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BELLSOUTH CORP  
Form 10-Q  
August 06, 2003

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D. C. 20549

-----  
FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2003

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 1-8607

BELLSOUTH CORPORATION  
(Exact name of registrant as specified in its charter)

Georgia  
(State of Incorporation)

58-1533433  
(I.R.S. Employer  
Identification Number)

1155 Peachtree Street, N. E.,  
Atlanta, Georgia  
(Address of principal executive offices)

30309-3610  
(Zip Code)

Registrant's telephone number 404-249-2000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No \_\_\_

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes \_\_\_X\_\_\_ No\_\_\_\_\_

At July 31, 2003, there were 1,847,358,800 common shares outstanding.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

BELLSOUTH CORPORATION  
CONSOLIDATED STATEMENTS OF INCOME  
(IN MILLIONS, EXCEPT PER SHARE AMOUNTS)  
(Unaudited)

For the Three Months  
Ended June 30,  
2002                      2003

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(As  
adjusted  
- Note D)

Operating Revenues:

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Communications group	\$ 4,631	\$4,545
Latin America	597	563
Advertising and publishing	538	520
All other	14	14
	-----	-----
Total Operating Revenues	5,780	5,642
Operating Expenses:		
Cost of services and products (excludes depreciation and amortization shown separately below)	1,922	2,008
Selling, general, and administrative expenses	1,132	1,133
Depreciation and amortization	1,170	1,046
Provisions for restructuring	357	20
	-----	-----
Total Operating Expenses	4,581	4,207
Operating income	1,199	1,435
Interest expense	301	249
Gain (loss) on sale of operations	-	(75)
Net (losses) earnings of equity affiliates	113	180
Foreign currency transaction gains (losses)	(355)	98
Other income (expense), net	2	84
	-----	-----
Income Before Income Taxes and Cumulative Effect of Changes in Accounting Principle	658	1,473
Provision for Income Taxes	395	522
	-----	-----
Income Before Cumulative Effect of Changes in Accounting Principle	263	951
Cumulative Effect of Changes in Accounting Principle, Net of Tax	-	-
	-----	-----
Net Income	\$ 263	\$ 951
	=====	=====
	=====	=====
Weighted-Average Common Shares Outstanding:		
Basic	1,875	1,847
Diluted	1,882	1,851
Dividends Declared Per Common Share	\$0.20	\$ 0.23
Basic Earnings Per Share:		
Income Before Cumulative Effect of Changes in Accounting Principle	\$ 0.14	\$ 0.51
Cumulative Effect of Accounting Changes	-	-
Net Income	\$ 0.14	\$ 0.51
	=====	=====
Diluted Earnings Per Share:		
Income Before Cumulative Effect of Changes in Accounting Principle	\$ 0.14	\$ 0.51
Cumulative Effect of Accounting Changes	-	-
Net Income	\$ 0.14	\$ 0.51

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

BELLSOUTH CORPORATION  
 CONSOLIDATED BALANCE SHEETS  
 (IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

	December 31, 2002	June 30, 2003
	(as adjusted note D)	(unaudited)
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 2,482	\$ 4,122
Accounts receivable, net of allowance for uncollectibles of \$476 and \$492	4,129	2,999
Material and supplies	313	312
Other current assets	938	1,029
	-----	-----
Total current assets	7,862	8,462
	-----	-----
Investments and advances	9,741	8,283
Property, plant and equipment, net	23,445	24,047
Deferred charges and other assets	5,726	5,757
Goodwill	347	346
Intangible assets, net	2,358	2,356
	-----	-----
Total assets	\$ 49,479	\$ 49,251
	=====	=====
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities:		
Debt maturing within one year	\$ 5,114	\$ 3,694
Accounts payable	1,572	1,344
Other current liabilities	2,897	3,421
	-----	-----
Total current liabilities	9,583	8,459
	-----	-----
Long-term debt	12,283	11,718
	-----	-----
Noncurrent liabilities:		
Deferred income taxes	4,452	5,109
Other noncurrent liabilities	5,255	4,908
	-----	-----
Total noncurrent liabilities	9,707	10,017
	-----	-----

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Shareholders' equity:		
Common stock, \$1 par value		
(8,650 shares authorized;		
1,860 and 1,847 shares		
outstanding)	2,020	2,020
Paid-in capital	7,546	7,620
Retained earnings	14,531	15,744
Accumulated other		
comprehensive income (loss)	(740)	(779)
Shares held in trust and		
treasury	(5,372)	(5,503)
Guarantee of ESOP debt	(79)	(45)
	-----	-----
Total shareholders' equity	17,906	19,057
	-----	-----
Total liabilities and		
shareholders' equity	\$ 49,479	\$ 49,251
	=====	=====

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

BELLSOUTH CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(IN MILLIONS)  
(Unaudited)

	For the Six Months	
	Ended June 30,	
	2002	2003
	-----	
	(As adjusted	
	- Note D)	
Cash Flows from Operating Activities:		
Net Income	\$ 109	\$ 2,181
Adjustments to net income:		
Depreciation and amortization	2,331	2,084
Provision for uncollectibles	420	306
Net losses (earnings) of equity		
affiliates	122	(353)
Minority interests in income		
(loss) of subsidiaries	(77)	12
Deferred income taxes and		
investment tax credits	777	688
Net losses on sale or impairment		
of equity securities	388	8
Pension income	(410)	(267)

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Pension settlement losses	-	87
Curtailement and termination benefit charges	60	-
Stock-based compensation expense	92	67
Unbilled receivable adjustment	163	-
Foreign currency transaction (gains) losses	645	(144)
Cumulative effect of changes in accounting principles	1,285	(539)
(Gain) loss on sale of operations	(1,335)	75
Net Change in:		
Accounts receivable and other current assets	77	(1)
Accounts payable and other current liabilities	(285)	111
Deferred charges and other assets	(44)	114
Other liabilities and deferred credits	-	(39)
Other reconciling items, net	(125)	36
-----		
Net cash provided by operating activities	4,193	4,426
-----		
Cash Flows from Investing Activities:		
Capital expenditures	(2,028)	(1,360)
Investments in and advances to equity affiliates	(7)	-
Proceeds from sale of securities and operations	1,454	81
Proceeds from repayment of loans and advances	426	1,899
Settlement of derivatives on advances	85	(352)
Other investing activities, net	(20)	(29)
-----		
Net cash provided by (used for) investing activities	(90)	239
-----		
Cash Flows from Financing Activities:		
Net repayments of short-term debt	(1,393)	(381)
Proceeds from long-term debt	8	1
Repayments of long-term debt	(568)	(1,586)
Dividends paid	(713)	(759)
Purchase of treasury shares	(189)	(322)
Other financing activities, net	2	22
-----		
Net cash used by financing activities	(2,853)	(3,025)
-----		
Net increase in cash and cash equivalents	1,250	1,640
Cash and cash equivalents at beginning of period	592	2,482
-----		
Cash and cash equivalents at end of period	\$ 1,842	\$ 4,122
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The accompanying notes are an integral part of these consolidated financial statements.

BELLSOUTH CORPORATION  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME  
(IN MILLIONS)  
(Unaudited)

	Number of Shares		Amount			Accumulated Other Comprehensive Income (Loss)
	Common Stock	(a) Shares Held in Trust and Treasury	Common Stock	Paid-in Capital	Retained Earnings	
Balance (as adjusted see Note D) at December 31, 2001	2,020	(143)	\$ 2,020	\$ 7,368	\$ 14,805	\$ (
Net Income					109	
Other comprehensive income, net of tax						(
Foreign currency translation adjustment						
Net unrealized losses on securities						
Net unrealized gains on derivatives (b)						
Total comprehensive income						
Dividends declared					(734)	
Share issuances for employee benefit plans		4		(6)	(65)	
Stock-based compensation				92		
Purchase of stock by grantor trust		-			(18)	
Purchase of treasury stock		(8)				
ESOP activities and related tax benefit					2	
Balance at June 30, 2002	2,020	(147)	\$ 2,020	\$ 7,454	\$ 14,099	\$ (
Balance (as adjusted see Note D) at December 31, 2002	2,020	(160)	\$ 2,020	\$ 7,546	\$ 14,531	\$ (
Net Income					2,181	
Other comprehensive income, net of tax						
Foreign currency translation						

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adjustment (c)						
Net unrealized gains on securities						
Net unrealized losses on derivatives (b)						
Total comprehensive income						
Dividends declared						(815)
Share issuances for employee benefit plans	2				(15)	(42)
Stock-based compensation					67	
Purchase of stock by grantor trust	-					(112)
Purchase of treasury stock	(15)					
Tax benefit related to stock options					22	
ESOP activities and related tax benefit						1
Balance at June 30, 2003	2,020	(173)	\$ 2,020	\$ 7,620	\$ 15,744	\$ (

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

BELLSOUTH CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)  
(Unaudited)

### NOTE A - PREPARATION OF INTERIM FINANCIAL STATEMENTS

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

The accompanying unaudited consolidated financial statements have been prepared based upon Securities and Exchange Commission (SEC) rules that permit reduced disclosure for interim periods. In our opinion, these statements include all adjustments necessary for a fair presentation of the results of the interim periods shown. All adjustments are of a normal recurring nature unless otherwise disclosed. Revenues, expenses, assets and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those for the full year. For a more complete discussion of our significant accounting policies and other information, you should read this report in conjunction with the consolidated financial statements included in our latest annual report on Form 10-K, as modified by the current report on Form 8-K dated May 30, 2003.

Certain amounts within the prior year's information have been reclassified to conform to the current year's presentation.

### NOTE B - EARNINGS PER SHARE

Basic earnings per share is computed on the weighted-average number of common shares outstanding during each period. Diluted earnings per share is based on the weighted-average number of common shares outstanding plus net incremental shares arising out of employee stock options and benefit plans. The following is a reconciliation of the weighted-average share amounts (in millions) used in calculating earnings per share:



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	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2002	2003	2002	2003
Basic common shares outstanding	1,875	1,847	1,877	1,853
Incremental shares from stock options and benefit plans	7	4	8	2
Diluted common shares outstanding	1,882	1,851	1,885	1,855

The earnings amounts used for per-share calculations are the same for both the basic and diluted methods. Outstanding options to purchase 67 million shares for the three months ended June 30, 2002 and 62 million shares for the six months ended June 30, 2002 were not included in the computation of diluted earnings per share because the exercise price of these options was greater than the average market price of the common stock. Outstanding options to purchase 81 million shares for the three months ended June 30, 2003 and 82 million shares for the six months ended June 30, 2003 were not included in the computation of diluted earnings per share because the exercise price of these options was greater than the average market price of the common stock.

NOTE C - RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Derivative Instruments and Hedging Activities

In April 2003, the Financial Accounting Standards Board ("FASB") issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." This standard amends and clarifies the accounting for and definition of derivative instruments and hedging activities under SFAS No. 133. This statement is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. Adoption of this standard will not have a material impact on our results of operations, financial position or cash flows.

Financial Instruments with Characteristics of Both Liabilities and Equity

In May 2003, the FASB issued SFAS No. 150 "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability because that financial instrument embodies an obligation of the issuer. This Statement is effective beginning July 1, 2003. This standard will not have a material impact on our results of operations, financial position and cash flows.

Consolidation of Variable Interest Entities

In January 2003, the FASB issued FASB Interpretation No. 46, Consolidation of Variable Interest Entities (FIN 46). FIN 46 clarified the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at

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(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)  
(Unaudited)

### NOTE C - RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS (Continued)

risk for the entity to finance its activities without additional subordinated support from other parties. FIN 46 requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. All companies with variable interests in variable interest entities created after January 31, 2003, must apply the provisions of this Interpretation to those entities immediately. A public company with a variable interest in a variable interest entity created before February 1, 2003, must apply the provisions of this Interpretation to that entity no later than the beginning of the first interim or annual reporting period after June 15, 2003. For variable interest entities for which an enterprise holds a variable interest that it acquired before February 1, 2003, FIN 46 may be applied by restating previously issued financial statements or prospectively from the date of adoption. We have evaluated our investments and concluded that neither Cingular nor any of our other equity method investments will qualify as a "variable interest entity" as described in FIN 46. Accordingly, none of our investments qualified for consolidation under FIN 46 and our accounting treatment of these entities will remain unchanged.

### Revenue Recognition for Multi-Element Deliverables

In November 2002, the EITF of the FASB reached a consensus on EITF No. 00-21, Accounting for Revenue Arrangements with Multiple Element Deliverables. The issue addresses how to account for arrangements that may involve the delivery or performance of multiple products, services and/or rights to use assets. Revenue arrangements with multiple deliverables should be divided into separate units of accounting if the deliverables in the arrangement meet certain criteria. Arrangement consideration should be allocated among the separate units of accounting based on their relative fair values. The issue also supersedes certain guidance set forth in Staff Accounting Bulletin No. 101 (SAB 101), Revenue Recognition in Financial Statements. The final consensus is applicable to agreements entered into in quarters beginning after June 15, 2003, with early adoption permitted. Additionally, companies are permitted to apply the consensus guidance to all existing arrangements as a cumulative effect of a change in accounting principle. We adopted this new pronouncement July 1, 2003. The impacts of adoption of 00-21 will not have a material impact on our results of operations, financial position and cash flows.

### NOTE D - CHANGES IN ACCOUNTING PRINCIPLE

#### Stock Options

Effective January 1, 2003, we adopted the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," for stock-based employee compensation. Previously, we applied the intrinsic value method permitted under SFAS No. 123 in accounting for our stock-based compensation plans. Compensation cost related to stock options was not reflected in previously reported results, as all options granted had an exercise price equal to the market value of the underlying stock on the date of grant. We elected to adopt the fair value recognition method using the retroactive restatement alternative provided by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure." Accordingly, all prior periods presented have been restated to reflect the compensation cost that would have been recorded had the fair value expense recognition provisions of SFAS No. 123 been applied. Stock-based compensation cost related to stock options of \$29 (\$19 net of tax or \$0.01 per share) for the second quarter 2003 and \$57 (\$37 net of tax or \$0.02 per share) for the six months ended June 30, 2003 is included in our results of operations. Stock-based compensation cost related to stock options of \$46 (\$29

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net of tax or \$0.02 per share) for the second quarter 2002 and \$84 (\$53 net of tax or \$0.03 per share) for the six months ended June 30, 2002 is included in our results of operations.

### Asset Retirement Obligations

Effective January 1, 2003, we adopted SFAS No. 143, "Accounting for Asset Retirement Obligations" (SFAS No. 143). This statement 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 were 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.

BELLSOUTH CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)  
(Unaudited)

### NOTE D - CHANGES IN ACCOUNTING PRINCIPLE (Continued)

In connection with the adoption of this standard, we were required to remove existing accrued net costs of removal in excess of the related estimated salvage from our accumulated depreciation for those accounts. The adjustment is reflected in the first quarter 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 the change increased net income by \$816 or \$0.44 per share for the six months ended June 30, 2003.

Since we previously accrued for net cost of removal through our depreciation rates, depreciation expense for the three months ended June 30, 2003 and the six months ended June 30, 2003 was approximately \$33 and \$66, respectively, lower than it otherwise would have been absent this change in accounting. We are expensing net cost of removal as incurred beginning January 1, 2003 for the affected plant accounts. Cost of removal expensed for the three months ended June 30, 2003 and for the six months ended June 30, 2003 was approximately \$10 and \$18, respectively.

### 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% of the revenues and direct expenses at the time the directories were published and delivered to end-users. Under the deferral

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method, revenues and direct expenses are recognized ratably over the life of the related directory, generally 12 months. The change in accounting method recorded in the first quarter 2003 is reflected in the 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 or \$0.27 per share for the six months ended June 30, 2003.

### Pro Forma Impact of Accounting Changes

The following table presents our 2002 results (adjusted for stock-based compensation) on a basis comparable to the 2003 results, adjusted to reflect the changes in accounting for asset retirement obligations and revenue recognition for publishing revenues:

	For the Three Months Ended		
	2002 As Adjusted	SFAS No. 143	Directory Publishing
Total Operating Revenue	\$ 5,780	\$ -	\$ 26
Operating Expenses			
Cost of services and products	1,922	9	10
Selling, general, and administrative expenses	1,132	-	4
Depreciation and amortization	1,170	(33)	-
Provision for restructuring	357	-	-
Total operating expenses	4,581	(24)	14
Operating income	1,199	24	12
Non-operating income (expense), net	(541)	-	-
Income before income taxes and cumulative effect of changes in accounting principle	658	24	12
Provision for income taxes	395	8	4
Income before cumulative effect of changes in accounting principle	263	16	8
Cumulative effect of changes in accounting principle, net of tax	-	-	-
Net Income	\$ 263	\$ 16	\$ 8
Basic earnings per share*:			
Income before cumulative effect of changes in accounting principle	\$ 0.14	\$ 0.01	-
Net income	\$ 0.14	\$ 0.01	-
Diluted earnings per share*:			
Income before cumulative effect of changes in accounting principle	\$ 0.14	\$ 0.01	-
Net income	\$ 0.14	\$ 0.01	-

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BELLSOUTH CORPORATION  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
 (DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)  
 (Unaudited)

NOTE D - CHANGES IN ACCOUNTING PRINCIPLE (Continued)

	For the Six Months Ended		
	2002 As Adjusted	SFAS No. 143	Directory Publishing
Total Operating Revenue	\$ 11,314	\$ -	\$ 153
Operating Expenses			
Cost of services and products	3,839	16	42
Selling, general, and administrative expenses	2,219	-	24
Depreciation and amortization	2,331	(66)	-
Provision for restructuring	357	-	-
Total operating expenses	8,746	(50)	66
Operating income	2,568	50	87
Non-operating income (expense), net	(26)	-	-
Income before income taxes and cumulative effect of changes in accounting principle	2,542	50	87
Provision for income taxes	1,148	18	33
Income before cumulative effect of changes in accounting principle	1,394	32	54
Cumulative effect of changes in accounting principle, net of tax	(1,285)	-	-
Net Income	\$ 109	\$ 32	\$ 54
Basic earnings per share*:			
Income before cumulative effect of changes in accounting principle	\$ 0.74	\$ 0.02	\$ 0.03
Net income	\$ 0.06	\$ 0.02	\$ 0.03
Diluted earnings per share*:			
Income before cumulative effect of changes in accounting principle	\$ 0.74	\$ 0.02	\$ 0.03
Net income	\$ 0.06	\$ 0.02	\$ 0.03

\*Earnings per share amounts do not sum due to rounding.

NOTE E - INVESTMENTS AND ADVANCES

Brazil

In May 2003, we sold our entire stake in BSE, a wireless communications company that operates in six states of Brazil's Northeastern region, to Telecom Americas, a subsidiary of America Movil. We received net proceeds of \$20 and recorded a loss of \$75, or \$73 net of tax, which included the recognition of cumulative foreign currency translation losses of \$86.

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BCP, a wireless communications company that operates in Brazil, and its controlling shareholders, including BellSouth, are negotiating with representatives of BCP's senior secured creditors a settlement that contemplates the restructuring of BCP's debt and the transfer of the shares held by the controlling shareholders to such creditors. The settlement is subject to the approval of the senior secured creditors and to regulatory approvals. Upon sale or liquidation of our investment, we will recognize cumulative foreign currency translation losses as part of the gain or loss on exit. The cumulative foreign currency translation losses related to this investment were \$182 at June 30, 2003.

### Colombia

In January 2003, we received proceeds of \$35 from the exercise of a put in our \$279 loan participation agreement with our Colombian partner. As a result, no gain or loss was recognized.

### Note Receivable from KPN

In April 2003, we received net proceeds of \$1,458 resulting from an early repayment by KPN of the entire outstanding balance of a Euro loan we had extended to KPN and the settlement of related currency swaps. The net proceeds include \$1,802 for the full face value of the loan and \$8 for accrued interest, reduced by a settlement of a \$352 liability associated with foreign currency swap contracts. As a result of the early repayment and settlement of the currency contracts, we recorded a gain of \$20, or \$13 net of tax.

### BELLSOUTH CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)  
(Unaudited)

### NOTE E - INVESTMENTS AND ADVANCES (Continued)

#### Cingular

The following table displays the summary combined financial information of Cingular, our wireless equity method business in which we own 40%. These amounts are shown on a 100% basis.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2002	2003	2002	2003
Revenues	\$ 3,748	\$ 3,786	\$ 7,291	\$ 7,376
	=====	=====	=====	=====
Operating income	\$ 722	\$ 756	\$ 1,389	\$ 1,472
	=====	=====	=====	=====
Net income	\$ 395	\$ 410	\$ 733	\$ 829
	=====	=====	=====	=====

#### Real Estate Partnerships

In June 2003, we sold our interests in two real estate partnerships that held buildings, portions of which we used for general and administrative space. We received proceeds of \$26 for our interest in the partnerships resulting in

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recognition of a gain of \$16, or \$11 net of tax. In addition, we received proceeds of \$97 for the repayment of loans we had extended to the partnerships.

NOTE F - PURCHASE OF TREASURY SHARES

For the six months ended June 30, 2003, we purchased 14.8 million shares of our common stock for an aggregate cost of \$322. There were no purchases during second quarter 2003, however \$67 of first quarter 2003 purchases settled in April 2003. During second quarter 2002, we purchased 7.6 million shares of our common stock in the open market for approximately \$235, which included \$189 of cash payments and \$46 of purchases that settled in July 2002. There were no purchases in first quarter 2002. In July 2002, we announced our intention to purchase up to \$2 billion of our outstanding common stock through December 31, 2003. As of June 30, 2003, our total purchases since the announcement are 29.6 million shares for an aggregate of \$678.

NOTE G - WORKFORCE REDUCTION AND RESTRUCTURING

Based on ongoing challenges in the telecom industry, continued economic pressures and the uncertainty resulting from recent Federal Communications Commission (FCC) regulatory rulings, we initiated workforce reductions of approximately 1,800 positions during the six months ended June 30, 2003. The positions are primarily in network operations where the volume of work has substantially decreased. The accrual was recorded in accordance with the provisions of SFAS No. 112, "Employers Accounting for Postemployment Benefits," and consisted of cash severance, outplacement and payroll taxes related to ongoing separation pay plans. The \$71 in additions to the accrual associated with employee separations relate to accruals for estimated payments for the current year workforce reductions. Deductions of \$104 consist of \$88 in cash severance payments and \$16 for adjustments to the accrual 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 cash payments of \$18 settling liabilities for early contract terminations.

The following table summarizes activity associated with the workforce reduction and restructuring liability for the six months ended June 30, 2003:

	Type of Cost		
	Employee Separations	Other Exit Costs	Total
Balance at December 31, 2002	\$ 84	\$ 31	\$115
Additions	71	-	71
Deductions	(104)	(23)	(127)
	----	---	----
Balance at June 30, 2003	\$ 51	\$ 8	\$ 59
	====	===	====

As a result of the work force reductions, lump-sum distributions from the pension plan exceeded the settlement threshold equal to the sum of the service and interest costs components of net periodic pension costs. This resulted in the recognition of settlement losses of \$20, or \$12 net of tax, in the second quarter and \$87, or \$53 net of tax, in the year-to-date period.

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BELLSOUTH CORPORATION  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
 (DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)  
 (Unaudited)

### NOTE H - DEBT

During the second quarter of 2003 we redeemed \$300 of 40-year, 7.5 percent debentures, due June 15, 2033. The redemption price was 104.75 percent of the principal amount resulting in a loss of \$18, or \$11 net of tax, on the early extinguishment of this debt.

### NOTE I - SEGMENT INFORMATION

We have four reportable operating segments: (1) Communications group; (2) Domestic wireless; (3) Latin America; and (4) Advertising and publishing.

To align with internal reporting, the 2002 segment results for the Advertising and publishing segment have been recast to reflect the change in accounting method as discussed in Note D. Prior period results for all segments have been restated for the effects of adopting the fair value method of accounting for stock-based compensation.

The following table provides information for each operating segment:

	For the Three Months Ended June 30,		
	2002 ----	2003 ----	
Communications group			
External revenues	\$ 4,631	\$ 4,545	\$
Intersegment revenues	40	41	
	--	--	
Total segment revenues	4,671	4,586	
Segment operating income	1,244	1,162	
Segment net income	702	679	
Domestic wireless			
External revenues	\$ 1,500	\$ 1,514	\$
Intersegment revenues	-	-	
	---	---	
Total segment revenues	1,500	1,514	
Segment operating income	290	303	
Segment net income	99	104	
Latin America			
External revenues	\$ 597	\$ 563	\$
Intersegment revenues	1	2	
	---	---	
Total segment revenues	598	565	
Segment operating income	76	75	
Net earnings (losses) of equity affiliates	(2)	2	
Segment net income	12	41	
Advertising and publishing			
External revenues	\$ 565	\$ 520	\$
Intersegment revenues	5	5	
	---	---	



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Total segment revenues	570	525
Segment operating income	247	252
Segment net income	151	157

RECONCILIATION TO CONSOLIDATED FINANCIAL INFORMATION

	For the Three Months Ended June 30,		
	2002	2003	
Operating revenues			
Total reportable segments	\$ 7,339	\$ 7,190	\$ 1
Cingular proportional consolidation	(1,500)	(1,514)	(
Advertising and publishing accounting change	(26)	-	
Unbilled receivable adjustment	-	-	
Corporate, eliminations and other	(33)	(34)	
Total consolidated	\$ 5,780	\$ 5,642	\$ 1

BELLSOUTH CORPORATION  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
 (DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)  
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NOTE I - SEGMENT INFORMATION (Continued)

	For the Three Months Ended June 30,		
	2002	2003	
Operating income			
Total reportable segments	\$ 1,857	\$ 1,792	\$
Cingular proportional consolidation	(290)	(303)	
Advertising and publishing accounting change	(12)	-	
Unbilled receivable adjustment	-	-	
Restructuring charge	(357)	-	
Pension settlement loss	-	(20)	
Corporate, eliminations and other	1	(34)	
Total consolidated	\$ 1,199	\$ 1,435	\$
Net Income			
Total reportable segments	\$ 964	\$ 981	\$
Foreign currency transaction gains (losses)	(354)	65	
Brazil loan impairments	-	-	
Net gain (loss) on sale of operations	-	(73)	
Unbilled receivable adjustment	-	-	

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Net losses on sale or impairment of securities	(124)	(5)	
Cumulative effect of changes in accounting principle	-	-	
Advertising and publishing accounting change	(8)	-	
Restructuring charge	(225)	-	
Pension settlement loss	-	(12)	
Corporate, eliminations and other	10	(5)	
	-----	-----	-----
Total consolidated	\$ 263	\$ 951	\$
	=====	=====	=====

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.

NOTE J - RELATED PARTY TRANSACTIONS

We have made advances to Cingular that totaled \$3,816 at June 30, 2003 and June 30, 2002. We earned \$71 in the second quarter of 2003, \$71 in the second quarter of 2002, \$141 year-to-date 2003 and \$141 year-to-date 2002 from interest income on this advance. In addition, Cingular owed us \$43 at June 30, 2003, which represents receivables primarily incurred in the ordinary course of business. We generated revenues of approximately \$103 and \$112 in second quarter 2003 and 2002, respectively, and \$201 and \$190 year-to-date 2003 and 2002, respectively, from the provision of local interconnect and long distance services to Cingular and sales agency fees from Cingular.

NOTE K - VENEZUELAN CURRENCY TRANSLATION

In Venezuela, we own a 78.2% interest in Telcel, a wireless communications company that we consolidate in our financial statements. The functional currency used for accounting purposes is the Venezuelan Bolivar. The local currency has significantly devalued against the U.S. Dollar over the past 12 months due primarily to political and economic turmoil and the government's decision in February 2002 to let the currency trade freely in the open market ending the government's prior fixed band exchange policy. During February 2003, the Venezuelan government announced a new foreign exchange control regime and set a fixed exchange rate of 1,600 Bolivars to the U.S. Dollar. The government has established procedures for the conversion of Bolivars into U.S. Dollars for the import of a limited number of goods and services. Our local operation has been able to purchase dollars for the import of cellular handsets used in its business.

Due to the currency controls, there is no free market currency exchange rate. Therefore, in preparing our consolidated financial statements, we used the exchange rate established by the Venezuelan government of 1,600 Bolivars to the U.S. Dollar to translate the local currency financial statements into our reporting currency, the U.S. Dollar. When the Bolivar resumes trading on the open market, the exchange rate may be different than the rate set by the government. A significant devaluation of the local currency would result in a decline in revenues and, to a lesser extent, operating expenses when reported in the U.S. Dollar. As an example, a devaluation in the Venezuelan currency from the 1,600 rate currently used in our financial statements to 2,400 Bolivars to the U.S. Dollar would equate to a decrease in revenues of approximately \$80 for the quarter ended June 30, 2003. Such a change in the exchange rate would also result in a

BELLSOUTH CORPORATION  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
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(Unaudited)

### NOTE K - VENEZUELAN CURRENCY TRANSLATION (Continued)

reduction in the company's net assets of approximately \$200 which would be reported as a reduction in shareholder's equity through the cumulative foreign currency translation adjustment. Because certain expenses are settled in U.S. Dollars, determination of the net income impact of such a devaluation is not practicable.

Due to the currency controls in place, we are currently unable to repatriate capital related to this investment. We have assessed the situation and believe it is temporary in nature. Therefore, we have continued to consolidate the financial statements of this operation in accordance with SFAS No. 94. In the event the situation is deemed other than temporary, we would cease to consolidate this operation and would reflect the investment using the cost method of accounting.

### NOTE L - CONTINGENCIES

#### VENEZUELAN PUT-CALL PROVISION

We own approximately 78% of Telcel, our Venezuelan operation. Telcel's other major shareholder holds an indirect 21% interest in Telcel. Under a Stock Purchase Agreement, that shareholder has the right to initiate a process that could require us to purchase (the puts), and we have the right to initiate a process that could require that shareholder to sell (the calls) to us, the shareholder's interest in Telcel with notice of the initiation of the process with respect to approximately half of that shareholder's interest to be given in 2000 and notice with respect to the remaining balance to be given in 2002. If we exercise our call right, we would purchase that shareholder's interest at between 100% and 120% of its appraised fair value. If we are required to purchase the interest, we would do so at between 80% and 100% of its appraised fair value.

In 2000, the shareholder initiated a process for appraising the value of approximately half of its interest in Telcel, but the process was not completed. The shareholder also has sent a letter purporting to exercise the balance of the Buy-back Rights under the Stock Purchase Agreement. We are currently in arbitration with our partner over alleged breaches by BellSouth and the shareholder of the Stock Purchase Agreement, including the timing of the valuation and whether the process was properly initiated in 2000. The arbitration does not directly involve the valuation of the balance of the Buy-back Rights. The shareholder is seeking damages and specific performance, and BellSouth is seeking, among other things, unspecified damages and a ruling that it has not breached the Stock Purchase Agreement in any respect. We expect the hearing on this matter to take place later this year. If the arbitration panel rules against BellSouth, it is possible that the appraised fair value of the shareholder's interest in Telcel could be substantially in excess of current value. At this time, the likely outcome of this arbitration cannot be predicted, nor can a reasonable estimate of the amount of loss, if any, be made.

#### RECIPROCAL COMPENSATION

Following the enactment of the Telecommunications Act of 1996, our telephone company subsidiary, BellSouth Telecommunications, Inc. (BST), and various competitive local exchange carriers entered into interconnection agreements providing for, among other things, the payment of reciprocal compensation for local calls initiated by the customers of one carrier that are completed on the network of the other carrier. These agreements were the subject of litigation before various regulatory commissions. After an FCC ruling in April 2001 prescribing new rates, BellSouth settled its claims with competitors for traffic

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occurring through mid-June 2001, and entered into agreements that contained the FCC rates for traffic occurring from mid-June 2001 forward. The District of Columbia Circuit Court of Appeals, in the second quarter of 2002, remanded the ruling to the FCC to implement a rate methodology consistent with the Court's opinion. The FCC's previous rules and rates remain in effect while it reconsiders them. A change in the rules or rates could increase our expenses.

### REGULATORY MATTERS

Beginning in 1996, we operated under a price regulation plan approved by the South Carolina Public Service Commission (PSC) under existing state laws. In April 1999, however, the South Carolina Supreme Court invalidated this price regulation plan. In July 1999, we elected to be regulated under a new state statute, adopted subsequent to the Commission's approval of the earlier plan. The new statute allows telephone companies in South Carolina to operate under price regulation without obtaining approval from the Commission. The election became effective during August 1999. The South Carolina Consumer Advocate petitioned the Commission seeking review of the level of our earnings during the 1996-1998 period when we operated under the subsequently invalidated price regulation plan. The Commission voted to dismiss the petition in November 1999 and issued orders confirming the vote in February and June of 2000. In July 2000, the Consumer Advocate appealed the Commission's dismissal of the petition. If the Consumer Advocate prevails, the case could be remanded to the South Carolina PSC, which could, after considering evidence, order material refunds to customers in South Carolina. At this time, we are unable to predict the outcome of this appeal and, therefore, cannot determine the impact, if any, this matter may have on future earnings.

### BELLSOUTH CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

(Unaudited)

### NOTE L - CONTINGENCIES (Continued)

#### LEGAL PROCEEDINGS

##### Employee Related

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 United States 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 at any time since April 29, 1988, and a class of all African-American salaried workers employed by BellSouth at any time since April 29, 1988 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 early stage of the litigation, the likely outcome of the case cannot be predicted, nor can a reasonable estimate of the amount of loss, if any, be made.

##### Securities

As previously disclosed, 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

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securities laws. The cases have been consolidated in the United States 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 on or about July 15, 2003 and named four outside directors as additional defendants. The Consolidated and Amended Class Action Complaint alleges that during the period November 7, 2000 through February 19, 2003, the Company (1) overstated the unbilled receivables balance of its advertising and publishing subsidiary; (2) failed to properly implement SAB 101 with regard to its recognition of advertising and 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. The plaintiffs are seeking an unspecified amount of damages, as well as attorneys' fees and costs. At this early stage of the litigation, 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. On or about July 3, 2003, the federal court issued a ruling that the case should be remanded to Fulton County Superior Court. Defendants are seeking permission to appeal this determination. The plaintiffs are seeking an unspecified amount of damages, as well as attorneys' fees and costs. At this early stage of the litigation, the likely outcome of the case cannot be predicted, nor can a reasonable estimate of loss, if any, be made.

As previously disclosed, in September and October 2002 three substantially identical class action lawsuits were filed in the United States 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) plan (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 Plan participants and beneficiaries; (2) failing to ensure that the Plan's assets were invested properly; (3) failing to monitor the Plan's 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 and publishing subsidiary and its 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 early stage of the litigation, the likely outcome of the cases cannot be predicted, nor can a reasonable estimate of loss, if any, be made.

### Antitrust

A number of antitrust class action lawsuits have been filed against BellSouth in federal district courts in Atlanta, Georgia and Ft. Lauderdale, Florida. The plaintiffs purport to represent putative classes consisting of all BellSouth local telephone service subscribers and/or all subscribers of competitive local exchange carriers in nine southeastern states since 1996.

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BELLSOUTH CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)  
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### NOTE L - CONTINGENCIES (Continued)

The plaintiffs allege that BellSouth engaged in unlawful anti-competitive conduct in violation of state and federal antitrust laws by, among other things, (1) denying competitors access to certain essential facilities necessary for competitors to provide local telephone service; (2) using its monopoly power in the wholesale market for local telephone service as leverage to maintain a monopoly in the retail market; and (3) failing to provide the same quality of service, access and billing to competitors that it provides its own retail customers. The plaintiffs are seeking an unspecified amount of treble damages, injunctive relief, as well as attorneys' fees and costs. At this early stage of the litigation, the likely outcome of the case cannot be predicted, nor can a reasonable estimate of loss, if any, be made.

A consumer class action alleging antitrust violations of Section 1 of the Sherman Antitrust Act has been filed against BellSouth, Verizon, SBC and Qwest in Federal Court in the Southern District of New York. The complaint alleges that defendants conspired to restrain competition by "agreeing not to compete with one another and otherwise allocating customers and markets to one another." The plaintiffs are seeking an unspecified amount of treble damages and injunctive relief, as well as attorneys' fees and expenses. At this early stage of the litigation, the likely outcome of the case cannot be predicted, nor can a reasonable estimate of loss, if any, be made.

### Other

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 involving environmental liabilities, rates, taxes, contracts and torts. Certain contingent liabilities for pre-divestiture events are shared with AT&T Corp. 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 M - 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, BST is no longer subject to the reporting requirements of the Securities Exchange Act of 1934, and 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. During the second quarter of 2003, we revised the condensed consolidating financial information as of December 31, 2002 and for the three- and six-month periods ended June 30, 2002 to reflect the application by BST and BellSouth (Parent) of the equity method of accounting for investments in their subsidiaries. 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.

The revisions described above had no effect on the consolidated financial statements. Further, the revisions had no effect on the revenues or net income in the BST column. The primary impact of these revisions on the December 31,

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2002 consolidating information was an approximate \$19 billion increase in Parent Shareholders' Equity (of which \$17 billion was an increase in Investments in Subsidiaries) and a reclassification of approximately \$3 billion between Accounts Receivable and Investments in the BST column. Additionally, there were reclassifications between Operating Expenses, Equity in Earnings and Income Taxes. These changes resulted in increases in Operating Expenses, Cash Flows, and Equity in Earnings, and decreases in Income Taxes in the BST column, which were offset by changes within the Adjustments column. We do not believe any of these revisions are material.

The condensed consolidating financial information as of December 31, 2002 and for the three- and six-month periods ended June 30, 2002 has also been revised to reflect the retroactive application of the fair value method of recognizing stock-based employee compensation as described in Note D.

BELLSOUTH CORPORATION  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
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NOTE M - SUBSIDIARY FINANCIAL INFORMATION (Continued)

Condensed Consolidating Statements of Income

	For the Three Months Ended Ju (As adjusted - Note		
	BST	Other	Parent
Total operating revenues	\$ 4,571	\$ 1,929	\$ --
Total operating expenses	4,382	1,483	114
Operating income	189	446	(114)
Interest expense	146	81	157
Net earnings (losses) of equity affiliates	434	117	436
Other income (expense), net	(7)	(309)	12
Income before income taxes and cumulative effect of changes in accounting principle	470	173	177
Provision (benefit) for income taxes	(3)	210	(86)
Income before cumulative effect of changes in accounting principle	473	(37)	263
Cumulative effect of changes in accounting principle	--	--	--
Net income (losses)	\$ 473	\$ (37)	\$ 263

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	For the Three Months Ended Jun		
	BST	Other	Parent
Total operating revenues	\$ 4,335	\$ 1,956	\$ --
Total operating expenses	3,705	1,527	15
Operating income	630	429	(15)
Interest expense	135	30	147
Net earnings (losses) of equity affiliates	287	185	1,017
Other income (expense), net	(21)	77	52
Income before income taxes and cumulative effect of changes in accounting principle	761	661	907
Provision (benefit) for income taxes	178	227	(44)
Income before cumulative effect of changes in accounting principle	583	434	951
Cumulative effect of changes in accounting principle	--	--	--
Net income (losses)	\$ 583	\$ 434	\$ 951

	For the Six Months Ended Jun (As Adjusted - Note		
	BST	Other	Parent
Total operating revenues	\$ 8,929	\$ 3,567	\$ --
Total operating expenses	7,652	2,939	118
Operating income	1,277	628	(118)
Interest expense	300	175	317
Net earnings (losses) of equity affiliates	540	(114)	1,755
Other income (expense), net	(20)	979	(151)
Income before income taxes and cumulative effect of changes in accounting principle	1,497	1,318	1,169
Provision (benefit) for income taxes	359	701	(225)
Income before cumulative effect of changes in accounting principle	1,138	617	1,394
Cumulative effect of changes in accounting principle	--	(1,285)	(1,285)



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Net income (losses)	\$ 1,138	\$ (668)	\$ 109
	=====	=====	=====

BELLSOUTH CORPORATION  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
 (DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)  
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NOTE M - SUBSIDIARY FINANCIAL INFORMATION (Continued)

Condensed Consolidating Statements of Income (Continued)

	For the Six Months Ended Jun		
	BST	Other	Parent
Total operating revenues	\$ 8,732	\$ 3,732	\$ --
Total operating expenses	7,444	2,922	36
Operating income	1,288	810	(36)
Interest expense	281	99	297
Net earnings (losses) of equity affiliates	536	366	2,014
Other income (expense), net	(21)	184	106
Income before income taxes and cumulative effect of changes in accounting principle	1,522	1,261	1,787
Provision (benefit) for income taxes	371	398	(79)
Income before cumulative effect of changes in accounting principle	1,151	863	1,866
Cumulative effect of changes in accounting principle	816	(501)	315
Net income (losses)	\$ 1,967	\$ 362	\$ 2,181
	=====	=====	=====

Condensed Consolidating Balance Sheets

December 31, 2002

BST	Other	Parent	Adjust-	Total	BST	Ot
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ments

ASSETS

Current assets:

Cash and cash equivalents	\$ --	\$ 752	\$ 1,643	\$ 87	\$ 2,482	\$ --	\$
Accounts receivable, net	63	1,901	2,807	(642)	4,129	65	1
Other current assets	463	695	81	12	1,251	435	
Total current assets	526	3,348	4,531	(543)	7,862	500	2
Investments and advances	3,322	6,924	23,340	(23,845)	9,741	3,411	7
Property, plant and equipment, net	21,351	2,037	5	52	23,445	22,088	1
Deferred charges and other assets	4,698	329	124	575	5,726	4,756	
Intangible assets, net	1,072	1,477	3	153	2,705	1,083	1
Total assets	\$ 30,969	\$ 14,115	\$ 28,003	\$ (23,608)	\$ 49,479	\$31,838	\$ 13

LIABILITIES AND SHAREHOLDERS'  
EQUITY

Current liabilities:

Debt maturing within one year	\$ 2,845	\$1,120	\$ 2,991	\$ (1,842)	\$ 5,114	\$ 2,958	\$
Other current liabilities	3,351	1,563	743	(1,188)	4,469	3,556	1
Total current liabilities	6,196	2,683	3,734	(3,030)	9,583	6,514	2
Long-term debt	5,371	3,344	6,294	(2,726)	12,283	4,848	1
Noncurrent liabilities:							
Deferred income taxes	3,507	1,508	(733)	170	4,452	4,365	1
Other noncurrent liabilities	3,224	1,147	802	82	5,255	3,199	1
Total noncurrent liabilities	6,731	2,655	69	252	9,707	7,564	2
Shareholders' equity	12,671	5,433	17,906	(18,104)	17,906	12,912	7
Total liabilities and shareholders' equity	\$30,969	\$14,115	\$28,003	\$ (23,608)	\$49,479	\$31,838	\$13

BELLSOUTH CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

(Unaudited)

NOTE M - SUBSIDIARY FINANCIAL INFORMATION (Continued)

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### Condensed Consolidating Cash Flow Statements

	For the Six Months Ended Jun		
	BST	Other	Parent
Cash flows from operating activities	\$ 3,441	\$ 447	\$ 1,987
Cash flows from investing activities	(1,800)	(300)	1,390
Cash flows from financing activities	(1,646)	(3)	(2,222)

Net (decrease) increase in cash	\$ (5)	\$ 144	\$ 1,155
---------------------------------	--------	--------	----------

	For the Six Months Ended Jun		
	BST	Other	Parent
Cash flows from operating activities	\$ 3,367	\$ 1,026	\$ 2,344
Cash flows from investing activities	(1,365)	(236)	683
Cash flows from financing activities	(2,002)	(734)	(1,430)

Net (decrease) increase in cash	\$ --	\$ 56	\$ 1,597
---------------------------------	-------	-------	----------

#### NOTE N - SUBSEQUENT EVENTS

As of July 1, 2003, Cingular executed Amended, Restated and Consolidated Subordinated Promissory Notes to modify the terms of our and SBC Communication's (SBC) advances to them. These notes to us and SBC reduced the fixed interest rate from 7.5% to 6.0% per annum and extended the maturity date from March 31, 2005 to June 30, 2008.

In August 2003, Cingular executed an agreement with NextWave Telecom, Inc. and certain of its affiliates ("NextWave") pursuant to which Cingular would purchase FCC licenses to provide wireless services in 34 markets from NextWave and its affiliates for \$1.4 billion in cash, subject to terms and conditions set forth in the agreement. Because NextWave and its affiliates are currently seeking relief under Chapter 11 of the Bankruptcy Code, the agreement and the transactions contemplated thereby are subject to the approval of the United States Bankruptcy Court for the Southern District of New York. Furthermore, the transaction is subject to various other closing conditions, many of which are outside of Cingular's control, including the receipt of all necessary approvals of the FCC and expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended.

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### Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollars in Millions, Except Per Share Amounts)

For a more complete understanding of our industry, the drivers of our business and our current period results, you should read the following Management's Discussion and Analysis of Financial Condition and Results of Operations in conjunction with our latest annual report on Form 10-K, as modified by the current report on Form 8-K dated May 30, 2003.

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#### Consolidated Results of Operations

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Key financial and operating data for the three and six months ended June 30, 2002 and 2003 are as follows. All references to earnings per share are on a diluted basis. The discussion of consolidated results should be read in conjunction with the discussion of results by segment directly following this section.

Prior year periods have been restated to include the effects of the adoption of the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation."

	For the Three Months Ended June 30,		%
	2002	2003	Change
<b>Results of operations:</b>			
Total operating revenues	\$ 5,780	\$ 5,642	-2.4%
Cost of services and products	1,922	2,008	4.5%
Selling, general, and administrative expenses	1,132	1,133	0.1%
Depreciation and amortization	1,170	1,046	-10.6%
Provision for restructuring and asset impairments	357	20	*
	---	---	
Total operating expenses	4,581	4,207	-8.2%
Operating income	1,199	1,435	19.7%
Interest expense	301	249	-17.3%
Net (losses) earnings of equity affiliates	113	180	59.3%
Gain (loss) on sale of operations	-	(75)	*
Foreign currency transaction gains (losses)	(355)	98	*
Other income (expense), net	2	84	*
	-	--	
Income before taxes and cumulative effect of changes in accounting principle, net of tax	658	1,473	*
Provision for income taxes	395	522	32.2%
	---	---	

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Income before cumulative effect of changes in accounting principle	263	951	*
Cumulative effect of changes in accounting principle, net of tax	-	-	*
	-----	-----	
Net income	\$ 263	\$951	*
	=====	=====	
Earnings per share:			
Income before effect of changes in accounting principle	\$ 0.14	\$ 0.51	*
Net income	\$ 0.14	\$ 0.51	*
Cash flow data:			
Cash provided by operating activities	\$ 2,128	\$2,518	18.3%
Cash (used for) provided by investing activities	\$ (835)	\$ 859	*
Cash used for financing activities	\$ (1,512)	\$ (1,697)	12.2%
Other:			
Effective tax rate	60.0%	35.4%	*
Average short-term debt	\$ 5,256	\$ 3,942	-25.0%
Average long-term debt	\$ 13,606	\$ 12,033	-11.6%
Total average debt	\$ 18,862	15,975	-15.3%
* Not meaningful			

### Operating Revenues

Operating revenues of \$5,642 in second quarter 2003 and \$11,165 in the year-to-date period decreased \$138 and \$149, respectively, as compared to the same periods in 2002 reflecting:

- o A decline in revenues of \$86 for the second quarter 2003 and \$223 for the year-to-date period at the Communications group attributable to: weak economic conditions and increased competitive activity including wireless substitution; conversion of retail access lines to UNE-P, primarily in the residential market; and unfavorable impacts from the movement of wholesale customers from a resale basis to lower-priced unbundled network elements. These decreases were partially offset by growth in retail DSL and long distance revenues.
- o A decline in revenues of \$34 for the second quarter 2003 and \$181 for the year-to-date period at the Latin America group. Revenues in this segment were negatively impacted by the effect of foreign currency exchange rates as the currencies in Argentina and Venezuela both experienced significant devaluations against the U.S. Dollar since the beginning of 2002, although the Argentine Peso has strengthened in recent months. The exit from the advertising and publishing business during the fourth quarter of 2002 also negatively impacted the period over period comparisons.

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- o A decrease in revenues of \$18 for the second quarter 2003 and an increase of \$260 for the year-to-date period at the Advertising and publishing group. The increase in the year-to-date period was primarily driven by a change in accounting principle for recognizing revenues during 2003 (see Note D) and the impact of a \$163 reduction in revenues recorded in the first quarter of 2002 related to the correction of unbilled accounts receivable.

### Operating Expenses

#### Cost of services and products

Cost of services and products is comprised primarily of network infrastructure and related support costs associated with the Communications group and Latin America group and printing and distribution costs associated with our advertising and publishing business. This line item also includes expenses associated with certain aspects of customer service operations for the Communications group. Cost of services and products of \$2,008 in the second quarter 2003 and \$3,941 in the year-to-date period increased \$86 and \$102, respectively, from the same periods in the prior year. The increases were driven primarily by higher expenses in the Communications group associated with increases in expenses attributable to pension and postretirement benefits plans driven by rising health care costs, unfavorable returns on pension assets due to weak capital markets and changes to plan assumptions regarding expected asset returns and health care inflation rates. Other Communications group increases include increases in costs supporting retail long distance growth partially offset by lower salary and wages and other labor costs related to workforce reductions.

#### Selling, general, and administrative expenses

Selling, general, and administrative expenses are comprised primarily of selling and marketing expenses, administrative costs, provisions for uncollectible accounts and costs associated with customer service and billing. Selling, general, and administrative expenses of \$1,133 in second quarter 2003 and \$2,185 in the year-to-date period were relatively flat in second quarter 2003 as compared to second quarter 2002 and decreased \$34 in the year-to-date period as compared to the same period in 2002. Second quarter 2003 expenses increased \$20 in the Communications group, primarily due to increased customer acquisition costs and increased employee pension and benefits, substantially offset by lower uncollectible expense. This increase was partially offset by lower expense in Latin America of \$20, primarily due to the impacts of currency devaluations, and lower expenses in the Advertising and Publishing group of \$36, primarily due to a decrease in uncollectible expense. The \$34 decrease in the year-to-date period was driven primarily by lower expense in Latin America of \$100, primarily due to the impacts of currency devaluations, and higher expenses in the Communication group of \$58, primarily due to increased customer acquisition costs, increases in expenses attributable to pension and postretirement benefits plans driven by rising health care costs, unfavorable returns on pension assets due to weak capital markets and changes to plan assumptions regarding expected asset returns and health care inflation rates, partially offset by reductions in salary and wages and lower uncollectible expense.

#### Depreciation and amortization

Depreciation and amortization of \$1,046 in second quarter 2003 and \$2,084 in the year-to-date period 2003 decreased \$124 and \$247, respectively, as compared to the same periods in 2002 reflecting:

- o a decline in the Communications group of \$98 and \$193 compared to second quarter 2002 and the year-to-date period 2002, respectively.

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These declines reflect the adoption of SFAS No. 143 and lower depreciation rates under the group life method precipitated primarily by the significant reductions in capital expenditures.

- o a decrease in the Latin America group of \$25 and \$53 compared to the second quarter 2002 and the year-to-date period 2002 due to the effects of currency devaluations, primarily in Venezuela for the quarter over quarter decrease and primarily in Argentina and Venezuela for the year-to-date decrease.

### Provision for restructuring

The provision for restructuring recorded in the second quarter 2003 relates to:

- o pension settlement losses of \$20. As a result of the work force reductions, lump-sum distributions from the pension plan exceeded the settlement threshold equal to the sum of the service and interest costs components of net periodic pension costs. The accrual for workforce reductions in the second quarter was insignificant after netting adjustments to the existing accrual for changes in estimates.

The provision for restructuring in the year-to-date period 2003 relates to the following:

- o net charges of \$54 associated with actions taken to reduce our workforce, consisting of an accrual for cash severance payments.
- o pension settlement losses of \$87. As a result of the work force reductions, lump-sum distributions from the pension plan exceeded the settlement threshold equal to the sum of the service and interest costs components of net periodic pension costs.

The provision for restructuring recorded in the second quarter and year-to-date 2002 relates to the following:

- o charges of \$297 associated with actions taken to reduce our workforce, consisting of an accrual for cash severance payments.
- o curtailment charges and special termination benefits of \$60 related to the workforce reduction.

### Interest Expense

Interest expense of \$249 in the second quarter and \$545 in the year-to-date period declined \$52 and \$60, respectively. Interest expense related to interest-bearing debt was down \$42 quarter-over-quarter and \$67 year-over-year reflecting debt reductions of \$2.6 billion. The remaining differences in the quarter and the year-to-date periods relate to interest accruals on other liabilities and contingencies.

### Net earnings (losses) of equity affiliates

Earnings from our unconsolidated businesses increased \$67 in second quarter 2003 and \$475 in the year-to-date period as compared to same periods in 2002. Losses from our Guatemalan investment were \$61 lower in second quarter 2003 compared to 2002 due to the recognition of other-than-temporary impairments of \$62 in second quarter 2002. Due to the recognition of other-than-temporary impairments of \$383 in first quarter 2002 and the cessation of the recognition of operating losses subsequent to the impairment, there are no losses in 2003. Equity earnings

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related to Cingular increased \$7 in second quarter 2003 and \$23 in the year-to-date period as compared to same periods in 2002, offset by lower earnings related to our equity investment in Israel of \$3 in second quarter 2003 and \$11 in the year-to-date period.

### Gain (loss) on sale of operations

The \$75 loss on sale of operations in second quarter 2003 relates to the sale of our entire stake in BSE. The \$1,335 gain on sale of operations in the year-to-date period 2002 relates to the conversion of our ownership interest in E-Plus and related disposition of shares in KPN.

### Foreign currency transaction gains (losses)

Foreign currency transaction gains (losses) of consolidated subsidiaries, which relate primarily to U.S. Dollar denominated debt in Latin America, included a net gain of \$98 and \$144 in the second quarter and year-to-date periods of 2003, respectively, and a net loss of \$355 and \$645 in the second quarter and year-to-date periods of 2002, respectively. The majority of the losses in 2002 were driven by the devaluation of the Argentinean Peso, while the 2003 gain reflects a slight recovery of the Argentinean Peso, offset to some extent by losses in Colombia. Second quarter 2003 includes a gain of \$20 for the settlement of foreign currency swap contracts resulting from the early repayment of advances to KPN.

### Other income (expense), net

Other income (expense), net includes interest income, gains (losses) on disposition of assets, gains (losses) on the sale and impairments of investments and miscellaneous non-operating income.

The quarter-over-quarter increase of \$82 and year-over-year increase of \$160 is primarily driven by the recognition of \$88 and \$318 in losses in second quarter 2002 and the year-to-date period 2002, respectively, related to our investment in Qwest, which was liquidated in second quarter 2002. In addition, we recognized \$29 in gains in second quarter 2003 related to the sale of interests in two real estate partnerships and the sale of a building. These increases were partially offset by an increase in minority interests expense for Colombia for the quarter compared to the second quarter 2002, and \$98 of minority interest benefit recorded in Argentina in the year-to-date period 2002, driven by significant foreign currency losses. Interest income was also down \$9 in second quarter 2003 and \$60 in the year-to-date period as

compared to the same periods in 2002. The second quarter of 2003 also includes \$18 in losses related to the early extinguishment of debt.

### Provision for income taxes

The provision for income taxes increased \$127 in second quarter 2003 and decreased \$152 in the year-to-date period as compared to the same periods in 2002. The effective tax rate decreased substantially to 35.4% in second quarter 2003 from 60.0% in second quarter 2002. The recording of a foreign tax valuation allowance, deferring recognition of the tax benefits generated by losses at our operations in Argentina, substantially increased the rate in the second quarter 2002. Included in the second quarter 2003 rate were the recording of a valuation allowance on the capital loss from the sale of BSE, offset by the impact of reversal of foreign tax valuation allowance associated with Argentina foreign currency gains.

The effective tax rate declined to 34.8% for the year-to-date period in 2003



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from 45.2% for the year-to-date period in 2002. This decrease was impacted by the items described above for the quarterly periods and the reversal of deferred tax valuation allowances on net operating losses in Ecuador in the first quarter of 2003. The year-to-date 2003 effective rate was further reduced by income tax benefits related to the inflation adjustments deductible for Venezuelan tax purposes.

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. See Note D for further discussion of this change.

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. See Note D for further discussion of this change.

Goodwill and Other Intangible Assets

On January 1, 2002, we adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (SFAS No. 142). In connection with the adoption of SFAS No. 142, we recorded an impairment loss in first quarter 2002 of \$1,277, with no income tax benefit. Additionally, Cingular completed its transitional impairment test resulting in an additional loss to BellSouth in first quarter 2002 of \$8 after taxes.

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

- o Communications group;
- o Domestic wireless;
- o Latin America; and
- o Advertising and publishing.

We have included the operations of all other businesses falling below the reporting threshold in the "All other businesses" segment.

Management evaluates 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. In addition, when changes in our business affect the comparability of current versus historical results, we will adjust historical operating information to reflect the current business structure. See Note I for a reconciliation of segment results to the unaudited 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

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business, and our current period results, you should read this discussion in conjunction with our consolidated financial statements, including the related notes.

### Adjustments to Segment Results

To align with internal reporting, the 2002 segment results for the Advertising and publishing segment have been recast to reflect the change in accounting method as discussed in Note D. Prior period results for all segments and consolidated results have been restated for the effects of adopting the fair value method of accounting for stock-based compensation.

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### Communications Group

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

	For the Three Months Ended June 30,		%	For E
	2002	2003	Change	20
<hr/>				
Segment operating revenues:				
Voice	\$3,132	\$ 3,175	1.4%	\$
Data	1,067	1,064	-0.3%	
Other	472	347	-26.5%	
	---	---		
Total segment operating revenues	4,671	4,586	-1.8%	
Segment operating expenses:				
Cost of services and products	1,637	1,712	4.6%	
Selling, general, and administrative expenses	748	768	2.7%	
Depreciation and amortization	1,042	944	-9.4%	
	-----	---		
Total segment operating expenses	3,427	3,424	-0.1%	
Segment operating income	1,244	1,162	-6.6%	
Segment net income	\$ 702	\$ 679	-3.3%	\$
Segment net income including unusual items	\$ 550	\$ 656	19.3%	\$

June 30,

%

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Key Indicators (000s except where noted)	2002	2003	Change	2003
Access lines(1):				
Residential retail				1
Residential wholesale				
Total residential lines				1
Business retail				
Business wholesale				
Total business lines				
Other				
Total access lines				2
Resale lines				
UNE-P (included in access lines above)				
UNE-Loop				
Total Resale lines and UNEs				
DSL customers				
Long distance customers				
Access minutes of use (millions)	25,073	23,053	-8.1%	5
Capital expenditures	\$ 918	\$ 665	-27.6%	\$
* Not meaningful				

(1) Access lines include an adjustment to convert ISDN lines to a switched access line basis for comparability.

Segment operating revenues

Beginning with the second-quarter 2003, we began reporting product-aligned revenue categories for the Communications Group segment. The new revenue categories of Voice, Data and Other will replace Local Service, Network Access, Long Distance, and Other. Long distance related revenues are included in the Voice line item. The product-based categories will provide a clearer presentation of the Communication Group revenue, and are more closely aligned with the way we manage the business. This change has no net impact on total revenues.

Voice

Voice revenues increased \$43 in the second quarter 2003 and decreased \$3 in the year-to-date period as compared to the same periods in 2002 driven primarily by the growth in interLATA long distance offset by continued access line share loss. Total switched access lines declined 3.9% year-over-year. Retail residential lines declined 7.4%; retail business lines declined 6.3%. The access line decline was the result of a continued weak economy, share loss and technology substitution. Wholesale lines continued to grow in the second quarter driven by growth in UNE-P lines, which now total over 2 million. Total UNE-P lines added in the quarter totaled 249,000, a reduction of 11.4% of additions as compared with the prior year. The vast majority of the quarterly UNE-P adds were residential. Business UNE-P line adds of 21,000 rose slightly from the prior quarter while other wholesale UNE-P lines, primarily public, added 15,000 in the

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second quarter 2003 to total 43,000.

In efforts to combat share loss, we continue to grow our package services. BellSouth Answers is our signature residential package that combines wireline, wireless and Internet services. The package combines the Complete Choice calling plan of local service and multiple convenience calling features with BellSouth Long Distance, FastAccess DSL or dial-up Internet, and Cingular Wireless services. Customers have numerous Answers package options to choose from, or they can customize their own package to best meet their communications needs.

We added approximately 544 thousand Answers customers in the second quarter, ending the quarter with over 2.1 million residential packages, representing a 16.7% penetration of our retail primary line residence base. Over 70% of Answers customers have long distance in their package and more than 35% have either DSL or dial-up Internet. We believe the Answers package helps reduce competitive churn for our high-value customers.

Long distance revenue increased 45.1%, driven primarily by growth in interLATA and wireless long distance, partially offset by the discontinuance of BellSouth's wholesale long distance business. InterLATA revenues were \$126 in the second quarter 2003, a \$125 increase over the same period in 2002, while the year-to-date revenues in 2003 were \$203, a \$202 increase compared to 2002. At June 30, 2003 BellSouth had nearly 2.8 million long distance customers, a penetration rate of 19% of primary residential access lines and 29% of mass-market small business accounts. In Georgia and Louisiana, the only two states where BellSouth has been offering LD service for at least a full year, the company has achieved total mass market residential and business penetration of 25.5%.

Switched access revenues are down in the second quarter and year-to-date periods compared to the same periods last year due to volume and rate decreases. Switched access rates were lower due to effects of the CALLs program, an FCC access reform initiative. The decline in rates, however, is substantially offset by higher subscriber line charges. Switched access minutes of use declined 8.1% compared to the second quarter of 2002 and 9.5% compared to the year-to-date period of 2002. These volumes continue to be negatively impacted by migration of minutes to dedicated digital and data service offerings which are fixed-charge based rather than usage based, competition from competitive local exchange carriers whose traffic completely bypasses our network, and the effect of alternative services such as wireless and internet e-mail.

### Data

Data revenues decreased \$3 in the second quarter 2003 and \$5 in the year-to-date period when compared to the same periods in 2002. Data revenue growth has slowed compared to historical rates due primarily to weak sales of wholesale data transport services to other communications providers. Wholesale data revenues represented about 49% of total data services revenues while retail services such as FastAccess DSL, ISDN, Frame Relay, Lightgate, and Smartring accounted for the remaining 51%. Retail data services grew 11.5% in the second quarter 2003 and 10.3% for the year-to-date 2003 compared to the corresponding periods in 2002 driven primarily by FastAccess DSL growth. Revenues from the sale of wholesale data transport services to other communications providers, including long distance companies and CLECs, declined 10.1% in the second quarter 2003 and 8.8% in the year-to-date 2003 compared to the same periods in 2002, primarily due to the lingering impacts of a soft economy, network consolidation by large inter-exchange carriers and the renegotiation of an access contract with a bankrupt wholesale customer.

Combined wholesale and retail DSL revenues of \$166 in second quarter 2003 and \$323 in the year-to-date period 2003 were up \$52 and \$98, respectively, from the comparable prior year periods due to a larger customer base, although average

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revenue per user was lower due to promotional activity. As of June 30, 2003, we had 1.2 million customers, an increase of over 400 thousand customers compared to June 2002. Other retail data products, primarily DS1 (dedicated high capacity lines) lines were lower driven by decreases in demand and due to special access rate reductions effective July 2002.

### Other

Other communications revenue decreased \$125 in the second quarter 2003 and \$183 for the year-to-date period primarily due to the continuing phase-out of our payphone business and declines of sales to second and third tier long distance carriers due to our decision to eliminate certain products within the wholesale long distance portfolio, which collectively decreased \$63 in the second quarter and \$118 in the year-to-date period when compared to the same periods in 2002.

We plan to complete the exit of the payphone business by the end of 2003. Other revenues were also impacted by decreases in late payment fees and revenues from billing and collection agreements for other communications companies. Collectively, these revenues decreased \$24 in the second quarter and \$45 in the year-to-date period when compared to the same period in 2002. The late payment fee decrease was due in part to the late 2002 Florida Supreme Court decision regarding late payment billings in Florida. Billing and collection revenues continue to decrease reflecting additional carriers utilizing their own billing systems and the loss of carrier billing revenues as customers change from other carriers to our long distance services.

### Segment operating expenses

#### Cost of services and products

Cost of services and products of \$1,712 in second quarter 2003 and \$3,337 in the year-to-date period increased \$75 and \$82, respectively as compared to the same periods in 2002. The increase for the second quarter period reflects increases in expenses attributable to pension and postretirement benefits plans driven by rising health care costs, unfavorable returns on pension assets due to weak capital markets and changes to plan assumptions regarding expected asset returns and health care inflation rates impact of \$80 compared to the same period in 2002. Other increases include higher long distance costs, which increased \$64 as compared to the second quarter of 2002, associated with the substantial growth in retail interLATA long distance, increased service installation expense of \$39, reflecting decreased deferrals as compared to the prior period and higher overtime for network repair and maintenance activity.

These cost increases were partially offset by work force reductions, primarily as a result of reduced business volumes, that resulted in decreased salary and wage related expenses of \$47 in the second quarter of 2003. Costs associated with the sale of wholesale long distance and data networking and paging equipment were \$83 lower due to the decision to de-emphasize sales of these products.

The year-to-date increase reflects increases in expenses attributable to pension and postretirement benefits plans driven by rising health care costs, unfavorable returns on pension assets due to weak capital markets and changes to plan assumptions regarding expected asset returns and health care inflation rates impact of \$160 compared to the same period in 2002. Other year-to-date increases include retail interLATA long distance growth of \$94 and installation expense increase of \$97, reflecting decreased deferrals as compared to the prior period.

These year-to-date cost increases were partially offset by work force

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reductions, primarily as a result of reduced business volumes, that resulted in decreased salary and wage related expenses of \$91 in the year-to-date period compared to the same period in 2002. Costs associated with the sale of wholesale long distance and data networking and paging equipment were \$144 lower due to the decision to de-emphasize sales of these products, and contract services decreases of \$20 reflecting lower demand.

### Selling, general, and administrative expenses

Selling, general, and administrative expenses of \$768 in second quarter 2003 and \$1,532 in the year-to-date period increased \$20 and \$58, respectively, when compared to the same periods in 2002. The periods presented were impacted by increases in advertising of \$34 in the second quarter and \$60 in the year-to-date period compared to the same periods in 2002, and outside sales commission increases of \$18 in the second quarter and \$28 in the year-to-date period compared to the same periods in 2002. Insurance costs and SEEM payments also increased \$20 in the second quarter and \$53 in the year-to-date period compared to the same period in 2002. The periods presented were also impacted by increases in expenses attributable to pension and postretirement benefits plans driven by rising health care costs, unfavorable returns on pension assets due to weak capital markets and changes to plan assumptions regarding expected asset returns and health care inflation rates of \$9 in the second quarter and \$18 in the year-to-date periods compared to the same period in 2002.

These increases were somewhat offset by decreases in uncollectible expenses of \$72 in the second quarter 2003 and \$77 in the year-to-date period when compared to the same period in 2002. Prior year periods included the impact of higher bankruptcies and non-pay accounts driving the decrease in the current year. Salary and wage related expense decreased \$36 in the second quarter 2003 and \$44 in the year-to-date period compared to the corresponding periods in 2002 reflecting headcount reductions due to workforce reductions.

### Depreciation and amortization

Depreciation and amortization expense decreased \$98 during second quarter 2003 and \$193 in the year-to-date period as compared to same periods in 2002. The primary driver of the year-over-year 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 significant reductions in capital expenditures over the past several years. In addition, depreciation expense was lower due to the adoption of SFAS No. 143. In connection with the adoption of this standard, we no longer accrue for net cost of removal in our depreciation rates causing lower depreciation expense. Amortization expense slightly increased due to higher levels of capitalized software.

### Unusual items excluded from segment net income

Unusual items that were excluded from this segment's net income consisted of the following: for second quarter 2003, special items of \$(23) related to severance costs and pension settlement losses and costs associated with the early extinguishment of debt; for year-to-date 2003, special items of \$719 in income for the cumulative effect of change in accounting principle related to the adoption of FAS 143 offset by restructuring charges and costs associated with the early extinguishment of debt; for second quarter and year-to-date 2002, special items of \$(152) related to restructuring costs.

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Domestic Wireless  
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We own an approximate 40% economic interest in Cingular, a joint venture with SBC Communications (SBC). Because we exercise influence over the financial and operating policies of Cingular, we use the equity method of accounting for this investment. Under the equity method of accounting, we record our proportionate share of Cingular's earnings in our consolidated statements of income. These earnings are included in the caption "Net earnings (losses) of equity affiliates." For management purposes, we evaluate our Domestic wireless segment based on our proportionate share of Cingular's results. Accordingly, results for our Domestic wireless segment reflect the proportional consolidation of approximately 40% of Cingular's results.

	For the Three Months Ended June 30,		%
	2002	2003	Change
-----			
Segment operating revenues:			
Service revenues	\$1,398	\$1,412	1.0%
Equipment revenues	102	102	0.0%
Total segment operating revenues	1,500	1,514	0.9%
Segment operating expenses:			
Cost of services and products	478	501	4.8%
Selling, general, and administrative expenses	550	507	-7.8%
Depreciation and amortization	182	203	11.5%
Total segment operating expenses	1,210	1,211	0.1%
Segment operating income	290	303	4.5%
Segment net income	\$ 99	\$104	5.1%
Segment net income including unusual items	\$ 99	\$104	5.1%
Key Indicators:			
Cellular/PCS Customers (000s)			
Wireless service average monthly revenue per customer			
- Cellular/PCS	\$ 52.11	\$51.80	-0.6%

### Segment operating revenues

Cingular's cellular/PCS customers increased 2.1% compared to June 30, 2002. Net cellular/PCS additions in the second quarter 2003 increased 52.7% compared to second quarter 2002 and increased 24.1% in the year-to-date period 2003 as compared to 2002. Cingular's net cellular/PCS additions for the quarter represented the largest net customer additions in two years. Improvement in customer additions are partly attributable to several business initiatives Cingular implemented earlier in 2003: (1) reorganization of Cingular's marketing, sales and operations activities from a national to a regional basis to more effectively address local market needs; (2) introduction of a more meaningful brand message - "Cingular Fits You Best" - to tie in with the more focused local market strategy; and (3) increased emphasis on Cingular's affiliation with us and SBC and co-branding and more effectively utilizing our

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and SBC's sales channels in those areas where Cingular's wireless markets overlap with our and SBC's wireline markets. During the three months ended June 30, 2003, Cingular's postpaid, prepaid and reseller subscriber bases increased. Prepaid subscriber growth was impacted positively by the KIC (Keep in Contact) prepaid plan launched in the fourth quarter of 2002, and the reseller subscriber base increased largely due to the loss of WorldCom reseller customers in the second quarter of 2002, which resulted from its decision to exit the reseller business, and aggressive growth by Cingular's primary reseller.

The cellular/PCS churn rate was 2.5% in second quarter 2003 and 2.6% in the year-to-date period 2003 compared with a 2.7% churn rate second quarter 2002 and 2.8% for the year-to-date period 2002. Although, for the six months ended June 30, 2003, total gross cellular/PCS customer additions were 4.0% lower than for the same period in 2002, the lower churn rate contributed to the 24.1% increase in net cellular/PCS customer additions.

Segment operating revenues grew \$14 during second quarter 2003 and \$33 in the year-to-date period as compared to the same periods in 2002. Service revenues increased \$14 in the second quarter 2003 and \$26 in the year-to-date period,

driven by the increase in the average subscriber base for both periods. Other increases were a result of an increase in data revenues from the second quarter of 2002 and from the year-to-date period 2002, reflective of higher penetration and usage of SMS short messaging data services with Cingular's cellular/PCS customers as well as increased revenue per customer related to its Mobitex data business. Partially offsetting these increases were declines in roaming and long distance revenues reflecting the migration of customers to regional and national rate plans and a reduction in roaming rates with major roaming partners to support all-inclusive rate plans, and the formation of a venture to share infrastructure with T-Mobile USA, Inc., which reduced roaming charges to both carriers' customers. Average revenue per user (ARPU) for cellular/PCS customers declined \$0.31 to \$51.80 in the second quarter 2003 from \$52.11 in the second quarter 2002 and declined \$0.35 to \$50.93 in the year-to-date period 2003 from \$51.28 in the year-to-date period 2002. Continued competitive pricing pressure in combination with a higher percentage of lower ARPU reseller and prepaid customers in Cingular's customer base in 2003 negatively impacted ARPU when compared with the same periods in 2002. An increase in ARPU related to local service revenues was more than offset by reductions in revenues from roaming and long distance, thereby reducing overall service ARPU when compared to second quarter 2002 and the year-to-date period 2002.

Equipment revenues remained flat in second quarter 2003 and increased \$7 in the year-to-date period as compared to the same periods in 2002 due to increased handset revenues driven by higher per unit handset pricing, partially offset by lower accessory revenues.

Segment operating expenses

Cost of services and products

Cost of services and products increased \$23 during second quarter 2003 and \$40 in the year-to-date period as compared to the same periods in 2002. Cingular's expense growth was driven by increases in minutes of use on the network, system expansion and the increased costs of redundant networks required during the current system overlay. These increases were partially offset by lower third party system costs due to a decrease in roaming costs. An increase in equipment costs was due to increased per unit handset costs driven by a shift to higher-end handsets such as the dual-system TDMA/GSM handset in use during the GSM system conversion and newly introduced GSM-only handsets.



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### Selling, general, and administrative expenses

Selling, general, and administrative expenses of \$507 in second quarter 2003 decreased \$43 and expenses of \$994 in the year-to-date period decreased \$76, when compared to same periods in 2002, due to reduced employee-related costs as a result of the sales operation reorganization in 2002, lower commissions expense as a result of fewer gross additions, lower billing expenses as a result of billing system conversions and related consolidations, lower provision for uncollectibles, lower customer service expenses, and reduced advertising and promotion costs on a year-to-date basis. Advertising costs increased for the second quarter of 2003.

### Depreciation and amortization

Depreciation and amortization increased \$21 in second quarter 2003 and \$36 in the year-to-date period when compared to the same periods in 2002. The increase in depreciation expense of \$25 for second quarter 2003 and \$45 for the year-to-date period 2003 was attributable to higher levels of gross property, plant and equipment plus accelerated depreciation on TDMA assets that began in 2003. Amortization expense declined \$4 during second quarter 2003 and \$9 in the year-to-date period as compared to the same periods in 2002 due to certain finite-lived intangibles becoming fully amortized during 2002.

### Unusual items excluded from segment net income

Unusual items that were excluded from this segment's net income consisted of the following: in second quarters 2003 and 2002 and year-to-date 2003, there were no special items excluded from this segment's results; in year-to-date 2002, special items of \$(8) related to the cumulative effect of change in accounting principle for the adoption of FAS 142.

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### Latin America

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The Latin America segment is comprised of our investments in wireless businesses in eleven countries in Latin America. Consolidated operations include our businesses in Argentina, Chile, Colombia, Ecuador, Nicaragua, Peru and Venezuela. All other businesses are accounted for under the equity method and accordingly their results are reported as Net earnings (losses) of equity affiliates.

	For the Three Months			
	Ended June 30,	2003	%	For
	2002	2003	Change	En
				200
<hr/>				
Segment operating revenues:				
Service revenues	\$ 501	\$471	-6.0%	\$ 1
Equipment and other revenues	78	94	20.5%	
Advertising and publishing revenues	19	-	-100.0%	
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Total segment operating revenues	598	565	-5.5%	
Segment operating expenses:				
Cost of services and products	230	243	5.7%	
Selling, general, and administrative expenses	174	154	-11.5%	
Depreciation and amortization	118	93	-21.2%	
	---	---		
Total segment operating expenses	522	490	-6.1%	
Segment operating income	76	75	-1.3%	
Net earnings (losses) of equity affiliates	(2)	2	*	
Segment net income	12	41	*	
Segment net income (loss) including unusual items	(409)	48	*	(2,
Key Indicators:				
Customers (a) (000s)				7,
Average monthly revenue per customer (a)	\$ 20	\$ 18	-10.0%	\$

\* Not meaningful

(a) The amounts shown are for our consolidated properties and do not include customer data for our unconsolidated properties.

### Segment operating revenues

Although the customer base in Latin America increased 13.8% over the prior year, segment operating service revenues decreased \$30 in second quarter 2003 as compared to same period in 2002. During the second quarter we added 377 thousand customers with over 300 thousand in Ecuador, Colombia, and Chile combined. The impact of a larger customer base from prior year was more than offset by the effect of the weakening of the Venezuelan Bolivar against the U.S. Dollar and the resulting effect on translating those revenues to our reporting currency, the U.S. Dollar. The Venezuelan Bolivar devalued over 40% since second quarter 2002, resulting in a \$45 decrease in revenue in Venezuela in the second quarter 2003 compared to the same period in 2002. Partially offsetting the second quarter decline were increases of \$20 related to favorable interconnect billing true-ups in one of our operations. The decrease in the second quarter 2003 compared to second quarter 2002 was also partially offset by increased revenues in Ecuador due to strong customer growth and revenue increases in Argentina reflecting increased business volumes.

Year-to-date service revenues in Latin America of \$1,063 decreased \$160 compared to the same period in 2002. This decrease includes the second quarter activity above and additional devaluation in Argentina in the first half of 2003 compared to the first half of 2002. Argentina and Venezuela combined service revenues decreased \$165 in the year-to-date period as compared to the same periods in 2002. The declines in service revenue were partially offset by an increase at Ecuador of \$45 for the year-to-date period 2003 as compared to the same periods in 2002, reflecting a 63% increase in its customer base as well as a \$18 increase in the first half of 2003 associated with a settlement reached with another wireless carrier over disputed interconnect fees. The settlement also resulted in recording \$26 in cost of services resulting in a net reduction to operating income of \$8 for the year-to-date period.

Equipment and other revenues increased \$16 in second quarter 2003 primarily due to the 38.7% increase in gross customer additions over the same period last year. These revenues decreased \$1 in the year-to-date period as compared to same period in 2002 due to the impact of the previously discussed currency

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devaluations, offset by the 16.6% increase in gross customer additions from the prior year-to-date amounts.

Segment operating expenses

Cost of services and products

Cost of services and products increased \$13 in second quarter 2003 and \$5 in the year-to-date period as compared to the same periods in 2002. The second quarter increase was primarily caused by cost of equipment increases from higher

gross additions. The year-to-date period of 2003 also includes \$26 of additional expense recorded in Ecuador associated with an interconnect settlement previously described. Currency devaluations in Venezuela and Argentina that have the effect of lowering the expense in the U.S. Dollar significantly offset these year-to-date increases.

Additionally, year-to-date costs increased due to a \$34 contingency accrual recorded in the first half of 2003. Recent administrative regulations in one of the countries in which we operate, regarding the inclusion of interconnection income in the taxable revenue base, contradicted the method of calculation used by our subsidiary in computing and paying its liability for taxes on telecommunications services. We believe we have a valid argument under existing law for our method of calculating the tax. However, because of uncertainty in the outcome of this issue, our subsidiary has recorded a contingency accrual for prior unpaid taxes based on the new regulations and it intends to calculate taxes in future periods in conformity with these regulations until the legal issues are resolved. We plan to defend our position, in the courts if necessary. We cannot predict how long it will take to resolve this issue, however we do not expect the impact, if any, to be material to our results of operations, financial position or cash flows.

The cost of services change also was impacted by a \$10 decrease in the second quarter 2003 and \$12 year-to-date 2003 compared to the same periods last year due to the exit of advertising and publishing business in 2002.

Selling, general, and administrative expenses

Selling, general, and administrative expenses decreased \$20 in second quarter 2003 and \$100 in the year-to-date period as compared to the same periods in 2002. The significant decrease in the year-to-date period was caused primarily by currency devaluations in Argentina and Venezuela, which recorded declines of \$27 and \$43, respectively, and by cost containment efforts. The year-to-date period 2003 also reflects a \$12 benefit in Ecuador associated with cumulative future deductions to be used to calculate employee profit-sharing expense.

During second quarter 2003, the Argentinean Peso strengthened to a level comparable to the second quarter 2002, resulting in relatively flat expenses in that operation. The second quarter decrease of \$20 was caused primarily by the currency devaluation in Venezuela, where expenses decreased \$14 compared to second quarter 2002, as well as by cost containment efforts. Selling, general, and administrative expenses were also impacted by a \$10 decrease in the second quarter 2003 and \$17 year-to-date 2003 compared to the same periods last year due to the exit of advertising and publishing business in 2002.

Depreciation and amortization

Depreciation and amortization expense decreased \$25 in second quarter 2003 and \$53 in the year-to-date period as compared to the same periods in 2002. The decline reflects the impact of currency devaluations on the amortizable basis of

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tangible and intangible assets.

Net losses of equity affiliates

Net losses from our Latin America equity affiliates improved \$4 to \$2 in second quarter 2003 and \$16 to \$8 in the year-to-date period as compared to the same periods in 2002, primarily as a result of the cessation of recording losses from our equity investments in Brazil.

Provision for income taxes

The provision for taxes in the year-to-date period 2003 includes benefits related to inflation adjustments deductible for Venezuelan tax purposes and benefits related to the reversals of deferred tax valuation allowances on net operating losses in Ecuador and Argentina.

Unusual items excluded from segment net income

Unusual items that were excluded from this segment's net income consisted of the following: in second quarter 2003, special items of \$7 related to foreign currency transaction gains offset by the loss on the sale of BSE and by restructuring charges; in year-to-date 2003, special items of \$54 related to foreign currency transaction gains offset by the loss on sale of BSE and by restructuring charges; in second quarter 2002, special items of \$(421) related to foreign currency transaction losses, asset impairments and severance costs; in year-to-date 2002, special items of \$(2,158) related to impairment losses under SFAS No. 142, foreign currency transaction losses, Brazil loan impairments, asset impairments and severance costs, partially offset by gain on sale of stock.

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### Advertising and Publishing

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Our Advertising and publishing segment is comprised of companies in the U.S. that publish, print, sell advertising in and perform related services concerning alphabetical and classified telephone directories and electronic product offerings.

As discussed more fully in Note D to the interim financial statements, effective January 1, 2003, we changed our method for recognizing revenues and expenses related to our directory publishing business. This was treated as a cumulative effect of accounting change and therefore prior year results were not restated. However, to align with internal reporting, the 2002 segment results for the Advertising and publishing segment have been recast to reflect the change.

	For the Three Months Ended June 30, 2002	2003	%	For En 200
			Change	
Segment operating revenues	\$ 570	\$525	-7.9%	\$1
Segment operating expenses:				
Cost of services and products	91	82	-9.9%	
Selling, general, and administrative expenses	224	184	-17.9%	
Depreciation and amortization	8	7	-12.5%	
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Total segment operating expenses	323	273	-15.5%	
Segment operating income	247	252	2.0%	
Segment net income	\$ 151	\$157	4.0%	\$
Segment net income (loss) including unusual items	\$ 152	\$156	*	\$

\* Not meaningful

### Segment operating revenues

Segment operating revenues decreased \$45 from the second quarter of 2002 to the second quarter of 2003, and decreased \$57 on a year-to-date basis. The overall industry environment continues to reflect weak economic conditions and resulted in a reduction in publishing revenues of \$22 for the quarter and \$44 for the year-to-date period. The decreases in both periods also reflect the favorable impact of \$24 recorded in the second quarter of last year related predominately to billing and claims related true-ups. Absent these items, the decline in revenues would have been 3.8% for the quarter and 3.1% for the year-to-date period. The 2003 period declines were primarily driven by the amortization of revenues from directories issued in 2002, and to a lesser extent from those issued in 2003. When compared to their previous issues, the total revenues on directories issued during second quarter 2003 declined 2.5%; total revenues for all directories issued during 2003 have also declined 2.5%. The declines in both periods were partially offset by increases in revenues from electronic media offerings.

### Segment operating expenses

Cost of services and products decreased \$9 for the quarter and \$22 on a year-to-date basis. The decreases primarily reflect the impact of manufacturing cost reduction efforts that were made during the latter half of 2002.

Selling, general, and administrative expenses decreased \$40 compared to the corresponding periods in 2002. The provision for uncollectible expense decreased \$43 for the quarter and \$25 for the year-to-date period. These decreases reflect the impact of increased collection performance in the 2003 periods.

Administrative expenses, which were flat quarter-over-quarter, decreased on a year-to-date basis as the result of cost-control efforts. The decreases in both the quarter- and year-to-date periods were partially offset by increases attributable to pension and postretirement benefits plans driven by rising health care costs, unfavorable returns on pension assets due to weak capital markets and changes to plan assumptions regarding expected asset returns and health care inflation rates.

Depreciation and amortization was relatively flat for both the quarter and year-to-date periods.

### Unusual items excluded from segment net income

Unusual items that were excluded from this segment's net income consisted of the following: in second quarter 2003, special items of \$(1) related to severance costs and pension settlement losses; in year-to-date 2003, special items of \$(505) included the cumulative effect of change in accounting principle and severance and pension costs; in second quarter 2002, special items of \$1 related to severance costs and employee benefits related to workforce reduction; and in year-to-date 2002, special items of \$(100) related to an unbilled receivable adjustment, severance costs and employee benefits related to workforce reduction.

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 All Other Businesses  
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All other businesses primarily consist of a captive insurance subsidiary and equity investments in wireless operations in Israel and Denmark and our former operations in Germany.

	For the Three Months		%	For
	Ended June 30,			
	2002	2003	Change	2002
Segment operating revenues	\$25	\$25	*	\$
Segment operating expenses	15	13	-13.3 %	
	--	--		
Segment operating income	10	12	20.0 %	
Net earnings of equity affiliates	15	11	-26.7 %	
Segment net income	\$ 21	\$19	-9.5 %	\$
Segment net income including unusual items	\$ 21	\$19	*	\$

\* Not meaningful.

Segment operating results

Revenues and expenses were derived primarily from the sale of insurance on customer premises equipment and amortization of deferred revenues related to a transaction with Crown Castle to monetize wireless towers in 1999. While revenues increased slightly, operating expenses remained flat, resulting in an improved segment operating income.

Net earnings of equity affiliates decreased \$4 and \$8 in the second quarter 2003 and year-to-date period 2003 as compared to the same periods in 2002, attributable to lower income from the operations in Israel, offset in the year-to-date period by the cessation of recording losses related to our former German operation subsequent to its sale during the first quarter of 2002.

Unusual items excluded from segment net income

Unusual items that were excluded from this segment's results consisted of the following: in second quarter and year-to-date 2003 and second quarter 2002, there were no special items excluded from this segment's results; in year-to-date 2002, special items of \$857 related to a gain on the conversion of E-Plus, a loss on the sale of KPN stock, and a gain on the settlement of forward

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contracts associated with advances to E-Plus.

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### Liquidity and Financial Condition

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Net cash provided by (used for):

	For the Six Months Ended June 30,		Change	
	2002	2003		
Operating activities..	\$ 4,193	\$ 4,426	233	5.6 %
Investing activities..	\$ (90)	\$ 239	329	*
Financing activities..	\$ (2,853)	\$ (3,025)	(172)	6.0 %

\* Not meaningful

Net cash provided by operating activities

Cash generated by operations increased \$233 during 2003 compared to the prior year. The increase was driven primarily by working capital changes partially offset by lower operating cash flow in the Communications group driven primarily by revenue decreases.

Net cash used for investing activities

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 incidental costs of preparing the asset for its intended use, and (b) gross additions to capitalized software. Our capital expenditures during 2003 of \$1,360 were incurred to support our wireline and wireless networks, to promote the introduction of new products and services and to increase operating efficiency and productivity. The decline in capital expenditures compared to the prior period relates primarily to targeted capital management and lower demand levels.

Other investing activities

In 2003, we received proceeds of \$35 from the exercise of a put in a loan agreement with our Colombian partner and proceeds of \$20 related to the sale of an equity investment in Brazil. In June 2003, we sold our entire interest in two real estate partnerships for net proceeds of \$26. In conjunction with the sale, we received proceeds of \$97 for the repayment of loans we had extended to the partnerships. In addition, we received \$1,458 in net proceeds resulting from an early repayment by KPN of the entire outstanding balance of the loan we had extended to them and the settlement of related currency swaps.

Net cash used for financing activities

During the six months ended June 30, 2003 we utilized cash from operations to reduce long-term borrowings by \$1,586 and short-term borrowings by \$381. In addition, we paid dividends of 41 cents per share totaling \$759. During 2003, we purchased 14.8 million shares of our common stock for an aggregate of \$322. Our debt to total capitalization ratio of 44.6% at June 30, 2003 decreased from 49.2% at December 31, 2002. The six months ended June 30, 2002 included

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substantial reductions in commercial paper as well as dividend payments of 38 cents per share totaling \$713.

### Anticipated sources and uses of funds

Cash flows from operations are our primary source of cash for funding existing operations, capital expenditures, debt interest and principal payments, and dividend payments to shareholders. Should the need arise, however, we believe we are well positioned to raise capital in the public debt markets. At June 30, 2003, our corporate debt rating was A1 from Moody's Investor Service and A+ from Standard and Poor's. Our short-term credit rating at June 30, 2003 was P-1 from Moody's and A-1 from Standard and Poor's. Our authorized commercial paper program as of June 30, 2003 was \$8.0 billion, with \$1.5 billion outstanding. We believe that we have ready access to the commercial paper market in the event funding in excess of our operating cash flows is needed. We also have a syndicated line of credit in the amount of \$1.5 billion that we would use in the event we are unable to access the commercial paper market. The line of credit contains no significant financial covenants or requirements for compensating balances. We do not have any balances outstanding under the line of credit. We also have a registration statement on file with the SEC under which \$2.3 billion of long-term debt securities could be issued. While current liabilities exceed current assets, 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 needs of our business for at least the next twelve months.

The majority of our operating cash flow is generated by our Communications group and Advertising and publishing segments. These segments generate sufficient cash flow to both cover their operating, investing and financing needs and provide excess cash to the corporate parent for corporate uses. The Latin America group is expected to generate sufficient cash to meet its operating needs. The Domestic Wireless segment, which consists entirely of our equity investment in Cingular, does not rely on BellSouth for funding; Cingular generates sufficient cash flow to meet its operating, investing and financing needs through its own operations or through its own financing activities.

### Venezuelan Put-Call Provision

We own approximately 78% of Telcel, our Venezuelan operation. Telcel's other major shareholder holds an indirect 21% interest in Telcel. Under a Stock Purchase Agreement, that shareholder has the right to initiate a process that could require us to purchase (the puts), and we have the right to initiate a process that could require that shareholder to sell (the calls) to us, the shareholder's interest in Telcel with notice of the initiation of the process with respect to approximately half of that shareholder's interest to be given in 2000 and notice with respect to the remaining balance to be given in 2002. If we exercise our call right, we would purchase that shareholder's interest at between 100% and 120% of its appraised fair value. If we are required to purchase the interest, we would do so at between 80% and 100% of its appraised fair value.

In 2000, the shareholder initiated a process for appraising the value of approximately half of its interest in Telcel, but the process was not completed. The shareholder also has sent a letter purporting to exercise the balance of the Buy-back Rights under the Stock Purchase Agreement. We are currently in arbitration with our partner over alleged breaches by BellSouth and the shareholder of the Stock Purchase Agreement, including the timing of the valuation and whether the process was properly initiated in 2000. The arbitration does not directly involve the valuation of the balance of the Buy-back Rights. The shareholder is seeking damages and specific performance, and BellSouth is seeking, among other things, unspecified damages and a ruling



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that it has not breached the Stock Purchase Agreement in any respect. We expect the hearing on this matter to take place later this year. If the arbitration panel rules against BellSouth, it is possible that the appraised fair value of the shareholder's interest in Telcel could be substantially in excess of current value. At this time, the likely outcome of this arbitration cannot be predicted, nor can a reasonable estimate of the amount of loss, if any, be made.

### Colombia Put-Call Provision

We own approximately 66% of BellSouth Colombia. Our partner holds the remaining 34% interest. We have agreed with our partner to a series of related put and call agreements whereby we can acquire, or could be compelled by our partner to acquire, additional shares of the company, up to the partner's entire interest, at a price approximately equal to appraised fair value. Our partner currently has the right to put to us approximately one-half of his 34% interest in the Colombian operations. The put expires in June 2005. The remaining balance can be put to us beginning in 2006 until 2009. Our first call option for up to a number of shares currently equal to approximately 10.5% of BellSouth Colombia's outstanding common stock is first exercisable beginning in December 2003. We cannot determine who will exercise their rights under the agreement, or the amount if exercised.

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### Market Risk

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For a complete discussion of our market risks, you should refer to the caption "Quantitative and Qualitative Disclosure About Market Risk" in our 2002 annual report on Form 10-K as modified by the current report on Form 8-K, dated May 30, 2003. Our primary exposure to market risks relates to unfavorable movements in interest rates and foreign currency exchange rates. We do not anticipate any significant changes in our objectives and strategies with respect to managing such exposures.

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### Off-Balance Sheet Arrangements and Aggregate Contractual Obligations

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Other than reductions in debt maturing within one year associated with debt retirements, there are no material changes with respect to off-balance sheet arrangements and aggregate contractual obligations as presented in our 2002 Form 10-K, as modified by the current report on Form 8-K dated May 30, 2003.

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### Operating Environment and Trends of the Business

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#### Domestic Economic Trends

On average, the economy of the nine-state region tends to closely track the U.S. economy. Economic activity during the second quarter of 2003 remained sluggish, hampered by geopolitical concerns. The pace of economic growth is expected to improve during the latter half of 2003. Real gross domestic product is projected to grow at an average annual rate of 2.5 percent, slightly better than 2002's growth.

Real personal income growth in our region, estimated at 2.2 percent in 2002, is expected to reach 2.3 percent in 2003. Employment in the region, which has historically been closely correlated with various measures of BellSouth's business performance, is projected to rise 0.3 percent in 2003 after falling an

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estimated 0.6 percent in 2002. With 492,000 housing starts in the region in 2002, residential construction activity was at its strongest level since 1985-1986. Although it is unlikely to maintain that pace, residential construction in the region was still strong in the first quarter and 490,000 starts are projected for 2003. Historically, our business has generally followed the timing of the cycle in the overall economy, so we expect to see signs of recovery in our operations as the pace of economic activity improves during 2003.

### Domestic Telecommunications Industry Trends

The domestic telecommunications industry continues to be negatively affected by the combination of excess capacity, reduced capital spending, technology migration and diminished investor confidence. These issues translate to reduced revenues and earnings and widespread layoffs and bankruptcies. The convergence of these factors has the potential to adversely affect the overall economy's growth and productivity in both the short and long-term.

Specifically, the regional Bell operating companies continue to be adversely affected by economic weakness, technology substitution, competition and regulatory burdens. In addition, smaller telecommunications competitors are in bankruptcy proceedings, raising questions about the ability of these companies to pay their obligations and their business models if they re-emerge from bankruptcy with significantly less leverage. Technology substitution from wireless services, DSL and cable telephony is expected to continue for the foreseeable future. Further, CLECs continue to use UNE-P as an alternative to facilities deployment, significantly reducing their costs. The widespread use of UNE-P enables competitive local exchange carriers to offer lower priced services, enabling them to gain market share. Meanwhile, the obligation to provide competitors with access to facilities under UNE-P significantly reduces the revenue and margins of the regional Bell operating companies. The FCC is considering the effects of UNE-P pricing and availability in the triennial review of its policies on unbundled network elements. The FCC announced decisions in that proceeding on February 20, 2003, but has not yet issued the required order and rules that provide the legal content of the decisions. We believe the ability to offer long distance services gives us product parity to influence customer retention and reacquisition but will do little to offset the reduced margin effects of current UNE-P pricing.

Over the next 12 to 24 months, we expect to see continued growth in our wholesale and retail DSL subscribers and a significant increase in our long-distance subscriber base.

In the domestic wireless area, increasing competition, market saturation and a weak economy will likely cause continued pricing pressures and the increase in subscribers to continue at a moderate level in comparison to historical growth rates.

### Other Matters in the Domestic Business

We have contractual arrangements with WorldCom, Inc. (which now calls itself MCI) and/or its subsidiaries related to interconnection of our networks, provision of telecommunication services and purchase of WorldCom's accounts receivables in connection with a billing and collection agreement. Monthly billings to WorldCom are approximately \$50 while monthly payables under the billing and collection agreement are approximately \$35.

On July 21, 2002, WorldCom and certain of its subsidiary corporations filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code. A plan of reorganization was filed in April 2003 and is scheduled for a

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confirmation hearing in early September 2003. On July 25, 2003, WorldCom filed a motion with the Bankruptcy court requesting approval of a settlement with us regarding pre-petition and post-petition claims through April 30, 2003. As of April 30, 2003, we had not paid certain pre-petition amounts due WorldCom primarily related to a billing and collection agreement pending this settlement. In addition, WorldCom had not paid us a lesser amount they owed us for purchases of telecommunications services. As a result of the settlement, we will make a net payment of \$81 to WorldCom representing the negotiated difference between the amounts owed. The income statement impact of the settlement is insignificant. The settlement also resolves numerous business issues that existed between the parties and with certain exceptions, releases all claims arising on or before April 30, 2003. The settlement will be final upon the effective date of the plan of reorganization.

### Latin America Economic Trends

Latin American economies were generally very weak entering 2003. Venezuela's economy has contracted sharply as a result of currency devaluation and a general strike. Low business confidence amid political uncertainty will likely keep that economy in a deep recession in 2003. A slow recovery appears to be underway in Argentina following four years of recession. Real gross domestic product growth in Colombia, which was below 2 percent in 2002, is likely to remain sluggish in 2003.

We are restricting new investment in the region and have expectations that the Latin America group can fund its financial needs from the group's operating cash flows. In addition, we do not expect to enter into additional, or increase existing, debt guarantees.

### Foreign Risks

Our reporting currency is the U.S. Dollar. However, most of our revenues are generated in the currencies of the countries in which we operate. In addition, many of our operations and equity investees hold U.S. Dollar-denominated short and long-term debt. The currencies of many Latin America countries have experienced substantial volatility and depreciation in the past. Declines in the value of the local currencies in which we are paid relative to the U.S. Dollar will cause local currency-denominated revenues and expenses in U.S. Dollar terms to decrease and U.S. Dollar-denominated assets and liabilities to increase in local currency terms. Where we consider it to be economically feasible, we attempt to limit our exposure to exchange rate fluctuations by using foreign currency forward exchange contracts or similar instruments as a vehicle for hedging; however, a substantial amount of our exposure is unhedged.

The impact of a devaluation or depreciating currency on an entity depends on the residual effect on the local economy and the ability of an entity to raise prices and/or reduce expenses. Our ability to raise prices is limited in many instances by government regulation of tariff rates and competitive constraints. Due to our constantly changing currency exposure and the potential substantial volatility of currency exchange rates, we cannot quantify the anticipated effect of exchange rate fluctuations on our business.

Economic, social and political conditions in Latin America are, in some countries, unfavorable and volatile, which have adversely affected our operations. These conditions are making it difficult for us to continue development of our business, generate revenues or achieve or sustain profitability in some countries, and could have this effect throughout the region. Historically, recessions and volatility have been primarily caused by: monetary, exchange rate and/or fiscal policies; currency devaluations; significant governmental influence over many aspects of local economies; political and economic instability; unexpected changes in regulatory

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requirements; social unrest or violence; slow or negative economic growth; imposition of trade barriers; and wage and price controls. Our Latin America business has been materially and adversely affected by the recent political and economic crises in Argentina, Brazil and Venezuela. Other operations in the region could be materially adversely affected if these crises spread to other Latin America countries.

Most or all of these factors have occurred at various times in the last two decades in our core Latin America markets. We have no control over these matters. Economic conditions in Latin America are generally less attractive than those in the U.S., and poor social, political and economic conditions may limit use of our services, which may adversely impact our business.

### Legal Matters

We are involved in numerous legal proceedings associated with state and federal regulatory matters. While complete assurance cannot be given as to the outcome of these matters, we believe that any financial impact would not be material, individually or in the aggregate, to our results of operations, financial position or cash flows. See Note L to our consolidated interim financial statements.

### Recently Issued Accounting Pronouncements

See Note C to our consolidated interim financial statements.

### Item 3. Qualitative and Quantitative Disclosures About Market Risk

See the caption labeled "Market Risk" in Management's Discussion and Analysis of Financial Condition and Results of Operations.

### Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Management necessarily applied its judgment in assessing the costs and benefits of such controls and procedures, which, by their nature, can provide only reasonable assurance regarding management's control objectives. We also have investments in certain unconsolidated entities. As we do not control or manage these entities, the disclosure controls and procedures with respect to such entities are necessarily more limited than those we maintain with respect to our consolidated subsidiaries.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of management, including the Chief Executive Officer along with the Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon the foregoing, the Chief Executive Officer along with the Chief Financial Officer concluded that our disclosure controls and procedures are effective, in all material respects, in timely alerting them to material information relating to BellSouth (including consolidated subsidiaries) required to be included in our Exchange Act reports. There have been no significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to the date we carried out the evaluation.

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### Cautionary Language Concerning Forward-Looking Statements

In addition to historical information, this document contains forward-looking statements regarding events and financial trends that may affect our future operating results, financial position and cash flows. 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:

- o a change in economic conditions in domestic or international markets where we operate or have material investments which could affect demand for our services;
- o changes in U.S. or foreign 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;
- o continued pressure on the telecommunications industry from a financial, competitive and regulatory perspective;
  
- o a continued decrease in the growth rate of demand for, and the success of our efforts to market, our services;
- o the intensity of competitive activity and its resulting impact on pricing strategies and new product offerings;
- o changes in the federal and state regulations governing the terms on which we offer wholesale services to our competitors;
- o our ability to successfully penetrate the interLATA long distance market;
- o significant deterioration in foreign currencies relative to the U.S. Dollar in foreign countries in which we operate, particularly in Latin America;
- o the unwillingness or inability of our partners to fund their obligations to our international joint ventures due to deteriorating economic conditions or other factors;
- o the unwillingness of banks or other lenders to lend to our international joint ventures due to deteriorating economic conditions and tightening credit standards or to restructure existing debt, particularly in Latin America;
- o higher than anticipated start-up costs or significant up-front investments associated with new business initiatives;
- o the outcome of pending litigation;
- o unanticipated higher capital spending from, or delays in, the deployment of new technologies;
- o the impact of terrorist attacks on our business; and
- o the impact and the success of the wireless joint venture with SBC Communications, known as Cingular Wireless, including marketing and product development efforts, technological change and financial capacity.

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### PART II -- OTHER INFORMATION

#### Item 1. Legal Proceedings

As previously disclosed, 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 United States 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 on or about July 15, 2003 and named four outside directors as additional defendants. The Consolidated and Amended Class Action Complaint alleges that during the period November 7, 2000 through February 19, 2003, the Company (1) overstated the unbilled receivables balance of its advertising and publishing subsidiary; (2) failed to properly implement SAB 101 with regard to its recognition of advertising and 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. The plaintiffs are seeking an unspecified amount of damages, as well as attorneys' fees and costs. At this early stage of the litigation, 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. On or about July 3, 2003, the federal court issued a ruling that the case should be remanded to Fulton County Superior Court. Defendants are seeking permission to appeal this determination. The plaintiffs are seeking an unspecified amount of damages, as well as attorneys' fees and costs. At this early stage of the litigation, the likely outcome of the case cannot be predicted, nor can a reasonable estimate of loss, if any, be made.

As previously disclosed, in September and October 2002 three substantially identical class action lawsuits were filed in the United States 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) plan (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 Plan participants and beneficiaries; (2) failing to ensure that the Plan's assets were invested properly; (3) failing to monitor the Plan's 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 and publishing subsidiary and its 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 early

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stage of the litigation, the likely outcome of the cases cannot be predicted, nor can a reasonable estimate of loss, if any, be made.

### Item 4. Submission of Matters to a Vote of Security Holders

Our annual meeting of shareholders was held on April 28, 2003. The voting results were as follows:

Number of Shares Outstanding as of Record Date:	1,897,161,787
Number of Shares Present:	1,548,230,291
Percent of Shares Present:	81.61%

#### Proposal 1: Election of Directors

	For	Withheld
	-----	-----
J. Hyatt Brown	1,500,724,775	47,505,516
James P. Kelly	1,496,912,105	51,318,186
Eugene F. Murphy	1,447,051,035	101,179,256
Robin B. Smith	1,444,605,780	103,624,511
William S. Stravropoulos	1,501,415,709	46,814,582

The term of the following directors continued after the meeting:

F. Duane Ackerman  
 Reuben V. Anderson  
 James H. Blanchard  
 Armando Codina  
 Kathleen F. Feldstein  
 Joseph M. Magliochetti  
 Leo F. Mullin

#### Proposal 2: Ratification of Independent Accountants

For	Against	Abstain
-----	-----	-----
1,421,411,398	109,556,476	17,262,417

#### Proposal 3: Shareholder Proposal re: Indexing Stock Options

For	Against	Abstain	Broker Non-Votes
-----	-----	-----	-----
300,053,592	949,374,136	38,565,593	260,236,970

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Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

Exhibit Number	
4a	No instrument which defines the rights of holders of our long- and intermediate-term debt is filed herewith pursuant to Regulation S-K, Item 601(b)(4)(iii)(A). Pursuant to this regulation, we agree to furnish a copy of any such instrument to the SEC upon request.
10hh-4	Agreement dated May 19, 2003 with Ronald M. Dykes
10jj-2	The Amended and Restated BellSouth Officer Compensation Deferral Plan Effective April 1, 2003 As Amended
11	Computation of Earnings Per Common Share
12	Computation of Ratio of Earnings to Fixed Charges
31-a	Section 302 Certification of F. Duane Ackerman
31-b	Section 302 Certification of Ronald M. Dykes
32	Statement Required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K:

Date of Event	Subject
May 30, 2003	Restatement of Financial Statements to reflect the adoption of the fair value expense recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation."

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

BELLSOUTH CORPORATION

By /s/ W. Patrick Shannon

-----  
W. PATRICK SHANNON  
Vice President - Finance  
(Principal Accounting Officer)

August 4, 2003



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EXHIBIT INDEX

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