewal, other plans contain specified termination dates or review periods. Upon review or renewal, a regulatory commission could attempt to require substantial modifications to prices and other terms of these plans. During 2005, the state commission in North Carolina prescribed changes to its price regulation plan that were not material to our results of operations.

OTHER STATE REGULATORY MATTERS

In each of our states, we are subject to performance measurement plans that measure our service performance to competitors against certain benchmarks in our own retail performance. When we do not meet the relevant standards, we make payments to the competitors or the state's treasury. In some states, if we continuously fail to meet certain criteria, we also would be required to suspend our marketing and sale of long distance services. We made immaterial payments in all states in 2004 and 2005, and likely will make immaterial payments in 2006. The plans underwent revisions in eight states in 2005, and revisions are pending in the ninth state.

WIRELESS REGULATORY ENVIRONMENT

Overview

The FCC regulates the licensing, construction, operation, acquisition and transfer of wireless systems in the US pursuant to the Communications Act of 1934 (Communications Act) and its associated rules, regulations and policies.

To obtain the authority to have the exclusive use of radio frequency spectrum to provide Commercial Mobile Radio Service (CMRS) in an area subject to jurisdiction, wireless communications systems must be licensed by the FCC to operate the wireless network and wireless devices in assigned spectrum segments and must comply with the rules and policies governing the use of the spectrum as adopted by the FCC. These rules and policies, among other things:

- regulate Cingular Wireless' ability to acquire and hold radio spectrum licenses or to lease spectrum;
- impose technical obligations on the operation of Cingular Wireless' network;
- impose requirements on the ways Cingular Wireless provides service to and communicates with its customers;
- regulate the interconnection of Cingular Wireless' network with the networks of other carriers;
- obligate Cingular Wireless to permit resale of its services by resellers, if it offers resale opportunities, and to serve roaming customers of other wireless carriers; and
- impose a variety of fees and charges on Cingular Wireless' business that are used to finance numerous regulatory programs and a substantial part of the FCC's budget.

Licenses are issued for only a fixed period of time, typically 10 years for CMRS licenses. Consequently, Cingular Wireless must periodically seek renewal of those licenses. The FCC will award a renewal expectancy to a CMRS wireless licensee that has provided substantial service during its past license term and has substantially complied with applicable FCC rules and policies and the Communications Act. The FCC has routinely renewed wireless licenses in the past. However, the Communications Act provides that licenses may be revoked for cause and license renewal applications denied if the FCC determines that a renewal would not serve the public interest. Violations of FCC rules may also result in monetary penalties or other sanctions. FCC rules provide that applications competing with a license renewal application may be considered in comparative hearings and establish the qualifications for competing applications and the standards to be applied in hearings.

CMRS wireless systems are subject to Federal Aviation Administration and FCC regulations governing the location, lighting and construction of antenna structures on which Cingular Wireless' antennas and associated equipment are located and are also subject to regulation under federal environmental laws and the FCC's environmental regulations, including limits on radio frequency radiation from wireless handsets and antennas on towers. Zoning and land use regulations, including compliance with historic preservation requirements, also apply to tower siting and construction activities.

Regulatory developments

The FCC eliminated the rules limiting the amount of spectrum a wireless carrier can own in a market effective January 1, 2003. Except through a case-by-case analysis of individual transactions, it has not yet replaced these spectrum limits with published rules or guidelines setting forth how the FCC will review carriers' spectrum aggregations. The FCC also eliminated the prohibition on ownership of both cellular licenses by a single entity, except it will review on a case-by-case basis applications for authority to own both cellular licenses in a rural area. Certain acquisitions of spectrum would remain subject to approval of the US Department of Justice.

The FCC has imposed rules requiring carriers to provide emergency 911 services, including enhanced 911 services that provide to local public safety dispatch agencies the caller's communications number and approximate location. Providers are required to transmit the geographic coordinates of the customer's location within accuracy parameters set forth by the FCC, either by means of network-based or handset-based technologies. Providers may not demand cost recovery as a condition of doing so, although they are permitted to negotiate cost recovery if it is not mandated by the state or local governments. Because of the delayed availability of vendor equipment that could reasonably be relied upon to comply with the FCC's location accuracy rules, Cingular Wireless and other wireless carriers negotiated settlement arrangements with the FCC that established increasingly rigorous compliance standards and deadlines.

The FCC has established federal universal service requirements that affect CMRS operators. Under the FCC's rules, CMRS providers are potentially eligible to receive universal service subsidies; however, they are also required to contribute to the federal universal service fund and may be required to contribute to state universal service funds. Contributions into the federal fund are based on the interstate and international revenues generated by the properties owned by a CMRS provider. For 2005, Cingular Wireless had payment obligations into the federal universal service fund of approximately $710. Because the amount that Cingular Wireless is required to pay into the fund is based on revenues generated by its properties, we anticipate that this amount should continue to increase over time. Cingular Wireless recovers most of this expense from its customers. Many states also are moving forward to develop state universal service fund programs. A number of these state funds require contributions, varying greatly from state to state, from CMRS providers. If these programs expand they will impose a correspondingly growing expense on Cingular Wireless' business. As mentioned, CMRS providers are now eligible to receive universal service subsidies if federal and state conditions are met. Cingular Wireless is pursuing this funding in states where the corresponding regulatory burdens do not exceed the benefits of the subsidies.

In November 2003, the FCC's rules on wireless local number portability became operative, enabling wireless customers to keep their wireless number when switching to another carrier. These rules have increased competition, costs and customer churn across the industry.

The FCC has adopted rules requiring wireless providers to provide functions to facilitate electronic surveillance by law enforcement officials pursuant to the Communications Assistance for Law Enforcement Act of 1995. These obligations are likely to result in significant costs to Cingular Wireless for the purchase, installation and maintenance of network software and other equipment needed.

The Communications Act and the FCC's rules grant various rights and impose various obligations on CMRS providers when they interconnect with the facilities of local exchange carriers. Generally, CMRS providers are entitled to ''reciprocal compensation'' in connection with the termination of wireline-originated local traffic, in which they are entitled to collect the same charges for terminating wireline-to-wireless local traffic on their system similar to the charges that the local exchange carriers levy for terminating wireless-to-wireline local calls. Interconnection agreements are typically negotiated by carriers, but in the event of a dispute, state public utility commissions, courts and the FCC all have a role in enforcing the interconnection provisions of the Communications Act. Although Cingular Wireless has interconnection agreements in place with the major local exchange carriers in virtually all of its service areas, those agreements are subject to modification, expiration or termination in accordance with their terms. Moreover, Cingular Wireless is negotiating and must continue to negotiate interconnection agreements with a number of independent telephone companies in its service areas. Until these agreements are concluded, Cingular Wireless must accrue for contractual liabilities associated with the resulting unpaid invoices from those companies. Additionally, as Cingular Wireless expands its coverage footprint, Cingular Wireless will be required to negotiate interconnection arrangements with other wireline carriers.

State regulation and local approvals

With the rapid growth and penetration of wireless services has come a commensurate surge of interest on the part of state legislatures and state public utility commissions and local governmental authorities in regulating the domestic wireless industry. This interest has taken the form of efforts to regulate customer billing, termination of service arrangements, advertising, filing of ''informational'' tariffs, certification of operation, use of handsets when driving, service quality, sales practices and many other areas. We anticipate that this trend will continue. It will require Cingular Wireless to devote legal and other resources to working with the states to respond to their concerns while minimizing, if not preventing, any new regulation that could increase Cingular Wireless' costs of doing business.

While the Communications Act generally preempts state and local governments from regulating entry of, or the rates charged by, wireless carriers, it also permits a state to petition the FCC to allow it to impose CMRS rate regulation when market conditions fail adequately to protect customers and such service is a replacement for a substantial portion of the telephone wireline exchange service within a state. No state currently has such a petition on file. In addition, the Communications Act does not expressly preempt the states from regulating the ''terms and conditions'' of wireless service.

Several states have invoked this ''terms and conditions'' authority to impose or propose various consumer protection regulations on the wireless industry. California's recently enacted, but currently suspended, rules are potentially quite costly. State attorneys general have become more active in enforcing state consumer protection laws against sales practices and services of wireless carriers. Consent decrees negotiated with or imposed by the attorneys general have the effect of indirectly regulating the targeted wireless carrier. States also may impose their own universal service support requirements on wireless and other communications carriers, similar to the contribution requirements that have been established by the FCC.

States have become more active in imposing new taxes on wireless carriers, such as gross receipts taxes, and fees for items such as the use of public rights of way. These taxes and fees are generally passed through to Cingular Wireless' customers and result in higher costs to its customers.

At the local level, wireless facilities typically are subject to zoning and land use regulation. Neither local nor state governments may categorically prohibit the construction of wireless facilities in any community or take actions, such as indefinite moratoria, which have the effect of prohibiting construction. Nonetheless, securing state and local government approvals for new tower sites has been and is likely to continue to be difficult, lengthy and costly.

COMPETITION

Wireline services

Our wireline voice services face significant competition from wireless, cable and other telecommunications service providers and VoIP providers. Competition within the wireless industry has created lower price point service offerings that include larger buckets of anytime local and long distance minutes, resulting in many customers choosing wireless service for their primary or sole voice communications option. As wireless companies expand their offerings to include high speed data services, we expect this migration trend to continue.

We are also facing increasing competition from cable companies and other entities for both our mass market broadband Internet access service and voice services. Technological developments have made it feasible for cable television networks to carry data and voice communications. Our cable competitors are increasingly targeting our mass market broadband Internet access service. New competition for our voice services is also resulting from the development of commercial applications using Internet Protocol technology, such as VoIP. Both cable companies and independent providers offer VoIP services to the public.

We compete with other telecommunication service providers for wireline customers based principally on service offerings, price and customer service. Both local and long distance services are subject to this competition. Increasing competition has resulted in innovative packaging and services that strive to simplify the customer's experience. Pricing pressures in the market have increased, resulting in opportunities for the customer to purchase value based packages and services. Competitive pressures across the board have resulted in an increase in advertising and promotional spending. Competitors are able to resell our local services, enter into commercial contracts with us, or lease separate unbundled network elements (UNEs). They can also resell long distance services at bulk rates or they can provide those services over their own facilities. In addition, an increasing number of voice and data communications networks utilizing fiber optic lines have been constructed by communications providers in all major metropolitan areas throughout our wireline service territory.

FCC rules require us to offer expanded interconnection for interstate special and switched network access transport. As a result, we must permit competitive carriers to terminate their transmission lines on our facilities in our central office buildings and other locations through collocation arrangements. The effects of the rules are to increase competition for network access transport. Furthermore, long distance carriers are increasingly connecting their lines directly to their customers' facilities, bypassing our networks and thereby avoiding network access charges entirely.

Wireless services

There is substantial and increasing competition in all aspects of the wireless communications industry. Cingular Wireless expects this to continue as consolidation in the industry continues. Cingular competes for customers based principally on its reputation, network quality, customer service, price and service offerings.

Cingular Wireless' competitors are principally the other national providers of cellular, PCS and other wireless communications services, which together with Cingular serve over 90 percent of the US wireless customers. Cingular Wireless' competitors also include regional carriers, niche carriers and resellers. Some of the indirect retailers who sell Cingular Wireless services also sell its competitors' services.

Regulatory policies favor robust competition in wireless markets. Wireless Local Number Portability (WLNP), which was implemented by the FCC late in 2003, has also increased the level of competition in the industry. WLNP allows subscribers to switch carriers without having to change their telephone numbers.

Consolidation, alliances and business ventures increase competition. Consolidation and the formation of alliances and business ventures within the wireless communications industry have occurred, and Cingular Wireless expects that this trend will continue. Consolidation may create larger, better-capitalized competitors with substantial financial, technical, marketing, distribution and other resources to compete with its product and service offerings. In addition, combinations of wireless carriers may give some domestic competitors better access to international technologies, marketing expertise and strategies and diversified sources of capital. Other large, national wireless carriers have affiliations with a number of smaller, regional wireless carriers that offer wireless services under the same national brand, thereby expanding the national carrier's perceived national scope.

Cingular Wireless' ability to compete successfully will depend, in part, on the quality of its network, customer service and sales and distribution channels, as well as its marketing efforts and its ability to anticipate and respond to various competitive factors affecting the industry. These factors include the introduction of new services and technologies, changes in consumer preferences, demographic trends, economic conditions, pricing strategies of competitors and Cingular Wireless' ability to take advantage of its relationship with BellSouth and AT&T.

Advertising & Publishing

Competition in the yellow pages industry continues to intensify. Major markets are seeing multiple competitors in the print yellow pages business, with many different media competing for advertising revenue. In addition, our online yellow pages see competition from large and small Internet search engines. Competition for directory sales agency contracts for the sale of advertising in publications of nonaffiliated companies also continues to be strong. We respond to the increasing competition and the dynamic media environment with investments in product enhancements, multiple delivery options, local promotions, customer value plans, increased advertising, and sales execution.

TECHNOLOGY

Wireline

The wireline portion of the telecommunications industry is rapidly transforming from a circuit switched voice environment to broadband services network. This transformation has fiber optic cable, Internet Protocol (IP), Ethernet and evolving Digital Subscriber Line (DSL) technologies at its core.

BellSouth is well positioned for this transformation due to the high level of fiber in its network and the advanced nature of its IP network. Approximately half the homes in the BellSouth region are expected to be within 5,000 feet of fiber and to be served by Gigabit Ethernet-fed IP aware DSL technology by December 31, 2007. This can be achieved at a reasonable economic cost due to the Company's history of fiber investment and deployment. At these short distances, data speeds of 12Mbps+ (single lines) and 24Mbps+ (two ''bonded'' lines) are possible with ADSL2+ technology, which is an evolution of DSL technology. With the completion of even more advanced standards in 2005, referred to as VDSL2, even higher speeds are expected to be possible at shorter distances in 2007.

The transformation, when complete, will allow a single converged IP network to provide voice, data, and video services. As an example of potential new services, voice over IP (VoIP) may enable cost savings and differentiated feature capabilities. VoIP can also provide the basis for converged wireless/wireline services in conjunction with Cingular. This capability would combine the best of the wireless and wireline networks in a handset that operates as a cell phone while away from the home and as a ''VoIP cordless'' while in the home, for both voice and data services. In the business markets BellSouth has been successful with IP, Ethernet and Virtual Private Network data services. The same Regional Internet Backbone that was built to support these services will potentially be used to transport VoIP and video services, again demonstrating the power of converged IP networking.

Wireless

In the US wireless telecommunications industry, there are two principal frequency bands currently licensed by the FCC for transmitting two-way voice and data signals — the 850 MHz band and the 1900 MHz band. The services provided over these two frequency bands are commonly referred to as cellular and PCS, respectively. PCS infrastructure is characterized by shorter transmission distances and the need for closer spacing of cells and towers than in a cellular network to accommodate the different characteristics of the PCS radio signals. However, PCS service does not differ functionally to the user from digital cellular service. Handsets contain receivers and transmitters that allow the user to seamlessly access both 850 and 1900 MHz networks utilizing the same technology as that of the network infrastructure.

Cingular Wireless' primary network technology is Global System for Mobile Communication (GSM) with 95% of minutes being carried on its GSM network as of December 31, 2005. Hardware and software enhancements, referred to as General Packet Radio Service (GPRS), and Enhanced Data Rates for GSM Evolution (EDGE), allow higher-speed data communications, which delivers two to three times higher data rates than GPRS technology, provides Cingular Wireless' customers with greater connectivity and communications capabilities, including faster speeds for accessing the wireless Internet.

Although many advances are still underway for enhanced capacity, performance and features in GSM/GPRS/EDGE deployed technologies, Cingular Wireless is building a network offering 3G technology using the Universal Mobile Telephone System (UMTS) standard to support significantly higher data speeds and capacity. UMTS also supports voice, so building this 3G network will obviate the need to separately augment voice infrastructures as network voice usage grows. Cingular Wireless' deployed 3G UMTS systems currently allow user average data download speeds between 220-320 Kbps, providing the capability for a variety of services such as streaming audio, video and simultaneous voice and data applications. Much like Cingular Wireless' EDGE technology, UMTS allows for packet data enabling ''always on'' connectivity, which is useful for receiving email when it arrives, versus the need to set aside time for an email download, and allowing billing based on the amount of data transferred, rather than the amount of time a given device is connected.

In January 2005, Cingular Wireless field tested a higher speed downlink component of UMTS called ''High Speed Downlink Packet Access'' (HSDPA). HSDPA has average mobile data throughput speed in the 400-700 Kbps range and theoretical data speeds of 14 Mbps. Development and deployment of UMTS with HSDPA continued throughout 2005 and, in December 2005, Cingular Wireless commercially launched 3G networks in the following markets: Austin, Baltimore, Boston, Chicago, Dallas, Houston, Las Vegas, Phoenix, Portland, Salt Lake City, San Diego, San Francisco, San Jose, Seattle, Tacoma and Washington DC. Cingular Wireless currently expects to deploy UMTS/HSDPA in most major metropolitan areas by the end of 2006.

NEW ACCOUNTING PRONOUNCEMENTS

See Note B to our consolidated financial statements for a description of new accounting pronouncements.

Critical Accounting Policies

We consider an accounting estimate to be critical if: (1) the accounting estimate requires us to make assumptions about matters that were highly uncertain at the time the accounting estimate was made, and (2) changes in the estimate that are reasonably likely to occur from period to period, or use of different estimates that we reasonably could have used, would have a material impact on our financial condition or results of operations.

Senior management regularly discusses the development and selection of these critical accounting estimates with the Audit Committee of our Board of Directors.

DEPRECIATION OF PROPERTY, PLANT AND EQUIPMENT

See Note G to our consolidated financial statements for more information regarding costs and assumptions for property, plant and equipment.

Nature of estimates required

We use the group life method to depreciate the assets of our telephone subsidiary. Telephone plant acquired in a given year is grouped into similar categories and depreciated over the remaining estimated useful life of the group. Due to rapid changes in technology and new competitors, selecting the estimated economic life of telecommunications plant and equipment requires a significant amount of judgment. We periodically review data on expected utilization of new equipment, asset retirement activity and net salvage values to determine adjustments to our depreciation rates. We also utilize studies performed by outside consultants to assist us in our determination. We have not made any changes to the lives of assets resulting in a material impact in the three years presented.

Sensitivity analysis

The effect of a one year change in the useful lives of our telephone plant accounts is shown below:

	2006 Depreciation Expense Higher/(Lower)
Increasing economic life by one year	$(275)
Decreasing economic life by one year	$340

PENSIONS AND OTHER POSTRETIREMENT BENEFIT PLANS

The measurement of our pension and other postretirement benefit obligations and costs is dependent on a variety of assumptions including estimates of the present value of projected future payments to plan participants, net of projected government prescription drug subsidy receipts, and consideration of the likelihood of potential future events such as salary and medical cost increases and changes in demographic experience. These assumptions may have an effect on the amount and timing of future contributions.

Our measurements generate unrecognized gains or losses which include changes in economic assumptions such as those for discount rates, medical trends and inflation. Other examples include, but are not limited to, differences between actual experience and our assumptions about:

- Asset returns
- Medical claims activity
- Compensation increases
- Employee separations, retirements, mortality, etc.

Because gains and losses reflect refinements in estimates as well as real changes in economic values and because some gains in one period may be offset by losses in another or vice versa, we are not required to recognize these gains and losses in the period that they occur. Instead, if the gains and losses exceed a 10 percent threshold defined in the accounting literature, we amortize the excess over the average remaining service period of active employees expected to receive benefits under the plan, generally 10 to 15 years. For a more complete description of assumptions used and the measurement of our pension and other postretirement benefit obligations and cost, refer to Note L to our consolidated financial statements.

Sensitivity analysis

The effect of the change in selected assumptions for our pension plans is:

Assumption	Percentage Point Change	December 31, 2005 Obligation Higher/(Lower)	2006 Expense Higher/(Lower)
Discount rate	+/- 0.5 pts.	$(450)/$450	$30/$(15)
Expected return on assets	+/- 1.0 pts.	–	(150)/150

The effect of the change in selected assumptions for our other benefits plans is:

Assumption	Percentage Point Change	December 31, 2005 Obligation Higher/(Lower)	2006 Expense Higher/(Lower)
Discount rate	+/- 0.5 pts.	$(680)/$730	$(50)/$50
Health care cost trend	+/- 1.0 pts.	1,200/(1,000)	175/(150)

Accounting for pension and other postretirement benefits is currently a topic under re-examination by the organizations that set accounting standards (standards setters). The decisions tentatively reached by the standard setters would require significant changes to the way we account for our defined benefit plans, including the way we record their funded status. However, the final outcome of the standard setters' deliberations has not yet been determined.

OTHER LOSS CONTINGENCIES

Other loss contingencies are recorded as liabilities when it is probable that a liability has been incurred and the amount of the loss is reasonably estimable. Disclosure is required when there is a reasonable possibility that the ultimate loss will exceed the recorded provision. Contingent liabilities are often resolved over long time periods. Estimating probable losses requires analysis of multiple forecasts that often depend on judgments about potential actions by third parties such as regulators.

OTHER SIGNIFICANT ACCOUNTING POLICIES

Other significant accounting polices, not involving the same level of measurement uncertainties as those discussed above, are nevertheless important to an understanding of the financial statements. Policies related to revenue recognition, stock-based compensation, uncollectible reserves and tax valuation allowances require difficult judgments on complex matters that are often subject to multiple sources of authoritative guidance. Certain of these matters are among topics currently under re-examination by accounting standard setters and regulators. Specific conclusions have not been reached by these standard setters, and outcomes cannot be predicted with confidence. Also see Note A to our consolidated financial statements, which discusses accounting policies that we have selected from acceptable alternatives.

Cautionary Language Concerning Forward-Looking Statements

In addition to historical information, this document contains forward-looking statements regarding business prospects, financial trends and accounting policies that may affect our future operating results, financial position and cash flows. From time to time, we also may provide oral or written forward-looking statements in other materials we release to the public. Forward-looking statements give our current expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historic or current facts. They use words such as ''will,'' ''anticipate,'' ''estimate,'' ''expect,'' ''project,'' ''intend,'' ''plan,'' ''believe,'' ''target,'' ''forecast'' and other words and terms of similar meaning in connection with any discussion of future operating or financial performance. In particular, they include statements relating to future actions, prospective products and services, future performance or results of current and anticipated products and services, sales efforts, capital expenditures, expenses, interest rates, the outcome of contingencies, such as legal proceedings, and financial results.

These statements are based on our assumptions and estimates and are subject to risks and uncertainties. For these statements, we claim the protection of the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995.

There are possible developments that could cause our actual results to differ materially from those forecast or implied in the forward-looking statements. You are cautioned not to place undue reliance on these forward-looking statements, which are current only as of the date of this filing. We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

While the below list of cautionary statements is not exhaustive, some factors, in addition to those contained throughout this document, that could affect future operating results, financial position and cash flows and could cause actual results to differ materially from those expressed in the forward-looking statements are:

- the impact and the success of Cingular Wireless, our wireless joint venture with AT&T, including marketing and product development efforts, technological changes and financial capacity;
- Cingular Wireless' failure to realize, in the amounts and within the timeframe contemplated, the capital and expense synergies and other financial benefits expected from its acquisition of AT&T Wireless as a result of technical, logistical, regulatory and other factors;
- changes in laws or regulations, or in their interpretations, which could result in the loss, or reduction in value, of our licenses, concessions or markets, or in an increase in competition, compliance costs or capital expenditures;
- continued pressures on the telecommunications industry from a financial, competitive and regulatory perspective;
- the intensity of competitive activity and its resulting impact on pricing strategies and new product offerings;
- changes in the federal and state regulations governing the terms on which we offer retail and wholesale services;
- the impact on our business of consolidation in the wireline and wireless industries in which we operate;
- the impact on our network and our business of adverse weather conditions;
- the issuance by the Financial Accounting Standards Board or other accounting bodies of new accounting standards or changes to existing standards;
- changes in available technology that increase the likelihood of our customers choosing alternate technology to our products (technology substitution);
- higher than anticipated start-up costs or significant up-front investments associated with new business initiatives;
- the outcome of pending litigation; and
- unanticipated higher capital spending from, or delays in, the deployment of new technologies.

For a detailed discussion of certain risks facing our Company, see ''Risk Factors.''

CONSOLIDATED STATEMENTS OF INCOME

BELLSOUTH CORPORATION

(IN MILLIONS, EXCEPT PER SHARE AMOUNTS)	For the Year Ended December 31, 2003	2004	**2005**
Operating Revenues:			
Communications Group	$18,269	$18,256	**$18,451**
Advertising & Publishing Group	2,033	2,005	**2,046**
All other	39	39	**50**
Total operating revenues	20,341	20,300	**20,547**
Operating Expenses:			
Cost of services and products (excludes depreciation and amortization shown separately below)	6,991	7,520	**8,067**
Selling, general, and administrative expenses	3,777	3,816	**3,873**
Depreciation and amortization	3,811	3,636	**3,661**
Provisions for restructuring and asset impairments	205	39	**276**
Total operating expenses	14,784	15,011	**15,877**
Operating income	5,557	5,289	**4,670**
Interest expense	947	916	**1,124**
Net earnings of equity affiliates	452	68	**165**
Gain on sale of operations	–	462	**351**
Other income	362	283	**240**
Income from continuing operations before income taxes	5,424	5,186	**4,302**
Provision for income taxes	1,936	1,792	**1,389**
Income from continuing operations	3,488	3,394	**2,913**
Income from discontinued operations, net of tax	101	1,364	**381**
Income before cumulative effect of changes in accounting principle	3,589	4,758	**3,294**
Cumulative effect of changes in accounting principle, net of tax	315	–	**–**
Net income	$ 3,904	$ 4,758	**$ 3,294**
Weighted-Average Common Shares Outstanding:			
Basic	1,848	1,832	**1,823**
Diluted	1,852	1,836	**1,829**
Basic Earnings Per Share:			
Income from continuing operations	$ 1.89	$ 1.85	**$ 1.60**
Discontinued operations, net of tax	$ 0.05	$ 0.74	**$ 0.21**
Cumulative effect of accounting changes, net of tax	$ 0.17	$ –	**$ –**
Net income*	$ 2.11	$ 2.60	**$ 1.81**
Diluted Earnings Per Share:			
Income from continuing operations	$ 1.88	$ 1.85	**$ 1.59**
Discontinued operations, net of tax	$ 0.05	$ 0.74	**$ 0.21**
Cumulative effect of accounting changes, net of tax	$ 0.17	$ –	**$ –**
Net income*	$ 2.11	$ 2.59	**$ 1.80**
Dividends Declared Per Common Share	$ 0.92	$ 1.06	**$ 1.14**

* *Net income per share may not sum due to rounding*

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED BALANCE SHEETS

BELLSOUTH CORPORATION

(IN MILLIONS)	December 31, 2004	**2005**
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 680	**$ 427**
Short-term investments	16	**–**
Accounts receivable, net of allowance for uncollectibles of $317 and $289	2,559	**2,555**
Material and supplies	321	**385**
Other current assets	969	**842**
Assets of discontinued operations	1,068	**–**
Total current assets	5,613	**4,209**
Investments in and advances to Cingular Wireless	22,771	**21,274**
Property, plant and equipment, net	22,039	**21,723**
Other assets	7,329	**7,814**
Intangible assets, net	1,587	**1,533**
Total assets	$59,339	**$56,553**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Debt maturing within one year	$ 5,475	**$ 4,109**
Accounts payable	1,047	**1,040**
Other current liabilities	3,018	**3,505**
Liabilities of discontinued operations	830	**–**
Total current liabilities	10,370	**8,654**
Long-term debt	15,108	**13,079**
Noncurrent Liabilities:		
Deferred income taxes	6,406	**6,607**
Other noncurrent liabilities	4,389	**4,679**
Total noncurrent liabilities	10,795	**11,286**
Shareholders' Equity:		
Common stock, $1 par value (8,650 shares authorized; 1,831 and 1,798 shares outstanding)	2,020	**2,020**
Paid-in capital	7,840	**7,960**
Retained earnings	19,267	**20,383**
Accumulated other comprehensive income (loss)	(157)	**(14)**
Shares held in trust and treasury	(5,904)	**(6,815)**
Total shareholders' equity	23,066	**23,534**
Total liabilities and shareholders' equity	$59,339	**$56,553**

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

BELLSOUTH CORPORATION

(IN MILLIONS)	2003	2004	**2005**
	For the Year Ended December 31,		
Cash Flows from Operating Activities:			
Net income	$ 3,904	$ 4,758	**$ 3,294**
Less income from discontinued operations, net of tax	(101)	(1,364)	**(381)**
Less cumulative effect of changes in accounting principle, net of tax	(315)	—	**—**
Income from continuing operations	$ 3,488	$ 3,394	**$ 2,913**
Adjustments to reconcile income to cash provided by operating activities from continuing operations:			
Depreciation and amortization	3,811	3,636	**3,661**
Provision for uncollectibles	523	384	**348**
Net earnings of equity affiliates	(452)	(68)	**(165)**
Deferred income taxes and investment tax credits	788	1,081	**306**
Pension income	(534)	(484)	**(532)**
Stock-settled compensation expense	124	116	**94**
Gain on sale of operations	–	(462)	**(351)**
Asset impairments	52	–	**166**
Net change in:			
Accounts receivable and other current assets	(55)	(419)	**(353)**
Accounts payable and other current liabilities	110	(644)	**228**
Deferred charges and other assets	299	(43)	**(128)**
Other liabilities and deferred credits	(276)	184	**440**
Other reconciling items, net	5	126	**81**
Net cash provided by operating activities from continuing operations	7,883	6,801	**6,708**
Cash Flows from Investing Activities:			
Capital expenditures	(2,926)	(3,193)	**(3,457)**
Investment in short-term instruments	(3,439)	(3,770)	**(822)**
Proceeds from sale of short-term instruments	2,291	5,363	**838**
Proceeds from sale of operations	–	3,392	**1,555**
Investments in debt and equity securities	(194)	(632)	**(285)**
Proceeds from sale of debt and equity securities	27	286	**87**
Net repayments from (advances to) Cingular Wireless	–	(646)	**1,627**
Proceeds from repayment of loans and advances	1,899	109	**2**
Settlement of derivatives on advances	(352)	(17)	**–**
Investments in equity affiliates	–	(14,445)	**(4)**
Other investing activities, net	(12)	(7)	**(24)**
Net cash used for investing activities from continuing operations	(2,706)	(13,560)	**(483)**
Cash Flows from Financing Activities:			
Net borrowings (repayments) of short-term debt	(431)	1,738	**(1,863)**
Proceeds from the issuance of long-term debt	–	6,078	**–**
Repayments of long-term debt	(1,849)	(759)	**(1,513)**
Dividends paid	(1,608)	(1,901)	**(2,051)**
Purchase of treasury shares	(858)	(151)	**(1,096)**
Other financing activities, net	67	66	**160**
Net cash (used in) provided by financing activities from continuing operations	(4,679)	5,071	**(6,363)**
Net (decrease) increase in cash and cash equivalents from continuing operations	498	(1,688)	**(138)**
Cash flows from discontinued operations (Revised - See Note D)			
Net cash provided by operating activities	646	561	**10**
Net cash used for investing activities	(140)	(997)	**(125)**
Net cash used in financing activities	(78)	(143)	**–**
Net (decrease) increase in cash and cash equivalents from discontinued operations	428	(579)	**(115)**
Net (decrease) increase in cash and cash equivalents	926	(2,267)	**(253)**
Cash and cash equivalents at beginning of period	2,021	2,947	**680**
Cash and cash equivalents at end of period	$ 2,947	$ 680	**$ 427**

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME

BELLSOUTH CORPORATION

	Number of Shares		Amount						
(IN MILLIONS)	Common Stock	Shares Held in Trust and Treasury[(a)]	Common Stock	Paid-in Capital	Retained Earnings	Accum. Other Compre-hensive Income (Loss)	Shares Held in Trust and Treasury[(a)]	Guar-antee of ESOP Debt	Total
Balance at December 31, 2002	**2,020**	**(160)**	**$2,020**	**$7,546**	**$14,531**	**$(740)**	**$(5,372)**	**$ (79)**	**$17,906**
Net Income					3,904				3,904
Other comprehensive income, net of tax						155			155
Total comprehensive income									4,059
Dividends declared					(1,696)				(1,696)
Share issuances for employee benefit plans		5		(19)	(89)		169		61
Purchase of treasury stock		(35)					(858)		(858)
Purchases and sales of treasury stock with grantor trusts				43	(112)		69		–
Stock-based compensation				137					137
Tax benefit related to stock options				22					22
ESOP activities and related tax benefit					2			79	81
Balance at December 31, 2003	**2,020**	**(190)**	**$2,020**	**$7,729**	**$16,540**	**$(585)**	**$(5,992)**	**$ –**	**19,712**
Net Income					4,758				4,758
Other comprehensive income, net of tax						428			428
Total comprehensive income									5,186
Dividends declared					(1,934)				(1,934)
Share issuances for employee benefit plans		7		(59)	(94)		241		88
Purchase of treasury stock		(6)					(151)		(151)
Purchases and sales of treasury stock with grantor trusts				2			(2)		–
Stock-based compensation				121					121
Tax benefit related to stock options				39					39
Other				8	(3)				5
Balance at December 31, 2004	**2,020**	**(189)**	**$2,020**	**$7,840**	**$19,267**	**$(157)**	**$(5,904)**	**$ –**	**$23,066**
Net Income					3,294				3,294
Other comprehensive income, net of tax						143			143
Total comprehensive income									3,437
Dividends declared					(2,087)				(2,087)
Share issuances for employee benefit plans		8		(58)	(91)		265		116
Purchase of treasury stock		(41)					(1,096)		(1,096)
Purchases and sales of treasury stock with grantor trusts				80			(80)		–
Stock-based compensation				94					94
Tax benefit related to stock options				4					4
Balance at December 31, 2005	**2,020**	**(222)**	**$2,020**	**$7,960**	**$20,383**	**$ (14)**	**$(6,815)**	**$ –**	**$23,534**

(a) Trust and treasury shares are not considered to be outstanding for financial reporting purposes. As of December 31, 2005, there were approximately 17 shares held in trust and 205 shares held in treasury.

The accompanying notes are an integral part of these consolidated financial statements.

Note A – Accounting Policies

In this report, BellSouth Corporation and its subsidiaries are referred to as ''we'', the ''Company'' or ''BellSouth.''

ORGANIZATION

We are a communications company headquartered in Atlanta, Georgia. For management purposes, our operations are organized into three reportable segments: Communications Group; Wireless; and Advertising & Publishing Group.

BASIS OF PRESENTATION

The consolidated financial statements include the accounts of BellSouth's wholly-owned subsidiaries and subsidiaries in which we have a controlling financial interest. Investments in businesses that we do not control, but have the ability to exercise significant influence over operations and financial policies, are accounted for using the equity method. All significant intercompany transactions and accounts have been eliminated. We own a 40 percent economic interest in Cingular Wireless and we share control with AT&T. Accordingly, we account for this investment under the equity method. Certain amounts in the prior period consolidated financial statements have been reclassified to conform to the current year's presentation.

In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, ''Accounting for the Impairment or Disposal of Long-Lived Assets'' (SFAS No. 144), we have classified the results of our Latin American segment as discontinued operations. The presentation of discontinued operations includes revenues and expenses of the Latin American operations as one line item on the income statement for all periods presented. All Latin America related balance sheet items at December 31, 2004 are presented in the assets and liabilities of Discontinued Operations line items.

USE OF ESTIMATES

Our consolidated financial statements have been prepared in accordance with Generally Accepted Accounting Principles (GAAP). We are required to make estimates and assumptions that affect amounts reported in our financial statements and the accompanying notes. Actual results could differ from those estimates.

CASH AND CASH EQUIVALENTS

We consider all highly liquid investments with an original maturity of three months or less to be cash equivalents. Investments with an original maturity of over three months to one year are not considered cash equivalents and are included as other current assets in the consolidated balance sheets. Interest income on cash equivalents and temporary cash investments in continuing operations was $76 for 2003, $60 for 2004, and $23 for 2005.

Included in the December 31, 2004 cash balance of $680 are cash balances of $148 held by our discontinued operations in Latin America.

SHORT-TERM INVESTMENTS

Short-term investments represent auction rate securities which are highly liquid, variable-rate debt securities. While the underlying security has a long-term nominal maturity, the interest rate is reset through dutch auctions that are typically held every 7, 28 or 35 days, creating a short-term instrument. The securities trade at par and are callable at par on any interest payment date at the option of the issuer. Interest is paid at the end of each auction period.

MATERIAL AND SUPPLIES

New and reusable material held at our telephone subsidiary is carried in inventory, principally at average cost, except that specific costs are used in the case of large individual items. Non-reusable material is carried at estimated salvage value. Inventories of our other subsidiaries are stated at the lower of cost or market, with cost determined principally on either an average cost or first-in, first-out basis.

PROPERTY, PLANT AND EQUIPMENT

The investment in property, plant and equipment is stated at original cost. For plant dedicated to providing regulated telecommunications services, depreciation is based on the group remaining life method of depreciation and straight-line rates determined on the basis of equal life groups of certain categories of telephone plant acquired in a given year. This method requires the periodic revision of depreciation rates. When depreciable telephone plant is disposed of, the original cost less any net salvage proceeds is charged to accumulated depreciation. We perform inventories of the telephone plant to verify the existence of these assets and reconcile these inventories to our property records. In addition, the inventory reconciliation results allow us to correct our records for investment moved from one location to another and to account for delayed retirements. The cost of other property, plant and equipment is depreciated using either straight-line or accelerated methods over the estimated useful lives of the assets. Depreciation of property, plant and equipment in continuing operations was $3,257 for 2003, $3,039 for 2004, and $3,058 for 2005.

Gains or losses on disposal of other depreciable property, plant and equipment are recognized in the year of disposition as an element of Other income (expense), net. The cost of maintenance and repairs of plant, including the cost of replacing minor items not resulting in substantial betterments, is charged to operating expenses. Interest expense and network engineering costs incurred during the construction phase of our networks are capitalized as part of property, plant and equipment until the projects are completed and placed into service.

VALUATION OF LONG-LIVED ASSETS

Long-lived assets, including property, plant and equipment and intangible assets with finite lives are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The communications industry is rapidly evolving and therefore it is reasonably possible that our long-lived assets could become impaired as a result of technological or other industry changes. For assets we intend to hold for use, if the total of the expected future undiscounted cash flows is less than the carrying amount of the asset, we recognize a loss for the difference between the fair value and carrying value of the asset. For assets we intend to dispose of, we recognize a loss for the amount that the estimated fair value, less costs to sell, is less than the carrying value of the assets. We principally use the discounted cash flow method to estimate the fair value of long-lived assets.

We account for equity security investments in which we exercise significant influence under the equity method of accounting. In accordance with Accounting Principles Board (APB) Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock, we periodically review equity method investments for impairment. These reviews are performed to determine whether a decline in the fair value of an investment below its carrying value is deemed to be other than temporary.

FOREIGN CURRENCY

Assets and liabilities of foreign subsidiaries and equity investees with a functional currency other than US Dollars are translated into US Dollars at exchange rates in effect at the end of the reporting period. Foreign entity revenues and expenses are translated into US Dollars at the average rates that prevailed during the period. The resulting net translation gains and losses are reported as foreign currency translation adjustments in shareholders' equity as a component of accumulated other comprehensive income (loss).

COST METHOD INVESTMENTS

We have investments in marketable securities, primarily common stocks, which are accounted for under the cost method. Securities classified as available-for-sale under SFAS No. 115, ''Accounting for Certain Investments in Debt and Equity Securities,'' are carried at fair value, with unrealized gains and losses, net of income taxes, recorded in accumulated other comprehensive income (loss) in the statement of changes in shareholders' equity and comprehensive income. The fair values of individual investments in marketable securities are determined based on market quotations. Gains or losses are calculated based on the original cost of the specific investment. We periodically review cost method investments for impairment. These reviews are performed to determine whether a decline in the fair value of an investment below its carrying value is deemed to be other than temporary. Equity securities that are restricted for more than one year or not publicly traded are recorded at cost.

DERIVATIVE FINANCIAL INSTRUMENTS

We generally enter into derivative financial instruments only for hedging purposes. In hedging the exposure to variable cash flows or foreign currency impacts on forecasted transactions, deferral accounting is applied when the derivative reduces the risk of the underlying hedged item effectively as a result of high inverse correlation with the value of the underlying exposure. If a derivative instrument either initially fails or later ceases to meet the criteria for deferral accounting, any subsequent gains or losses are recognized currently in income. In hedging the exposure to changes in the fair value of a recognized asset or liability, the change in fair value of both the derivative financial instrument and the hedged item are recognized currently in income. Cash flows resulting from derivative financial instruments are classified in the same category as the cash flows from the items being hedged.

REVENUE RECOGNITION

Revenues are recognized when earned. Certain revenues derived from local telephone services are billed monthly in advance and are recognized the following month when services are provided. Revenues derived from other telecommunications services, principally network access, long distance and wireless airtime usage, are recognized monthly as services are provided. Marketing incentives, including cash coupons, package discounts and free service are recognized as revenue reductions and are accrued in the period the service is provided. With respect to coupons, accruals are based on historical redemption experience. While cash is generally received at the time of sale, revenues from installation and activation activities are deferred and recognized over the life of the customer relationship, which is generally four years. Print Advertising & Publishing revenues and related directory costs are recognized ratably over the life of the related directory, generally 12 months. Allowances for uncollectible accounts are determined based on analysis of history and future expectations. The provision for such uncollectible accounts in continuing operations was $523 for 2003, $384 for 2004, and $348 for 2005.

DEFERRED ACTIVATION AND INSTALLATION EXPENSES

We defer certain expenses associated with installation and activation activities. Expense is only deferred to the extent associated revenues are deferred. Service costs in excess of revenues are recognized in the period incurred. The deferred costs are recognized over approximately 4 years.

ADVERTISING

We expense advertising costs as they are incurred. These expenses include production, media and other promotional and sponsorship costs. Our total advertising expense in continuing operations was $300 for 2003, $328 for 2004, and $298 for 2005.

INCOME TAXES

The consolidated balance sheets reflect deferred tax balances associated with the anticipated tax impact of future income or deductions implicit in the consolidated balance sheets in the form of temporary differences. Temporary differences primarily result from the use of accelerated methods and shorter lives in computing depreciation for tax purposes and the basis differential related to our equity investment in Cingular Wireless. Interest payable on settlement of prior years' tax returns is included as a component of interest expense in the consolidated income statement.

EARNINGS PER SHARE

Basic earnings per share are computed based on the weighted-average number of common shares outstanding during each year. Nonvested restricted stock carries dividend and voting rights and, in accordance with GAAP, is not included in the weighted average number of common shares outstanding used to compute basic earnings per share. Diluted earnings per share are based on the weighted-average number of common shares outstanding plus net incremental shares arising out of employee stock compensation and benefit plans. The earnings amounts used for per-share calculations are the same for both the basic and diluted methods. The following is a reconciliation of the weighted-average share amounts (in millions) used in calculating earnings per share:

	2003	2004	**2005**
Basic common shares outstanding	1,848	1,832	**1,823**
Incremental shares from stock-based compensation and benefit plans	4	4	**6**
Diluted common shares outstanding	1,852	1,836	**1,829**
Stock options excluded from the computation	92	79	**77**

Options with an exercise price greater than the average market price of the common stock or that have an anti-dilutive effect on the computation are excluded from the calculation of diluted earnings per share.

INTANGIBLE ASSETS

Intangible assets are comprised of capitalized software, intellectual property and FCC wireless spectrum licenses. The Company capitalizes certain costs incurred in connection with developing or obtaining internal use software in accordance with American Institute of Certified Public Accountants Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. Capitalized costs include direct development costs associated with internal use software, including internal direct labor costs and external costs of materials and services. Capitalized software costs are being amortized on a straight-line basis generally over periods of three to five years. Costs incurred during the preliminary project stage, as well as maintenance and training costs, are expensed as incurred. Intellectual property consists primarily of capitalized costs associated with patents, copyright and trademarks. Licenses to wireless spectrum represent authorizations to provide service in specific geographic services areas on WCS and MMDS spectrum. The Company has determined that its FCC spectrum licenses should be treated as indefinite-lived intangible assets. Amortization of intangibles in continuing operations was $554 for 2003, $597 for 2004, and $603 for 2005.

We test indefinite-lived intangible assets for impairment on an annual basis. Additionally, indefinite-lived intangible assets are tested between annual tests if events or changes in circumstances indicate that the asset might be impaired. These events or circumstances would include a significant change in the business climate, legal factors, operating performance indicators, competition, sale or disposition of a significant portion of the business or other factors.

Note B – Recently Issued Accounting Pronouncements

SHARE-BASED PAYMENTS

In December 2004, the FASB issued SFAS No. 123 (Revised 2004), "Share-Based Payment." This standard amends and clarifies the accounting for stock compensation plans under SFAS No. 123, "Accounting for Stock-Based Compensation," which we adopted effective January 1, 2003. Effective January 1, 2006, we adopted the revised statement. The adoption did not have a material impact on our results of operations, financial position or cash flows.

CONDITIONAL ASSET RETIREMENT OBLIGATIONS

In March 2005, the FASB issued FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations" (FIN 47). FIN 47 clarifies that the term conditional asset retirement obligation as used in FASB Statement No. 143, "Accounting for Asset Retirement Obligations," (SFAS No. 143) refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. We adopted the provisions of this interpretation effective December 31, 2005. There was no material impact on our results of operations, financial position or cash flows.

DOLLARS ARE IN MILLIONS, EXCEPT PER SHARE AMOUNTS AND AS OTHERWISE INDICATED

Note C – Changes in Accounting Principle

ASSET RETIREMENT OBLIGATIONS

SFAS No. 143 provides the accounting for the cost of legal obligations associated with the retirement of long-lived assets. SFAS No. 143 requires that companies recognize the fair value of a liability for asset retirement obligations in the period in which the obligations are incurred and capitalize that amount as part of the book value of the long-lived asset. SFAS No. 143 also precludes companies from accruing removal costs that exceed gross salvage in their depreciation rates and accumulated depreciation balances if there is no legal obligation to remove the long-lived assets. For our outside plant accounts, such as telephone poles and cable, estimated cost of removal does exceed gross salvage.

Although we have no legal obligation to remove assets, we have historically included in our group depreciation rates estimated net removal costs associated with these outside plant assets in which estimated cost of removal exceeds gross salvage. These costs have been reflected in the calculation of depreciation expense, which results in greater periodic depreciation expense and the recognition in accumulated depreciation of future removal costs for existing assets. When the assets are actually retired and removal costs are expended, the net removal costs are recorded as a reduction to accumulated depreciation.

In connection with the adoption of this standard, we removed existing accrued net costs of removal in excess of the related estimated salvage from our accumulated depreciation for those accounts. The adjustment was reflected in the 2003 income statement as a cumulative effect of accounting change adjustment and on the balance sheet as an increase to net plant and equipment of $1,334 and an increase to deferred income taxes of $518. The cumulative effect of change increased net income by $816 for the year ended December 31, 2003.

REVENUE RECOGNITION FOR PUBLISHING REVENUES

Effective January 1, 2003, we changed our method for recognizing revenues and expenses related to our directory publishing business from the publication and delivery method to the deferral method. Under the publication and delivery method, we recognized 100 percent of the revenues and direct expenses at the time the directories were published and delivered to end-users. Under the deferral method, revenues and direct expenses are recognized ratably over the life of the related directory, generally 12 months. The change in accounting method is reflected in the 2003 income statement as a cumulative effect of accounting change adjustment and on the balance sheet as a decrease to accounts receivable of $845, increase to other current assets of $166, increase to current liabilities of $129, and a decrease to deferred income taxes of $307. The cumulative effect of the change resulted in a decrease to net income of $501 for 2003. Absent this one-time adjustment, the change in accounting did not materially affect our annual results.

Note D – Discontinued Operations

In March 2004, we signed an agreement with Telefónica Móviles, S.A., the wireless affiliate of Telefónica, S.A., to sell all of our interests in Latin America.

During October 2004, we closed on the sale of 8 of the 10 properties: Venezuela, Colombia, Ecuador, Peru, Guatemala, Nicaragua, Uruguay and Panama. During January 2005, we closed on the sale of the operations in the remaining two Latin American countries: Argentina and Chile.

SUMMARY OF SALE TRANSACTIONS

	Gross Proceeds	After-Tax Gain
For the Year Ended December 31:		
2004	$4,037	$ 850
2005	**$1,077**	**$ 390**
Total	$5,114	$1,240

The 2004 gain includes the recognition of cumulative foreign currency translation losses of $421 and the 2005 gain includes the recognition of cumulative foreign currency translation losses of $68.

SUMMARY FINANCIAL INFORMATION

Summarized results for the discontinued operations are as follows:

	For the Year Ended December 31,		
	2003	2004	**2005**
Operating revenue	$2,294	$2,429	**$ 66**
Operating income (loss)	$ 349	$ 647	**$ (5)**
Gain on sale of operations	$ –	$1,312	**$629**
Income before income taxes	$ 176	$1,525	**$616**
Provision for income taxes	$ 75	$ 161	**$235**
Net income from discontinued operations	$ 101	$1,364	**$381**

CASH FLOW INFORMATION

In 2005, the Company has separately disclosed the operating, investing, and financing portions of the cash flows attributable to its discontinued operations, which were, in prior periods, reported on a combined basis as a single amount.

Note E – Investments in and Advances to Cingular Wireless

	As of December 31, 2004	As of December 31, 2005
Investment	$18,311	**$18,447**
Advances	4,460	**2,827**
	$22,771	**$21,274**

INVESTMENT

We own a 40 percent economic interest in Cingular Wireless, and share joint control of the venture with AT&T. The following table presents 100 percent of Cingular Wireless' assets, liabilities, and results of operations as of and for the year ended December 31:

	2004	2005
Balance Sheet Information:		
Current assets	$ 5,570	**$ 6,049**
Noncurrent assets	$76,668	**$73,270**
Current liabilities	$ 7,983	**$10,008**
Noncurrent liabilities	$29,110	**$23,790**
Minority Interest	$ 609	**$ 543**
Members' capital	$44,536	**$44,978**

	2003	2004	2005
Income Statement Information:			
Revenues	$15,577	$19,565	**$34,433**
Operating Income	$ 2,254	$ 1,528	**$ 1,824**
Net Income	$ 977	$ 201	**$ 333**

As of December 31, 2004 and 2005, our book investment exceeded our proportionate share of the net assets of Cingular Wireless by $497 and $456, respectively. As of December 31, 2005, $1,510 of our consolidated retained earnings represented undistributed earnings from Cingular Wireless.

On October 26, 2004, Cingular Wireless completed its acquisition of AT&T Wireless, creating the largest wireless carrier in the United States based on the number of customers and revenue. Cingular Wireless' cash purchase price for AT&T Wireless shares totaled approximately $41 billion. That amount was funded by equity contributions from Cingular Wireless' two owners in proportion to their equity ownership of Cingular Wireless — 60 percent for AT&T (formerly SBC) and 40 percent for BellSouth — with the remainder provided from cash on hand at AT&T Wireless. BellSouth's portion of the funding, which was reflected as an increase in our investment in Cingular Wireless, was approximately $14.4 billion.

ADVANCE

We have an advance to Cingular Wireless that was $3,792 at December 31, 2004 and $2,622 at December 31, 2005. The advance bears interest at 6% per annum and has a maturity date of June 30, 2008. Cingular Wireless may generally prepay the advance at any time, and is obligated to prepay the advance to the extent of excess cash (as defined) pursuant to the Revolving Line of Credit. The advance is subordinated to Cingular Wireless' Senior Notes, including the Senior Notes of AT&T, and other borrowings of external parties as defined in our agreement with Cingular Wireless.

REVOLVING LINE OF CREDIT

Effective August 1, 2004, BellSouth and AT&T (formerly SBC) agreed to finance their respective pro rata shares of Cingular Wireless' capital and operating cash requirements based upon Cingular Wireless' budget and forecasted cash needs. Borrowings under this agreement bear interest at 1-Month LIBOR plus 0.05% payable monthly. In conjunction with the signing of the agreement, Cingular Wireless terminated its bank credit facilities and ceased issuing commercial paper and long-term debt. Available cash (as defined) generated by Cingular Wireless is applied on the last day of the month to the repayment of the advances from BellSouth and AT&T. With regard to any interim loans Cingular Wireless makes to BellSouth from time to time, BellSouth pays Cingular Wireless interest on the excess cash at 1-Month LIBOR. The line of credit terminates on July 31, 2007. As of December 31, 2004 and 2005, the balance outstanding under the revolving credit line, including interest, was $668 and $204, respectively.

PROVISION OF SERVICES

We also generate revenues from Cingular Wireless in the ordinary course of business for the provision of local interconnection services, long distance services, sales agency fees and customer billing and collection fees.

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SUMMARY OF FINANCIAL TRANSACTIONS WITH CINGULAR

	For the Year Ended December 31,		
	2003	2004	**2005**
Revenues	$426	$537	**$724**
Interest income on advances	$256	$230	**$204**
Interest expense on credit line	$ –	$ –	**$ 2**

Interest income on advances is offset by a like amount of interest expense recorded by Cingular Wireless and reported in our financial statements in the caption ''Net earnings of equity affiliates.''

Receivables and payables incurred in the ordinary course of business are recorded in our balance sheets as follows:

	As of December 31,	
	2004	**2005**
Receivable from Cingular Wireless	$56	**$51**
Payable to Cingular Wireless	$44	**$54**

Note F – Other Assets

Other assets at December 31 consist of the following:

	2004	**2005**
Deferred activation and installation expenses	$1,405	**$1,227**
Prepaid pension and postretirement benefits	4,291	**4,915**
Equity method investments other than Cingular Wireless	275	**33**
Cost method investments	921	**1,192**
Other	437	**447**
Other assets	$7,329	**$7,814**

DEFERRED ACTIVATION AND INSTALLATION EXPENSES

Deferred activation and installation expenses December 31, 2003	$1,614
Amortization of previous deferrals	(811)
Current period deferrals	602
Deferred activation and installation expenses December 31, 2004	1,405
Amortization of previous deferrals	(730)
Current period deferrals	552
Deferred activation and installation expenses December 31, 2005	$1,227

EQUITY METHOD INVESTMENTS OTHER THAN CINGULAR

Ownership in equity investments other than Cingular Wireless at December 31 is as follows:

	2004		**2005**	
	Ownership Percentage	Investment Balance	Ownership Percentage	Investment Balance
Cellcom (Israel)	34.8%	$242	**–**	**$ –**
Internet Yellow Pages	34.0%	33	**34.0%**	**33**
		$275		**$33**

INVESTMENT IN CELLCOM

In May 2005 we signed an agreement with Discount Investment Corp Ltd. (Discount) to sell our 50 percent interest in Tele-Man Netherlands B.V. (Tele-Man), which holds a 69.5 percent interest in Cellcom Israel Ltd. (Cellcom), a cellular communications operator in Israel. Our book basis in the investment exceeded the tax basis by approximately $263. No US tax expense was previously recognized on income generated by the Israeli operations due to the essentially permanent duration of the investment. The agreement with Discount provided evidence that the temporary difference would reverse in the foreseeable future, and, accordingly, we recognized a tax liability of $92 in 2005.

In September 2005, we closed the transaction and received gross proceeds of $625 and recorded a gain of $351, or $228 net of tax. The gain includes the recognition of cumulative foreign currency translation losses of $10.

COST METHOD INVESTMENTS

We have investments in marketable securities, primarily common stocks, which are accounted for under the cost method. These investments are held in grantor trusts and our captive insurance subsidiary. The grantor trusts are designed to provide funding for benefits payable under certain nonqualified benefit plans. The trusts are irrevocable and the assets contributed to the trusts can only be used to pay such benefits but are subject to the claims of general creditors of the Company in the event of the Company's insolvency.

The components of cost investments are as follows:

	Cost Basis	Unrealized Gain (Loss)	Recorded Basis
Equity securities with unrealized gains	$ 633	$111	$ 744
Equity securities with unrealized losses < 1 year	108	(11)	97
Total equity securities	741	100	841
Total debt securities	60	–	60
Other investments	20	–	20
As of December 31, 2004	$ 821	$100	$ 921
Equity securities with unrealized gains	**$ 682**	**$199**	**$ 881**
Equity securities with unrealized losses < 1 year	**92**	**(5)**	**87**
Equity securities with unrealized losses > 1 year	**136**	**(14)**	**122**
Total equity securities	**910**	**180**	**1,090**
Debt securities	**12**	**–**	**12**
Debt securities with unrealized losses > 1 year	**82**	**(2)**	**80**
Total debt securities	**94**	**(2)**	**92**
Other investments	**10**	**–**	**10**
As of December 31, 2005	**$1,014**	**$178**	**$1,192**

Since we held a well-diversified portfolio, no single common stock comprises a material unrealized loss. We evaluate the near-term prospects of our investment holdings in relation to the severity and duration of unrealized losses. Based on that evaluation and our ability and intent to hold those investments for a reasonable period of time sufficient for a forecasted recovery of fair value, we do not consider these investments to be other-than-temporarily impaired at December 31, 2005.

Note G – Supplemental Balance Sheet and Cash Flow Information

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is summarized as follows at December 31:

	Estimated Depreciable Lives (In Years)	Average Remaining Life	2004	**2005**
Central office equipment	8–11	4.6	$26,539	**$27,029**
Outside plant:				
Copper cable	15–16	6.6	20,440	**20,615**
Fiber cable	20	10.9	3,270	**3,519**
Poles and conduit	36–55	28.0	3,620	**3,631**
Operating and other equipment	5–15	3.4	1,684	**1,672**
Building and building improvements	25–45	28.0	4,597	**4,635**
Furniture and fixtures	10–15	9.3	2,429	**2,388**
Station equipment	6	3.2	542	**569**
Land	–	–	274	**277**
Plant under construction	–	–	206	**239**
			63,601	**64,574**
Less: accumulated depreciation			41,562	**42,851**
Property, plant and equipment, net			$22,039	**$21,723**

INTANGIBLE ASSETS

Intangible assets are summarized as follows at December 31:

	2004	**2005**
Capitalized software	$2,930	**$2,924**
Intellectual property	37	**40**
Wireless licenses	20	**34**
	2,987	**2,998**
Less: accumulated amortization	1,400	**1,465**
Intangible assets, net	$1,587	**$1,533**

The following table presents current and expected amortization expense of the existing intangible assets as of December 31, 2005 for each of the following periods:

Aggregate amortization expense:	
For the year ended December 31, 2005	$603
Expected amortization expense:	
For the year ended December 31,	
2006	$525
2007	401
2008	277
2009	167
2010	55

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OTHER CURRENT LIABILITIES

Other current liabilities are summarized as follows at December 31:

	2004	**2005**
Advanced billing and customer deposits	$ 832	**$ 785**
Interest and rents accrued	382	**342**
Taxes payable	222	**642**
Dividends payable	493	**529**
Salaries and wages payable	403	**392**
Accrued compensated absences	229	**236**
Restructuring and severance accrual	26	**100**
Other	431	**479**
Other current liabilities	$3,018	**$3,505**

OTHER NONCURRENT LIABILITIES

Other noncurrent liabilities are summarized as follows at December 31:

	2004	**2005**
Deferred installation and activation revenues	$1,405	**$1,227**
Accrued postretirement benefits	1,136	**1,597**
Deferred credits	652	**578**
Compensation related accruals	879	**974**
Postemployment benefits	254	**228**
Derivatives liability	32	**44**
Other	31	**31**
Other noncurrent liabilities	$4,389	**$4,679**

SUPPLEMENTAL CASH FLOW FROM CONTINUING OPERATIONS INFORMATION

	2003	2004	**2005**
Cash paid for:			
Income taxes	$ 678	$1,279	**$ 816**
Interest	$ 867	$ 842	**$1,056**

INVESTMENT IN AND ADVANCE TO SONOFON

On February 12, 2004, we sold our interest in Danish wireless provider, Sonofon, for 3.68 billion Danish Kroner to Telenor ASA. We received 3.05 billion Danish Kroner, or $525, for our 46.5 percent equity stake and 630 million Danish Kroner, or $109, for our shareholder loan and accrued interest, reduced by a settlement of $17 associated with foreign currency swap contracts. As a result of these transactions, we recorded a gain of $462, or $295 net of tax, which included the recognition of cumulative foreign currency translation gains of $13.

Note H – Debt

DEBT MATURING WITHIN ONE YEAR

Debt maturing within one year is summarized as follows at December 31:

	2004	**2005**
Commercial paper	$3,248	**$1,386**
Current maturities of long-term debt	2,227	**2,723**
Debt maturing within one year	$5,475	**$4,109**

Weighted-average interest rate at end of period:

	2004	**2005**
Commercial paper	2.26%	**4.22%**

Credit lines at end of period:

	2004	**2005**
Available committed credit lines	$3,523	**$3,000**
Borrowings under credit lines	$ –	**$ –**

There are no significant commitment fees or requirements for compensating balances associated with any lines of credit.

LONG-TERM DEBT

Interest rates and maturities in the table below are for the amounts outstanding at December 31:

		2004	**2005**
Issued by BellSouth Telecommunications, Inc.			
5.85%–5.88%	2009–2045(1)	$ 437	**$ 429**
6.13%–7%	2006–2033(1)	1,949	**1,091**
7.63%	2035	300	**–**
7%	2095	500	**500**
2.48%–4.37%	Extendible liquidity securities due 2006	745	**410**
6.65%	Zero-to-full debentures due 2095	232	**248**
6.3%	Amortizing debentures due 2015	261	**244**
Issued by BellSouth Corporation			
2.42%–4.47%	2007	500	**500**
4.2%–4.75%	2009–2012(1)	2,299	**2,285**
5%–6.88%	2006–2034(1)	6,631	**6,623**
7.75%–7.88%	2010–2030(1)	2,000	**1,996**
7.12%	2097	500	**500**
4.09%–4.26%	20-put-1 remarketable securities due 2021	1,000	**1,000**
Capital leases and other		58	**37**
Unamortized discount, net of premium		(77)	**(61)**
		17,335	**15,802**
Current maturities		(2,227)	**(2,723)**
Long-term debt		$15,108	**$13,079**

(1) These debt maturities are affected by FAS 133 accounting requirements to mark hedged debt to fair value.

Several issues of long-term debt contain embedded options, which may require us to repurchase the debt or which may alter the interest rate associated with that debt. Those issues, and their related options, are as follows:

Issue	Date of Put Option
20-put-1 remarketable securities due 2021	Annually in April
Putable debentures	November 2006

If the holders of the remarketing agreement on the 20-put-1 remarketable securities do not require us to repurchase the securities, the interest rates for these securities will be reset based on current market conditions. Since the 20-put-1 securities can be put to us annually, the balance is included in current maturities of long-term debt in our balance sheet. Holders of our 6.04% bond maturing November 15, 2026, have a one-time ability to put the bond back to us on November 15, 2006. Therefore, the balance of $281 is included in current maturities of long-term debt in our balance sheet.

The Amortizing debentures pay against principal on a semi-annual basis and were issued with an original principal balance of $375. The Zero-to-full debentures will accrete to a total principal balance of $500 in 2015, at which time we will begin paying interest through the maturity in 2095.

Maturities of long-term debt outstanding, in principal amounts, at December 31, 2005 are summarized below. Maturities after the year 2010 include the final principal amount of $500 for the Zero-to-full debentures due in 2095.

Maturities	
2006	$ 2,723
2007	526
2008	611
2009	1,855
2010	1,022
Thereafter	9,378
Total	$16,115

We did not issue any long-term debt during 2005. The table below summarizes long-term debt repayments made during 2005:

	Rate	Maturity	Principal
Maturing debt:			
	6.50%		$ 300
	7.00%		$ 150
	2.42%		$ 110
	3.39%		$ 225
Early redemptions:			
	6.75%	2033	$ 400
	7.63%	2035	$ 300

In connection with the early redemptions, we recognized a $42 loss, which included $18 associated with fully expensing remaining discount and deferred debt issuance costs.

At December 31, 2005, we had a shelf registration statement on file with the Securities and Exchange Commission under which $3,100 of debt securities could be publicly offered.

Note I – Income Taxes

The consolidated balance sheets reflect the anticipated tax impact of future taxable income or deductions implicit in the consolidated balance sheets in the form of temporary differences. These temporary differences reflect the difference between the basis in assets and liabilities as measured in the consolidated financial statements and as measured by tax laws using enacted tax rates.

The provision for income taxes attributable to continuing operations is summarized as follows:

	2003	2004	**2005**
Current			
Federal	$1,020	$ 645	**$ 983**
State	128	66	**100**
	1,148	711	**1,083**
Deferred, net			
Federal	730	1,010	**351**
State	85	71	**(45)**
	815	1,081	**306**
Investment tax credits, net			
Federal	(27)	–	**–**
Total provision for income taxes	$1,936	$1,792	**$1,389**

Temporary differences which gave rise to deferred tax assets and (liabilities) at December 31 were as follows:

	2004	2005
Operating loss and tax credit carryforwards	$ 363	**$ 412**
Capital loss carryforwards	658	**390**
Allowance for uncollectibles	125	**122**
Deferred revenue	231	**214**
Other	146	**149**
	1,523	**1,287**
Valuation Allowance	(873)	**(732)**
Deferred tax assets	$ 650	**$ 555**
Tangible and intangible property	$(4,667)	**$(4,551)**
Equity investments	(1,853)	**(2,133)**
Compensation related	(131)	**(117)**
Other	(147)	**(98)**
Deferred tax liabilities	(6,798)	**(6,899)**
Net deferred tax liability	$(6,148)	**$(6,344)**

Balance sheet classification as of December 31,

	2004	2005
Current deferred tax asset	$ 258	**$ 263**
Noncurrent deferred tax liability	(6,406)	**(6,607)**
Net deferred tax liability	$(6,148)	**$(6,344)**

The valuation allowance was established to reduce deferred tax assets associated with excess US capital losses, state operating losses, and state credits that may not be utilized during the carryforward period. The carryforward periods for the excess capital losses expire in 2007 and 2008. The operating losses relate to state losses and credit carryforwards expiring in various years beginning in 2006.

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At December 31, 2005, net deferred tax liabilities include a deferred tax asset of $360 relating to compensation expense recognized under SFAS 123, Accounting for Stock-Based Compensation. Full realization of the deferred asset requires stock options to be exercised at a price equaling the sum of the strike price plus the fair value at the grant date. A significant number of the options for which a tax benefit has been recognized have a combined strike price and fair value at grant date in excess of $45. Accordingly, there can be no assurance that the stock price of BellSouth will rise to levels sufficient to realize the entire tax benefit currently reflected in our balance sheet. The provisions of SFAS 123 prohibit us from recording a valuation allowance on the deferred tax asset related to these options. If the full value of the deferred tax asset is not realized either at the exercise or expiration of the options, the deferred tax asset will reverse against equity to the extent of previously recognized excess tax benefits, otherwise against income tax expense. At December 31, 2005, accumulated excess tax benefits of $75 have been recorded to equity. The amount of these accumulated excess tax benefits may increase upon the adoption of SFAS 123 (Revised 2004).

A reconciliation of the federal statutory income tax rate to the effective tax rate attributable to continuing operations follows:

	2003	2004	**2005**
Federal statutory tax rate	35.0%	35.0%	**35.0%**
State income taxes, net of federal income tax benefit	2.6	1.7	**0.8**
Net earnings (losses) of equity affiliates	(0.3)	(0.3)	**(0.2)**
Investment tax credits	(0.3)	–	**–**
Medicare drug subsidy	–	(0.6)	**(1.0)**
Valuation allowance release on capital losses	–	–	**(2.5)**
Other	(1.3)	(1.2)	**0.2**
Effective tax rate	35.7%	34.6%	**32.3%**

The decrease in valuation allowance on deferred tax assets during 2005 relates primarily to greater than expected capital loss utilization in connection with the gain on sale of our investment in Cellcom. This benefit was partially offset by recognition of a deferred tax liability for the excess of book basis over tax basis in Cellcom.

Note J – Hurricane Katrina

On August 29, 2005, Hurricane Katrina caused catastrophic damage in the areas of Louisiana, Mississippi and Alabama. The financial impacts of the storm to the Company included lower revenue as we issued $99 in proactive billing credits to address service outages and significant customer dislocation in the hardest-hit areas. In addition, we increased our allowance for uncollectibles by $36 to cover the estimated incremental uncollectible accounts receivable due to customer displacement and incurred $43 in other recovery costs.

During the year, we incurred $281 in expense and $211 in capital associated with wireline network restoration. In the quarter ended September 30, 2005, management reached the conclusion that the extent of damage to the Company's property, plant and equipment in the hurricane-damaged areas will require recognition of an asset impairment.

In accordance with generally accepted accounting principles, management estimated the impairment based on the best available information utilizing damage assessments. As a result, we recorded a charge of $166 in 2005. This charge reduced the carrying value of the Communication Group's impaired assets, primarily outside plant, to estimated salvage value.

We expect a portion of the cost associated with the Hurricane Katrina recovery effort to be covered by insurance. While the exact amount has not been determined, our current estimate of covered losses, net of our deductible, is approximately $250. The actual recovery will vary depending on the outcome of the insurance loss adjustment effort. Accordingly, no offsetting benefit for insurance recoveries was recorded against the loss in 2005 results.

Note K – Workforce Reduction and Restructuring

WORKFORCE REDUCTION CHARGES

Based on competitive activity in the telecom industry, continued economic pressures, realignment of our business and productivity improvements, we have initiated workforce reductions and recorded charges related to approximately 7,100 employees in the last three years. These downsizings were implemented on a voluntary and non-voluntary basis. The positions were both management and non-management, primarily in network operations where the volume of work has substantially decreased. Charges to earnings have been recognized in accordance with provisions of SFAS No. 112, "Employer's Accounting for Postemployment Benefits," and consisted primarily of cash severance and payroll taxes under separation pay plans. The following table summarizes the number of employees affected and the related charges by year:

	Employees	Related Charge
2003	3,500	$132
2004	1,400	$51
2005	**2,200**	**$114**

RESTRUCTURING LIABILITY

As of December 31, 2005, the aggregate liability related to the charges described above, excluding postretirement and pension impacts, was $100.

	Type of Cost		
	Employee Separations	Other Exit Costs	Total
Balance at December 31, 2003	$ 66	$ 6	$ 72
Accruals	51	–	51
Cash payments	(80)	(1)	(81)
Adjustments	(12)	(4)	(16)
Balance at December 31, 2004	$ 25	$ 1	$ 26
Accruals	**114**	–	**114**
Cash payments	**(35)**	**(1)**	**(36)**
Adjustments	**(4)**	–	**(4)**
Balance at December 31, 2005	**$ 100**	**$ –**	**$ 100**

Adjustments to the employee separations accrual are due to estimated demographics being different than actual demographics of employees that separated from the company. Deductions from the accrual for other exit costs consist primarily of changes to prior estimates.

Note L – Employee Benefit Plans

At December 31, 2005 our pensions and other postretirement benefit plans covered the following active and retired employees:

	Pensions	Other Benefits
Active employees:		
Management	20,600	16,000
Non-management	42,500	41,600
	63,100	57,600
Retirees:		
Management	18,200	23,400
Non-management	46,700	42,700
	64,900	66,100
Total	128,000	123,700

PENSION PLANS

Substantially all of our employees are covered by noncontributory defined benefit pension plans. For these plans, the benefit obligation is the projected benefit obligation, which represents the actuarial present value as of a date of all benefits attributed by the pension benefit formula to employee service rendered to that date. We maintain a trust to fund these pension benefits in compliance with ERISA regulations. Currently the pension benefits are fully funded.

The pension plan covering management employees is a cash balance plan, which provides pension benefits determined by a combination of compensation-based service and additional credits and individual account-based interest credits. While the written plan does not require additional interest credits (any additional credits are discretionary), based on past practices, the benefit obligation is determined assuming annual additional interest credits of 1 percent.

For non-management employees, pension benefits earned prior to 1999 are based on specified benefit amounts and years of service through 1998. Benefits earned in 1999 and subsequent years are calculated under a cash balance plan that is based on an initial cash balance amount, negotiated pension band increases and interest credits. Due to past practice, the non-management pension obligation includes the expectation of future pension band increases.

OTHER POSTRETIREMENT BENEFITS

We provide certain medical, dental and life insurance benefits to substantially all retired employees under various plans and accrue actuarially determined postretirement benefit costs as active employees earn these benefits. Management employees hired after January 1, 2001 are provided access to medical benefits at retirement but are required to pay 100 percent of the cost. As of December 31, 2005 approximately 4,400 active management employees have access only benefits. We maintain Voluntary Employee Beneficiary Association (VEBA) trusts to partially fund these postretirement benefits; however, there are no ERISA or other regulations requiring these postretirement benefit plans to be funded annually.

For postretirement benefit plans, the benefit obligation is the accumulated postretirement benefit obligation, which represents the actuarial present value as of a date of all future benefits attributed under the terms of the postretirement benefit plan to employee service rendered to that date.

Our management health care plan provides for annual dollar value limits on the company-funded portion of retiree medical costs (also referred to as caps) for eligible employees who retired after December 31, 1991. Historically, we have made discretionary increases to the caps for a portion of the medical cost increases, requiring the Company to absorb a portion of the increasing costs. We have previously accounted for this substantive plan in determining the benefit obligation, thus increasing the expected future liability. Effective January 1, 2006, the current cap was frozen requiring management retirees to absorb all future medical inflation. This change resulted in a reduction to the obligation of $380 that will be recognized in income over the remaining years of future service to full eligibility of active plan participants, or approximately 9 years.

Our non-management labor contract with the CWA contains caps on the Company-funded portion of retiree medical costs.

The current labor agreement with the CWA reached in 2004 included an increase in the amount of the caps. Concurrent with that agreement, we determined that the increase in the caps combined with BellSouth's history of increasing the caps in prior agreements created a substantive plan. Accordingly, we changed the calculation of the obligation to assume the Company will increase the caps in future periods, thus absorbing future increases in cost due to medical inflation. The change resulted in an increase to the obligation of approximately $3.5 billion in 2004 and is being recognized in income over the remaining years of future service to full eligibility of active plan participants, or approximately 14 years.

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MEDICARE PRESCRIPTION DRUG, IMPROVEMENT AND MODERNIZATION ACT OF 2003

In December 2003, the Medicare Prescription Drug Act was signed into law. The Act allows companies that provide certain prescription drug benefits for retirees to receive a federal subsidy beginning in 2006. In accordance with final FASB guidance, we accounted for the government subsidy provided for in the Medicare Act as an actuarial gain in determining our post retirement benefit obligations. Based on preliminary guidance, we previously calculated the benefit of the subsidy using the actuarial equivalence tests on the individual benefit plans separately. On January 21, 2005, the Centers for Medicare and Medicaid Services released final federal regulations regarding the calculation of actuarial equivalence and eligibility for the subsidy. As a result of the final regulations, we calculated actuarial equivalence based on weighted average benefits and premiums of all Medicare eligible participants as a whole rather than calculating equivalence separately for each group of retirees. On this basis, our plans are projected to satisfy actuarial equivalence for all participants in future years. The present value of the subsidy is $1.4 billion as of December 31, 2005.

ASSUMPTIONS AND APPROACH USED

A discount rate is selected annually to measure the present value of the benefit obligations. In determining the selection of a discount rate, we estimated the timing and amounts of expected future benefit payments and applied a yield curve developed to reflect yields available on high-quality bonds. The yield curve is based on an externally published index specifically designed to meet the criteria of GAAP. The discount rates selected as of December 31, 2005, 5.25% for pension and 5.50% for other benefits, reflect the results of this yield curve analysis and are unchanged from December 31, 2004.

Our assumption regarding expected return on plan assets reflects asset allocations, investment strategy and the views of investment managers, as well as historical experience. We use an assumed return of 8.5% for our pension trusts, which represent nearly 80% of invested assets. Actual asset returns for these trusts were approximately 15% in 2004 and 11% in 2005. As of December 2005, the 5-year average return on our pension assets was 6.3%, the 10-year average return was 9.5%, and the average return since inception was 10.9%.

Our health care cost trend assumptions are developed based on historical cost data, the near-term outlook, and an assessment of likely long-term trends. Due to their differing demographics, we developed separate inflation rates for pre- and post-age 65 retirees as well as medical claims and prescription drugs. Health care cost trend rates are assumed to decline by 75 to 150 basis points per year until they reach an ultimate rate of 5% in 2011. On average, health care cost trend rates over the latest five year period have been in line with initial year trend rate assumptions. Recent trend rates did not decline as anticipated, so changes to trend assumptions were made in the 2005 valuation. Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plan. A one-percentage point change in assumed health care cost trend rates would have the following effects as of December 31, 2005:

	1-Percentage Point Increase	1-Percentage Point Decrease
Effect on total service and interest cost components	$ 110	$ (80)
Effect on other postretirement benefit obligation	$1,200	$(1,000)

Other significant assumptions include inflation, salary growth, retirement rates, and mortality rates. Our inflation assumption is based on an evaluation of external market indicators. The salary growth assumptions reflect our long-term actual experience, the near-term outlook and assumed inflation. Compensation increases over the latest five year period have been in line with assumptions. Retirement and mortality rates are based on actual plan experience.

MEASUREMENT RESULTS

The following tables summarize benefit obligations, changes in plan assets, and funded status, as well as the assumptions, at or for the years ended December 31. The company uses a December 31 measurement date for its plans.

	Pension Benefits		Other Benefits	
	2004	**2005**	2004	**2005**
Change in benefit obligation:				
Benefit obligation at the beginning of the year	$11,620	**$11,725**	$ 7,156	**$10,883**
Service cost	177	**207**	66	**122**
Interest cost	696	**588**	472	**583**
Amendments	27	**–**	3,315	**(383)**
Actuarial (gain) loss	288	**334**	347	**199**
Gross benefits and lump sums paid	(1,083)	**(954)**	(473)	**(501)**
Benefit obligation at the end of the year	$11,725	**$11,900**	$10,883	**$10,903**
Change in plan assets:				
Fair value of plan assets at the beginning of the year	$14,605	**$15,612**	$ 3,693	**$ 4,198**
Actual return (loss) on plan assets	2,090	**1,657**	556	**457**
Employer contribution	–	**–**	422	**401**
Plan participants contributions	–	**–**	39	**43**
Benefits and lump sums paid	(1,083)	**(954)**	(512)	**(543)**
Fair value of plan assets at the end of year	$15,612	**$16,315**	$ 4,198	**$ 4,556**
Funded status:				
As of the end of the year	$ 3,887	**$ 4,415**	$(6,685)	**$(6,347)**
Unrecognized prior service cost	(362)	**(321)**	3,266	**2,715**
Unrecognized net (gain) loss	454	**417**	2,376	**2,339**
Unrecognized net (asset) obligation	–	**–**	219	**100**
Prepaid (accrued) benefit cost	$ 3,979	**$ 4,511**	$ (824)	**$(1,193)**
Amounts recognized in the consolidated balance sheets at December 31:				
Prepaid benefit cost	$ 3,979	**$ 4,511**	$ 312	**$ 404**
Accrued benefit cost	–	**–**	(1,136)	**(1,597)**
Net amount recognized	$ 3,979	**$ 4,511**	$ (824)	**$(1,193)**
Weighted-average assumptions used to determine benefit obligations at December 31:				
Discount rate	5.25%	**5.25%**	5.50%	**5.50%**
Rate of compensation increase	4.50%	**4.50%**	4.50%	**4.50%**
Health care cost trend rate assumed for the following year (Pre-age 65)			8.33%	**9.00%**
Health care cost trend rate assumed for the following year (Post-age 65)			11.67%	**12.00%**
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)			5.00%	**5.00%**
Year that the rate reaches the ultimate trend rate			2010	**2011**

Unrecognized prior service cost relates primarily to removal of a substantive plan for pension cost of living adjustments and to changes in our substantive commitments associated with the caps on our medical plans as discussed above. Unrecognized gains and losses have been primarily generated by changes in discount rates in previous years, asset return differences from the preceding five years, and changes in medical trend rates.

In contrast to the projected benefit obligation, the accumulated benefit obligation represents the actuarial present value of benefits based on employee service and compensation as of a certain date and does not include an assumption about future compensation levels. The accumulated benefit obligation for the qualified defined benefit pension plans was $11,486 and $11,717 at December 31, 2004 and 2005, respectively.

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The other benefits funded status above, includes a plan with a positive funded status of $461 and $546 for December 31, 2004 and 2005, respectively. For the remaining plans, the unfunded status was comprised of the following:

	At December 31,	
	2004	**2005**
Benefit obligation	$10,492	**$10,505**
Fair value of plan assets	3,346	**3,612**
Funded status	$(7,146)	**$(6,893)**

The following table summarizes benefit costs for the years ended December 31. Benefit costs are included in operating expenses (in cost of sales and selling, general and administrative expenses) in the accompanying Consolidated Statements of Income. Approximately 10 percent of these costs are capitalized to property, plant and equipment with labor related to network construction.

	Pension Benefits			Other Benefits		
	2003	2004	**2005**	2003	2004	**2005**
Components of net periodic benefit cost:						
Service cost	$ 181	$ 177	**$ 207**	$ 50	$ 66	**$ 122**
Interest cost	742	696	**588**	478	472	**583**
Expected return on plan assets	(1,386)	(1,319)	**(1,286)**	(315)	(321)	**(336)**
Amortization of prior service cost	(39)	(43)	**(41)**	149	235	**225**
Amortization of actuarial (gain) loss	(28)	5	**–**	108	88	**103**
Amortization of transition (asset) obligation	(5)	–	**–**	66	80	**73**
Net periodic benefit cost	$ (535)	$ (484)	**$ (532)**	$ 536	$ 620	**$ 770**
Settlement (gain) loss	49	–	**–**	–	–	**–**
Net periodic benefit cost with adjustments	$ (486)	$ (484)	**$ (532)**	$ 536	$ 620	**$ 770**
Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31:						
Discount rate	6.75%	6.25%	**5.25%**	6.75%	6.00%	**5.50%**
Expected return on plan assets	8.50%	8.50%	**8.50%**	8.00%	8.00%	**8.25%**
Rate of compensation increase	5.10%	5.10%	**4.50%**	4.80%	4.80%	**4.50%**
Health care cost trend rate pre-age 65				10.00%	9.00%	**8.33%**
Health care cost trend rate post-age 65				12.00%	13.00%	**11.67%**

PLAN ASSETS

BellSouth's weighted-average target allocations and actual asset allocations by asset category are:

	Pension			Other Benefits		
		At December 31,			At December 31,	
Asset Category	Target	2004	**2005**	Target	2004	**2005**
Equity securities	55-65%	58%	**58%**	60-80%	81%	**82%**
Debt securities	15-25	20	**21**	0-5	3	**3**
Real estate	10-15	10	**10**	5-15	4	**4**
Other	10-15	12	**11**	15-25	12	**11**
Total		100%	**100%**		100%	**100%**

BellSouth has established and maintains separate investment policies for assets held in each employee benefit trust. Our investment strategies are of a long-term nature and are designed to meet the following objectives:

- ensure that funds are available to pay benefits as they become due;
- maximize the trusts total return subject to prudent risk taking; and
- preserve and/or improve the funded status of the trusts over time.

Investment policies and strategies are periodically reviewed to ensure the objectives of the trusts are met considering any changes in benefit plan design, market conditions or other material items.

Derivatives are permitted in the investment portfolio to gain investment exposure as a substitute for physical securities and to manage risk. Derivatives are not permitted for speculative or leverage purposes. Trust investments in BellSouth securities are immaterial.

CASH FLOWS

Contributions

Due to the funded status of our pension plans, we do not expect to make contributions to these plans in 2006. Consistent with prior years, we expect to contribute cash to the VEBA trusts to fund other benefit payments. Contributions for 2006 are estimated to be in the range of $350 to $400.

Estimated future benefit payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid over the next ten years. Based on current business conditions, we expect to have the necessary cash flows to fund our obligations.

		Other Benefits		
	Pension Benefits	Gross	Medicare Subsidy Receipts	Net
2006	$1,049	$ 594	$ (32)	$ 562
2007	1,059	644	(36)	608
2008	1,075	686	(42)	644
2009	1,084	725	(46)	679
2010	1,056	759	(52)	707
Years 2011-2015	5,032	4,011	(353)	3,658

CASH BALANCE PENSION PLAN

In July 2003, a Federal district court in Illinois ruled that the benefit formula used in International Business Machines Corporation's (IBM) cash balance pension plan violated the age discrimination provisions of ADEA. The IBM decision conflicts with decisions of at least three other district courts, including a November 2005 decision of the Federal district court in Pennsylvania. Congress is presently considering legislation that would clarify the legal status of cash balance plans under age discrimination rules. At this time, it is unclear what effect, if any, these decisions or possible Congressional action may have on our tax-qualified cash balance pension plans or our financial condition.

SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN

The pension amounts reported above do not include the supplemental executive retirement plan (SERP), which is an unfunded nonqualified pension plan. While this plan is unfunded, we have assets to provide for these benefits in a grantor trust. The net periodic benefit cost associated with this plan was $53 in 2003, $53 in 2004 and $61 in 2005.

Additional information for the plan, which has an accumulated benefit obligation in excess of plan assets, is:

	December 31,	
	2004	**2005**
Projected benefit obligation	$ 584	**$ 637**
Accumulated benefit obligation (net amount recognized pre-tax)	515	**552**
Fair value of plan assets	—	**—**
Amounts recognized in the consolidated balance sheet at December 31:		
Accrued benefit cost included in other noncurrent liabilities	(320)	**(353)**
Additional minimum liability recognized in other comprehensive income (pre-tax)	(195)	**(199)**

Projected benefit payments for this plan are $66, $51 and $86 for 2006, 2007 and 2008, respectively.

DEFINED CONTRIBUTION PLANS

We maintain several contributory savings plans that cover substantially all employees. The BellSouth Retirement Savings Plan and the BellSouth Savings and Security Plan (collectively, the Savings Plans) are tax-qualified defined contribution plans. Assets of the plans are held by two trusts (the Trusts) which, in turn, are part of the BellSouth Master Savings Trust. We match a portion of employees' eligible contributions to the Savings Plans at rates determined annually by the Board of Directors. Following is a summary of compensation expense associated with company matching obligations for the year ended December 31:

	2003	2004	**2005**
Compensation expense	$55	$94	**$121**

Note M – Financial Instruments

The recorded amounts of cash and cash equivalents, temporary cash investments, bank loans and commercial paper approximate fair value due to the short-term nature of these instruments. Fair value estimates for long-term debt and interest rate swaps are based on quotes from dealers. Since judgment is required to develop the estimates, the estimated amounts presented herein may not be indicative of the amounts that we could realize in a current market exchange.

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Following is a summary of financial instruments comparing the fair values to the recorded amounts as of December 31:

	2004	
	Recorded Amount	Estimated Fair Value
Assets:		
Advances to Cingular Wireless	$ 4,460	$ 4,460
Cost-method investments	$ 921	$ 921
Debt:(1)		
Issued by BST	$ 4,482	$ 4,699
Issued by BellSouth Corporation	16,179	16,999
FMV adjustment on hedged debt	(1)	(1)
Other debt and discounts	(77)	(76)
	$20,583	$21,621
Fair value interest rate swaps, net liability(1)	$ 1	$ 1
Cash flow interest rate swap, net liability(1)	$ 28	$ 28

	2005	
	Recorded Amount	Estimated Fair Value
Assets:		
Advances to Cingular Wireless	**$ 2,827**	**$ 2,827**
Cost-method investments	**$ 1,192**	**$ 1,192**
Debt:(1)		
Issued by BST	**$ 2,975**	**$ 3,086**
Issued by BellSouth Corporation	**14,317**	**14,759**
FMV adjustment on hedged debt	**(44)**	**(44)**
Other debt and discounts	**(60)**	**(60)**
	$17,188	**$17,741**
Fair value interest rate swaps, net liability(1)	**$ 44**	**$ 44**

(1) These amounts do not include accrued interest; accrued interest is classified as an other current liability in our balance sheet.

DERIVATIVE FINANCIAL INSTRUMENTS

We are, from time to time, party to interest rate swap agreements in our normal course of business for purposes other than trading. These financial instruments are used to mitigate interest rate risks, although to some extent they expose us to market risks and credit risks. We control the credit risks associated with these instruments through the evaluation and continual monitoring of the creditworthiness of the counterparties. In the event that a counterparty fails to meet the terms of a contract or agreement, our exposure is limited to the current value at that time of the currency rate or interest rate differential, not the full notional or contract amount. We believe that such contracts and agreements have been executed with creditworthy financial institutions. As such, we consider the risk of nonperformance to be remote.

INTEREST RATE SWAPS

We enter into interest rate swap agreements to exchange fixed and variable rate interest payment obligations without the exchange of the underlying principal amounts. We are a party to various interest rate swaps, which qualify for hedge accounting and we believe are 100% effective. The following table summarizes the weighted average rates and notional amounts of these agreements.

	For the Year Ended December 31,	
	2004	**2005**
Pay fixed/receive variable (cash flow hedge):		
Weighted average notional amount	$ 1,000	**$ 967**
Rate paid	5.90%	**5.90%**
Rate received	1.36%	**3.25%**
Pay variable/receive fixed (fair value hedge):		
Weighted average notional amount	$ 955	**$ 1,612**
Rate paid	3.25%	**4.89%**
Rate received	5.53%	**5.55%**

	As of December 31,	
	2004	**2005**
Pay fixed/receive variable (cash flow hedge):		
Notional amount	$ 1,000	**$ –**
Pay variable/receive fixed (fair value hedge):		
Notional amount	$ 1,400	**$ 1,800**

The change in fair market value for derivatives designated as hedging the exposure to variable cash flows of a forecasted transaction is recognized as a component of other comprehensive income, net of tax impacts. The change in fair market value for derivatives designated as hedging the exposure to changes in the fair value of a recognized asset or liability, is recognized in earnings in the period of change. Due to their effectiveness, our fair value hedges resulted in no impact to net income. The cash flow swap matured in 2005 and the fair value swaps mature in 2008-2010.

CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject us to credit risk consist principally of trade accounts receivable. Concentrations of credit risk with respect to these receivables, other than those from long distance carriers, are limited due to the composition of the customer base, which includes a large number of individuals and businesses. Accounts receivable from long distance carriers totaled $315 at December 31, 2004 and $295 at December 31, 2005.

Note N – Shareholders' Equity

COMMON STOCK AUTHORIZED

Our articles of incorporation authorize the issuance of 8,650,000,000 shares of common stock, par value $1 per share. Our Board of Directors is authorized to create from the unissued common stock one or more series, and, prior to the issuance of any shares in any particular series, to fix the voting powers, preferences, designations, rights, qualifications, limitations or restrictions of such series. The Board has not created any series of common stock.

PREFERRED STOCK AUTHORIZED

Our articles of incorporation authorize 100 million shares of cumulative first preferred stock having a par value of $1 per share, of which 30 million shares have been reserved and designated series B for possible issuance under a shareholder rights plan. As of December 31, 2005, no preferred shares had been issued. The series A first preferred stock was created for a previous shareholder rights plan which has expired.

SHAREHOLDER RIGHTS PLAN

In 1999, we adopted a shareholder rights plan by declaring a dividend of one right for each share of common stock then outstanding and to be issued thereafter. This plan was amended in 2005. Each right entitles shareholders to buy one one-thousandth of a share of series B first preferred stock for $200.00 per share. The rights may be exercised only if a person or group acquires 15% of the common stock of BellSouth without the prior approval of the Board of Directors or announces a tender or exchange offer that would result in ownership of 15% or more of the common stock. If a person or group acquires 15% of BellSouth's stock without prior Board approval, other shareholders are then allowed to purchase BellSouth common stock, or units of preferred stock with the same voting and economic characteristics, at half price. The rights currently trade with BellSouth common stock and may be redeemed by the Board of Directors for one cent per right until they become exercisable, and thereafter under certain circumstances. The rights expire in December 2009.

SHARES HELD IN TRUST AND TREASURY

Shares held in trust and treasury, at cost, as of December 31 are comprised of the following:

	2004		**2005**	
	Shares (in millions)	Amount	Shares (in millions)	Amount
Shares held in treasury	163	$5,524	**205**	**$6,616**
Shares held by grantor trusts	26	380	**17**	**199**
Shares held in trust and treasury	189	$5,904	**222**	**$6,815**

Treasury shares

Shares held in trust and treasury include treasury share purchases made by the Company primarily in open market transactions under repurchase plans and to satisfy shares issued in connection with employee share plans. The following table summarizes activity with respect to share repurchases for the periods presented:

	Number of shares purchased (in millions)	Aggregate purchase price	Average price per share
2003	35.0	$ 858	$24.50
2004	5.8	$ 151	$26.17
2005	**40.7**	**$1,096**	**$26.91**
Total	81.5	$2,105	$25.83

We reissued 4.5 million shares in 2003, 7.0 million shares in 2004, and 7.9 million shares in 2005 in connection with various employee benefit plans.

Grantor trusts

In accordance with Emerging Issues Task Force Issue ("EITF") 97-14, *Accounting for Deferred Compensation Arrangements Where Amounts Are Held in a Rabbi Trust and Invested,* assets of rabbi trusts are to be consolidated with those of the employer, and the value of the employer's stock held in the rabbi trusts should be classified in shareholders' equity and generally accounted for in a manner similar to treasury stock. Therefore, the BellSouth shares held in the grantor trusts are presented as a reduction of shareholders' equity and are not considered in the computation of shares outstanding for financial reporting purposes.

OTHER COMPREHENSIVE INCOME

Accumulated other comprehensive income (loss) is comprised of the following components as of December 31:

	2004	**2005**
Cumulative foreign currency translation adjustment	$ (79)	**$ (2)**
Minimum pension liability adjustment	(129)	**(133)**
Net unrealized (losses) gains on derivatives	(12)	**5**
Net unrealized gains on securities	63	**116**
	$(157)	**$ (14)**

Accumulated other comprehensive income (loss) for our discontinued operations included in the amounts above was $(77) as of December 31, 2004. Total comprehensive income details are presented in the table below.

	For the Year Ended December 31,		
Total Comprehensive Income	2003	2004	**2005**
Net Income	$3,904	$4,758	**$3,294**
Foreign currency translation[1]:			
Adjustments	(103)	(43)	**(1)**
Sale of foreign entities	268	408	**78**
	165	365	**77**

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Total Comprehensive Income	For the Year Ended December 31, 2003	2004	**2005**
Minimum pension liability adjustment, net of tax of $(10), $(20), and $(1)	(18)	(40)	**(4)**
Deferred gains (losses) on derivatives:			
Deferred gains (losses), net of tax of $8, $20, and $10	14	36	**19**
Reclassification adjustment for (gains) losses included in net income, net of tax of $(7), $0, and $0	(13)	8	**(2)**
	1	44	**17**
Unrealized gains (losses) on securities:			
Unrealized holdings gains (losses), net of tax of $21, $33, and $31	39	57	**54**
Reclassification adjustment for (gains) losses included in net income, net of tax of $(17), $1, and $0	(32)	2	**(1)**
	7	59	**53**
Total comprehensive income	$4,059	$5,186	**$3,437**

(1) Foreign currency translation amounts had no tax impacts in 2003. In 2004, the Adjustments are net of tax of $(42). There were no tax impacts on the 2004 sale of foreign entities. In 2005, the sale of foreign entities was net of tax of $42 and there was no tax on the Adjustments.

Note O – Stock Compensation Plans

We have granted stock-based compensation awards to key employees under several plans. In April 2004, BellSouth shareholders approved the adoption of the BellSouth Corporation Stock and Incentive Compensation Plan (the Stock Plan), which provides for various types of grants, including stock options, restricted stock, and performance-based awards. One share of BellSouth common stock is the underlying security for any award. The maximum number of shares available for future grants under the Stock Plan is limited to 80 million reduced by awards granted and increased by shares tendered in option exercises. Prior to adoption of the Stock Plan, stock options and other stock-based awards were granted under the BellSouth Corporation Stock Plan and the BellSouth Corporation Stock Option Plan. We account for stock-based compensation under the fair value recognition provisions of SFAS No. 123.

Given trends in long-term compensation awards and market conditions, over the last few years we have moved toward granting a mix of restricted stock and performance share units in lieu of stock options. The table below summarizes the total compensation cost for each type of award included in our results of operations:

	For the Year Ended December 31, 2003	2004	**2005**
Stock options	$114	$ 78	**$ 41**
Restricted stock	23	43	**54**
Performance share units	15	40	**71**
Totals	$152	$161	**$166**

As of December 31, 2005, there was $148 of total unrecognized compensation cost related to nonvested awards, which will be amortized over the remaining applicable vesting period of each award.

STOCK OPTION AWARDS

Stock options granted under the plans entitle recipients to purchase shares of BellSouth common stock within prescribed periods at a price either equal to, or in excess of, the fair market value on the date of grant. Options generally become exercisable at the end of three to five years, have a term of ten years, and provide for accelerated vesting if there is a change in control (as defined in the plans). A summary of option activity under the plans is presented below:

	2003	2004	**2005**
Options outstanding at January 1	106,328,465	112,840,873	**105,763,573**
Options granted	14,374,127	369,076	**69,247**
Options exercised	(4,495,974)	(4,832,564)	**(6,427,203)**
Options forfeited	(3,365,745)	(2,613,812)	**(2,602,828)**
Options outstanding at December 31	112,840,873	105,763,573	**96,802,789**
Weighted-average option prices per common share:			
Outstanding at January 1	$35.68	$34.52	**$35.19**
Granted at fair market value	$21.96	$27.25	**$26.40**
Exercised	$17.94	$18.54	**$20.59**
Forfeited	$38.85	$36.37	**$36.46**
Outstanding at December 31	$34.52	$35.19	**$36.12**
Weighted-average fair value of options granted at fair market value during the year	$4.20	$5.66	**$5.20**
Options exercisable at December 31	70,615,852	75,627,927	**82,252,669**
Shares available for grant at December 31	54,881,922	79,886,521	**77,532,962**

The value received by employees for options exercised during the years ended December 31, 2003, 2004, and 2005 was $40 million, $48 million and $41 million, respectively.

The fair value of each option grant is estimated on the grant date using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	2003	2004	**2005**
Expected life (years)	5	5	**5**
Dividend yield	3.87%	3.67%	**4.08%**
Expected volatility	29.0%	29.0%	**28.0%**
Risk-free interest rate	2.65%	3.46%	**3.90%**

The following table summarizes information about stock options outstanding at December 31, 2005:

	Outstanding			Exercisable	
Exercise Price Range	Options	Weighted Average Life[a]	Wtd. Avg. Exercise Price	Options	Wtd. Avg. Exercise Price
\$19.22 – \$22.19	20,460,094	4.71	\$21.81	8,738,594	\$21.90
\$22.20 – \$30.91	17,403,568	3.59	\$29.92	14,858,732	\$30.27
\$31.03 – \$41.00	15,906,638	5.76	\$38.96	15,636,854	\$38.93
\$41.26 – \$43.66	17,825,304	5.03	\$42.59	17,811,304	\$42.59
\$44.48 – \$51.78	25,207,185	3.62	\$45.66	25,207,185	\$45.66
\$19.22 – \$51.78	96,802,789	4.46	\$36.12	82,252,669	\$38.41

(a) Weighted-average remaining contractual life in years.

RESTRICTED STOCK AWARDS

Restricted stock awards granted to key employees under the plans are settled by issuing shares of common stock at the vesting date. Generally, the restrictions lapse in full on the third anniversary of the grant date, or on a pro rata basis on each of the first three anniversaries of the grant date in the case of retirement eligible employees. The vesting of restricted stock accelerates following an involuntary separation of employment (as defined in the plans) occurring within two years of a change in control (as defined in the plans). The grant date fair value of the restricted stock is expensed over the period during which the restrictions lapse. The shares represented by restricted stock awards are considered outstanding at the grant date, as the recipients are entitled to dividends and voting rights. The total fair value of restricted stock vested during the years ended December 31, 2003, 2004 and 2005, was \$13, \$11, and \$49, respectively. A summary of restricted stock activity under the plans is presented below:

	2003	2004	**2005**
Restricted shares:			
Outstanding at January 1	2,163,250	2,267,667	**3,974,851**
Granted	772,250	2,264,300	**2,353,430**
Vested	(489,691)	(407,286)	**(1,842,870)**
Forfeited	(178,142)	(149,830)	**(215,331)**
Outstanding at December 31	2,267,667	3,974,851	**4,270,080**
Weighted-average grant date fair value per restricted share:			
Outstanding at January 1	\$34.69	\$29.91	**\$28.24**
Granted	\$22.11	\$27.60	**\$26.07**
Vested	\$36.45	\$34.28	**\$28.40**
Forfeited	\$36.20	\$27.31	**\$27.27**
Outstanding at December 31	\$29.91	\$28.24	**\$27.02**

PERFORMANCE SHARE UNIT AWARDS

Performance share units granted to key employees are settled in cash based on an average stock price at the end of the three-year performance period multiplied by the number of units earned. The number of performance share units actually earned by recipients is based on the achievement of certain performance goals as defined by the terms of the awards, and can range from 0% to 150% of the number of units granted. At the end of the performance period, recipients also receive a cash payment equal to the dividends paid on a share of BellSouth stock during the performance period for each performance share unit earned. In the event of a change in control (as defined in the plans), the performance period is modified and participants receive prorated payments based on the modified performance period. Performance share unit expense is recognized over the performance period based on the stock price at each reporting date and the expected outcome of the performance condition; expense is also recognized for dividends accrued during the performance period. The total cash payment of performance share liabilities paid to employees in 2005 was \$13 related to the performance period which ended December 31, 2004. There were no payments made on shares vested in earlier performance periods. A summary of performance share unit activity under the plans is presented below:

	2003	2004	**2005**
Performance share units			
Outstanding at January 1	1,017,050	1,718,400	**3,788,782**
Units granted	1,244,700	2,699,400	**3,431,475**
Units vested	(448,200)	(504,815)	**(1,256,222)**
Units forfeited	(95,150)	(124,203)	**(106,430)**
Outstanding at December 31	1,718,400	3,788,782	**5,857,605**
Weighted-average grant date stock price per performance share unit	\$26.71	\$28.22	**\$26.04**

DOLLARS ARE IN MILLIONS, EXCEPT PER SHARE AMOUNTS AND AS OTHERWISE INDICATED

Note P – Segment Information

We have three reportable operating segments: (1) Communications Group; (2) Wireless; and (3) Advertising & Publishing Group.

We own a 40 percent economic interest in Cingular Wireless, and share joint control of the venture with AT&T. We account for the investment under the equity method. For management purposes we evaluate our wireless segment based on our proportionate share of Cingular Wireless' results. Accordingly, results for our wireless segment reflect the proportional consolidation of 40 percent of Cingular Wireless' results.

The following table provides information for each operating segment as of and for the year ended December 31:

	2003	2004	**2005**
Communications Group			
External revenues	$18,269	$18,306	**$18,404**
Intersegment revenues	138	107	**108**
Total segment revenues	18,407	18,413	**18,512**
Depreciation and amortization	3,787	3,609	**3,633**
Segment operating income	4,813	4,597	**4,255**
Interest expense	414	374	**391**
Income taxes	1,612	1,526	**1,389**
Segment net income	$ 2,829	$ 2,727	**$ 2,543**
Segment assets	$33,269	$33,252	**$33,599**
Capital expenditures	$ 2,898	$ 3,164	**$ 3,429**
Wireless (40% proportional interest)			
External revenues	$ 6,231	$ 7,826	**$13,773**
Intersegment revenues	–	–	**–**
Total segment revenues	6,231	7,826	**13,773**
Depreciation and amortization	835	1,073	**1,778**
Segment operating income	915	895	**1,811**
Interest expense	343	360	**504**
Net earnings (losses) of equity affiliates	(129)	(156)	**2**
Income taxes	159	146	**594**
Segment net income	$ 261	$ 209	**$ 701**
Segment assets	$10,212	$32,895	**$31,728**
Capital expenditures	$ 1,094	$ 1,380	**$ 2,990**
Advertising & Publishing Group			
External revenues	$ 2,033	$ 2,005	**$ 2,046**
Intersegment revenues	17	14	**14**
Total segment revenues	2,050	2,019	**2,060**
Depreciation and amortization	26	28	**28**
Segment operating income	973	954	**954**
Interest expense	7	8	**12**
Income taxes	368	363	**346**
Segment net income	$ 600	$ 583	**$ 595**
Segment assets	$ 1,002	$ 1,057	**$ 1,102**
Capital expenditures	$ 28	$ 29	**$ 28**

RECONCILIATION TO CONSOLIDATED FINANCIAL INFORMATION

	2003	2004	**2005**
Operating revenues			
Total reportable segments	$26,688	$28,258	**$ 34,345**
Cingular Wireless proportional consolidation	(6,231)	(7,826)	**(13,773)**
Deferred revenue adjustment	–	–	**47**
South Carolina regulatory settlement	–	(50)	**–**
Corporate, eliminations and other	(116)	(82)	**(72)**
Total consolidated	$20,341	$20,300	**$ 20,547**
Operating income			
Total reportable segments	$ 6,701	$ 6,446	**$ 7,020**
Cingular Wireless proportional consolidation	(915)	(895)	**(1,811)**
Restructuring charge and asset impairment	(158)	(50)	**(262)**
Pension settlement loss	(47)	–	
Deferred revenue adjustment	–	–	**47**
South Carolina regulatory settlement	–	(53)	**–**
Hurricane-related expenses	–	(164)	**(360)**
Corporate, eliminations and other	(24)	5	**36**
Total consolidated	$ 5,557	$ 5,289	**$ 4,670**
Net income			
Total reportable segments	$ 3,690	$ 3,519	**$ 3,839**
Restructuring charge and asset impairment	(97)	(31)	**(161)**
Pension settlement loss	(29)	–	**–**
Net gain on ownership transactions	–	295	**228**
Net losses on sale or impairment of securities	(5)	–	**–**
Early extinguishment of debt	(11)	–	**(26)**
Deferred revenue adjustment	–	–	**29**
South Carolina regulatory settlement	–	(33)	**–**
Hurricane-related expenses	–	(100)	**(247)**
Wireless merger integration costs and fair value adjustment	–	(66)	**(197)**
Cingular Wireless lease accounting adjustments	–	(43)	**–**
Wireless merger intangible amortization	–	(80)	**(374)**
Income from discontinued operations	101	1,364	**381**
Cumulative effect of changes in accounting principle	315	–	**–**
Corporate, eliminations and other	(60)	(67)	**(178)**
Total consolidated	$ 3,904	$ 4,758	**$ 3,294**

	2003	2004	2005
Total assets			
Total reportable segments	$ 44,483	$ 67,204	**$ 66,429**
Cingular Wireless proportional	(10,212)	(32,895)	**(31,728)**
Cingular investment	7,679	22,771	**21,274**
Corporate, eliminations and other	7,672	2,259	**578**
Total consolidated	$ 49,622	$ 59,339	**$ 56,553**

The Cingular Wireless proportional consolidation shown above represents the amount necessary to reconcile the proportional results of Cingular Wireless to GAAP results.

Reconciling items are transactions or events that are included in reported consolidated results but are excluded from segment results due to their nonrecurring or nonoperational nature. Net gain on ownership transactions include: in 2004, a gain on the sale of our operations in Denmark; in 2005, a gain on the sale of our operations in Israel.

Net revenues to external customers are based on the location of the customer. The customers of our reportable operating segments are principally in the United States.

Note Q – Commitments and Contingencies

LEASES

We have entered into operating leases for facilities and equipment used in operations. Rental expense under operating leases was $288 for 2003, $286 for 2004, and $285 for 2005. Capital leases currently in effect are not significant. The following table summarizes the approximate future minimum rentals under noncancelable operating leases in effect at December 31, 2005:

	Minimum Rentals
2006	$114
2007	93
2008	70
2009	52
2010	30
Thereafter	223
Total	$582

OUTSIDE PLANT

We currently self-insure all of our outside plant against casualty losses. Such outside plant, located in the nine southeastern states served by BST, is susceptible to damage from severe weather conditions and other perils. The net book value of outside plant was $8,530 at December 31, 2004 and $8,549 at December 31, 2005.

GUARANTEES

In most of our sale and divestiture transactions, we indemnify the purchaser for various items including labor and general litigation as well as certain tax matters. Generally, the terms last one to five years for general and specific indemnities and for the statutory review periods for tax matters. The events or circumstances that would require us to perform under the indemnity are transaction and circumstance specific. We regularly evaluate the probability of having to incur costs associated with these indemnifications and have accrued for expected losses that are probable. In addition, in the normal course of business, we indemnify counterparties in certain agreements. The nature and terms of these indemnities vary by transaction. Historically, we have not incurred significant costs related to performance under these types of indemnities.

PURCHASE OBLIGATIONS

As of December 31, 2005, we have contracts in place to outsource certain services, principally information technology, substantially all of which is with two vendors. We also have various commitments with vendors to purchase telecommunications equipment, software and services.

The following table discloses aggregate information about these purchase obligations and the periods in which payments are due:

	Payments Due by Period				
	Total	Less than 1 year	2007-2009	2010-2012	After 2012
Unconditional purchase obligations(1)	$2,633	$936	$1,482	$215	—

(1) *The unconditional purchase obligations include annual estimated expenditures based on anticipated volumes.*

REGULATORY MATTERS

In May 2005, we sued AT&T in US District Court for the Northern District of Georgia for unpaid access charges associated with AT&T's prepaid calling cards and its "IP in the middle" services that use Internet Protocol technology for internal call processing but use the public switched network to originate and terminate calls. The lawsuit follows two separate rulings by the FCC, one in April 2004 concerning "IP in the middle" services and one in February 2005 concerning prepaid card services, that each service was a telecommunications service subject to access charges, AT&T estimated in securities filings that it had "saved" $340 in access charges on its prepaid card services and $250 in access charges on its "IP in the middle" services. We believe that some of the improperly avoided access charges should have been paid to us for the use of our network. As the lawsuit progresses, we expect to obtain information from AT&T and other sources that will determine the amount of BellSouth access charges AT&T avoided. AT&T has appealed the FCC's decision related to prepaid card services. The court deciding the appeal held the hearing in the first quarter of 2006. In addition, AT&T has asserted certain defenses against BellSouth and has asserted the claim described below in an effort to reduce any amount it may owe to BellSouth. At this time, the likely outcome of the case cannot be predicted, nor can a reasonable estimate of gain, if any, be made. Accordingly, no revenue has been recognized with respect to this matter in our consolidated financial statements.

On November 4, 2005, AT&T sued BellSouth Long Distance, Inc. (BSLD) and Qwest Communications Corporation (Qwest) in US District Court for the Southern District of New York. AT&T has asserted claims of breach of contract, fraudulent misrepresentation and unjust enrichment against BSLD and related claims against Qwest. AT&T's claims arise from a contract with BSLD pursuant to which BSLD purchased wholesale long distance minutes that it resold to Qwest. The complaint does not specify the amount of damages sought by AT&T. At this time, the likely outcome of the case cannot be predicted, nor can a reasonable estimate of the amount of loss, if any, be made.

LEGAL PROCEEDINGS

Employment claim

On April 29, 2002, five African-American employees filed a putative class action lawsuit, captioned *Gladys Jenkins et al. v. BellSouth Corporation,* against the Company in the US District Court for the Northern District of Alabama. The complaint alleges that BellSouth discriminated against current and former African-American employees with respect to compensation and promotions in violation of Title VII of the Civil Rights Act of 1964 and 42 USC. Section 1981. Plaintiffs purport to bring the claims on behalf of two classes: a class of all African-American hourly workers employed by BellSouth Telecommunications at any time since April 29, 1998, and a class of all African-American salaried workers employed by BellSouth Telecommunications at any time since April 29, 1998 in management positions at or below Job Grade 59/Level C. The plaintiffs are seeking unspecified amounts of back pay, benefits, punitive damages and attorneys' fees and costs, as well as injunctive relief. At this time, the likely outcome of the case cannot be predicted, nor can a reasonable estimate of the amount of loss, if any, be made.

Securities and ERISA claims

From August through October 2002, several individual shareholders filed substantially identical class action lawsuits against BellSouth and three of its senior officers alleging violations of the federal securities laws. The cases have been consolidated in the US District Court for the Northern District of Georgia and are captioned *In re BellSouth Securities Litigation*. Pursuant to the provisions of the Private Securities Litigation Reform Act of 1995, the court has appointed a Lead Plaintiff. The Lead Plaintiff filed a Consolidated and Amended Class Action Complaint in July 2003 on behalf of two putative classes: (1) purchasers of BellSouth stock during the period November 7, 2000 through February 19, 2003 (the class period) for alleged violations of Sections 10(b) and 20 of the Securities Exchange Act of 1934 and (2) participants in BellSouth's Direct Investment Plan during the class period for alleged violations of Sections 11, 12 and 15 of the Securities Act of 1933. Four outside directors were named as additional defendants. The Consolidated and Amended Class Action Complaint alleged that during the class period the Company (1) overstated the unbilled receivables balance of its Advertising & Publishing subsidiary; (2) failed to properly implement SAB 101 with regard to its recognition of Advertising & Publishing revenues; (3) improperly billed competitive local exchange carriers (CLEC) to inflate revenues; (4) failed to take a reserve for refunds that ultimately came due following litigation over late payment charges; and (5) failed to properly write down goodwill of its Latin American operations.

On February 8, 2005, the District Court dismissed the Exchange Act claims, except for those relating to the writedown of Latin American goodwill. On that date, the District Court also dismissed the Securities Act claims, except for those relating to the writedown of Latin American goodwill, the allegations relating to unbilled receivables of the Company's Advertising & Publishing subsidiary, the implementation of SAB 101 regarding recognition of Advertising & Publishing revenues and alleged improper billing of CLECs. The plaintiffs are seeking an unspecified amount of damages, as well as attorneys' fees and costs. At this time, the likely outcome of the case cannot be predicted, nor can a reasonable estimate of loss, if any, be made.

In February 2003, a similar complaint was filed in the Superior Court of Fulton County, Georgia on behalf of participants in BellSouth's Direct Investment Plan alleging violations of Section 11 of the Securities Act. Defendants removed this action to federal court pursuant to the provisions of the Securities Litigation Uniform Standards Act of 1998. In July 2003, the federal court issued a ruling that the case should be remanded to Fulton County Superior Court. The Fulton County Superior Court has stayed the case pending resolution of the federal case. The plaintiffs are seeking an unspecified amount of damages, as well as attorneys' fees and costs. At this time, the likely outcome of the case cannot be predicted, nor can a reasonable estimate of loss, if any, be made.

In September and October 2002, three substantially identical class action lawsuits were filed in the US District Court for the Northern District of Georgia against BellSouth, its directors, three of its senior officers, and other individuals, alleging violations of the Employee Retirement Income Security Act (ERISA). The cases have been consolidated and on April 21, 2003, a Consolidated Complaint was filed. The plaintiffs, who seek to represent a putative class of participants and beneficiaries of BellSouth's 401(k) plans (the Plan), allege in the Consolidated Complaint that the company and the individual defendants breached their fiduciary duties in violation of ERISA, by among other things, (1) failing to provide accurate information to the Plans' participants and beneficiaries; (2) failing to ensure that the Plans' assets were invested properly; (3) failing to monitor the Plans' fiduciaries; (4) failing to disregard Plan directives that the defendants knew or should have known were imprudent and (5) failing to avoid conflicts of interest by hiring independent fiduciaries to make investment decisions. The plaintiffs are seeking an unspecified amount of damages, injunctive relief, attorneys' fees and costs. Certain underlying factual allegations regarding BellSouth's Advertising & Publishing subsidiary and its former Latin American operation are substantially similar to the allegations in the putative securities class action captioned *In re BellSouth Securities Litigation,* which is described above. At this time, the likely outcome of the cases cannot be predicted, nor can a reasonable estimate of loss, if any, be made.

Antitrust claims

In December 2002, a consumer class action alleging antitrust violations of Section 1 of the Sherman Antitrust Act was filed against BellSouth, Verizon, SBC and Qwest, captioned *William Twombly, et al v. Bell Atlantic Corp., et al,* in US District Court for the Southern District of New York. The complaint alleged that defendants conspired to restrain competition by agreeing not to compete with one another and to impede competition with others. The plaintiffs are seeking an unspecified amount of treble damages and injunctive relief, as well as attorneys' fees and expenses. In October 2003, the district court dismissed the complaint for failure to state a claim. In October 2005, the Second Circuit Court of Appeals reversed the District Court's decision and remanded the case to the District Court for further proceedings. At this time, the likely outcome of the case cannot be predicted, nor can a reasonable estimate of loss, if any, be made.

In June 2004, the US Court of Appeals for the 11th Circuit affirmed the District Court's dismissal of most of the antitrust and state law claims brought by a plaintiff CLEC in a case captioned *Covad Communications Company, et al v. BellSouth Corporation, et al.* The appellate court, however, permitted a price squeeze claim and certain state tort claims to proceed. In November 2005, Covad dismissed with prejudice the civil action and then contemporaneously filed complaints with the public service commissions of Florida and Georgia and filed an informal complaint with the Federal Communications Commission. The commission complaints allege breaches of our interconnection contracts approved by the state commissions, including failure to provide collocation, mishandling of orders, ineffective support systems, and failure to provide unbundled loops. The complaints also allege improper solicitation of Covad customers. These claims are similar to the claims raised in the civil action dismissed by Covad. The complaints seek credits and equitable relief. Covad has asked the state commissions to stay proceedings on its complaints pending resolutions of its FCC complaint. At this time, the likely outcome of the case cannot be predicted, nor can a reasonable estimate of loss, if any, be made.

OTHER CLAIMS

We are subject to claims arising in the ordinary course of business involving allegations of personal injury, breach of contract, anti-competitive conduct, employment law issues, regulatory matters and other actions. BST is also subject to claims attributable to pre-divestiture events, including environmental liabilities, rates and contracts. Certain contingent liabilities for pre-divestiture events are shared with AT&T Inc. While complete assurance cannot be given as to the outcome of these claims, we believe that any financial impact would not be material to our results of operations, financial position or cash flows.

Note R – Subsidiary Financial Information

We have fully and unconditionally guaranteed all of the outstanding debt securities of BellSouth Telecommunications, Inc. (BST), which is a 100% owned subsidiary of BellSouth. In accordance with SEC rules, we are providing the following condensed consolidating financial information. BST is listed separately because it has debt securities, registered with the SEC, that we have guaranteed. The Other column represents all other wholly owned subsidiaries excluding BST and BST subsidiaries. The Adjustments column includes the necessary amounts to eliminate the intercompany balances and transactions between BST, Other and Parent and to consolidate wholly owned subsidiaries to reconcile to our consolidated financial information.

DOLLARS ARE IN MILLIONS, EXCEPT PER SHARE AMOUNTS AND AS OTHERWISE INDICATED

CONDENSED CONSOLIDATING STATEMENTS OF INCOME

	For the Year Ended December 31, 2003				
	BST	Other	Parent	Adjust-ments	Total
Total operating revenues	$17,400	$ 5,695	$ –	$(2,754)	$20,341
Total operating expenses	14,838	4,169	25	(4,248)	14,784
Operating income (loss)	2,562	1,526	(25)	1,494	5,557
Interest expense	537	73	580	(243)	947
Net earnings (losses) of equity affiliates	1,067	498	3,799	(4,912)	452
Other income (expense), net	(10)	275	111	(14)	362
Income (loss) from continuing operations before income taxes	3,082	2,226	3,305	(3,189)	5,424
Provision (benefit) for income taxes	730	770	(183)	619	1,936
Income (loss) from continuing operations	2,352	1,456	3,488	(3,808)	3,488
Income (loss) from discontinued operations, net of tax	–	101	101	(101)	101
Cumulative effect of changes in accounting principle, net of tax	816	(501)	315	(315)	315
Net income (loss)	$ 3,168	$ 1,056	$ 3,904	$(4,224)	$ 3,904

	For the Year Ended December 31, 2004				
	BST	Other	Parent	Adjustments	Total
Total operating revenues	$16,884	$6,452	$ –	$(3,036)	$20,300
Total operating expenses	14,993	4,627	11	(4,620)	15,011
Operating income (loss)	1,891	1,825	(11)	1,584	5,289
Interest expense	529	26	607	(246)	916
Net earnings (losses) of equity affiliates	1,125	80	3,700	(4,837)	68
Other income (expense), net	12	667	114	(48)	745
Income (loss) from continuing operations before income taxes	2,499	2,546	3,196	(3,055)	5,186
Provision (benefit) for income taxes	484	858	(198)	648	1,792
Income (loss) from continuing operations	2,015	1,688	3,394	(3,703)	3,394
Income (loss) from discontinued operations, net of tax	–	1,364	1,364	(1,364)	1,364
Net income (loss)	$ 2,015	$3,052	$4,758	$(5,067)	$ 4,758

	For the Year Ended December 31, 2005				
	BST	Other	Parent	Adjustments	Total
Total operating revenues	**$16,851**	**$7,191**	**$ –**	**$(3,495)**	**$20,547**
Total operating expenses	**15,556**	**5,330**	**119**	**(5,128)**	**15,877**
Operating income (loss)	**1,295**	**1,861**	**(119)**	**1,633**	**4,670**
Interest expense	**513**	**29**	**891**	**(309)**	**1,124**
Net earnings (losses) of equity affiliates	**1,195**	**171**	**3,223**	**(4,424)**	**165**
Other income (expense), net	**(12)**	**552**	**225**	**(174)**	**591**
Income (loss) from continuing operations before income taxes	**1,965**	**2,555**	**2,438**	**(2,656)**	**4,302**
Provision (benefit) for income taxes	**257**	**952**	**(475)**	**655**	**1,389**
Income (loss) from continuing operations	**1,708**	**1,603**	**2,913**	**(3,311)**	**2,913**
Income (loss) from discontinued operations, net of tax	**–**	**381**	**381**	**(381)**	**381**
Net income (loss)	**$ 1,708**	**$1,984**	**$3,294**	**$(3,692)**	**$ 3,294**

CONDENSED CONSOLIDATING BALANCE SHEETS

	December 31, 2004					December 31, 2005				
	BST	Other	Parent	Adjust-ments	Total	BST	Other	Parent	Adjust-ments	Total
ASSETS										
Current assets:										
Cash and cash equivalents	$ 7	$ 405	$ 265	$ 3	$ 680	$ 98	$ 141	$ 138	$ 50	$ 427
Short-term investments	–	–	16	–	16	–	–	–	–	–
Accounts receivable, net	75	1,005	2,918	(1,439)	2,559	25	2,058	4,510	(4,038)	2,555
Other current assets	528	4,418	58	(3,714)	1,290	537	531	39	120	1,227
Assets of discontinued operations	–	1,068	–	–	1,068	–	–	–	–	–
Total current assets	610	6,896	3,257	(5,150)	5,613	660	2,730	4,687	(3,868)	4,2 09
Investments and advances to Cingular Wireless	3,515	21,686	1,539	(3,969)	22,771	–	21,069	205	–	21,274
Property, plant and equipment, net	21,339	665	3	32	22,039	21,045	644	3	31	21,723
Deferred charges and other assets	5,267	293	39,234	(37,465)	7,329	9,117	611	34,322	(36, 236)	7,814
Intangible assets, net	1,072	391	9	115	1,587	1,040	400	3	90	1,533
Total assets	$31,803	$29,931	$44,042	$(46,437)	$59,339	$31,862	$25,454	$ 39,220	$(39,983)	$56,553
LIABILITIES AND SHAREHOLDERS' EQUITY										
Current liabilities:										
Debt maturing within one year	$ 3,016	$ 15	$ 4,248	$ (1,804)	$ 5,475	$ 5,003	$ 270	$ 3,985	$ (5,149)	$ 4,109
Other current liabilities	3,941	1,165	4,905	(5,946)	4,065	3,307	1,437	1,113	(1,312)	4,545
Liabilities of discontinued operations	–	830	–	–	830	–	–	–	–	–
Total current liabilities	6,957	2,010	9,153	(7,750)	10,370	$ 8,310	1,707	5,098	(6,461)	8,654
Long-term debt	3,704	107	11,874	(577)	15,108	2,931	99	10,571	(522)	13,079
Noncurrent liabilities:										
Deferred income taxes	5,063	1,735	(576)	184	6,406	5,032	1,927	(574)	222	6,607
Other noncurrent liabilities	2,974	791	525	99	4,389	3,185	757	591	146	4, 679
Total noncurrent liabilities	8,037	2,526	(51)	283	10,795	8,217	2,684	17	368	11,286
Shareholders' equity	13,105	25,288	23,066	(38,393)	23,066	12,404	20,964	23,534	(33,368)	23,534
Total liabilities and shareholders' equity	$31,803	$29,931	$44,042	$(46,437)	$59,339	$31,862	$25,454	$ 39, 220	$(39,983)	$56,553

DOLLARS ARE IN MILLIONS, EXCEPT PER SHARE AMOUNTS AND AS OTHERWISE INDICATED

CONDENSED CONSOLIDATING CASH FLOW STATEMENTS

	For the Year Ended December 31, 2003				
	BST	Other	Parent	Adjustments	Total
Cash flows from continuing operations:					
Cash flows from operating activities	$ 7,654	$ 1,637	$ 4,038	$ (5,446)	$ 7,883
Cash flows from investing activities	(2,918)	(545)	(777)	1,534	(2,706)
Cash flows from financing activities	(4,731)	(1,082)	(2,825)	3,959	(4,679)
Cash flows from discontinued operations	–	428	–	–	428
Net increase in cash	$ 5	$ 438	$ 436	$ 47	$ 926

	For the Year Ended December 31, 2004				
	BST	Other	Parent	Adjustments	Total
Cash flows from continuing operations:					
Cash flows from operating activities	$ 5,456	$ 1,347	$ 3,210	$ (3,212)	$ 6,801
Cash flows from investing activities	(2,971)	(14,363)	(13,751)	17,525	(13,560)
Cash flows from financing activities	(2,483)	12,810	9,188	(14,444)	5,071
Cash flows from discontinued operations	–	(579)	–	–	(579)
Net increase (decrease) in cash	$ 2	$ (785)	$ (1,353)	$ (131)	$ (2,267)

	For the Year Ended December 31, 2005				
	BST	Other	Parent	Adjustments	Total
Cash flows from continuing operations:					
Cash flows from operating activities	**$ 5,341**	**$ 1,616**	**$ 7,267**	**$ (7,516)**	**$ 6,708**
Cash flows from investing activities	**(3,165)**	**4,727**	**820**	**(2,865)**	**(483)**
Cash flows from financing activities	**(2,085)**	**(6,492)**	**(8,214)**	**10,428**	**(6,363)**
Cash flows from discontinued operations	**—**	**(115)**	**—**	**—**	**(115)**
Net increase (decrease) in cash	**$ 91**	**$ (264)**	**$ (127)**	**$ 47**	**$ (253)**

SUPPLEMENTAL DATA

	For the Year Ended December 31, 2003				
	BST	Other	Parent	Adjustments	Total
Depreciation and amortization expense	$ 3,543	$ 191	$ 2	$ 75	$ 3,811
Capital expenditures	$ 2,704	$ 186	$ 4	$ 32	$ 2,926

	For the Year Ended December 31, 2004				
	BST	Other	Parent	Adjustments	Total
Depreciation and amortization expense	$ 3,365	$ 217	$ 3	$ 51	$ 3,636
Capital expenditures	$ 2,910	$ 255	$ 6	$ 22	$ 3,193

	For the Year Ended December 31, 2005				
	BST	Other	Parent	Adjustments	Total
Depreciation and amortization expense	**$ 3,369**	**$ 243**	**$ 2**	**$ 47**	**$ 3,661**
Capital expenditures	**$ 3,248**	**$ 189**	**$ 3**	**$ 17**	**$ 3,457**

Note S – Quarterly Financial Information (Unaudited)

In the following summary of quarterly financial information, all adjustments necessary for a fair presentation of each period were included.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
2004					
Operating revenues	$4,976	$5,083	$5,095	$5,146	$20,300
Operating income	1,358	1,442	1,401	1,088	5,289
Provision for income taxes	623	516	465	188	1,792
Income from continuing operations	1,150	939	852	453	3,394
Net income	$1,599	$ 996	$ 799	$1,364	$ 4,758
Basic earnings per share(a):					
Income from continuing operations	$ 0.63	$ 0.51	$ 0.47	$ 0.25	$ 1.85
Net income	$ 0.87	$ 0.54	$ 0.44	$ 0.74	$ 2.60
Diluted earnings per share(a):					
Income from continuing operations	$ 0.63	$ 0.51	$ 0.46	$ 0.25	$ 1.85
Net income	$ 0.87	$ 0.54	$ 0.44	$ 0.74	$ 2.59
Total comprehensive income	$1,713	$1,007	$ 789	$1,677	$ 5,186
2005					
Operating revenues	**$5,091**	**$5,142**	**$5,072**	**$5,242**	**$20,547**
Operating income	**1,352**	**1,350**	**971**	**997**	**4,670**
Provision for income taxes	**354**	**394**	**392**	**249**	**1,389**
Income from continuing operations	**683**	**795**	**817**	**618**	**2,913**
Net income	**$1,064**	**$ 795**	**$ 817**	**$ 618**	**$ 3,294**
Basic earnings per share(a):					
Income from continuing operations	**$ 0.37**	**$ 0.43**	**$ 0.45**	**$ 0.34**	**$ 1.60**
Net income	**$ 0.58**	**$ 0.43**	**$ 0.45**	**$ 0.34**	**$ 1.81**
Diluted earnings per share(a):					
Income from continuing operations	**$ 0.37**	**$ 0.43**	**$ 0.44**	**$ 0.34**	**$ 1.59**
Net income	**$ 0.58**	**$ 0.43**	**$ 0.44**	**$ 0.34**	**$ 1.80**
Total comprehensive income	**$1,141**	**$ 805**	**$ 859**	**$ 632**	**$ 3,437**

(a) Due to rounding, the sum of quarterly earnings per share amounts may not agree to year-to-date earnings per share amounts.

The quarters shown were affected by the items listed below. These items are specific to net income.

2004

- First quarter included a gain related to the sale of our operations in Denmark, which increased net income by $295, or $0.16 per share.
- First quarter also included a charge for a settlement with the South Carolina Consumer Advocate, which decreased net income by $33, or 0.02 per share.
- We recorded losses related to service repairs in the wireline business due to Hurricanes Charley, Frances, Ivan and Jeanne, which reduced net income by $23, or $0.01 per share in the third quarter and by $77, or $0.04 per share, in the fourth quarter.
- Our equity in earnings from Cingular Wireless included losses related to wireless merger integration costs for the Cingular Wireless/AT&T Wireless merger, a fair value adjustment for the sale of Cingular Wireless Interactive, and lease accounting adjustments, which reduced our net income by $17, or $0.01 per share, in the third quarter and by $92, or $0.05 per share in the fourth quarter. In addition, our equity in earnings from Cingular Wireless included amortization of intangibles, primarily customer lists, that were acquired as part of Cingular's merger with AT&T Wireless. These charges reduced our net income by $80, or $0.04 per share, in the fourth quarter.
- Fourth quarter also included charges related to severance and lease termination payments, which reduced net income by $18, or $0.01 per share.
- We recorded income (losses) related to our Discontinued Operations which impacted net income by $449, or $0.24 per share, in the first quarter; by $57, or $0.03 per share, in the second quarter; by $(53), or $(0.03) per share, in the third quarter; and by $911, or $0.50 per share, in the fourth quarter.

2005

- First quarter included income of $381, or $0.21 per share, related to our Discontinued Operations.
- We recorded charges related to the early extinguishment of debt, which reduced net income by $14, or $0.01 per share, in the first quarter and $12, or $0.01 per share, in the second quarter.

- Third quarter included a gain related to the sale of our operations in Israel, which increased net income by $228, or $0.12 per share.
- We recorded losses related to asset impairments and service repairs in the wireline business due to Hurricane Katrina, which reduced net income by $177, or $0.10 per share, in the third quarter and by $145, or $0.08 per share, in the fourth quarter.
- Our equity in earnings from Cingular Wireless included losses related to wireless merger integration costs for the Cingular Wireless/AT&T Wireless merger and hurricane costs, which reduced our net income by $21, or $0.01 per share, in the first quarter, $42, or $0.02 per share, in the second quarter, $79, or $0.04 per share, in the third quarter, and $82, or $0.05 per share, in the fourth quarter. In addition, our equity in earnings from Cingular Wireless included amortization of intangibles, primarily customer lists, that were acquired as part of Cingular's merger with AT&T Wireless. These charges reduced our net income by $100, or $0.05 per share, in the first quarter, $91, or $0.05 per share, in the second quarter, $94, or $0.05 per share, in the third quarter, and $90, or $0.05 per share, in the fourth quarter.
- Fourth quarter included a deferred revenue adjustment that corrected a system coding error that was resulting in underreporting revenues in prior periods. The adjustment increased net income by $29, or $0.02 per share.
- Fourth quarter also included charges related to severance, which reduced net income by $59, or $0.03 per share.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

BELLSOUTH CORPORATION

To the Shareholders of BellSouth Corporation:

We have completed integrated audits of BellSouth Corporation's 2005 and 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2005, and an audit of its 2003 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements

In our opinion, based on our audits and the report of other auditors, the accompanying consolidated balance sheets and the related consolidated statements of income, cash flows and shareholders' equity and comprehensive income present fairly, in all material respects, the financial position of BellSouth Corporation and its subsidiaries (''BellSouth'') at December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Cingular Wireless, LLC (''Cingular''), an equity method investee. BellSouth's consolidated financial statements include an investment of $18,447 million and $18,311 million as of December 31, 2005 and 2004, respectively and equity method income of $135 million, $24 million and $408 million, respectively, for each of the three years in the period ended December 31, 2005. Those statements were audited by other auditors whose report thereon has been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for Cingular, is based solely on the report of the other auditors. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note C to the consolidated financial statements, in 2003, BellSouth adopted Financial Accounting Standards Board Statement No. 143, ''Accounting for Asset Retirement Obligations,'' changing its method of accounting for asset retirement costs. BellSouth also changed its accounting for publication revenues from the publication and delivery method to the deferral method as of January 1, 2003.

Internal control over financial reporting

Also, in our opinion, management's assessment, included in the accompanying *Report of Management on Internal Control Over Financial Reporting,* that the Company maintained effective internal control over financial reporting as of December 31, 2005 based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control — Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

Atlanta, Georgia
February 27, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

BELLSOUTH CORPORATION

Board of Directors and Shareowners
Cingular Wireless Corporation, Manager of
Cingular Wireless LLC

We have audited the consolidated balance sheets of Cingular Wireless LLC as of December 31, 2004 and 2005, and the related consolidated statements of income, changes in members' capital, comprehensive income and cash flows for each of the three years in the period ended December 31, 2005 (not presented separately herein). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. The financial statements of Omnipoint Facilities Network II, LLC (Omnipoint), a wholly owned subsidiary of GSM Facilities, LLC (an equity investee in which the Company had an approximate 60% interest at December 31, 2004), have been audited by other auditors whose report has been furnished to us; insofar as our opinion on the consolidated financial statements relates to the 2003 and 2004 amounts included for Omnipoint, it is based solely on their report. In the consolidated financial statements, the Company's indirect investment in Omnipoint is stated at $880 million at December 31, 2004, and the Company's equity in net losses of Omnipoint is stated at $100 million for the year ended December 31, 2003 and $135 million for the year ended December 31, 2004.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors for 2003 and 2004 provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors for 2003 and 2004, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Cingular Wireless LLC at December 31, 2004 and 2005 and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2005 in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

Atlanta, Georgia
February 24, 2006

REPORT OF MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

BELLSOUTH CORPORATION

The management of BellSouth Corporation is responsible for establishing and maintaining adequate internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) or 15d-15(f) adopted under the Securities Exchange Act of 1934.

BellSouth's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2005. In making this assessment, BellSouth's management used the criteria set forth in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on its assessment, management concluded that BellSouth maintained effective internal control over financial reporting as of December 31, 2005.

PricewaterhouseCoopers LLP, BellSouth's independent registered public accounting firm, has audited our management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2005, as stated in their report which appears on page 89.

February 27, 2006

Shareholder Information

CORPORATE HEADQUARTERS

BellSouth Corporation
1155 Peachtree Street, N.E.
Atlanta, GA 30309-3610
404-249-2000

NOTICE OF ANNUAL MEETING

The 2006 Annual Meeting of BellSouth Shareholders will be held at 9:00 a.m. E.T. on Monday, April 24, 2006, at Cobb Galleria Centre in Atlanta, GA.

STOCK TRADING INFORMATION

BellSouth stock is listed on the New York Stock Exchange and on the London, Amsterdam and Swiss exchanges.

TICKER SYMBOL (NYSE)

BLS

NEWSPAPER STOCK LISTING

BellSouth or BellSo

SERVICES FOR REGISTERED SHAREHOLDERS

Mellon Investor Services, the transfer agent for BellSouth Shareholder Services, provides essential services such as record keeping, stock transfer, dividend payment and a toll-free shareholder services line. Registered shareholders who have questions or need assistance with their accounts should contact BellSouth Shareholder Services.

Services available at no cost to you:

- Automatic direct deposit of cash dividends to your bank account;
- Automatic reinvestment of dividends in BellSouth common stock; and
- Safekeeping of stock certificates by the agent.

INTERNET DELIVERY OF PROXY MATERIAL

Registered BellSouth shareholders can elect to receive notice of all future proxy materials over the Internet by enrolling in MLink℠. MLink is a service offered by our transfer agent that allows you convenient and easy online access to all of your shareholder communications. If you enroll in MLink, your proxy materials, including the Annual Report and Proxy Statement, will be made available to you via an e-mail notification with a hyperlink to the voting site containing the information. You can obtain more information and enroll in MLink by accessing your registered shareholder account at www.melloninvestor.com/isd.

DIRECT INVESTMENT PLAN

The BellSouth Direct Investment Plan provides a comprehensive package of services designed to make investing in BellSouth stock easy, convenient and more affordable. There is no charge for existing shareholders to enroll. If you are not a BellSouth shareholder, you can join the Plan for an initial minimum investment of $500, which includes a $10 enrollment fee.

To obtain a prospectus and enrollment form, go to www.bellsouth.com/investor and click on Shareholder Services, or call toll-free 888-266-6778.

INVESTOR INFORMATION AND PUBLICATIONS

Access www.bellsouth.com/investor for information about BellSouth. Inquiries from individual or institutional investors, security analysts and other members of the professional financial community should be directed to:

BellSouth Investor Relations
Room 14B06
1155 Peachtree Street, N.E.
Atlanta, GA 30309-3610
e-mail: investor@bellsouth.com

The Company's Annual Report and Forms 10-K and 10-Q are available on the Internet at BellSouth's investor home page, www.bellsouth.com/investor or without charge by writing to the BellSouth Investor Relations address above.

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Representatives are available 9:00 a.m. to 7:00 p.m. E.T. weekdays. Automated system available 24 hours a day/7 days a week.

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Visit www.melloninvestor.com/isd for secure online access to your registered account.

Visit www.bellsouth.com/investor for information about BellSouth.

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BELLSOUTH® 2005 Annual Report

BELLSOUTH®

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