

**BellSouth Corporation**

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**RATING**

No rating assigned. Reference report only.

**UPDATE**

BellSouth Corporation (“BellSouth” or the “Company”) continues to maintain one of the strongest credit profiles in the telecommunications industry, underpinned by its incumbent position in nine states in the southeastern U.S. Overall, BellSouth’s credit profile is expected to remain in the upper “A” range. The Company’s considerable size and advanced network permit very competitive bundles of service throughout its franchised areas. It also maintains a strong balance sheet and excellent liquidity. However, even with its considerable scale and cash flow, BellSouth is seeing some pressure from competition, along with some decline in performance measures, including ROE and EBITDA margins. This is to be expected as telco monopolies in many markets are opened to competition, although the pressure on BellSouth still appears quite manageable. With growing competition, there have been two noteworthy shifts in product mix, which have contributed to lower earnings and cash flow. The first product shift has been the decline in profitable residential second lines, coupled with the growth in the less profitable high-speed DSL Internet access service. The second shift has been the decline in profitable full service local lines, coupled with the growth in the less profitable unbundled networks elements platform (UNE-P) wholesale access service provided to competitors. In addition, BellSouth’s growing interLATA (national) long-distance, data, and, indirectly, wireless services (through Cingular Wireless LLC (“Cingular Wireless”) are also

providing lower margins. To manage this, the Company has lowered overhead expenses (by reducing the number of employees) and capex spending. The lower capex has allowed free cash flow to remain positive. Current capex levels now appear low when compared to both previous levels and the large annual depreciation expense. In the future, BellSouth may increase capex, although it is unlikely to return to previous levels or exceed depreciation over the near term. This will depend on how aggressively BellSouth spends to deploy consumer broadband services. If profitability from the changing product mix does not improve as new technologies are introduced, the Company may not fully recoup the value of the prior investments in fixed assets made over the years. If this became significant, the Company could consider a write-down in part of the asset base to better match the value of future cash flows. Beginning in 2004, BellSouth will focus on improving the penetration of bundled services and maintaining its strong liquidity. It will also introduce video services, co-branded through DIRECTV Inc. (“DIRECTV”), which should help reduce customer churn as more and more customers sign on for bundled services. In 2004, DBRS expects the Company to generate positive free cash flow of approximately \$1.6 billion based on \$6.7 billion in operating cash flow, \$3.5 billion in capex, and \$1.6 billion in dividends, so its balance sheet will continue to improve.

**CONSIDERATIONS**

Strengths:

- Third largest telco in North America
- Strong liquidity and balance sheet
- Last mile access to bundle data and wireless services
- Equity investment in Cingular Wireless

Challenges:

- Continued margin pressure going forward
- Line erosion due to competition facilitated by UNE-P
- Operates in a capital-intensive industry
- Faces a complex regulatory environment domestically

**FINANCIAL INFORMATION**

(US\$ millions)	6 mos. to		6 mos.		12 mos. to		For the year ended December 31			
	June 2003	June 2002	June 2003	June 2002	June 2003	2002	2001	2000	1999	1998
Total revenue	11,165	11,314	22,291	22,440	24,130	27,450	25,258	23,123		
EBITDA	4,772	4,846	9,645	9,719	10,684	11,894	11,428	10,261		
EBIT	2,688	2,515	5,249	5,076	5,902	6,790	6,757	5,904		
Core net income	1,393	1,242	2,679	2,527	2,982	3,509	3,723	3,294		
Cash flow from operations	3,477	3,573	7,075	7,170	7,764	8,613	8,394	7,651		
Free cash flow (before work. cap. chgs.)	1,358	832	2,435	1,908	339	191	745	1,019		
Cash flow/total debt	-	-	0.46	0.41	0.39	0.43	0.50	0.63		
EBIT gross interest coverage	4.93	4.16	4.65	4.27	4.49	4.88	6.56	7.05		
% total debt in capital structure	44.7%	50.4%	44.7%	49.6%	52.0%	54.2%	53.1%	43.0%		
EBITDA margin	42.7%	42.8%	43.3%	43.3%	44.3%	43.3%	45.2%	44.4%		
Domestic access lines (thousands)	24,150	25,138	24,150	24,603	25,422	25,908	25,499	24,630		
DSL subscribers (thousands)	1,225	803	1,225	1,021	621	215	30	-		
Domestic wireless subscribers (thousand)	9,056	8,873	9,056	8,770	8,638	8,337	5,337	4,796		
Return on equity	-	-	14.6%	13.9%	16.8%	22.1%	24.1%	21.1%		

\* Includes 40% proportion of Cingular Wireless subscribers.

**THE COMPANY** BellSouth Corporation is a diversified communications company that provides telephone service within its nine-state region servicing the southeastern U.S. BellSouth provides a full suite of telecommunication services. It also owns 40% of Cingular Wireless, as well as operations in South America.

## CONSIDERATIONS

**Strengths:** (1) BellSouth has over 24 million switched access lines in nine states in the southern and southeastern U.S. In addition, BellSouth has developed a highly modern network.

(2) BellSouth has strong earnings and liquidity. BellSouth is able to drive earnings through high access charges, which contribute to strong operating cash flow. As a result, BellSouth is able to internally finance operations and dividends. In addition, it has ample bank lines supporting its Commercial Paper program.

(3) Last mile advantage and brand recognition makes it very difficult for BellSouth's competitors to duplicate.

(4) The Company's ability to bundle services on a large scale should limit the erosion of local access lines. BellSouth's ability to bundle wireline, wireless, and data services is currently unmatched by the competition.

(5) With the creation of Cingular Wireless, a joint venture between BellSouth and SBC Communications Inc. ("SBC"), BellSouth is able to realize considerable operating efficiencies through greater economies of scale. BellSouth has a 40% equity investment in Cingular Wireless, which services over 22 million subscribers. Its ownership in a wireless provider also mitigates the impact of wireline to wireless substitution.

(6) Future revenue growth opportunities through domestic long-distance, data and IP, and continued wireless growth will help reduce the impact of erosion to its local market share.

(7) Due to its improved management focus, through the creation of Cingular Wireless and the potential spinoff of its Latin American operations, BellSouth can now focus its efforts on its core businesses.

**Challenges:** (1) BellSouth faces margin pressure going forward. Over the long term, it will become increasingly difficult to improve revenues, reduce costs, and maintain current margins given the shift in product mix.

(3) Access line erosion remains significant and is unlikely to stabilize over the near term. BellSouth is expected to lose 2% to 3% of its access line base in the near term. This line erosion is mainly due to UNE-P, wireless substitution, and a decline in second line usage.

(3) Competition from cable companies with the launch of telephony and competition from AT&T Corporation ("AT&T"), MCI (formerly WorldCom Inc.), and other wholesale providers using UNE-P, will impact local access fee income as other carriers are now able to use BellSouth's local exchanges on a lower margin wholesale basis. This will be particularly relevant where access fees set by state regulators are still relatively high.

(4) BellSouth operates in a capital-intensive industry with high capex requirements over the long term. The level of capex is a direct function of the level of competition for core services as operators are forced to upgrade networks and implement the latest technology in an increasingly competitive marketplace. Capex going forward will likely be focused on improving broadband capabilities throughout its service area.

(5) The telcos are regulated federally by the Federal Communications Commission (FCC) and regionally by each state regulatory commission. This results in a cumbersome and complex regulatory environment in which to operate and evolve the business. Moreover, as the U.S. telecommunications industry is opened to greater competition, regulatory disputes delay the rollout of services.

(6) The threat from Cable providers for a share of telephony and broadband services. Competition from cable operators is expected to intensify going forward. Cable's broadband services and its ability to bundle video, voice, and data into one package represent a growing competitive threat for the residential segment.

## EARNINGS PROFILE

(US\$ millions)	June 30 For the year ended Dec. 31			Operating Statistics (thousands)	June 30 For the year ended Dec. 31		
	2003	2002	2001		2003	2002	2001
Total revenue	22,291	22,440	24,130	EBITDA margin (consolidated)	43.3%	43.3%	44.3%
EBITDA	9,645	9,719	10,684	EBITDA margin (wireline)	44.5%	45.1%	47.3%
Depreciation and amortization	4,396	4,643	4,782	Residential access lines	16,217	16,462	16,958
EBIT	5,249	5,076	5,902	Business access lines	7,767	7,959	8,255
Gross interest expense	1,128	1,188	1,315	Other access lines	166	182	209
EBT	4,121	3,888	4,587	Total access lines	24,150	24,603	25,422
Core net income	2,679	2,527	2,982	Domestic wireless*	9,056	8,770	8,638
Reported net income	3,415	1,343	2,570	Internet subscribers (high-speed)	1,225	1,021	621

\*Based on 40% interest in Cingular.

### Summary:

- EBITDA for the 12-month period ended June 30, 2003, remains under pressure due to:
  - Access line and market share erosion from competition and wireline substitution;
  - Falling access line revenue due to wholesale UNE-P; and
  - Economic weakness in Latin American wireless operations.
- Despite EBITDA weakness, BellSouth's core net income remained stable due to cost-cutting efforts and lower financing costs.

### Outlook:

- EBITDA is expected to fall by approximately 3% to 5% over the next year as core wireline results come under pressure due to:
  - Continued trends in access line erosion; and
  - Falling network access fees due to increased competition and regulatory rate reductions.
- Overall, current trends should continue through 2004.

**SEGMENTED DATA****Domestic Wireline Segment**

	6 mos. to	6 mos. to	12 mos. to	For the year ended December 31				
	June 2003	June 2002	June 2003	2002	2001	2000	1999	1998
<b>Income Results</b>								
Total revenue	9,162	9,353	18,298	18,489	19,071	18,455	17,524	16,372
EBITDA	4,026	4,214	8,148	8,336	9,014	9,079	9,221	7,955
EBIT	2,145	2,140	4,260	4,255	4,969	5,293	5,828	4,599
Financing costs	219	245	472	498	597	699	560	551
<b>Core Net Income</b>	1,121	1,027	2,121	2,027	2,507	2,663	3,315	2,566
<b>Cash Flow Results</b>								
Core net income	1,121	1,027	2,121	2,027	2,507	2,663	3,315	2,566
Depreciation	1,881	2,074	3,888	4,081	4,045	3,786	3,393	3,356
Operating cash flow	3,002	3,101	6,009	6,108	6,552	6,449	6,708	5,922
Less: capex	1,231	1,840	2,728	3,337	5,125	5,440	4,638	3,502
Less: dividends (1)	489	457	984	951	915	948	1,209	1,420
Free cash flow	1,282	804	2,297	1,820	512	61	861	1,000
<b>Operational Data</b>								
EBITDA margins	43.9%	45.1%	44.5%	45.1%	47.3%	49.2%	52.6%	48.6%
Access lines - residential	16,217	16,765	16,217	16,462	16,958	17,135	17,002	16,497
Access lines - business	7,767	8,179	7,767	7,959	8,255	8,525	8,232	7,859
Access lines - other	166	194	166	182	209	248	265	274
Network access lines (thousands)	24,150	25,138	24,150	24,603	25,422	25,908	25,499	24,630
Resold lines (thousands)	319	532	319	436	729	800	665	520
UNE-P (thousands)	2,009	1,118	2,009	1,545	602	531	152	42
Unbundled loops (thousands)	359	398	359	377	423	-	-	-
Wholesale lines (thousands)	2,494	1,844	2,494	2,163	1,540	1,331	817	562
Access minutes (thousands)	45,848	50,656	93,763	98,571	110,106	115,217	110,088	104,373
DSL customers (thousands)	1,225	803	1,225	1,021	621	215	30	-

(1) Dividend based on a DBRS estimate allocation based on the proportion of revenue from this segment.

**Income Statement Data****Background:**

- This segment consists of core domestic wireline voice, data, broadband, e-commerce, long-distance, and Internet services, and added calling features.

**Local Services:**

- Local services revenue declined due to access line erosion attributable to:
  - Competition using UNE-P to gain residential customers;
  - DSL technology reducing the number of households with a second line;
  - Wireless substitution; and
  - A depressed economy reducing business lines.

**Network Access:**

- Network access revenues fell significantly due to reduced volume from:
  - Competitive bypass of network with shift to UNE-P from resale;
  - Wireless and e-mail substitution; and
  - Regulatory rate reductions.

**Long Distance:**

- Long-distance revenue increased due to:
  - The roll-out of InterLATA long-distance services and the addition of 2.8 million long-distance customers.
  - Partially offset by the discontinuation of the wholesale long-distance business

**Data:**

- Data revenues have come under pressure in 2003 due to a sluggish economy, causing a significant decline in wholesale data revenue.
- This decline was partially offset by strong retail data growth, especially in DSL where the Company has grown its subscriber base to over 1.2 million.

**Outlook:**

- EBITDA will remain pressured due to competition and a shift in product mix.
- Access line erosion of approximately 3% is expected over the next year, which will continue to negatively impact profitability.

**Cash Flow Data:**

- Operating cash flow from this segment is more than sufficient to cover dividends and capex.
- BellSouth's wireline segment remains one of the most profitable in the industry and generates considerable free cash flow.

**SEGMENTED DATA**

Wireless Segment* (US\$ millions)	6 mos. to	6 mos. to	12 mos. to	For the year ended December 31			
	June 2003	June 2002	June 2003	2002	2001	2000	1999
<b>Total Revenue</b>	2,950	2,917	5,924	5,891	5,643	4,281	3,486
EBITDA	987	918	1,895	1,826	1,787	1,152	872
EBIT	589	555	1,120	1,086	1,020	510	445
Less: Interest expense	182	178	368	364	328	177	100
Core net income	205	192	370	357	425	168	224
Wireless subscribers	9,056	8,873	9,056	8,770	8,638	8,337	5,337
EBITDA margins	33.5%	31.5%	32.0%	31.0%	31.7%	26.9%	25.0%
Revenue growth **	1.1%	-	1.1%	4.4%	31.8%	22.8%	-
ARPU	51.80	52.11	51.80	51.13	51.47	51.92	53.19
Churn	2.5%	2.7%	2.5%	2.7%	3.1%	2.7%	-

\* Results based on 40% proportional ownership of Cingular Wireless.

\*\* Growth rate annualized for the June 30, 2003, period.

**Background:**

- Cingular Wireless was created in 2000 through the merger of BellSouth and SBC's domestic wireless operations.
- Cingular Wireless has over 22 million subscribers on a consolidated basis. The Company operates a TDMA/GSM network and has signed roaming agreements with T-Mobile USA Inc. and AT&T Wireless to share national infrastructure costs.
- This is treated as an equity investment.

**Wireless Summary:**

- Churn rates continue to be costly and have negatively impacted EBITDA margins. Although churn rates have improved over the latest period to 2.5% in the second quarter of 2003 from 2.7% over the same period in 2002, these rates remain far too high and will need to be reduced significantly in the coming years.

- Despite these concerns, the Company has improved regional marketing and bundling efforts, managed costs, and focused on acquiring profitable customers.

**Outlook:**

- DBRS anticipates there will be only modest growth in BellSouth's EBITDA due to improved marketing efforts and a focus on profitable customer growth.
- However, results could be negatively impacted by the introduction of wireless number portability in November 2003, impacting churn and profitability going forward.
- It is unlikely BellSouth's 40% interest in Cingular Wireless will be sold in the near term.

Directories/Publishing	6 mos. to	6 mos. to	12 mos. to	For the year ended Dec. 31		
	June 2003	June 2002	June 2003	2002	2001	2000
<b>Total Revenue</b>	1,023	1,080	2,051	2,108	2,091	2,066
EBITDA	509	504	948	943	1,068	1,069
EBIT	495	490	921	916	1,040	1,041
EBITDA margin	49.8%	46.7%	46.2%	44.7%	51.1%	51.7%
Revenue growth **	-5.3%	-	-5.4%	0.8%	1.2%	-

\*\* Growth rate annualized for the June 30, 2003, period.

- Revenue has been impacted by a weak economy through the first half of 2003.
- EBITDA margins remain stable at 45% to 50%, with minimal capex requirements.
- The directories business has significant value, with current market valuations of between \$7 billion and \$9.5 billion.

- However, if divested, the proceeds could significantly fund a large scale rollout of broadband services.
- DBRS believes the divestiture of this segment is not under consideration at this time, but would improve financial flexibility if it were sold.

**SEGMENTED DATA**

<b>Latin America</b>	<u>6 mos. to</u>	<u>6 mos.</u>	<u>12 mos. to</u>	<u>For the year ended Dec. 31</u>		
	<u>June 2003</u>	<u>June 2002</u>	<u>June 2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>
<b>Total Revenue</b>	1,074	1,257	2,055	2,238	2,935	2,966
EBITDA	283	379	637	733	885	655
EBIT	100	143	250	293	280	50
Net interest expense	65	75	134	144	215	178
Net income	32	39	81	88	13	(128)
EBITDA margin	26.4%	30.2%	31.0%	32.8%	30.2%	22.1%

- This segment is self-funded and consists of major investments in wireless operations in 11 Latin American countries, most notably Argentina, Chile, Columbia, Ecuador, Nicaragua, Peru, and Venezuela.
- These business are now consolidated and are self-cash funded.
- This segment faces ongoing political and currency risks, given the volatile environment of South America.
- In addition, Telefónica Móviles SA and Telecom Italia have been consolidating their operations in Latin America, thus creating more formidable competition.
- Despite growth in customers from 7.8 million in June 2002, to 8.9 million as at June 2003, the impact of currency declines caused revenues and EBITDA to fall.
- Given the high risks associated with this business, DBRS believes these investments could be sold or spun off to shareholders over time.

**PENSION BENEFITS**

Year	Assumed Return (%)	Assumed Discount Rate on Liabilities (%)	(A) Expected Return (\$ millions)	(B) Actual Return (\$ millions)	(B-A) Surplus (Deficiency) (\$ millions)
2000	9.0%	7.75%	1,537.0	603.0	(934.0)
2001	9.0%	7.25%	1,655.0	(1,193.0)	(2,848.0)
2002	9.0%	6.75%	1,537.0	(1,279.0)	(2,816.0)
2003 (e)	8.5%	6.75%			

Year	(A) Pension Fund Assets (\$)	(B) Pension Fund Liabilities (\$)	(A-B) Net Pension Surplus (Deficiency) (\$)	Cash Contribution (by employer) (\$)	Pension Benefits (credit)/Expense (\$)
2000	19,406.0	12,264.0	7,142.0	0.0	(693.0)
2001	16,617.0	11,928.0	4,689.0	0.0	(797.0)
2002	13,338.0	11,386.0	1,952.0	0.0	(826.0)

- The assumed rate of return remains high and will likely need to be reduced to the 7.5% level. However, the greatest volatility in assumptions is typically the assumed discount rate, which has fallen to 6.75%, which is reasonable.
- BellSouth has generated negative actual returns over the last two years and a return deficiency (actual return minus expected) over the last three years.
- Despite poor pension plan performance over the last three years, BellSouth maintains a pension plan surplus.
- BellSouth is currently running a contra-expense through its income statement (\$826 million in 2002, \$797 million in 2001, and \$693 million in 2000).
- These pension credits inflate EBITDA and net income. However, they have no impact on operating cash flow or free cash flow.
- Overall, BellSouth is well positioned, relative to its peer group, in both assumptions and performance.

**Long-Term Debt Maturities:**
**Debt Maturities**

As at June 30, 2003

(US\$ millions)

Bank loans	510
Commercial Paper	1,502
Long-tem debt due in 2003	1,682
Long-tem debt due in 2004	536
Long-tem debt due in 2005	831
Long-tem debt due in 2006	2,120
Long-tem debt due in 2007	0
Long-tem debt due in >2008	8,231
<b>Total Debt</b>	<u><u>15,412</u></u>

**Liquidity**

Cash on hand	4,122	4,122
Backup credit facilities	1,500	
Total available liquidity	<u><u>5,622</u></u>	

**Cash flow**

Add: cash-on-hand		<u>4,122</u>
Less: bank loans	510	
Less: commercial paper	1,502	
Less: Long-tem debt due in 2003	1,682	
Less: Long-tem debt due in 2004	536	
Debt due in 18 months	<u>(4,230)</u>	
Stress tested free cash flow		
Add: 6 months to Dec. 2003 *	1,000	
Add: 12 months to Dec. 2004 *	1,600	(1,630)
Estimated cash balance Dec. 2004		<u><u>2,492</u></u>

\*DBRS stress tested.

- As the above table illustrates, BellSouth has excellent liquidity over the next 18 months to repay all short-term and long-term debt maturities due through cash on hand and internal cash flow.
- The estimated free cash flow as of December 2004 may be used as follows:
  - Share buybacks;
  - Broadband deployment; and
  - Pension contributions.
- BellSouth's short-term maturities of \$3.7 billion as of June 2003 consist of:
  - \$510 million in bank loans (December 2002 number);
  - \$1.5 billion in Commercial Paper; and
  - \$1.7 billion in long-term debt maturities.
- BellSouth's Commercial Paper program is backed by \$1.5 billion in committed credit facilities. The Company is currently authorized to issue up to \$8 billion in Commercial Paper.
- BellSouth also has access to an additional \$2.3 billion for additional debt financing through a shelf registration.

**InterLATA Long-Distance**

<u>Month Approved</u>	<u>State</u>
May 2002	Georgia
May 2002	Louisiana
September 2002	Alabama
September 2002	Kentucky
September 2002	Mississippi
September 2002	North Carolina
September 2002	South Carolina
December 2002	Florida
December 2002	Tennessee

- The FCC has approved the long-distance applications of BellSouth in each of the nine states in which the Company operates regulated wireline services.
- The table illustrates the month interLATA long-distance service was approved by each state.
- With this approval, BellSouth is free to bundle both local and long-distance services.
- After one full year of service in Georgia and Louisiana, BellSouth has successfully bundled approximately 25% of its wireline customers with long-distance services in these states.
- Throughout its service region, BellSouth has close to 2.8 million long-distance subscribers as of June 30, 2003.

## FINANCIAL PROFILE AND SENSITIVITY ANALYSIS

Cash Flow Statement (US\$ millions)	12 mos. to For the year ended Dec. 31			Sensitivity Analysis		
	June 2003	Dec. 2002	Dec. 2001	Year 1	Year 2	Year 3
EBITDA	9,645	9,719	10,684	9,175	7,471	6,016
Core net income	2,679	2,527	2,982	2,688	1,624	800
Depreciation and amortization	4,396	4,643	4,782	4,100	3,900	3,700
<b>Operating Cash Flow</b>	<b>7,075</b>	<b>7,170</b>	<b>7,764</b>	<b>6,788</b>	<b>5,524</b>	<b>4,500</b>
Less: capital expenditures	3,117	3,785	5,997	3,000	4,000	4,500
Less: dividends	1,506	1,460	1,424	1,550	1,650	1,700
Free cash flow (before work. cap.)	2,452	1,925	343	2,238	(126)	(1,700)
Changes in working capital	(32)	(633)	(1,175)	0	0	0
Free cash flow	2,420	1,292	(832)	2,238	(126)	(1,700)
Acquisitions/dispositions/other	3,212	3,803	509	0	0	0
<b>External Funding Requirements</b>	<b>5,632</b>	<b>5,095</b>	<b>(323)</b>	<b>2,238</b>	<b>(126)</b>	<b>(1,700)</b>
Change in equity	(724)	(591)	0	0	0	0
Change in debt	(2,627)	(2,614)	(146)	(2,000)	0	160
Change in cash	2,280	1,890	(469)	238	(126)	(1,540)
Year-end cash balance	4,122	2,482	592	238	112	(1,428)
<b>Actual</b>				<b>Assumptions</b>		
Revenue growth	-1.3%	-7.0%	-12.1%	-2.0%	-10.0%	-10.0%
EBITDA margin	43.3%	43.3%	44.3%	42.0%	38.0%	34.0%
Interest rate	6.9%	6.3%	6.5%	7.0%	8.0%	8.0%
Capex	3,117	3,785	5,997	3,000	4,000	4,500
<b>Liquidity and Coverage Ratios</b>						
% of debt in the capital structure	44.7%	49.6%	52.0%	39.9%	39.9%	41.3%
EBITDA interest coverage	8.55	8.18	8.12	9.77	6.96	5.54
EBIT interest coverage	4.65	4.27	4.49	5.41	3.33	2.13
Cash flow to total debt	0.46	0.41	0.39	0.51	0.41	0.33
Total debt to EBITDA	1.60	1.79	1.88	1.46	1.80	2.26

### Summary:

- BellSouth's balance sheet strengthened over the latest 12-month period, ended June 2003, as the Company used its significant free cash surplus to reduce debt levels.
- Operating cash flow remains pressured related to weakness in core wireline operations.
- Capex used for infrastructure build-out has been primarily completed and has been scaled back significantly.
- As a result, free cash flow before working capital changes was quite substantial at approximately \$2.4 billion for the 12-month period ended June 30, 2003.
- Overall, coverage and liquidity ratios remain well above industry averages.
- Operating cash flow over the next 12 months will likely see a slight decline, as revenue growth remains negative due to a continued decline in access line and network access revenues.
- Capex is expected to remain within the \$3.5 billion to \$4 billion as the Company matches growth rates with capex. Capex will likely be used to fund increased broadband capabilities.
- As a result, free cash flow is expected to be approximately \$1.6 billion over next 12 months and will likely be used to:
  - Reduce debt levels;
  - Buy back shares; and
  - Complete small strategic acquisitions.
- Coverage and liquidity ratios will likely continue to improve, excluding any future acquisitions.
- No major acquisitions are likely going forward. However, DBRS believes the divestiture of its directory or Latin American operations remain a possibility going forward.

### Outlook:

- BellSouth's balance sheet is expected to strengthen over the near term as it repays maturing debt through its sizeable free cash flow surplus and reduces its outstanding commercial paper.

### Sensitivity Analysis:

DBRS stress tests the financial strength of companies analyzed to measure their sensitivity under various extreme scenarios. The assumptions used in this stress test are not based on any information provided by the Company or DBRS expectations.

### Outcomes:

- Under a stress test scenario, coverage and liquidity ratios remain very strong.
- BellSouth is able to fund over 90% of its capex and dividends internally, with the remainder funded through current cash balances.
- No major funding requirements are likely over the medium term, barring acquisitions.

**INDUSTRY COMPARISON**
**Global Telco Comparison**

Rank	Symbols	= Above normal		= Normal		= Below normal	
	Characteristics	Profitability	Balance Sheet	Cash Flow-to-Debt	Coverage Ratios	Size	Key Support/Other
1	NTT Corp.						
2	SBC Communications Inc.						
3	Belgacom S.A.						
4	Telstra Corporation Limited						
5	BellSouth Corporation						
6	Verizon Communications Inc.						
7	Bell Canada						
8	ALLTEL Corporation						
9	Aliant Telecom Inc.						
10	Saskatchewan Telecommunications Holding						
11	Telefonica S.A.						
12	Manitoba Telecom Services Inc.						
13	Telecom Italia S.p.A.						
14	British Telecommunications plc						
15	Deutsche Telekom AG						
16	TELUS Corporation						
17	France Telecom SA						
18	Sprint Corporation						
19	Royal KPN N.V.						
20	Qwest Communications International Inc.						

Criteria	EBITDA Margins	Debt to Capital	Cash Flow to Debt	EBITDA Int. Coverage	Wireline Subscribers	Support/Other
	Above average	>42%	<45%	>0.40	>10.00	Gov't /Regul./ Shareholder
	Average	38%-42%	45%-55%	0.30-0.40	7.00-10.00	Regul./Shareholder
	Below average	<38%	>55%	<0.30	<7.00	None/Shareholder Drag

- BellSouth ranks as one of the top telcos in the world, owing to its:
  - Strong margins;
  - Good cash flow;
  - Reasonable balance sheet leverage; and
  - State-of-the-art network, including direct fibre to the curb in new residential developments.
- However, BellSouth operates in one of the most complex regulatory environments in the world.

**INDUSTRY COMPARISON**

(US\$ millions)\*

	Date	Total Revenue*	EBITDA*	EBITDA Margin	EBITDA Coverage	Cash Flow/Debt	% Debt in Cap. Stru.
ALLTEL Corporation (1)	June 2003	2,399	1,380	57.5%	7.66	0.38	47.1%
Aliant Telecom Inc.	Dec. 2002	1,191	573	48.2%	9.89	0.49	49.9%
Belgacom S.A.	Dec. 2002	5,486	2,034	37.1%	25.19	2.32	13.5%
Bell Canada **	Mar. 2003	9,407	4,089	43.5%	7.22	0.39	53.1%
BellSouth Corporation (1)	June 2003	18,298	8,005	43.7%	8.86	0.49	44.7%
British Telecommunications plc	Mar. 2003	29,963	9,288	31.0%	3.55	0.24	85.5%
Deutsche Telekom AG (1)	Mar. 2003	32,122	10,984	34.2%	2.25	0.12	61.5%
France Telecom (1) (6)	June 2003	19,128	7,989	41.8%	3.56	0.16	82.0%
Manitoba Telecom Service Inc. (11)	June 2003	562	298	53.1%	14.03	0.62	37.3%
Nippon Telegraph and Telephone Corporation	Mar. 2003	84,024	32,939	39.2%	32.99	0.49	49.4%
Qwest Communications International Inc.	June 2003	14,460	3,966	27.4%	2.17	0.09	n/a
Royal KPN N.V. (1)	June 2003	9,111	3,153	34.6%	3.85	0.28	67.5%
Saskatchewan Tel. Holding Co. (1) (2)	Dec. 2002	594	254	42.7%	12.29	0.68	39.7%
SBC Communications Inc.	June 2003	42,247	14,983	35.5%	11.85	0.66	32.7%
Sprint Corporation (1)	June 2003	6,164	2,954	47.9%	4.87	0.25	63.7%
Telecom Italia S.p.A. (1) (10)	Mar. 2003	17,995	8,419	46.8%	5.58	0.21	64.2%
Telefonica S.A. (1) (5)	June 2003	10,733	4,709	43.9%	7.25	0.35	52.7%
Telstra Corporation Limited	Dec. 2001	9,562	4,673	48.9%	10.98	0.45	50.0%
TELUS Corporation (1) (4)	June 2003	3,327	1,350	40.6%	3.84	0.22	55.4%
Verizon Communications Inc. (1)	June 2003	40,180	16,579	41.3%	8.73	0.42	45.6%
<b>High</b>				53.1%	32.99	2.32	85.5%
<b>Low</b>				27.4%	2.17	0.09	13.5%
<b>Median</b>				41.8%	7.25	0.39	51.4%

	Date	NAS (3) (thousands)	Wireless (thousands)	DSL (thousands)	Capex*	Operating Cash*	Free Cash Flow*
ALLTEL Corporation	June 2003	3,134	7,872	105	1,272	2,235	533
Aliant Telecom Inc. (7)	Dec. 2002	1,520	551	97	242	405	55
Belgacom S.A.	Dec. 2002	4,798	4,253	517	1,077	1,267	(120)
Bell Canada **	Mar. 2003	11,626	3,430	1,104	1,804	2,823	(275)
BellSouth Corporation (1) (12)	June 2003	24,150	9,056	1,225	3,117	7,578	2,923
British Telecommunications plc	Mar. 2003	29,353	-	937	3,648	6,117	1,082
Deutsche Telekom AG (8)	Mar. 2003	58,200	59,800	3,400	6,339	7,760	(278)
France Telecom SA (6)(8)	June 2003	33,965	51,943	2,110	6,697	10,840	3,633
Manitoba Telecom Service Inc. (11)	June 2003	712	242	67	118	217	61
Nippon Telegraph and Telephone Corporation	Mar. 2003	50,714	43,861	n/a	13,273	26,263	12,369
Qwest Communications International Inc.	June 2003	16,504	854	560	1,854	2,136	282
Royal KPN N.V. (1)	June 2003	9,979	13,766	513	1,181	3,516	2,335
Saskatchewan Tel. Holding Co. (1) (2)	Dec. 2002	614	259	64	110	168	9
SBC Communications Inc. (12)	June 2003	55,807	13,584	2,773	5,223	12,166	3,149
Sprint Corporation (1)	June 2003	7,982	15,290	223	3,831	5,819	1,526
Telecom Italia S.p.A. (1) (8)	Mar. 2003	27,107	40,171	1,100	3,280	10,496	314
Telefonica S.A. (1) (5) (8)	June 2003	17,557	30,554	1,294	3,550	7,834	3,052
Telstra Corporation Limited	Dec. 2001	8,680	5,636	122	2,065	3,230	(278)
TELUS Corporation (1) (9)	June 2003	4,887	3,165	821	835	1,187	238
Verizon Communications Inc. (1)	June 2003	56,761	34,619	1,930	12,190	20,500	3,571

\*Conversion rate: US\$ 1 = 0.95; US\$ 1 = Cdn\$ 1.50; US\$ 1.6 = £1; US\$ 1 = ¥30.

\*\*Reflects accounting restatements, Aliant at equity, Bell Express Vu at cost.

(1) Segmented wireline data for total revenue, EBITDA, and EBITDA margin. (2) DBRS tax-adjusted SaskTel's revenue and EBITDA by \$47.9 million.

(3) Network access lines. (4) Excludes TELUS Communications (Québec) Inc. results. (5) Revenue and EBITDA reflect Spanish wireline operations only.

(6) France only wireline and ADSL. (7) DBRS estimate for capex, operating cash flow, and free cash flow. (8) Includes global wireless subscribers.

(9) Includes TELUS Communications (Québec) Inc. (10) Telecom Italia's ratios factor in Olivetti due to the merger between Telecom Italia S.p.A. and Olivetti.

(11) MTS excludes Bell Intrigna results. (12) Wireless lines based on proportion of ownership interest in Cingular Wireless LLC (60% SBC, 40% BellSouth).

**BellSouth Corporation**

<b>Balance Sheet</b>	<u>June 30</u>	<u>Dec. 31</u>	<u>Dec. 31</u>		<u>June 30</u>	<u>Dec. 31</u>	<u>Dec. 31</u>
(US\$ millions)	<u>2003</u>	<u>2002</u>	<u>2001</u>	<b>Liabilities and Equity</b>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Cash and s.t. investments	4,122	2,482	592	Short-term borrowings	3,694	5,114	5,111
Other current assets	4,340	5,380	6,263	Other current liabilities	4,765	4,509	4,957
<b>Total Current Assets</b>	<b>8,462</b>	<b>7,862</b>	<b>6,855</b>	<b>Total Current Liabilities</b>	<b>8,459</b>	<b>9,623</b>	<b>10,068</b>
Net fixed assets	24,047	23,445	24,943	Long-term debt	11,718	12,283	15,014
Intangibles	2,356	2,705	4,506	Deferred taxes and other	10,017	9,927	8,367
Investments	8,283	9,741	10,620	Common equity	19,057	17,646	18,597
Other assets	6,103	5,726	5,122				
<b>Total</b>	<b>49,251</b>	<b>49,479</b>	<b>52,046</b>	<b>Total</b>	<b>49,251</b>	<b>49,479</b>	<b>52,046</b>

For the 12-month period ended	<u>6 mos. to</u>	<u>6 mos. to</u>	<u>12 mos. to</u>	For the year ended December 31			
	<u>June 2003</u>	<u>June 2002</u>	<u>June 2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>
<b>Liquidity Ratios</b>							
Current ratio	1.00	0.71	1.00	0.82	0.68	0.56	0.55
Asset coverage	2.08	1.81	2.08	1.86	1.70	1.64	1.66
Total assets/total debt	3.20	2.79	3.20	2.84	2.59	2.54	2.59
% total debt in capital structure	44.7%	50.4%	44.7%	49.6%	52.0%	54.2%	53.1%
Cash flow/total debt	-	-	0.46	0.41	0.39	0.43	0.50
% cap. spending funded internally	199.8%	141.0%	178.1%	150.4%	105.7%	102.7%	112.0%
<b>Coverage Ratios</b>							
EBIT gross interest coverage	4.93	4.16	4.65	4.27	4.49	4.88	6.56
EBITDA gross interest coverage	8.76	8.01	8.55	8.18	8.12	8.55	11.10
<b>Profitability, Earnings Quality Ratios</b>							
EBITDA margin	42.7%	42.8%	43.3%	43.3%	44.3%	43.3%	45.2%
Return on equity	7.6%	6.7%	14.6%	13.9%	16.8%	22.1%	24.1%
<b>Operating Data</b> (thousands)							
*Cingular Wireless Subscribers	9,056	8,873	9,056	8,770	8,638	8,337	5,337
Access lines - Residential	16,217	16,765	16,217	16,462	16,958	17,135	17,002
Access lines - Business	7,767	8,179	7,767	7,959	8,255	8,525	8,232
Access lines - Other	166	194	166	182	209	248	265
Access lines - Total	24,150	25,138	24,150	24,603	25,422	25,908	25,499
Resold lines	319	532	319	436	729	800	665
UNE-P	2,009	1,118	2,009	1,545	602	531	152
Unbundled	359	398	359	377	423	-	-
Wholesale lines	2,494	1,844	2,494	2,163	1,540	1,331	817
Long-distance subscribers	2,786	147	2,786	1,002	-	-	-
<b>Selected Results</b>							
(US\$ millions)							
Total revenue	11,165	11,314	22,291	22,440	24,130	27,450	25,258
EBITDA	4,772	4,846	9,645	9,719	10,684	11,894	11,428
EBIT	2,688	2,515	5,249	5,076	5,902	6,790	6,757
EBT	2,143	1,910	4,121	3,888	4,587	5,399	5,727
Core net income	1,393	1,242	2,679	2,527	2,982	3,509	3,723
Reported net income	2,181	109	3,415	1,343	2,570	4,220	3,448
Operating cash flow	3,477	3,573	7,075	7,170	7,764	8,613	8,394
Less: capital expenditures	1,360	2,028	3,117	3,785	5,997	6,995	6,200
Less: dividends	759	713	1,523	1,477	1,427	1,427	1,449
Free cash flow (bef. work. cap. changes)	1,358	832	2,435	1,908	339	191	745
Changes in working capital	221	(380)	(32)	(633)	(1175)	(592)	(398)
Free cash flow	1,579	452	2,403	1,275	(836)	(401)	347
Acquisitions/dispositions/other	2,349	2,941	3,212	3,803	509	(2,515)	(6,517)
Cash flow before financing	3,928	3,392	5,615	5,078	(327)	(2,916)	(6,170)
Change in equity	(322)	(189)	(724)	(591)	0	0	0
Change in debt	(1,966)	(1,953)	(2,627)	(2,614)	(146)	2,690	4,314
Increase (decrease) in cash position	1,640	1,250	2,263	1,873	(473)	(226)	(1,856)