BELLSOUTH CORP
Form 10-Q
November 01, 2006
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

(Mark One)

|X| QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2006

OR

o 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 a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer X Accelerated filer___ Non-accelerated filer___

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes___ No __X_

At October 30, 2006, 1,824,067,817 common shares were outstanding.

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PART I FINANCIAL INFORMATION

BELLSOUTH CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

(Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	**2006**	2005	**2006**
Operating revenues:				
Communications Group	$ 4,558	**$ 4,669**	$ 13,749	**$13,969**
Advertising & Publishing Group	506	**535**	1,521	**1,581**
All other	8	**14**	35	**45**
Total operating revenues	5,072	**5,218**	15,305	**15,595**
Operating expenses:				
Cost of services and products (excludes depreciation and amortization shown separately below)	2,017	**1,905**	5,862	**5,974**
Selling, general, and administrative expenses	996	**967**	2,833	**2,868**
Depreciation and amortization	922	**894**	2,756	**2,685**
Provisions for restructuring and asset impairments	166	**7**	181	**72**
Total operating expenses	4,101	**3,773**	11,632	**11,599**
Operating income	971	**1,445**	3,673	**3,996**
Interest expense	274	**302**	850	**860**
Net earnings (losses) of equity affiliates	97	**342**	85	**694**
Gain on sale of operations	351		351	
Other income (expense), net	64	**90**	176	**212**
Income from continuing operations before income taxes	1,209	**1,575**	3,435	**4,042**
Provision for income taxes	392	**516**	1,140	**1,312**
Income from continuing operations	817	**1,059**	2,295	**2,730**
Income from discontinued operations, net of tax			381	
Net income	$ 817	**$1,059**	$ 2,676	**$2,730**
Weighted-average common shares outstanding:				
Basic	1,831	**1,814**	1,831	**1,806**
Diluted	1,836	**1,822**	1,835	**1,813**
Dividends declared per common share	$ 0.29	**$ 0.29**	$ 0.85	**$ 0.87**
Basic earnings per share:				
Income from continuing operations	$ 0.45	**$ 0.58**	$ 1.25	**$ 1.51**
Discontinued operations, net of tax			0.21	
Net income	$ 0.45	**$ 0.58**	$ 1.46	**$ 1.51**
Diluted earnings per share:				
Income from continuing operations	$ 0. 44	**$ 0.58**	$ 1.25	**$ 1.51**
Discontinued operations, net of tax			0.21	
Net income	$ 0.44	**$ 0.58**	$ 1.46	**$ 1.51**

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, 2005	**September 30, 2006** (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 427	**$ 731**
Short-term investments		**1,327**
Accounts receivable, net of allowance for uncollectibles of $289 and $244	2,555	**2,562**
Material and supplies	385	**383**
Other current assets	842	**928**
Total current assets	4,209	**5,931**
Investments in and advances to Cingular Wireless	21,274	**22,357**
Property, plant and equipment, net	21,723	**21,820**
Other assets	7,814	**8,725**
Intangible assets, net	1,533	**1,540**
Total assets	$ 56,553	**$ 60,373**
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Debt maturing within one year	$ 4,109	**$ 3,926**
Accounts payable	1,040	**909**
Other current liabilities	3,505	**4,047**
Total current liabilities	8,654	**8,882**
Long-term debt	13,079	**14,278**
Noncurrent liabilities:		
Deferred income taxes	6,607	**6,818**
Other noncurrent liabilities	4,679	**4,959**
Total noncurrent liabilities	11,286	**11,777**
Shareholders equity:		
Common stock, $1 par value (8,650 shares authorized; 1,798 and 1,822 shares outstanding)	2,020	**2,020**
Paid-in capital	7,960	**8,130**
Retained earnings	20,383	**21,525**
Accumulated other comprehensive income (loss)	(14)	**35**
Shares held in trust and treasury	(6,815)	**(6,274)**
Total shareholders equity	23,534	**25,436**
Total liabilities and shareholders equity	$ 56,553	**$ 60,373**

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

BELLSOUTH CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN MILLIONS)

(Unaudited)

	For the Nine Months Ended September 30, 2005	**2006**
Cash Flows from Operating Activities:		
Net income	$ 2,676	**$ 2,730**
Less income from discontinued operations, net of tax	(381)	
Income from continuing operations	$ 2,295	**$ 2,730**
Adjustments to reconcile income to cash provided by operating activities from continuing operations:		
Depreciation and amortization	2,756	**2,685**
Provision for uncollectibles	258	**230**
Net earnings of equity affiliates	(85)	**(694)**
Deferred income taxes	51	**165**
Pension income	(399)	**(391)**
Stock-based compensation expense	70	**45**
Loss on extinguishment of debt	42	
Gain on sale of operations	(351)	
Asset impairments	166	
Net change in:		
Accounts receivable and other current assets	(174)	**(275)**
Accounts payable and other current liabilities	1,009	**447**
Deferred charges and other assets	(79)	**(49)**
Other liabilities and deferred credits	337	**332**
Other reconciling items, net	38	**43**
Net cash provided by operating activities from continuing operations	5,934	**5,268**
Cash Flows from Investing Activities:		
Capital expenditures	(2,465)	**(2,761)**
Investment in short-term instruments	(88)	**(5,227)**
Proceeds from sale of short-term instruments	104	**3,901**
Proceeds from sale of operations	1,555	
Investments in debt and equity securities	(156)	**(819)**
Proceeds from sale of debt and equity securities	45	**289**
Net repayments from (advances to) Cingular Wireless	1,736	**(416)**
Other investing activities, net	(37)	**(32)**
Net cash provided by (used for) investing activities from continuing operations	694	**(5,065)**
Cash Flows from Financing Activities:		
Net borrowings (repayments) of short-term debt	(2,110)	**234**
Proceeds from issuance of long-term debt		**1,200**
Repayments of long-term debt	(1,500)	**(433)**
Dividends paid	(1,520)	**(1,572)**
Purchase of treasury shares	(137)	**(52)**
Proceeds from issuing common stock	60	**654**
Other financing activities, net	44	**70**
Net cash (used in) provided by financing activities from continuing operations	(5,163)	**101**
Net increase in cash and cash equivalents from continuing operations	1,465	**304**

Cash flows from discontinued operations:

Net cash provided by operating activities	10	
Net cash used for investing activities	(125)	
Net cash provided by financing activities		
Net decrease in cash and cash equivalents from discontinued operations	(115)	
Net increase in cash and cash equivalents	1,350	**304**
Cash and cash equivalents at beginning of period	680	**427**
Cash and cash equivalents at end of period	$ 2,030	**$ 731**

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				
		(a)					(a)
		Shares Held in Trust and Treasury					Shares
	Common Stock		Common Stock	Paid-in Capital	Retained Earnings	Accum. Other Comprehensive Income (Loss)	
Balance at December 31, 2004	**2,020**	**(189)**	**$ 2,020**	**$ 7,840**	**$ 19,267**	**$ (157)**	**$ (5,9**
Net income					2,676		
Other comprehensive income, net of tax						129	
Total comprehensive income							
Dividends declared					(1,556)		
Purchase of treasury stock		(5)					(137)
Share issuances for employee benefit plans		5		(54)	(61)		176
Stock-based compensation				70			
Tax benefit related to stock options				5			
Balance at September 30, 2005	**2,020**	**(189)**	**$ 2,020**	**$ 7,861**	**$ 20,326**	**$ (28)**	**$ (5,8**
Balance at December 31, 2005	**2,020**	**(222)**	**$ 2,020**	**$ 7,960**	**$ 20,383**	**$ (14)**	**$ (6,8**
Net income					2,730		
Other comprehensive income, net of tax						49	
Total comprehensive income							
Dividends declared					(1,571)		
Purchase of treasury stock		(2)					(52)

Share issuances for employee benefit plans		26		(144)	(17)		838
Purchases and sales of treasury stock with grantor trusts				245			(245)
Stock-based compensation				45			
Tax benefit related to stock options				24			
Balance at September 30, 2006	**2,020**	**(198)**	**$ 2,020**	**$ 8,130**	**$ 21,525**	**$ 35**	**$ (6,2**

(a) Trust and treasury shares are not considered to be outstanding for financial reporting purposes.

	As of September 30,	
	2005	**2006**
Shares held in trust	26	**8**
Shares held in treasury	163	**190**
Total	189	**198**

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

BELLSOUTH CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

(Unaudited)

NOTE A - PREPARATION OF INTERIM FINANCIAL STATEMENTS

In this report, BellSouth Corporation and its subsidiaries are referred to as we , the Company , 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 presented. 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 annual report on Form 10-K for the year ended December 31, 2005.

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

NOTE B RECENTLY ISSSUED ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 158, "Employers Accounting for Defined Benefit Pension and Other Postretirement Plans" (SFAS No. 158). SFAS No. 158 amends FASB Statements No. 87, 88, 106, and 132(R) by requiring recognition of the over-funded or under-funded status of our defined benefit postretirement plans as assets or liabilities in our statement of financial position and to recognize changes in that funded status through comprehensive income in the year in which the changes occur. SFAS No. 158 is effective for BellSouth on a prospective basis beginning December 31, 2006. We are currently evaluating the impact SFAS No. 158 will have on our financial statements. If the standard had been applied based on balances as of December 31, 2005, net liabilities would have increased $2.9 billion with a corresponding decline in equity.

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." This Interpretation prescribes a recognition threshold and measurement attribute of tax positions taken or expected to be taken on a tax return. This Interpretation is effective for BellSouth beginning January 1, 2007. We are currently evaluating the impact FIN 48 will have on our financial statements.

NOTE C - EARNINGS PER SHARE

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	**2006**	2005	**2006**
Basic common shares outstanding	1,831	**1,814**	1,831	**1,806**
Incremental shares from stock-based compensation and benefit plans	5	**8**	4	**7**
Diluted common shares outstanding	1,836	**1,822**	1,835	**1,813**
Common stock equivalents excluded from the computation	77	**44**	77	**57**

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

NOTE D DISCONTINUED OPERATIONS

In March 2004, we signed an agreement with Telefónica Móviles, S.A., the wireless affiliate of Telefónica, S.A., to sell all of our interests in Latin America. During 2004, we closed on the sale of 8 of the 10 properties. During January 2005, we closed on the sale of the operations in the remaining two Latin American countries for gross proceeds of $1,077 and a gain of $390, net of tax. The gain includes the recognition of cumulative foreign currency translation losses of $68.

BELLSOUTH CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

NOTE D DISCONTINUED OPERATIONS (Continued)

Summarized results of operations for the discontinued operations for the nine months ended September 30, 2005 are as follows:

	2005
Revenue	$ 66
Operating loss	(5)
Gain on sale of operations	629
Income before income taxes	616
Income tax expense	235
Income from discontinued operations	$ 381

NOTE E - MERGER OF BELLSOUTH AND AT&T

On March 4, 2006, we agreed to merge with a subsidiary of AT&T Inc. (AT&T) in a transaction in which each share of BellSouth common stock will be exchanged for 1.325 shares of AT&T common stock. The stock consideration in the transaction is expected to be tax-free to our shareholders. On July 21, 2006, AT&T and BellSouth received approval from their stockholders for AT&T to acquire BellSouth. The acquisition is subject to approval by regulatory authorities and to other customary closing conditions. The US Department of Justice cleared the merger on October 11, 2006. The Federal Communications Commission has scheduled a meeting to vote on the merger on November 3, 2006. The acquisition is currently expected to close in the fall of 2006. However, it is possible that factors outside of our control could require us to complete the merger at a later time or not to complete it at all. The terms of certain of our agreements, including contracts, employee benefit arrangements and debt instruments, have provisions which could result in changes to the terms of these agreements upon a change in control of BellSouth.

NOTE F - INVESTMENTS IN AND ADVANCES TO CINGULAR WIRELESS

Investment

We own a 40 percent economic interest in Cingular Wireless, a joint venture with AT&T. Because we exercise influence over the financial and operating policies of Cingular Wireless, we use the equity method of accounting for this investment. Under the equity method of accounting, we record our proportionate share of Cingular Wireless' earnings in our consolidated statements of income. These earnings are included in the caption "Net earnings (losses) of equity affiliates."

The following table displays the summary financial information of Cingular Wireless. These amounts are shown on a 100 percent basis.

	December 31, 2005	September 30, 2006
Balance Sheet Information:		
Current assets	$ 6,049	**$ 6,826**
Noncurrent assets	$ 73,270	**$ 73,466**
Current liabilities	$ 10,008	**$ 9,543**
Noncurrent liabilities	$ 23,790	**$ 23,486**
Minority interest	$ 543	**$ 618**
Members capital	$ 44,978	**$ 46,645**

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	**2006**	2005	**2006**
Income Statement Information:				
Revenues	$ 8,746	**$ 9,553**	$ 25,584	**$ 27,751**
Operating income	$ 657	**$ 1,416**	$ 1,275	**$ 3,240**
Net income (loss)	$ 222	**$ 847**	$ 129	**$ 1,741**

As of September 30, 2006, our book investment exceeded our proportionate share of the net assets of Cingular Wireless by $456.

BELLSOUTH CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

NOTE F - INVESTMENTS IN AND ADVANCES TO CINGULAR WIRELESS (Continued)

Advance

We have an advance to Cingular Wireless that, with interest, totaled $2,622 at December 31, 2005 and September 30, 2006. This advance earns an interest rate of 6.0 percent per annum and matures on June 30, 2008.

Revolving Line of Credit

BellSouth and AT&T provide unsubordinated short-term financing on a pro rata basis for Cingular Wireless ordinary course of business cash requirements. Under the terms of the line of credit, Cingular Wireless available cash (as defined), if any, is applied first to repay amounts loaned to Cingular Wireless under the line of credit. Remaining available cash is applied to the repayment of the advance described above. Borrowings bear interest at 1-Month LIBOR plus 0.05 percent payable monthly. The line of credit terminates on July 31, 2007. Borrowings from BellSouth under the revolving credit line, including interest, were $204 at December 31, 2005 and $621 at September 30, 2006.

Provision of Services

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

Interest and Revenue Earned from Cingular Wireless:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	**2006**	2005	**2006**
Revenues	$ 193	**$ 214**	$ 527	**$ 607**
Interest income on advances	$ 47	**$ 49**	$ 163	**$ 140**
Interest expense on line of credit	$ 2	**$**	$ 2	**$**

Interest income on advances and interest expense on the line of credit are offset by a like amount of interest expense and interest income recorded by Cingular Wireless and reported in our financial statements in the caption Net earnings (losses) of equity affiliates.

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

	December 31, 2005	**September 30, 2006**
Receivable from Cingular	$ 51	**$ 73**
Payable to Cingular	$ 54	**$ 60**

NOTE G - DEBT

Issuances & Maturities

On August 2, 2006, we sold $1,200 of 2-year, floating rate notes due August 15, 2008. In addition, we incurred debt issuance costs of $2 related to this transaction.

The proceeds were used in part to fund $1,000 of maturing 5-year, 5.0 percent notes on October 16, 2006.

Early Redemptions

On January 18, 2005, we redeemed $400 of 40-year, 6.75 percent debentures, due October 15, 2033. The redemption price was 103.33 percent of the principal amount, and resulted in recognition of a loss of $22, or $14 net of tax, which includes $9 associated with fully expensing remaining discount and deferred debt issuance costs.

On May 18, 2005 we redeemed $300 of 40-year, 7.625 percent debentures, due May 15, 2035. The redemption price was 103.66 percent of the principal amount, and resulted in recognition of a loss of $20, or $12 net of tax, which includes $9 associated with fully expensing remaining discount and deferred debt issuance costs.

NOTE H - WORKFORCE REDUCTION AND RESTRUCTURING

Based on competitive activity in the telecommunications industry, realignment of our business and productivity improvements, we have periodically initiated workforce reductions and recorded charges for early termination benefits.

BELLSOUTH CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

NOTE H - WORKFORCE REDUCTION AND RESTRUCTURING (Continued)

In December 2005, we announced that we would reduce our management workforce by approximately 1,500 employees. The plan included a voluntary program offering a special termination benefit followed by an involuntary program to the extent necessary to achieve the targeted reductions. As a result of the pending merger of BellSouth and AT&T, we modified the terms of the fourth quarter 2005 announced workforce reduction by eliminating the involuntary component that was scheduled to follow the voluntary offer. Accordingly, in the first quarter of 2006 we reversed the minimum liability accrued (except with respect to the 60 employees who had already accepted under that program). Based on the acceptances of the voluntary offer, we accrued $73 for the second quarter of 2006 and $127 for the first half of 2006. Under the modified plan, we reduced our management workforce by approximately 1,350 employees. This reduction program was substantially complete at the end of June 2006.

In addition, we recorded restructuring charges totaling $7 for non-management surpluses announced in the third quarter of 2006 and $31 for the nine months ended September 30, 2006.

The following table summarizes activity associated with the workforce reduction and restructuring liability for the nine months ended September 30, 2006:

Balance at December 31, 2005	$ 100
Accruals	158
Cash Payments	(151)
Adjustments	(86)
Balance at September 30, 2006	**$ 21**

Adjustments to the employee separations accrual are due to the reversal noted above for $77 as well as estimated demographics being different than actual demographics of employees that separated from the Company.

NOTE I - EMPLOYEE BENEFITS PLANS

Substantially all of our employees are covered by noncontributory defined benefit pension plans. We provide certain medical, dental and life insurance benefits to substantially all retired employees under various plans and accrue actuarially-determined postretirement benefit costs as active employees earn these benefits. Management employees hired after January 1, 2001 are provided access to medical benefits at retirement but are required to pay 100 percent of the cost.

The following details pension and postretirement benefit costs included in operating expenses (in cost of sales and selling, general and administrative expenses) in the accompanying Consolidated Statements of Income. Approximately 10 percent of these costs are capitalized to property, plant and equipment with labor related to network construction. During the quarter, lump sum distributions from our management pension plan exceeded the settlement threshold equal to the sum of the service cost and interest cost components of net periodic pension cost; therefore, we recognized a settlement gain in addition to our normal periodic cost. Components of net periodic benefit costs were as follows:

	Pension Benefits For the Three Months Ended September 30,		**Other Benefits** For the Three Months Ended September 30,	
	2005	**2006**	2005	**2006**
Service cost	$ 52	**$ 49**	$ 31	**$ 31**
Interest cost	147	**150**	145	**146**
Expected return on plan assets	(322)	**(319)**	(84)	**(86)**
Amortizations:				
Unrecognized net obligation			19	**12**
Unrecognized prior service cost	(10)	**(10)**	56	**45**
Unrecognized (gain) loss			26	**29**
Net periodic benefit cost (income)	$ (133)	**$ (130)**	$ 193	**$ 177**
Settlements		**(8)**		
Net periodic benefit cost (income), adjusted	$ (133)	**$ (138)**	$ 193	**$ 177**

BELLSOUTH CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

NOTE I - EMPLOYEE BENEFITS PLANS (Continued)

	Pension Benefits For the Nine Months Ended September 30,		Other Benefits For the Nine Months Ended September 30,	
	2005	**2006**	2005	**2006**
Service cost	$ 155	**$ 147**	$ 92	**$ 94**
Interest cost	441	**449**	437	**438**
Expected return on plan assets	(964)	**(956)**	(252)	**(260)**
Amortizations:				
Unrecognized net obligation			55	**38**
Unrecognized prior service cost	(31)	**(31)**	169	**135**
Unrecognized (gain) loss			77	**86**
Net periodic benefit cost (income)	$ (399)	**$ (391)**	$ 578	**$ 531**
Settlements		**(8)**		
Net periodic benefit cost (income), adjusted	$ (399)	**$ (399)**	$ 578	**$ 531**

Employer Contributions

Due to the funded status of our pension plans, we do not expect to make contributions to these plans in 2006. Consistent with prior years, we expect to contribute cash to the Voluntary Employee Beneficiary Association trusts to fund other benefit payments. During the nine months ended September 30, 2006, we contributed $268 to fund these other benefits and expect to contribute approximately $80 to $130 during the remainder of 2006.

Cash Balance Pension Plans

In July 2003, a Federal district court in Illinois ruled that the benefit formula used in International Business Machines Corporation's (IBM) cash balance pension plan violated the age discrimination provisions of the Age Discrimination in Employment Act (ADEA) and certain provisions of the Employee Retirement Income Security Act (ERISA). Subsequent opinions of several other courts have conflicted with that court's view, while others have agreed. Recently, the Seventh Circuit Court of Appeals overturned the district court's opinion in the IBM case and determined that cash balance pension plan formulas are not inherently age discriminatory. Further, recent legislation, the Pension Protection Act of 2006, specifically validated prospectively the legal status of certain cash balance designs, including the types of cash balance formulas specified under our tax-qualified cash balance pension plans. At this time, it is unclear what effect, if any, the remaining negative decisions regarding cash balance formulas may have on our tax-qualified cash balance pension plans or our financial condition.

NOTE J - STOCK COMPENSATION PLANS

We have granted stock-based compensation awards to key employees under several plans. One share of BellSouth common stock is the underlying security for any award under these plans. Under the stock plan approved by shareholders in 2004, the maximum number of shares available for future grants is limited to 80 million reduced by awards granted and increased by shares tendered in option exercises. In 2003, we used the retroactive restatement method provided by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, to adopt the expense recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, (SFAS No. 123) by restating all periods beginning on or after January 1, 1995 (the effective date of SFAS No. 123). Effective January 1, 2006, we adopted SFAS No. 123 (Revised 2004), Share-Based Payment, (SFAS No. 123R) using the modified prospective application of its provisions; therefore, our financial statements for prior periods will not be restated. The cumulative effect of adopting SFAS No. 123R was immaterial. Because we previously adopted the expense recognition provisions of SFAS No. 123, the impact of adopting SFAS No. 123R resulted in essentially three changes: (1) use of an estimated forfeiture rate versus recognition of actual forfeitures as incurred, (2) use of fair value to measure expense for awards classified as liabilities, and (3) use of the alternative transition method to calculate the pool of excess tax benefits available to absorb tax deficiencies in future years, which increased the pool by $130. Effective with the adoption of SFAS No. 123R, we instituted a policy of recognizing expense for awards with graded vesting provisions using the straight-line method of expense attribution.

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

BELLSOUTH CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

NOTE J - STOCK COMPENSATION PLANS (Continued)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
Compensation cost:	2005	**2006**	2005	**2006**
Stock options	$ 9	**$ 2**	$ 32	**$ 9**
Restricted stock and restricted stock units	13	**12**	39	**36**
Performance share units	19	**57**	49	**133**
Total compensation cost	41	**71**	120	**178**
Income tax benefit	(15)	**(27)**	(44)	**(69)**
Compensation cost net of income tax benefit	$ 26	**$ 44**	$ 76	**$ 109**

Stock Option Awards

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

	Number of options	Weighted- average option prices per common share	Weighted- average remaining contractual term in years	Aggregate intrinsic value
Outstanding at December 31, 2005	96,802,789	$36.12		
Granted				
Exercised	(26,430,051)	$25.97		
Forfeited or expired	(2,443,580)	$38.58		
Outstanding at September 30, 2006	67,929,158	$39.97	3.98	$252
Exercisable at September 30, 2006	65,928,420	$40.33	3.91	$223

As of September 30, 2006, total compensation cost related to unvested stock options of $1 is expected to be amortized by the end of 2006. Information related to stock option exercises is provided below:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	**2006**	2005	**2006**
Total value received by employees for options exercised	$ 6	**$ 109**	$ 23	**$ 246**
Tax benefit realized for options exercised	$ 2	**$ 40**	$ 8	**$ 91**
Cash received for options exercised	$ 22	**$ 274**	$ 60	**$ 654**

Restricted Stock and Restricted Stock Unit Awards

Restricted stock and restricted stock unit awards granted to key employees under the plans are settled by issuing shares of common stock at the vesting date. Generally, the restrictions lapse in full on the third anniversary of the grant date, or on a pro rata basis on each of the first three anniversaries of the grant date. The vesting of restricted stock and restricted stock units accelerates if there is a change in control (as defined in the plans) and the employee is terminated or resigns for good reason within two years of the change in control. The grant date fair value of the restricted stock and restricted stock units, which is the stock price on the grant date, is expensed over the period during which the restrictions lapse. The shares represented by restricted stock awards (but not restricted stock unit awards) are considered outstanding at the grant date, as the recipients are entitled to dividends and voting rights. A summary of restricted stock and restricted stock unit activity under the plans is presented below:

	Number of shares & units	Weighted-average grant date fair value
Unvested at December 31, 2005	4,270,080	$27.02
Granted	1,604,386	$31.88
Vested	(848,920)	$27.52
Forfeited	(190,625)	$28.55
Unvested at September 30, 2006	4,834,921	$28.48

BELLSOUTH CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

NOTE J - STOCK COMPENSATION PLANS (Continued)

The weighted-average grant date fair value of restricted stock and restricted stock units granted during the three months ended September 30, 2005 and 2006 was $26.90 and $38.79, respectively. The weighted-average grant date fair value of restricted stock and restricted stock units granted during the nine months ended September 30, 2005 and 2006 was $26.06 and $31.88, respectively. As of September 30, 2006, the total unrecognized compensation cost for unvested restricted stock and restricted stock units of $65 is expected to be amortized over a weighted-average period of approximately 14 months. Information related to shares vested is provided below:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	**2006**	2005	**2006**
Total value received by employees for shares vested	$ 1	**$ 1**	$ 16	**$ 27**
Tax benefit realized for shares vested	$	**$**	$ 4	**$ 9**

Performance Share Unit Awards

Performance share units granted to key employees are settled in cash based on an average stock price at the end of the three-year performance period multiplied by the number of units earned. The number of performance share units actually earned by recipients is based on the achievement of certain performance goals as defined by the terms of the awards, and can range from 0% to 150% of the number of units granted. At the end of the performance period, recipients also receive a cash payment equal to the dividends paid on a share of BellSouth stock during the performance period for each performance share unit earned. Vesting accelerates and the performance period is modified if there is a change in control (as defined in the plans). For awards granted prior to 2006, performance share unit expense is generally recognized over the performance period; for awards granted in 2006, performance share unit expense is recognized over the vesting period, which approximates the performance period. Since performance share units are settled in cash, our obligations related to these awards are classified as liabilities. A summary of performance share unit activity under the plans is presented below:

	Number of units
Unvested at December 31, 2005	5,857,605
Granted	2,259,675
Vested	
Forfeited	(101,070)
Unvested at September 30, 2006	8,016,210

Effective with the adoption of the provisions of SFAS No. 123R on January 1, 2006, the amount of expense recognized for all unvested performance share units is based on the fair value of the performance shares at each reporting date and, as applicable, the expected outcome of performance conditions. The fair value of each performance share unit is determined at the grant date and at each reporting date using a Monte Carlo simulation model. The simulation model includes ranges of assumptions for stock price volatility, risk-free interest rates, and expected dividends. Expected volatilities for the three unvested awards are estimated based on a blend of historical volatility of our stock and implied volatilities from traded options on our stock and are currently estimated at 19% to 20%. The risk-free interest rate for periods within each performance period is based on the US Treasury yield curve in effect at the valuation date and currently ranges from 4.72% to 5.01%. Expected dividends are estimated based on historical patterns of increases.

The weighted-average fair value of unvested performance share units as of September 30, 2006 was $47.83, and the total unrecognized compensation cost of $181, based on this value, is expected to be amortized over a weighted-average period of approximately 15 months. Information related to performance share units vested and paid is provided below:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2005	**2006**	2005	**2006**
Total value received by employees for units vested and paid	$ 5	**$ 14**	$ 12	**$ 35**
Tax benefit realized for units vested and paid	$ 2	**$ 6**	$ 4	**$ 14**

NOTE K - SEGMENT INFORMATION

We have three reportable operating segments: (1) Communications Group; (2) Wireless; and (3) Advertising & Publishing Group. We own a 40 percent economic interest in Cingular Wireless, and share joint control of the venture with AT&T. We account for the investment under the equity method. For management purposes we evaluate our Wireless segment

BELLSOUTH CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

NOTE K - SEGMENT INFORMATION (Continued)

based on our proportionate share of Cingular Wireless results. Accordingly, results for our Wireless segment reflect the proportional consolidation of 40 percent of Cingular Wireless results.

The Company s chief decision makers evaluate the performance of each business unit based on segment 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.

The following table provides information for each operating segment:

	For the Three Months Ended September 30, 2005	2006	For the Nine Months Ended September 30, 2005	2006
Communications Group				
External revenues	$ 4,558	**$ 4,669**	$ 13,749	**$ 13,969**
Intersegment revenues	30	**27**	82	**79**
Total segment revenues	4,588	**4,696**	13,831	**14,048**
Segment operating income	1,021	**1,205**	3,228	**3,474**
Segment net income	$ 611	**$ 720**	$ 1,935	**$ 2,072**
Wireless				
Total segment revenues	$ 3,499	$ **3,821**	$ 10,234	**$ 11,100**
Segment operating income	555	**748**	1,301	**1,914**
Segment net income	$ 242	**$ 360**	$ 477	**$ 879**
Advertising & Publishing Group				
External revenues	$ 506	$ **535**	$ 1,521	$ **1,581**
Intersegment revenues	3	**2**	10	**9**
Total segment revenues	509	**537**	1,531	**1,590**
Segment operating income	233	**245**	709	**723**
Segment net income	$ 146	**$ 154**	$ 441	**$ 450**

RECONCILIATION TO CONSOLIDATED FINANCIAL INFORMATION

For the Three Months For the Nine Months

	Ended September 30, 2005	Ended September 30, **2006**	Ended September 30, 2005	Ended September 30, **2006**
Operating revenues				
Total reportable segments	$ 8,596	$ **9,054**	$ 25,596	$ **26,738**
Cingular proportional consolidation	(3,499)	**(3,821)**	(10,234)	**(11,100)**
Corporate, eliminations and other	(25)	**(15)**	(57)	**(43)**
Total consolidated	$ 5,072	$ **5,218**	$ 15,305	$ **15,595**
Operating income				
Total reportable segments	$ 1,809	$ **2,198**	$ 5,238	$ **6,111**
Cingular proportional consolidation	(555)	**(748)**	(1,301)	**(1,914)**
Hurricane Katrina-related expenses, net	(124)		(124)	**(119)**
Asset impairment	(166)		(166)	
AT&T merger costs		**(17)**		**(44)**
Severance charges				**(73)**
Corporate, eliminations and other	7	**12**	26	**35**
Total consolidated	$ 971	$ **1,445**	$ 3,673	$ **3,996**

BELLSOUTH CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

NOTE K - SEGMENT INFORMATION (Continued)

RECONCILIATION TO CONSOLIDATED FINANCIAL INFORMATION (Continued)

	For the Three Months Ended September 30, 2005	2006	For the Nine Months Ended September 30, 2005	2006
Net Income				
Total reportable segments	$ 999	$ **1,234**	$ 2,853	$ **3,401**
Wireless merger intangible amortization	(93)	**(75)**	(284)	**(240)**
Wireless merger integration costs	(56)	**(33)**	(119)	**(127)**
Hurricane Katrina-related expenses, net	(98)		(98)	**(73)**
Asset impairment	(102)		(102)	
AT&T merger costs		**(13)**		**(30)**
Severance charges				**(45)**
Early extinguishment of debt			(26)	
Gain on sale of operations	228		228	
Discontinued operations			381	
Corporate, eliminations and other	(61)	**(54)**	(157)	**(156)**
Total consolidated	$ 817	$ **1,059**	$ 2,676	$ **2,730**

NOTE L - OTHER COMPREHENSIVE INCOME

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

	December 31, 2005	**September 30, 2006**
Cumulative foreign currency translation adjustments	$ (2)	**$ (2)**
Minimum pension liability adjustment	(133)	**(125)**
Net unrealized gains on derivatives	5	**5**
Net unrealized gains on securities	116	**157**
	$ (14)	**$ 35**

Total comprehensive income details are presented in the table below:

	For the Three Months Ended September 30, 2005	2006	For the Nine Months Ended September 30, 2005	2006
Net Income	$ 817	**$ 1,059**	$ 2,676	**$ 2,730**

Other comprehensive income, net of tax:				
Foreign currency translation:				
Adjustments	(11)		(1)	
Sale of foreign entities	10		78	
	(1)		77	
Minimum pension liability adjustment, net of tax		**3**		**8**
Deferred gains on derivatives:				
Deferred gains	5		16	
Reclassification adjustment for (gains) losses included in net income	(1)		(1)	
	4		15	
Unrealized gains (losses) on securities:				
Unrealized holdings gains (losses)	35	**22**	34	**48**
Reclassification adjustment for (gains) losses included in net income	4	**(9)**	3	**(7)**
	39	**13**	37	**41**
Other comprehensive income	42	**16**	129	**49**
Total comprehensive income	$ 859	**$ 1,075**	$ 2,805	**$ 2,779**

BELLSOUTH CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

NOTE M - CONTINGENCIES

GUARANTEES

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

LEGAL PROCEEDINGS

Regulatory-related claims

In May 2005, we sued AT&T in the U.S. District Court for the Northern District of Georgia for unpaid access charges associated with AT&T s prepaid calling cards and its IP in the middle services that use Internet Protocol technology for internal call processing but use the public switched network to originate and terminate calls. The lawsuit follows two separate rulings by the Federal Communications Commission (FCC), one in April 2004 concerning IP in the middle services and one in February 2005 concerning prepaid card services, that each service was a telecommunications service subject to access charges. AT&T estimated in securities filings that it had saved $340 in access charges on its prepaid card services and $250 in access charges on its IP in the middle services. We believe that some of the improperly avoided access charges should have been paid to us for the use of our network. AT&T appealed the FCC s decision relating to the prepaid card services to the Court of Appeals for the D.C. Circuit, which denied the appeal in July 2006. If the U.S. District Court lawsuit in Georgia progresses, we expect to obtain information from AT&T and other sources that will determine the amount of BellSouth access charges AT&T avoided. In addition, AT&T has asserted certain defenses against BellSouth and has filed the New York lawsuit described below in an effort to reduce any amount it may owe to BellSouth. In April 2006, BellSouth and AT&T agreed to stay the U.S. District Court lawsuit in Georgia until the earlier of 12 months or the consummation or termination of the Merger Agreement between BellSouth and AT&T. At this time, the likely outcome of the case cannot be predicted, nor can a reasonable estimate of the amount of gain, if any, be made. Accordingly, no revenue has been recognized with respect to this matter in our consolidated financial statements.

On November 4, 2005, AT&T sued BellSouth Long Distance, Inc. (BSLD) and Qwest Communications Corporation (Qwest) in the U.S. District Court for the Southern District of New York. AT&T has asserted claims of breach of contract, fraudulent misrepresentation and unjust enrichment against BSLD and related claims against Qwest. AT&T s claims arise from a contract with BSLD pursuant to which BSLD purchased wholesale long distance minutes that it resold to Qwest. The complaint does not specify the amount of damages sought by AT&T. The parties have agreed to stay the New York lawsuit pending the arbitration of the dispute between AT&T and BSLD. To date, no arbitration has been initiated by AT&T. At this time, the likely outcome of the case cannot be predicted, nor can a reasonable estimate of the amount of loss, if any, be made.

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

Employment claim

On April 29, 2002, five African-American employees filed a putative class action lawsuit, captioned *Gladys Jenkins et al. v. BellSouth Corporation,* against the Company in the U.S. 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

BELLSOUTH CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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(Unaudited)

NOTE M - CONTINGENCIES (Continued)

Telecommunications at any time since April 29, 1998, and a class of all African-American salaried workers employed by BellSouth Telecommunications at any time since April 29, 1998 in management positions at or below Job Grade 59/Level C. The plaintiffs are seeking unspecified amounts of back pay, benefits, punitive damages and attorneys fees and costs, as well as injunctive relief. The District Court denied plaintiffs motion for class certification on September 19, 2006. The plaintiffs have filed a motion for reconsideration of the class certification ruling.

Securities and ERISA claims

From August through October 2002, several individual shareholders filed substantially identical class action lawsuits against BellSouth and three of its senior officers alleging violations of the federal securities laws. The parties have reached a settlement agreement, subject to court approval, pursuant to which the class will receive $35 (all of which will be funded by insurance except for a $2.5 deductible).

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. We believe the settlement in the securities case described above will also resolve the claims brought in this litigation.

In September and October 2002, three substantially identical class action lawsuits were filed in the U.S. 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). Subject to approval of the court, the parties reached a settlement of the ERISA lawsuits. The settlement is on behalf of the Plans and certain participants who brought claims individually and on behalf of the Plans pursuant to ERISA section 502(a)(2). BellSouth does not expect the settlement to have a material effect on the Company. The principal terms of the settlement increase the minimum levels below which the Company matching contributions may not fall for a three-year period. The settlement does not require any other unreimbursed cash payments by the Company.

Antitrust claims

In December 2002, a consumer class action alleging antitrust violations of Section 1 of the Sherman Antitrust Act was filed against BellSouth, Verizon, AT&T (formerly known as SBC) and Qwest, captioned *William Twombly, et al v. Bell Atlantic Corp., et al,* in U.S. District Court for the Southern District of New York. The complaint alleged that defendants conspired to restrain competition by agreeing not to compete with one another and to impede competition with others. The plaintiffs are seeking an unspecified amount of treble damages and injunctive relief, as well as attorneys fees and expenses. In October 2003, the district court dismissed the complaint for failure to state a claim. In October 2005, the Second Circuit Court of Appeals reversed the District Court s decision and remanded the case to the District Court. In June 2006, the U.S. Supreme Court granted the defendants petition for writ of certiorari. At this time, the likely outcome of the case cannot be predicted, nor can a reasonable estimate of the amount of loss, if any, be made.

Other claims

We are subject to claims arising in the ordinary course of business involving allegations of personal injury, breach of contract, anti-competitive conduct, employment law issues, regulatory matters and other actions. BellSouth Telecommunications, Inc. is also subject to claims attributable to pre-divestiture events, including environmental liabilities, rates and contracts. Certain contingent liabilities for pre-divestiture events are shared with AT&T. 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 N - SUBSIDIARY FINANCIAL INFORMATION

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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(Unaudited)

NOTE N - SUBSIDIARY FINANCIAL INFORMATION (Continued)

Condensed Consolidating Statements of Income

	For the Three Months Ended September 30, 2005				
	BST	Other	Parent	Adjustments	Total
Total operating revenues	$ 4,165	$ 1,810	$	$ (903)	$ 5,072
Total operating expenses	4,065	1,366	(6)	(1,324)	4,101
Operating income (loss)	100	444	6	421	971
Interest expense	129	7	222	(84)	274
Net earnings (losses) of equity affiliates	292	96	819	(1,110)	97
Other income (expense), net	6	400	52	(43)	415
Income (loss) from continuing operations before income taxes	269	933	655	(648)	1,209
Provision (benefit) for income taxes	(28)	411	(162)	171	392
Income (loss) from continuing operations	297	522	817	(819)	817
Income (loss) from discontinued operations, net of tax					
Net income (loss)	$ 297	$ 522	$ 817	$ (819)	$ 817

	For the Three Months Ended September 30, 2006				
	BST	**Other**	**Parent**	**Adjustments**	**Total**
Total operating revenues	**$ 4,230**	**$ 1,757**	**$**	**$ (769)**	**$ 5,218**
Total operating expenses	**3,677**	**1,214**	**20**	**(1,138)**	**3,773**
Operating income (loss)	**553**	**543**	**(20)**	**369**	**1,445**
Interest expense	**152**	**9**	**251**	**(110)**	**302**
Net earnings (losses) of equity affiliates	**257**	**352**	**1,154**	**(1,421)**	**342**
Other income (expense), net	**14**	**45**	**99**	**(68)**	**90**
Income (loss) from continuing operations before income taxes	**672**	**931**	**982**	**(1,010)**	**1,575**
Provision (benefit) for income taxes	**139**	**299**	**(77)**	**155**	**516**
Income (loss) from continuing operations	**533**	**632**	**1,059**	**(1,165)**	**1,059**
Income (loss) from discontinued operations, net of tax					
Net income (loss)	**$ 533**	**$ 632**	**$ 1,059**	**$ (1,165)**	**$ 1,059**

	For the Nine Months Ended September 30, 2005				
	BST	Other	Parent	Adjustments	Total
Total operating revenues	$ 12,567	$ 5,329	$	$ (2,591)	$ 15,305
Total operating expenses	11,543	3,927	3	(3,841)	11,632
Operating income (loss)	1,024	1,402	(3)	1,250	3,673
Interest expense	375	14	668	(207)	850
Net earnings (losses) of equity affiliates	855	86	2,494	(3,350)	85
Other income (expense), net	(24)	505	161	(115)	527
	1,480	1,979	1,984	(2,008)	3,435

Income (loss) from continuing operations before income taxes					
Provision (benefit) for income taxes	184	771	(311)	496	1,140
Income (loss) from continuing operations	1,296	1,208	2,295	(2,504)	2,295
Income (loss) from discontinued operations, net of tax		381	381	(381)	381
Net income (loss)	$ 1,296	$ 1,589	$ 2,676	$ (2,885)	$ 2,676

	For the Nine Months Ended September 30, 2006				
	BST	**Other**	**Parent**	**Adjustments**	**Total**
Total operating revenues	**$ 12,652**	**$ 5,503**	**$**	**$ (2,560)**	**$ 15,595**
Total operating expenses	**11,409**	**3,913**	**(16)**	**(3,707)**	**11,599**
Operating income (loss)	**1,243**	**1,590**	**16**	**1,147**	**3,996**
Interest expense	**455**	**24**	**715**	**(334)**	**860**
Net earnings (losses) of equity affiliates	**807**	**704**	**2,974**	**(3,791)**	**694**
Other income (expense), net	**24**	**141**	**253**	**(206)**	**212**
Income (loss) from continuing operations before income taxes	**1,619**	**2,411**	**2,528**	**(2,516)**	**4,042**
Provision (benefit) for income taxes	**252**	**787**	**(202)**	**475**	**1,312**
Income (loss) from continuing operations	**1,367**	**1,624**	**2,730**	**(2,991)**	**2,730**
Income (loss) from discontinued operations, net of tax					
Net income (loss)	**$ 1,367**	**$ 1,624**	**$ 2,730**	**$ (2,991)**	**$ 2,730**

BELLSOUTH CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(Unaudited)

NOTE N - SUBSIDIARY FINANCIAL INFORMATION (Continued)

Condensed Consolidating Balance Sheets

	December 31, 2005					**September 30, 2006**				
	BST	Other	Parent	Adjust- ments	Total	**BST**	**Other**	**Parent**	**Adjust- ments**	**Total**
ASSETS										
Current assets:										
Cash and cash equivalents	$ 98	$ 141	$ 138	$ 50	$ 427	**$ 4**	**$ 108**	**$ 576**	**$ 43**	**$ 731**
Short-term investments								**1,327**		**1,327**
Accounts receivable, net	25	2,058	4,510	(4,038)	2,555	**58**	**1,029**	**4,194**	**(2,719)**	**2,562**
Other current assets	537	531	39	120	1,227	**507**	**519**	**84**	**201**	**1,311**
Total current assets	660	2,730	4,687	(3,868)	4,209	**569**	**1,656**	**6,181**	**(2,475)**	**5,931**
Investments in and advances to Cingular Wireless		21,069	205		21,274		**21,736**	**621**		**22,357**
Property, plant and equipment, net	21,045	644	3	31	21,723	**21,176**	**590**	**2**	**52**	**21,820**
Deferred charges and other assets	9,117	611	34,322	(36,236)	7,814	**9,529**	**548**	**35,671**	**(37,023)**	**8,725**
Intangible assets, net	1,040	400	3	90	1,533	**1,095**	**367**	**2**	**76**	**1,540**
Total assets	$ 31,862	$ 25,454	$ 39,220	$ (39,983)	$ 56,553	**$ 32,369**	**$ 24,897**	**$ 42,477**	**$ (39,370)**	**$ 60,373**
LIABILITIES AND SHAREHOLDERS EQUITY										
Current liabilities:										
Debt maturing within one year	$ 5,003	$ 270	$ 3,985	$ (5,149)	$ 4,109	**$ 3,744**	**$ 176**	**$ 3,857**	**$ (3,851)**	**$ 3,926**
Other current liabilities	3,307	1,437	1,113	(1,312)	4,545	**3,868**	**1,104**	**1,115**	**(1,131)**	**4,956**
Total current liabilities	8,310	1,707	5,098	(6,461)	8,654	**7,612**	**1,280**	**4,972**	**(4,982)**	**8,882**
Long-term debt	2,931	99	10,571	(522)	13,079	**2,894**	**94**	**11,772**	**(482)**	**14,278**
Noncurrent liabilities:										
Deferred income taxes	5,032	1,927	(574)	222	6,607	**4,972**	**1,991**	**(298)**	**153**	**6,818**
Other noncurrent liabilities	3,185	757	591	146	4,679	**3,268**	**847**	**595**	**249**	**4,959**
Total noncurrent liabilities	8,217	2,684	17	368	11,286	**8,240**	**2,838**	**297**	**402**	**11,777**
Shareholders equity	12,404	20,964	23,534	(33,368)	23,534	**13,623**	**20,685**	**25,436**	**(34,308)**	**25,436**
Total liabilities and shareholders equity	$ 31,862	$ 25,454	$ 39,220	$ (39,983)	$ 56,553	**$ 32,369**	**$ 24,897**	**$ 42,477**	**$ (39,370)**	**$ 60,373**

Condensed Consolidating Cash Flow Statements

	For the Nine Months Ended September 30, 2005				
	BST	Other	Parent	Adjustments	Total
Cash flows from continuing operations:					
Cash flows from operating activities	$ 5,254	$ 1,257	$ 6,473	$ (7,050)	$ 5,934
Cash flows from investing activities	(2,344)	4,709	1,975	(3,646)	694
Cash flows from financing activities	(2,905)	(6,053)	(6,935)	10,730	(5,163)
Cash flows from discontinued operations		(115)			(115)
Net (decrease) increase in cash	$ 5	$ (202)	$ 1,513	$ 34	$ 1,350

	For the Nine Months Ended September 30, 2006				
	BST	**Other**	**Parent**	**Adjustments**	**Total**
Cash flows from continuing operations:					
Cash flows from operating activities	**$ 4,225**	**$ 1,821**	**$ 2,011**	**$ (2,789)**	**$ 5,268**
Cash flows from investing activities	**(2,754)**	**26**	**(2,081)**	**(256)**	**(5,065)**
Cash flows from financing activities	**(1,565)**	**(1,880)**	**508**	**3,038**	**101**
Cash flows from discontinued operations					
Net (decrease) increase in cash	**$ (94)**	**$ (33)**	**$ 438**	**$ (7)**	**$ 304**

Supplemental Data

	For the Nine Months Ended September 30, 2005				
	BST	Other	Parent	Adjustments	Total
Depreciation and amortization expense	$ 2,535	$ 183	$ 2	$ 36	$ 2,756
Capital expenditures	$ 2,336	$ 115	$ 2	$ 12	$ 2,465

	For the Nine Months Ended September 30, 2006				
	BST	**Other**	**Parent**	**Adjustments**	**Total**
Depreciation and amortization expense	**$ 2,462**	**$ 189**	**$ 2**	**$ 32**	**$ 2,685**
Capital expenditures	**$ 2,613**	**$ 126**	**$ -**	**$ 22**	**$ 2,761**

BELLSOUTH CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL

CONDITION AND RESULTS OF OPERATIONS

(Dollars in Millions, Except Per Share Amounts and as Otherwise Indicated)

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 annual report on Form 10-K for the year ended December 31, 2005 and our other filings with the SEC.

Overview

We are a Fortune 500 company with annual revenues of over $20 billion. Our core businesses are wireline and wireless communications and our largest customer segment is the retail consumer. We have interests in wireless communications through our ownership of 40 percent of Cingular Wireless, the nation s largest wireless company based on number of customers and revenue. We also operate one of the largest directory advertising businesses in the United States. The majority of our revenues are generated based on monthly recurring services.

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

INDUSTRY DYNAMICS

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

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

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

REGULATION AND COMPETITION

Our core businesses are subject to regulation, and all of our businesses are subject to vigorous competition.

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

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

During 2005 and early 2006, we transitioned most former UNE-P customers to a similar platform service at commercially negotiated terms and prices. Our completion of the FCC-ordered phase out is being litigated before certain state commissions.

(Dollars in Millions, Except Per Share Amounts and as Otherwise Indicated)

The FCC provided additional relief when it released new broadband rules effective in November 2005 that responded to a U.S. Supreme Court decision. The new rules are designed to provide our high speed Internet access services with regulation equivalent to that of our competition, particularly cable modem providers. The new rules were fully phased in during the third quarter of 2006.

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

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

Competition in the yellow pages industry continues to intensify. Major markets are seeing multiple competitors, with many different media competing for advertising revenue. We continue to respond to the increasing competition and the dynamic media environment with investments in product enhancements, multiple delivery options, local promotions, customer value plans, increased advertising and sales execution.

MERGERS, ACQUISITIONS AND DISPOSITIONS

On March 4, 2006, we agreed to merge with a subsidiary of AT&T. In the merger, shareholders of BellSouth will receive 1.325 shares of AT&T common stock for each share of BellSouth common stock. The transaction has been approved by the Board of Directors and shareholders of each company, as well as the US Department of Justice (DOJ) and all necessary state and foreign regulatory authorities. The FCC has scheduled a meeting to vote on the merger on November 3, 2006. We currently expect the transaction to close in the fall of 2006. We expect the combined company to be a more effective and efficient provider in the wireless, broadband, video, voice and data markets. The merger will also put control of Cingular Wireless in one company.

We have completed the exit of our international operations and increased our investment in the wireless market through Cingular Wireless acquisition of AT&T Wireless. The addition of AT&T Wireless filled in Cingular Wireless national coverage footprint, added depth to its licensed spectrum position, and added size and scale to compete more effectively. Cingular Wireless improvements in customer service and network coverage combined with new advertising campaigns are driving customer loyalty and growth. Customer churn has reduced appreciably, integration efforts are well underway and cost synergies are contributing to margin expansion. This acquisition substantially increases BellSouth s participation in the wireless industry, bringing wireless to over 40 percent of our proportional revenues including Cingular Wireless. As Cingular completes its integration of AT&T Wireless and executes its strategy, we expect its contribution to BellSouth s earnings to increase.

HIGHLIGHTS AND OUTLOOK

Consolidated revenues, which do not include our share of Cingular, increased 2.9 percent in the third quarter of 2006 and 1.9 percent year-to-date compared to the same periods of 2005, attributable to growth in both the Communications Group and Advertising & Publishing Group. The year-over-year growth in consolidated revenues was positively impacted by $51 in one-time credits issued during the third quarter of 2005 to customers affected by Hurricane Katrina. Revenue growth was driven by digital subscriber lines (DSL), long distance, wholesale wireless transport and emerging data services, as well as by electronic media and print services. This growth was partially offset by revenue declines from retail residence and wholesale voice access line losses. We added 176,000 net DSL customers and 118,000 long distance customers during the third quarter of 2006. We served more than 3.4 million total DSL customers and approximately 7.6 million long distance customers at September 30, 2006. At September 30, 2006 we had more than 5.1 million residential packages, an increase of 5.7 percent compared to the same period in 2005. Nearly 44 percent of packages included multiple products.

Total access lines were down 301,000 from June 30, 2006 driven by technology substitution and competition from cable telephony providers. Total retail access lines were down 127,000, which included 135,000 of line losses in consumer and positive retail small business line growth of 20,000 offset by a 13,000 decline in retail large business. The wholesale line base, of which the majority is UNE-P, declined 174,000 compared to June 30, 2006.

Our cost structure is heavily weighted towards labor and fixed asset related costs. We have adjusted our workforce due to shifts in market share of access lines. Since the beginning of 2001, we have reduced our domestic workforce by nearly 21,000 employees, or 26 percent. These workforce reductions along with reduced overtime and project spending contributed to improved year-over-year wireline operating margins. Sustaining our margins will require continued

(Dollars in Millions, Except Per Share Amounts and as Otherwise Indicated)

market penetration of new services and improvements in productivity to manage our costs as competition and technology substitution intensifies.

Operating cash flow from continuing operations of $5,268 for the first nine months of 2006 was $666 lower than the same period in 2005 primarily due to a $566 federal income tax payment in the third quarter of 2006. Capital expenditures were $2,761 for the first nine months of 2006 and $2,465 for the first nine months of 2005. The increase in capital expenditures compared to the prior period relates primarily to expenditures of approximately $265 for Hurricane Katrina restoration efforts in 2006 compared to $22 in the third quarter of 2005, and increased spending for broadband investments in infrastructure and systems.

Cingular Wireless

Cingular Wireless added approximately 1.4 million net customers in the third quarter of 2006, bringing its nationwide customer base to 58.7 million customers. Customer churn of 1.8 percent in the third quarter of 2006 decreased 50 basis points compared to the same period in the prior year. Year-over-year revenue growth exceeded 9 percent driven by subscriber growth and higher data average revenue per user (ARPU). Operating margin has been improving due to revenue growth and ARPU stabilization coupled with operational and merger-related synergies.

Consolidated Results of Operations

Key financial and operating data for BellSouth Corporation for the three and nine months ended September 30, 2005 and 2006 are set forth below. 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.

Following Generally Accepted Accounting Principles (GAAP), we use the equity method of accounting for our investment in Cingular Wireless. We record and present our proportionate share of Cingular Wireless earnings as net earnings of equity affiliates in our consolidated income statements. Additionally, our financial statements reflect results for our former Latin American operations and other associated activities as Discontinued Operations.

	For the Three Months Ended September 30,		Percent	For the Nine Months Ended September 30,		Percent
	2005	**2006**	Change	2005	**2006**	Change
Operating revenues	$ 5,072	**$ 5,218**	2.9%	$ 15,305	**$ 15,595**	1.9%
Operating expenses						
Cost of services and products	2,017	**1,905**	(5.6%)	5,862	**5,974**	1.9%
Selling, general, and administrative expenses	996	**967**	(2.9%)	2,833	**2,868**	1.2%
Depreciation and amortization	922	**894**	(3.0%)	2,756	**2,685**	(2.6%)
Provisions for restructuring and asset impairments	166	**7**	*	181	**72**	(60.2%)
Total operating expenses	4,101	**3,773**	(8.0%)	11,632	**11,599**	(0.3%)
Operating income	971	**1,445**	48.8%	3,673	**3,996**	8.8%
Interest expense	274	**302**	10.2%	850	**860**	1.2%
Net earnings (losses) of equity affiliates	97	**342**	252.6%	85	**694**	*
Gain on sale of operations	351		*	351		*

Other income (expense), net	64	**90**	40.6%	176	**212**	20.5%
Income from continuing operations before income taxes	1,209	**1,575**	30.3%	3,435	**4,042**	17.7%
Provision for income taxes	392	**516**	31.6%	1,140	**1,312**	15.1%
Income from continuing operations	817	**1,059**	29.6%	2,295	**2,730**	19.0%
Income from discontinued operations, net of tax				381		*
Net income	$ 817	**$ 1,059**	29.6%	$ 2,676	**$2,730**	2.0%

* Not meaningful.

Operating revenues

Consolidated operating revenues increased $146 in the third quarter of 2006 and $290 year-to-date compared to the same periods in 2005 reflecting growth in DSL, long distance, wholesale wireless transport and emerging data services as well as electronic media and print services. These increases were partially offset by the impact of revenue declines associated with retail residence and wholesale voice access line losses due to competition and technology substitution. The year-over-year increase in the third quarter of 2006 also reflects the impact of $51 in credits issued to customers affected by Hurricane Katrina in the third quarter of 2005. Combined revenues from DSL and long distance increased $154 in the third quarter of 2006 and $482 year-to-date compared to the same periods last year. Other data revenues increased $44 in the third quarter of 2006 and $52 year-to-date compared to the same periods in 2005. Other voice and access line-related revenues declined $134 in the third quarter of 2006 and $362 year-to-date compared to the same periods in 2005.

(Dollars in Millions, Except Per Share Amounts and as Otherwise Indicated)

Electronic media and print revenues grew $28 in the third quarter of 2006 and $59 year-to-date compared to the same periods last year.

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

Operating expenses

Total operating expenses decreased $328 in the third quarter of 2006 compared to the same period of the prior year. The major driver of this decrease was $290 incurred during the third quarter of 2005 for Hurricane Katrina-related asset impairments, service restoration and network repair costs. Other year-over-year decreases during the third quarter of 2006 included $48 at the Communications Group which consisted primarily of lower information technology platform spending, fees and labor costs (from force reductions and lower overtime primarily offset by increases in stock-based compensation). Also, depreciation and amortization was lower by $28 due to reduced rates. These declines were slightly offset by $24 of costs directly associated with the pending merger with AT&T and incremental severance-related costs associated with voluntary management workforce reductions. Additionally, the Advertising & Publishing Group experienced $15 of higher growth-related expenses and uncollectibles expense.

Year-to-date, total operating expenses decreased $33 compared to the same period of 2005. Expenses in 2006 continued to be impacted by service restoration and network repair activities carrying over from damage caused by Hurricanes Katrina and Wilma in late 2005. These costs, net of $50 in insurance recoveries, were less than the weather-related spending of the corresponding period of the prior year, resulting in an overall decrease in weather-related expenses of $104 year-to-date. Lower depreciation and amortization of $72 as well as $24 of year-to-date expense declines at the Communications Group also contributed to the year-over-year decrease. This year-to-date expense decline was partially offset by $57 of incremental severance-related costs associated with voluntary management workforce reductions, $44 of costs directly associated with the pending merger with AT&T and $43 of year-over-year increases at the Advertising & Publishing Group.

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

Interest expense

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,		
	2005	**2006**	Change	2005	**2006**	Change
Interest expense debt	$ 248	**$ 271**	$ 23	$ 771	**$ 781**	$ 10
Interest expense other	26	**31**	5	79	**79**	
Total interest	$ 274	**$ 302**	$ 28	$ 850	**$ 860**	$ 10
Average debt balances	$17,292	**$17,908**	$616	$18,468	**$17,615**	$(853)
Effective rate	5.7%	**6.0%**	30 bps	5.6%	**5.9%**	30 bps

Interest expense associated with interest-bearing debt was higher in the third quarter and year-to-date periods of 2006 compared to the same periods of the prior year. This was primarily the result of higher interest rates on variable rate debt. The increase in interest expense in the third quarter of 2006 compared to prior year was also impacted by higher average debt balances due to borrowings.

Net earnings (losses) of equity affiliates

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,		
	2005	**2006**	Change	2005	**2006**	Change
Cingular	$ 89	**$ 339**	$ 250	$ 53	**$ 696**	$ 643
Other equity investees	8	**3**	(5)	32	**(2)**	(34)
Total	$ 97	**$ 342**	$ 245	$ 85	**$ 694**	$ 609

The increase in earnings from Cingular Wireless in 2006 was attributable to growth in the customer base and merger synergies associated with its increased scale and integration of the former AT&T Wireless operations. See the Wireless segment results section for a further discussion of operational drivers. The decline in earnings from other equity investees is due to the sale of our interest in Cellcom in the third quarter of 2005.

(Dollars in Millions, Except Per Share Amounts and as Otherwise Indicated)

Other income (expense), net

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,		
	2005	**2006**	Change	2005	**2006**	Change
Interest income	$ 8	**$ 21**	$ 13	$ 18	**$ 36**	$ 18
Interest on advances to Cingular	47	**49**	2	163	**140**	(23)
Loss on early extinguishment of debt				(42)		42
Other, net	9	**20**	11	37	**36**	(1)
Total other income (expense), net	$ 64	**$ 90**	$ 26	$ 176	**$ 212**	$ 36

Interest income for the three and nine months ended September 30, 2006 increased over the same periods of the prior year due to increased average invested cash and higher interest rates. Interest on advances to Cingular for the three months ended September 30, 2006 was higher than the same period of the prior year due to principal borrowings and rate increases. The decline in interest on advances to Cingular in the year-to-date period is due to principal repayments, partially offset by rate increases. Interest income on advances to Cingular is offset by a like amount of interest expense recorded by Cingular and reported in our financial statements in the caption Net earnings (losses) of equity affiliates.

Provision for income taxes

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,		
	2005	**2006**	Change	2005	**2006**	Change
Provision for income taxes	$ 392	**$ 516**	$ 124	$ 1,140	**$ 1,312**	$ 172
Effective tax rate	32.4%	**32.8%**	40 bps	33.2%	**32.5%**	(70 bps)

The effective rates in both periods of 2006 are favorably impacted by year-over-year increases in tax benefits associated with the dividends received deduction for our investment in Cingular, the release of valuation allowance against state net operating losses, the Medicare Part D subsidy, and a tax benefit for production activities conducted within the US. Current year increases in these benefits are offset by tax impacts of certain non-deductible merger-related costs incurred in 2006, and higher state tax expense primarily due to enacted state law changes.

Income from discontinued operations, net of tax

In the first quarter of 2005, we sold the final two of the ten Latin American properties, which resulted in a $390 gain, net of tax.

Results by Segment

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

Communications Group;

Wireless; and

Advertising & Publishing Group.

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

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

(Dollars in Millions, Except Per Share Amounts and as Otherwise Indicated)

Communications Group

The Communications Group is our core domestic business and it includes all domestic wireline voice, data, broadband, long distance, Internet services and advanced voice features. The Communications Group provides these services to an array of customers, including residential, business and wholesale.

BellSouth continues to focus its marketing on long distance and BellSouth® FastAccess® DSL, encouraging customers to purchase packages containing multiple telecommunications services. We also continue to experience access line market share loss due to competition and technology substitution, and we expect these overall trends to continue throughout 2006.

	For the Three Months Ended September 30, 2005	2006	Percent Change	For the Nine Months Ended September 30, 2005	2006	Percent Change
Segment operating revenues:						
Voice	$ 3,136	**$ 3,058**	(2.5%)	$ 9,445	**$ 9,289**	(1.7%)
Data	1,166	**1,315**	12.8%	3,491	**3,861**	10.6%
Other	286	**323**	12.9%	895	**898**	0.3%
Total segment operating revenues	4,588	**4,696**	2.4%	13,831	**14,048**	1.6%
Segment operating expenses:						
Cost of services and products	1,860	**1,833**	(1.5%)	5,563	**5,627**	1.2%
Selling, general, and administrative expenses	793	**772**	(2.6%)	2,306	**2,285**	(0.9%)
Depreciation and amortization	914	**886**	(3.1%)	2,734	**2,662**	(2.6%)
Total segment operating expenses	3,567	**3,491**	(2.1%)	10,603	**10,574**	(0.3%)
Segment operating income	1,021	**1,205**	18.0%	3,228	**3,474**	7.6%
Segment net income	$ 611	**$ 720**	17.8%	$ 1,935	**$ 2,072**	7.1%
Unusual items excluded from segment net income:						
Hurricane Katrina-related expenses	(172)		*	(172)	**(74)**	*
Severance charges			*		**(45)**	*
AT&T merger costs		**(13)**	*		**(30)**	*
Early extinguishment of debt costs			*	(26)		*
Segment net income including unusual items	$ 439	**$ 707**	61.0%	$ 1,737	**$ 1,923**	10.7%

Key Indicators (000s except where noted)

	For the Three Months 2005	2006	Percent Change	For the Nine Months 2005	2006	Percent Change
Switched access lines [(1)]:						
Residence retail:						
Primary				11,465	**10,932**	(4.6%)
Additional				1,206	**1,044**	(13.4%)
Total retail residence				12,671	**11,976**	(5.5%)
Residential wholesale voice lines				1,674	**1,121**	(33.0%)
Total residence				14,345	**13,097**	(8.7%)
Business retail				5,294	**5,305**	0.2%
Business wholesale voice lines				712	**553**	(22.3%)
Total business				6,006	**5,858**	(2.5%)
Other retail/wholesale lines (primarily payphones)				95	**83**	(12.6%)
Total Switched access lines				20,446	**19,038**	(6.9%)
DSL customers (retail and wholesale)				2,678	**3,449**	28.8%
Retail long distance customers				6,993	**7,596**	8.6%
Switched access and local minutes of use (millions)	15,511	**14,810**	(4.5%)	47,279	**45,088**	(4.6%)
Retail long distance minutes of use (millions)	6,660	**6,703**	0.6%	18,972	**19,877**	4.8%
Total access minutes of use (millions)	22,171	**21,513**	(3.0%)	66,251	**64,965**	(1.9%)

Capital expenditures	$ 878	**$ 725**	(17.4%)	$ 2,446	**$ 2,743**	12.1%

* Not meaningful.

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

(Dollars in Millions, Except Per Share Amounts and as Otherwise Indicated)

Segment operating revenues

Revenue grew 2.4 percent in the third quarter of 2006 compared to the same period in 2005. Adjusting for $44 of one-time Hurricane Katrina credits in the third quarter of 2005, the year-over-year increase would have been 1.4 percent. Revenue growth in mass-market broadband and long distance services and growth in emerging data services offset revenue declines from traditional access line services.

Growth in consumer long distance and DSL revenue was partially offset by retail residential access line losses, resulting in a 2.8 percent year-over-year increase in consumer revenue. Revenue for our small business unit increased 10.6 percent in the third quarter of 2006 when compared to the same period in 2005. We continue to reacquire and retain customers with competitively priced term agreements while also increasing customer ARPU with FastAccess DSL and long distance packages. Revenue for our large business segment increased 2.3 percent in the third quarter of 2006 compared to the same period last year. Revenue growth in emerging data products and long distance offset declines in legacy services coupled with pricing stability. Wholesale revenue decreased 1.8 percent in the third quarter of 2006 compared to the same period in the prior year as declines in local wholesale revenue, which includes UNE-P and Internet Service Provider (ISP) dial-up contracts, were offset by wireless transport growth and Georgia regulatory rate adjustments.

Voice

Voice revenues decreased $78 in the third quarter of 2006 and $156 year-to-date when compared to the same periods in 2005. Access line-related revenues declined $82 in the third quarter of 2006 and $254 year-to-date when compared to the same periods in 2005 due to total switched access line losses of 1,408,000, or 6.9 percent. The access line decline was the result of continued share loss, wireless and broadband technology substitution and, to a lesser extent, losses to Voice over Internet Protocol providers. Wholesale lines totaled over 1.7 million at September 30, 2006, down 722,000 year-over-year. Wholesale lines consist primarily of both the grandfathered service provided under invalidated FCC rules (UNE-P) and successor service provided under commercial contracts at negotiated rates. Commercial contracts covered predominately all of the wholesale lines at September 30, 2006.

In efforts to combat share loss, we continue to further penetrate our customer base with package services. At the end of the third quarter of 2006, we had more than 5.1 million residential packages, representing a 47 percent penetration of our retail primary line residence base. As of September 30, 2006, 86 percent of our package customers had long distance in their package and 49 percent had either FastAccess DSL or BellSouth dial-up Internet.

Long distance voice revenue increased $56 in the third quarter of 2006 and $206 year-to-date when compared to the same periods in 2005, driven primarily by growth in interLATA retail revenues and wholesale long distance services sold to Cingular. InterLATA retail revenues increased $46 in the third quarter and $156 year-to-date reflecting an increase in the proportion of customers on BellSouth Unlimited Long Distance Plans and continued market share gains both driven by marketing efforts. At September 30, 2006, we had nearly 7.6 million retail long distance customers and a mass-market penetration rate of almost 63 percent of our retail customer base.

Switched access revenues decreased $23 in the third quarter of 2006 and $53 year-to-date when compared to the same periods in 2005. Our entry into interLATA long distance shifted switched access minutes from other carriers to our service, resulting in a transfer from wholesale switched access revenues to retail long distance revenue. Excluding our retail long distance traffic, switched access and local minutes of use decreased 4.5 percent in the third quarter when compared to the same period in 2005. The decrease is due to access line losses and alternative communications services, primarily wireless and e-mail.

Data

Data revenues increased $149 in the third quarter of 2006 and $370 year-to-date when compared to the same periods in 2005. Data revenues were driven primarily by strong growth from the sale of BellSouth® FastAccess® DSL service. Combined wholesale and retail DSL revenues of $405 in the quarter and $1,187 year-to-date were up $100 and $302, respectively, when compared to the same periods in 2005 due primarily to a larger customer base. As of September 30, 2006, we had more than 3.4 million DSL customers, an increase of 771,000 customers compared to September 30, 2005. DSL net subscriber additions were 176,000 in the third quarter of 2006. More than 30 percent of BellSouth s broadband customers subscribe to the Company s premium service offerings -- FastAccess DSL Xtreme and FastAccess DSL Xtreme 6.0.

Revenue from other retail data products increased $34 in the third quarter of 2006 and $61 year-to-date when compared to the same periods in 2005. This growth was driven by our long distance offerings in complex business and emerging data services, particularly BellSouth Metro Ethernet Service and BellSouth Virtual Private Network, coupled with pricing stability. These growth areas more than offset declines in legacy services.

Revenue from the sale of wholesale data transport services, including long distance companies, wireless service providers and competitive local exchange carriers (CLEC), increased $15 in the third quarter of 2006 and $7 year-to-date when compared to the same periods in 2005. Data transport sold to inter-exchange carriers declined as they continue to reduce their network costs in response to declining volumes. In addition, dial-up ISP traffic revenue declined as volumes declined. These declines were offset by revenue growth in transport sold to wireless carriers as wireless subscribers and volumes continue to expand. The third quarter of 2005 also included $12 of negative billing adjustments.

Other

Other revenues increased $37 in the third quarter of 2006 and were essentially flat year-to-date when compared to the same periods in 2005 reflecting incremental revenue of $12 associated with Georgia regulatory rate adjustments and higher equipment revenues.

Segment operating expenses

Cost of services and products

Cost of services and products decreased $27 in the third quarter of 2006 and increased $64 year-to-date when compared to the same periods in 2005. The third quarter decrease includes $33 decrease in fees for contributions to the Universal Service Fund (USF) and access fees based on volumes, along with decreases of $22 in labor costs primarily associated with headcount reductions and $15 in deferred activation expense recognition. These decreases were offset by increases of $19 in materials and supplies related to fuel and utility costs, $11 in contract services primarily for network-related costs as a result of weather and $10 in cost of goods sold related to higher volumes in long distance service.

The year-to-date increase reflects a $117 increase in contract services primarily related to network repairs associated with damage caused by Hurricane Wilma, $45 in materials and supplies related to increased fuel costs and DSL modems, and $29 in cost of goods sold driven by higher volumes in long distance service. These increases were partially offset by a $79 reduction in penalties associated with CLEC parity requirements, USF contributions and access fees, $17 in deferred activation expense recognition and a $21 reduction in labor costs due to lower benefit valuations and increased capitalization. Savings due to headcount reductions were offset by rate increases.

Selling, general, and administrative expenses

Selling, general, and administrative expenses decreased $21 in the third quarter of 2006 and year-to-date when compared to the same periods in 2005. The third quarter decrease reflects a $59 decrease in contract services for technology platform initiatives, partially offset by increases of $15 in labor costs due to the increased stock price s impact on stock-based compensation partially offset by headcount reductions, $15 in uncollectibles driven by a third quarter 2005 reserve adjustment and $13 in outside sales commissions related to higher vendor sales volumes.

The year-to-date decrease reflects a $37 decrease in contract services for technology platform initiatives, $11 in fees, $10 in labor costs due to headcount, overtime, bonus awards offset by stock-based compensation and $6 in material and supplies. These decreases were partially offset by increases of $33 in outside sales commissions related to higher vendor sales volumes and $12 in advertising due to campaign timings.

Depreciation and amortization

Depreciation and amortization expense decreased $28 during the third quarter of 2006 and $72 year-to-date when compared to the same periods in 2005 reflecting reduced depreciation rates under the group life method of depreciation partially offset by depreciation expense on new capital expenditures in the previous 12 months.

Wireless

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

The wireless industry continued its strong growth trajectory seen in 2005 through the first nine months of 2006. Despite industry consolidation, competition continues to be intense among the current four national competitors, their affiliates and the smaller regional carriers. Cingular Wireless year-to-date third quarter ARPU decreased 1.8 percent year-over-year, driven primarily by lower voice ARPU partially offset by increased data ARPU. However, third quarter ARPU increased slightly year-over-year from data revenue growth. Data revenue continues to play an increasingly important role in revenue composition, rising from 8.7 percent of ARPU during the third quarter of 2005 to 12.7 percent of ARPU in the third quarter of 2006.

(Dollars in Millions, Except Per Share Amounts and as Otherwise Indicated)

	For the Three Months Ended September 30, 2005	2006	Percent Change	For the Nine Months Ended September 30, 2005	2006	Percent Change
Segment operating revenues:						
Service revenues	$ 3,089	**$ 3,464**	12.1%	$ 9,144	**$ 9,984**	9.2%
Equipment revenues	410	**357**	(12.9%)	1,090	**1,116**	2.4%
Total segment operating revenues	3,499	**3,821**	9.2%	10,234	**11,100**	8.5%
Segment operating expenses:						
Cost of services and products	1,395	**1,464**	4.9%	4,171	**4,427**	6.1%
Selling, general, and administrative expenses	1,128	**1,125**	(0.3%)	3,438	**3,341**	(2.8%)
Depreciation and amortization	421	**484**	15.0%	1,324	**1,418**	7.1%
Total segment operating expenses	2,944	**3,073**	4.4%	8,933	**9,186**	2.8%
Segment operating income	555	**748**	34.8%	1,301	**1,914**	47.1%
Segment net income	$ 242	**$ 360**	48.8%	$ 477	**$ 879**	84.3%
Unusual items excluded from segment net income:						
Merger integration costs	(56)	**(33)**	*	(119)	**(127)**	*
Wireless merger intangible amortization	(93)	**(75)**	*	(284)	**(240)**	*
Hurricane Katrina-related expenses	(23)		*	(23)		*
Segment net income including unusual items	$ 70	**$ 252**	*	$ 51	**$ 512**	*

Key Indicators (100% Cingular):						
Cellular/PCS Customers (000s)				52,292	**58,666**	12.2%
Wireless service average monthly revenue per customer Cellular/PCS	$ 49.65	**$ 49.76**	0.2%	$ 49.92	**$ 49.04**	(1.8%)
Capital Expenditures	$ 1,346	**$ 1,828**	35.8%	$ 4,505	**$ 4,851**	7.7%

* Not meaningful

Segment operating revenues

Cingular Wireless had net additions of 1.4 million during the third quarter of 2006, up from 867,000 during the third quarter of 2005 and 4.5 million net additions year-to-date up from 3.2 million in the corresponding prior year period. This resulted in 58.7 million cellular/PCS customers on September 30, 2006. Gross customer additions during the third quarter of 2006 totaled 4.6 million and totaled 13.7 million year-to-date, up from 4.4 million and 13.4 million from the same periods a year ago. The slight increase in gross customer additions for both periods was primarily driven by new prepaid offerings launched in the second half of 2005. Additionally, strong reseller gross additions attributed to the year-to-date increase. These additions were partially offset by decreased postpaid additions due to planned distribution rationalization such as the reduction of retail stores and agents, higher wireless market penetration in general and lower churn among major wireless carriers.

The cellular/PCS churn rate was 1.8 percent for both the third quarter of 2006 and year-to-date, down from 2.3 percent and 2.2 percent in the corresponding prior year periods. Postpaid churn for both the third quarter of 2006 and year-to-date was 1.5 percent, down from 2.0 percent and 1.9 percent in the corresponding prior year periods. The decline in cellular/PCS churn was driven by a 9.1 percent reduction in disconnects in the third quarter of 2006 and a 9.7 percent reduction in disconnects year-to-date in comparison to the same periods of 2005, which Cingular believes is attributable primarily to better network quality and coverage, and improvements in the overall customer experience.

Cellular/PCS ARPU slightly increased to $49.76 in the third quarter of 2006 from $49.65 in the third quarter of 2005. Year-to-date ARPU declined 1.8 percent to $49.04, down from $49.92 in the corresponding prior year period. The third quarter increase was driven by continued increased incremental data revenues resulting from Cingular s competitive data products, such as ringtones and messaging. Data revenue increases also partially offset the year-to-date ARPU decline. The third quarter increase also reflected an approximate $0.20 impact for service credits to customers affected by Hurricane Katrina in the third quarter of 2005. Driving the year-to-date decline and partially offsetting the third quarter increase were the addition of a disproportionately higher percentage of lower-ARPU prepaid and reseller customers than postpaid customers over the past four quarters, an increase in the number of customers on plans allowing free mobile-to-mobile calling, roaming, and long distance, and a higher percentage of customers on lower access revenue FAMILYTALK® plans.

Segment operating revenues, consisting of service revenue and equipment sales, increased $322 in the third quarter of 2006 and $866 year-to-date when compared with the same periods of 2005. The growth in service revenue of $375 during the third quarter of 2006 and $840 year-to-date was primarily due to the increases in local service voice and data revenues. The year-to-date increase was partially offset by decreases in roamer and other revenues. Cingular Wireless revenue growth in both periods also reflects the impact of $12 of service credits to customers affected by Hurricane Katrina in third quarter of 2005. The local service voice component of total service revenues includes recurring monthly

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access charges, airtime usage, including prepaid service, and charges for optional features and services, such as voice mail, mobile-to-mobile calling, roadside assistance, caller ID and handset insurance. It also includes billings to Cingular Wireless customers for the USF and other regulatory fees and taxes. The key driver of the $180 increase in local service voice revenues in the third quarter of 2006, $433 year-to-date, was an increase of 12.1 percent for the third quarter of 2006 and 11.3 percent year-to-date in the average number of cellular/PCS subscribers. This volume-based increase was partially offset by the incremental impact of a disproportionate amount of lower-ARPU prepaid and reseller customers added to the base.

Increases in data revenues also favorably impacted total service revenues. Data revenues increased $167 in the third quarter of 2006 and $422 year-to-date over the same prior year periods driven by greater data service penetration and usage of short message service (SMS) messaging, email, and other data services by Cingular Wireless cellular/PCS customers.

Incollect roamer revenues in the third quarter of 2006 increased $14 when compared with the third quarter of 2005 because of current quarter rate increases, which were partially offset by decreased volume. Year-to-date incollect roamer revenues decreased $28 when compared with amounts from the corresponding prior year period due to the continued impact of bundling free roaming minutes with all-inclusive regional and national rate plans.

Long distance revenues increased $8 in the third quarter of 2006 and $22 year-to-date from the corresponding prior year periods due to increases in international long distance revenues resulting from the successful marketing of international calling plan initiatives.

Outcollect revenues increased $9 in the third quarter of 2006 and $10 year-to-date when compared with the corresponding prior year periods primarily from increased minutes of use. The year-to-date increase is partially offset by decreases in the average rate.

Equipment sales, comprised of product, accessory and upgrade sales, decreased $53 during the third quarter of 2006 and increased $26 year-to-date from the corresponding prior year periods. The third quarter decrease is primarily attributable to increased rebate activity and reduced handset pricing partially offset by increased accessory pricing and increased upgrade volume. The year-to-date increase was primarily driven by a higher volume of new customer handsets, increased volume and price of upgrades by existing customers to devices with more advanced features than those in the past, and accessory price increases, partially offset by increased rebate activity.

Segment operating expenses

Cost of services and products

Cost of services and products increased $69 in the third quarter of 2006 and $256 year-to-date when compared to the same periods of 2005 primarily driven by increased minutes of use. In addition, higher handset volumes contributed to the year-to-date increase.

The local systems component increased $54 in the third quarter of 2006 and $121 year-to-date when compared to the corresponding prior year periods. Both increases resulted primarily from higher interconnection fees of $34 associated with a 21.3 percent growth in system minutes in the third quarter of 2006 and $101 associated with a 21.0 percent growth in system minutes year-to-date over the prior year corresponding periods; USF and gross receipts tax increases of $16 in the third quarter of 2006 and $19 year-to-date; and an increase in local network system costs of $15 in the third quarter of 2006 and $39 year-to-date primarily related to increased maintenance expense. These increases were partially offset by a decrease in reseller services expense of $12 in the third quarter of 2006 and $38 year-to-date in comparison to the corresponding prior year periods. The decrease in reseller services expense was driven by decreases in minutes of use on the T-Mobile network of 60.1 percent in the third quarter of 2006 and 50.1 percent year-to-date partially offset by higher handset insurance claims and third party license expenses in both periods when compared to the same periods of the prior year.

Third-party network system costs increased $17 for the third quarter of 2006 resulting from a $7 increase in roaming expense and $10 increase in long distance expense over the corresponding prior year period. Third-party network system costs increased $76 year-to-date when compared to the same period of the prior year resulting from increases of $32 in roaming expense and $44 of long distance expense compared to the prior year period. Roaming costs increased primarily due to increased usage minutes over the comparable prior periods. Increases in long distance costs were driven by higher minutes of use resulting from the increased number of average subscribers, partially offset by minor rate decreases.

Equipment sales expenses declined $2 in the third quarter 2006 and grew $58 year-to-date when compared to the same periods of the prior year. The third quarter decrease is related to lower average per unit costs of handsets and insurance program adjustments partially offset by higher volumes. The year-to-date increase is driven by higher volume of product and upgrade handsets and a higher average cost per upgrade unit sold partially offset by decreases in the average cost per unit sold of product handsets.

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Selling, general, and administrative expenses

Selling, general, and administrative expenses were flat in the third quarter of 2006 and decreased $97 year-to-date when compared to the same periods of 2005. Selling expenses increased $18 in the third quarter of 2006 and $11 year-to-date compared to the prior year corresponding periods driven by increases in sales expenses related to the long-term incentive plan and direct commissions from sales compensation plan changes; the year-to-date increase was partially offset by lower indirect commissions and lower advertising in the year-to-date period. Costs for maintaining and supporting Cingular Wireless customer base decreased $5 in the third quarter of 2006 and $70 year-to-date when compared to the same periods of 2005 principally due to a decrease in bad debt primarily from improved collections and improved involuntary churn which contributed to lower net write-offs, a decrease in customer service costs due to reduced outsourced professional services at call centers and reduced billing expenses resulting from continued migration to the combined billing system. These decreases were partially offset by prepaid card replenishment costs and increased migration and upgrade transactions in both periods. Additionally, administrative expenses decreased $14 in the third quarter of 2006 and $37 year-to-date in comparison to the corresponding periods of the prior year driven by lower litigation related expenses partially offset by higher third-party transaction processing fees in both periods. The year-to-date decrease was also driven by lower rent expense from combining AT&T Wireless and legacy Cingular office space and a federal excise tax refund accrual.

Depreciation and amortization

Depreciation expense increased $68 in the third quarter of 2006 and $107 year-to-date when compared to the same periods in 2005 primarily due to Cingular Wireless increased network investment and reductions to depreciation expense recorded in 2005 from the revaluation of acquired AT&T Wireless assets pursuant to the network rationalization plans offset by the impact of assets being fully depreciated in 2006. Amortization expense decreased $5 for the third quarter of 2006 and $13 year-to-date primarily due to amortization associated with intangible assets that became fully amortized during 2005 and year-to-date 2006.

Advertising & Publishing Group

Our Advertising & Publishing Group is comprised of companies in the US that publish, print, and sell advertising in and perform related services concerning alphabetical and classified telephone directories and electronic media offerings.

In the third quarter of 2006, our Advertising & Publishing Group continued to see the favorable impact from strategic initiatives implemented in prior years, partially offset by continued competitive pressures.

	For the Three Months Ended September 30,		Percent	For the Nine Months Ended September 30,		Percent
	2005	**2006**	Change	2005	**2006**	Change
Segment operating revenues	$ 509	**$ 537**	5.5%	$ 1,531	**$ 1,590**	3.9%
Segment operating expenses:						
Cost of services and products	94	**96**	2.1%	283	**286**	1.1%
Selling, general, and administrative expenses	175	**188**	7.4%	518	**558**	7.7%
Depreciation and amortization	7	**8**	14.3%	21	**23**	9.5%
Total segment operating expenses	276	**292**	5.8%	822	**867**	5.5%
Segment operating income	233	**245**	5.2%	709	**723**	2.0%
Segment net income	$ 146	**$ 154**	5.5%	$ 441	**$ 450**	2.0%
Unusual items excluded from segment net income:						

Hurricane Katrina-related credits (charges)		(6)		*	(6)	**1**	*
Segment net income including unusual items	$ 140		**$ 154**	10.0%	**$ 435**	**$ 451**	3.7%
Capital Expenditures		$ 7	**$ 5**	(28.6%)	$ 19	**$ 18**	(5.3%)

* Not meaningful

Segment operating revenues

Segment operating revenues increased $28 in the third quarter of 2006 and $59 year-to-date compared to the same periods of 2005. These increases include an improvement in print revenues as a result of core print growth and new products and growing electronic media revenues. The year-over-year comparison is impacted by $7 in credits issued to customers affected by Hurricane Katrina in the third quarter of 2005.

Segment operating expenses

Cost of services and products increased $2 in the third quarter of 2006, $3 year-to-date, and selling, general, and administrative expenses increased $13 in the third quarter of 2006, $40 year-to-date, compared to the same periods of

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2005. These increases were primarily from sales commissions on higher revenues, traffic costs related to growth initiatives for electronic media products and weather-related delivery costs, as well as higher bad debt.

Liquidity and Financial Condition

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

Sources and uses of cash

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

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

Net cash provided by (used for):

	For the Nine Months Ended September 30,						
		2005		**2006**		Change	
Continuing Operations							
Operating activities	$	5,934	**$**	**5,268**	$	(666)	(11.2%)
Investing activities	$	694	**$**	**(5,065)**	$	(5,759)	*
Financing activities	$	(5,163)	**$**	**101**	$	5,264	*
Discontinued Operations	$	(115)	**$**		$	115	*

*Not meaningful

Cash generated by operations declined $666 in the first nine months of 2006 compared to the same period in the prior year due primarily to a $566 federal income tax payment in 2006, higher incremental cash expenses associated with network restoration from hurricane damage sustained in late 2005, and severance payments under the 2006 workforce reduction. Partially offsetting this negative impact was higher operating income (absent hurricane-related expense) and positive changes in working capital.

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 of $2,761 during the first nine months of 2006 and of $2,465 during the first nine months of 2005 were incurred to support our wireline network, to promote the introduction of new products and services and to increase operating efficiency and productivity. The increase in capital expenditures compared to the prior period relates primarily to expenditures of approximately $265 for Hurricane Katrina restoration efforts in 2006, as compared to $22 in the third quarter of 2005, and increased spending for broadband investments in infrastructure and systems.

WIRELESS

In general, Cingular Wireless funds its capital and operating cash requirements from operations. To the extent additional funding is required, BellSouth and AT&T provide unsubordinated short-term financing on a pro rata basis. As of September 30, 2006, BellSouth had outstanding advances under the line of credit of $621. During the remainder of 2006, we expect Cingular Wireless to utilize its operating cash flow after capital expenditures primarily to pay its obligation relating to the recent FCC auction of 90 MHz of spectrum and maturing third-party debt.

(Dollars in Millions, Except Per Share Amounts and as Otherwise Indicated)

DISTRIBUTIONS TO SHAREHOLDERS

Dividends

Our Board of Directors considers the cash dividend on a quarterly basis. BellSouth has paid a dividend each quarter since it began operations in 1984. Over the last four years, BellSouth increased its quarterly dividend 45 percent from 20 cents per common share to 29 cents per common share. Under the merger agreement with AT&T, without AT&T s prior written consent, BellSouth is not permitted to pay a quarterly dividend in excess of 29 cents per share.

Share repurchases

BellSouth uses share repurchases to help manage cash distributions to shareholders. In October 2005, BellSouth s Board of Directors authorized the repurchase of up to $2 billion of BellSouth s common shares through 2007. Under this plan, we repurchased nearly $1 billion through December 31, 2005 and approximately $42 during 2006. Under the merger agreement with AT&T, without AT&T s prior written consent, BellSouth is not permitted to repurchase shares other than those necessary to offset shares issued in connection with employee benefit plans or the direct investment plan. Further, share repurchases may not exceed $500 per fiscal quarter.

EXTERNAL FINANCING

Credit ratings

At September 30, 2006, our long-term credit ratings were A2 from Moody s Investors Service and A from Standard and Poor s, and our short-term credit ratings were P-1 from Moody s and A-1 from Standard and Poor s. On July 27, 2006, Moody s confirmed the A2 long-term and P-1 short-term credit ratings of BellSouth.

Standard and Poor s placed the credit ratings of BellSouth on CreditWatch with negative implications on January 13, 2006, which reflected Standard and Poor s concern that the local wireline businesses of investment-grade communications carriers faced more uncertain business prospects. On September 15, 2006, Standard and Poor s stated that it expects to affirm both the A long-term and A-1 short-term credit ratings of BellSouth if the merger of AT&T and BellSouth is consummated under the contemplated terms. Pending the closing of the merger, however, Standard and Poor s credit ratings of BellSouth remain on CreditWatch with negative implications.

Financing arrangements

As of September 30, 2006, our authorized commercial paper program was $10.5 billion, with $1.6 billion outstanding. We believe that we have ready access to the commercial paper market in the event we need funding in excess of our operating cash flows. We also have an effective registration statement on file with the Securities and Exchange Commission under which we could issue $1.9 billion of long-term debt securities. The merger agreement with AT&T provides that we cannot incur additional indebtedness in excess of $1.5 billion in the aggregate without AT&T s prior written consent.

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

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

Except as described in this paragraph, the line of credit contains no financial covenants or requirements for compensating balances. Further, the line of credit does not contain any provisions that are tied to the ratings assigned to us or our affiliates by an external debt rating agency. The line of credit limits the debt of the Company and its consolidated subsidiaries to 300 percent of consolidated earnings before interest, taxes, depreciation and amortization for the preceding four quarters. During the first nine months of 2006, this debt to earnings ratio was approximately 210 percent. In addition, the line of credit prohibits the Company and its significant subsidiaries from permitting liens to be placed on their properties or assets except in specified circumstances. If BellSouth or any of our subsidiaries defaults on any outstanding debt in excess of $200, an event of default will occur under the line of credit.

(Dollars in Millions, Except Per Share Amounts and as Otherwise Indicated)

Market Risk

For a complete discussion of our market risks, you should refer to the caption Quantitative and Qualitative Disclosure About Market Risk in our annual report on Form 10-K for the year ended December 31, 2005. Our primary exposure to market risks relates to unfavorable movements in interest rates and changes in equity investment prices. Since December 31, 2005, we have invested approximately $530 in debt and equity securities subject to market risk. We do not anticipate any significant changes in our objectives and strategies with respect to managing such exposures.

In order to limit our risk from fluctuations in interest rates, we enter into interest rate swap agreements to exchange fixed and variable rate interest payment obligations without the exchange of the underlying principal amounts.

Off-Balance Sheet Arrangements and Aggregate Contractual Obligations

Other than repayments of debt as discussed in the Liquidity and Financial Condition Section, there are no material changes with respect to off-balance sheet arrangements and aggregate contractual obligations as presented in our annual report on Form 10-K for the year ended December 31, 2005.

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

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

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, our disclosure controls and procedures with respect to such entities are necessarily more limited than those we maintain with respect to our consolidated subsidiaries.

The Company s management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls can prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. There are inherent limitations in all control systems, including the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of one or more persons. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and, while our disclosure controls and procedures are designed to be effective under circumstances where they should reasonably be expected to operate effectively, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitations in any control system, misstatements due to error or fraud may occur and not be detected.

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 Rules 13a-15(b) and 15d-15(b). Based upon the foregoing, the Chief Executive Officer along with the Chief Financial Officer concluded that our disclosure controls and procedures are effective at providing reasonable assurance that all material information relating to BellSouth (including consolidated subsidiaries) required to be included in our Exchange Act reports is reported in a timely manner. In addition, based on such evaluation we have identified no change in our internal control over financial reporting that occurred during the fiscal quarter covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Cautionary Language Concerning Forward-Looking Statements

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

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

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

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

- the impact and the success of Cingular Wireless, our wireless joint venture with AT&T, including marketing and product development efforts, technological changes and financial capacity;

changes in laws or regulations, or in their interpretations, which could result in the loss, or reduction in value, of our licenses, concessions or markets, or in an increase in competition, compliance costs or capital expenditures;

continued pressures on the telecommunications industry from a financial, competitive and regulatory perspective;

the intensity of competitive activity and its resulting impact on pricing strategies and new product offerings;

changes in the federal and state regulations governing the terms on which we offer retail and wholesale services;

the impact on our business of consolidation in the wireline and wireless industries in which we operate;

the impact on our network and our business of adverse weather conditions;

the issuance by the Financial Accounting Standards Board or other accounting bodies of new accounting standards or changes to existing standards;

changes in available technology that increase the likelihood of our customers choosing alternate technology to our products (technology substitution);

higher than anticipated start-up costs or significant up-front investments associated with new business initiatives;

the outcome of pending litigation; and

unanticipated higher capital spending from, or delays in, the deployment of new technologies.

PART II -- OTHER INFORMATION

Item 1. Legal Proceedings

For a description of material developments relating to certain pending legal proceedings, see Note M to the consolidated financial statements.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2005 and the factor set forth below, all of which could materially affect our business, financial condition or future results. These described risks are not the only risks facing our company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

The pending merger with AT&T may create uncertainty for our customers, employees and suppliers.

On March 5, 2006, we announced that we had entered into a merger agreement with AT&T. Completion of the merger requires certain regulatory approvals. The US Department of Justice cleared the merger on October 11, 2006. The Federal Communications Commission has scheduled a meeting to vote on the merger on November 3, 2006. Current employees may experience uncertainty about their post-merger roles with AT&T. This may materially adversely affect the ability of BellSouth to attract and retain key management, sales, marketing, technical and other personnel. In addition, key employees may depart because of issues relating to the uncertainty and difficulty of integration or a desire not to remain with AT&T following the merger. Accordingly, no assurance can be given that we will be able to attract or retain key employees to the same extent as we have in the past. Further, diversion of attention from ongoing operations on the part of management and employees could adversely affect our customers, suppliers and other parties with whom we have relationships. While the merger is pending, customers and strategic partners may delay or defer decisions to use BellSouth services, which could adversely affect our revenues and earnings, as well as the market price of our common shares.

In addition, customers may experience uncertainty about their BellSouth services, including network integration, pricing, and customer service, after the closing of the merger. This may materially adversely affect the ability of BellSouth to gain new customers and retain existing customers.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table contains information about our purchases of our equity securities during the third quarter of 2006.

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased(1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plan	Approximate Dollar Value that May Yet Be Purchased Under the Plan (2)
July 1 31, 2006	2,892	$ 37.18		$ 1,012,540,000
August 1 - 31, 2006	1,703	$ 40.08		$ 1,012,540,000
September 1 - 30, 2006	1,239	$ 42.18		$ 1,012,540,000
Total	5,834	$ 39.09		$ 1,012,540,000

(1) Represents shares purchased from employees to pay taxes related to the vesting of restricted shares, at an average price of $39.09. Excludes shares purchased from employees to pay taxes related to the exercise of stock options.

(2) On October 25, 2005, we announced that the Board of Directors authorized the repurchase of up to $2 billion of common stock through the end of 2007. Under the merger agreement with AT&T, share repurchases may not exceed $500 million per fiscal quarter. Furthermore, BellSouth may not repurchase shares other than as necessary to offset shares issued in connection with employee benefit plans or the direct investment plan.

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

A special meeting of shareholders was held on July 21, 2006. The voting results were as follows:

Number of Shares Outstanding as of Record Date: 1,825,692,542

Number of Shares Present: 1,265,955,733

Percent of Shares Present: 69.34%

Proposal to Approve the Agreement and Plan of Merger dated March 4, 2006, among BellSouth, AT&T and a wholly-owned subsidiary of AT&T

For	Against	Abstain
1,228,061,127	25,504,276	12,390,330

Item 6. 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.
10k-1	BellSouth Corporation Nonqualified Deferred Compensation Plan as amended and restated effective January 1, 2005.
10l-3	BellSouth Corporation Supplemental Executive Retirement Plan as amended and restated effective as of January 1, 2005.
10y-6	BellSouth Corporation Trust Under Executive Benefit Plan(s) as amended and restated effective as of October 11, 2006.
10z-6	BellSouth Telecommunications, Inc. Trust Under Executive Benefit Plan(s) as amended and restated effective as of October 11, 2006.
10aa-5	BellSouth Corporation Trust Under Board of Directors Benefit Plan(s) as amended and restated effective as of October 11, 2006.
10bb-5	BellSouth Telecommunications, Inc. Trust Under Board of Directors Benefit Plan(s) as amended and restated effective as of October 11, 2006.
11	Computation of Earnings Per Common Share.
12	Computation of Ratio of Earnings to Fixed Charges.
31a	Section 302 certification of F. Duane Ackerman.
31b	Section 302 certification of W. Patrick Shannon.
32	Statement Required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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/ Raymond E. Winborne, Jr.

RAYMOND E. WINBORNE, JR.

Controller

(Principal Accounting Officer)

November 1, 2006

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