

Pipex Homecall Limited

Directors' report and financial
statements

Registered number 4063120

For the year ended 31 December 2006

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Directors' report

The directors present their directors' report and financial statements for the year ended 31 December 2006.

Principal activities

The company's principal activity during the year was the provision of fixed line communication services.

Business review

On 22 March 2006 the company was acquired by Pipex Communications plc.

The company's trading results reflect the investment made in its business during the year.

The results for the year ended 31 December 2006 and the financial position of the company at that date are set out on pages 6 and 7 of the financial statements.

Risk

Senior management are aware of their responsibility for managing risks within their business units. Each business unit head reports to the board on the status of these risks through management reports. Risk is regularly reviewed at board level to ensure that risk management is being implemented and monitored effectively.

The board's policy is to ensure that the business units are empowered to run their business effectively and appropriately, bearing in mind the requirements for timely decision making and commercial reality. Insurance policies are regularly reviewed to ensure these are adequate and appropriate, in line with the nature, size and complexity of the business. Standard form contracts are provided for commercial use and to assist the commercial function to negotiate within approved parameters. Through management reports, risks are highlighted and monitored to identify potential business risk areas and to quantify and address the risk wherever possible.

Business Review

The following business review has been provided by the directors in accordance with the Companies Act. The company is disclosing the main trends and factors likely to affect the future development, performance and position of the business.

Key Performance Indicators (KPIs), which are set at group level, have been devised to allow the board and shareholders to monitor the group as a whole, as well as operating businesses within the group.

The company has financial KPIs which it monitors on a regular basis at board level and where relevant at business unit management meetings as follows:

	Year ended 31 December 2006	Year ended 31 December 2005
Revenue	£151,960,000	£159,841,000
Gross Profit Margin	30.1%	11.1%
EBITDA	£9,721,000	£(25,957,000)
Cash at Bank	13,404,000	£3,647,000
ARPU (Broadband and Voice)	£25.87	-

ARPU was set after the company was acquired by Pipex Communications Plc on 22 March 2006. Therefore, ARPU was not available for the year ended 31 December 2005.

The company has identified in details of various risks it faces. These include:

- the maintenance of a healthy cash balance and debt facilities to allow investment and future development;
- not rationalising cost base effectively resulting in inefficiency/duplication of effort;
- further market pressures on broadband pricing;
- failure to improve the ratio of services sold re customer putting pressure on ARPUs;
- further gross margin erosion from the impact of line rental in revenue mix.

Directors' report *(continued)*

The company perceives and monitors the following major trends, opportunities and risks for the year ending 31 December 2007 and beyond:

- ensuring that the company's objectives of growing revenue and profit in line with market expectations are met, particularly given the challenges of integration,
- which the board needs to ensure are successfully implemented;
- focusing attention on continuing to improve the strength of the Pipex brand;
- improving EBITDA margins;
- maintaining revenue in a fiercely competitive market is a risk to the business. The board will continue to focus on reducing customer churn by improving service quality and increasing the average number of services taken by each customer;
- maintaining our reputation for highest connection quality.

Dividends

The directors do not recommend the payment of a dividend. (2005: £nil)

Market value of land and buildings

In the opinion of the directors, the market value of the land and buildings of the Company exceeds the book values of these assets at 31 December 2006.

Directors and directors' interests

The directors who held office during the year were as follows:

John Caudwell	(resigned 22 March 2006)
Craig Bennett	(resigned 22 March 2006)
Brian Caudwell	(resigned 22 March 2006)
Timothy Whiting	(resigned 22 March 2006)
Craig Gibson	(resigned 22 March 2006)
Damone Quigley	(resigned 22 March 2006)
Peter Dubens	(appointed 22 March 2006)
Michael Read	(appointed 22 March 2006)
Stewart Porter	(appointed 22 March 2006)

None of the directors who held office at the end of the year had any disclosable interest in the shares of the company. Directors' interests, in the ordinary shares of the ultimate holding company, Pipex Communications plc, are disclosed in the financial statements of that company. The register of directors' interests is available from the address in note 18.

Employees

The company is an equal opportunity employer and accordingly has a policy of giving full and fair consideration to applications for employment from Registered Disabled people. In cases where disablement occurs whilst in service, company policy is, wherever practicable, to continue employment and to arrange for any necessary re-training. Opportunities for training, career development and promotion apply equally to disabled and non-disabled employees alike.

The company's policy is to consult and discuss with employees, matters likely to affect employees' interests. Information on matters of concern to employees is given through team briefings, internal publications and notice boards which seek to achieve a common awareness of the financial and economic factors affecting the company's performance.

Directors' report *(continued)*

Political and charitable contributions

The Company made no political or charitable donations or incurred any political expenditure during the year. (2005: *£nil*).

Disclosure of information to auditors

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware; and each director has taken all the steps that he/she ought to have taken as a director to make himself/herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Auditors

On 23 August 2006 in accordance with Section 392 of the Companies Act 1985, a resolution for the resignation of Ernst and Young LLP as auditors was approved and a resolution for the appointment of KPMG Audit Plc as auditors was approved.

In accordance with Section 385 of the Companies Act 1985, a resolution for the re-appointment of KPMG Audit Plc as auditors of the Company is to be proposed at the forthcoming Annual General Meeting.

By order of the board



Stewart Porter
Secretary
1 Triangle Business Park
Stoke Mandeville
Buckinghamshire
HP22 5BL

7 September 2007

Statement of directors' responsibilities in respect of the Directors' Report and the financial statements

The directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

The financial statements are required by law to give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

Independent auditors' report to the members of Pipex Homecall Limited

We have audited the financial statements of Pipex Homecall Limited for the year ended 31 December 2006 which comprise the Profit and Loss Account, Balance Sheet, Statement of Recognized Gains and Losses, Reconciliation of Movements in Shareholders' Funds and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the financial statements in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities on page 4.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements:

- give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2006 and of its profit for the year then ended; and
- have been properly prepared in accordance with the Companies Act 1985.
- the information given in the Directors' report is consistent with the financial statements.

KPMG Audit Plc
KPMG Audit Plc
Chartered Accountants
Registered Auditor
8 Salisbury Square
London
EC4Y 8BB

7 September 2007

Profit and Loss Account
for the year ended 31 December 2006

	<i>Note</i>	2006 £000	<i>Restated</i> <i>(Note 1)</i> 2005 £000
Turnover	2	151,960	159,841
Cost of sales		(106,160)	(142,149)
		<hr/>	<hr/>
Gross profit		45,800	17,692
Administrative expenses	3	(39,042)	(46,325)
		<hr/>	<hr/>
Operating profit/(loss)	3	6,758	(28,633)
Other interest receivable and similar income	6	167	-
Interest payable and similar charges	7	(2,190)	(4,892)
		<hr/>	<hr/>
Profit/(loss) on ordinary activities before taxation		4,735	(33,525)
Tax on profit/(loss) on ordinary activities	8	309	548
		<hr/>	<hr/>
Profit/(loss) for the financial year		5,044	(32,977)
		<hr/> <hr/>	<hr/> <hr/>

There were no other recognised gains or losses other than the profit for the financial year.

All of the above results relate to continuing operations.

The loss on historic basis is the same as the results reported above.

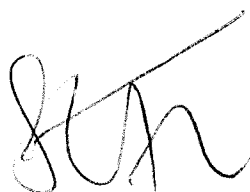
The accompanying notes on pages 9 to 16 form an integral part of the financial statements.

Balance Sheet
at 31 December 2006

	<i>Note</i>	2006	2006	<i>Restated (Note 1)</i>	
		£000	£000	2005	2005
				£000	£000
Fixed assets					
Tangible assets	9		12,019		6,122
Investments	10		-		-
Current assets					
Debtors	11	12,465		15,734	
Cash at bank and in hand		13,404		3,647	
		<hr/>		<hr/>	
Creditors: amounts falling due within one year	12	25,869		19,381	
		(87,668)		(128,799)	
		<hr/>		<hr/>	
Net current liabilities			(61,799)		(109,418)
			<hr/>		<hr/>
Total assets less current liabilities			(49,780)		(103,296)
			<hr/>		<hr/>
Net liabilities			(49,780)		(103,296)
			<hr/>		<hr/>
Capital and reserves					
Called up share capital	15		-		-
Share premium account	16		48,472		-
Profit and loss account	16		(98,252)		(103,296)
			<hr/>		<hr/>
Equity shareholders' deficit			(49,780)		(103,296)
			<hr/>		<hr/>

The accompanying notes on pages 9 to 16 form an integral part of these financial statements.

These financial statements were approved by the board of directors on 7 Sept 2007 and were signed on its behalf by:



Stewart Porter
Director

Statement of Recognised Gains and Losses
for the year ended 31 December 2006

	2006	<i>Restated</i>
	£000	<i>(Note 1)</i>
		2005
		£000
Profit/(loss) for the financial year	5,044	<i>(32,977)</i>
Total recognised gains relating to the financial year	5,044	
Prior year adjustment (as explained in note 1)	1,525	
Total gains recognised since the last annual report	6,569	

Reconciliation of Movements in Shareholders' Funds
for the year ended 31 December 2006

	2006	<i>Restated</i>
	£000	<i>(Note 1)</i>
		2005
		£000
Profit/(loss) for the financial year	5,044	<i>(32,977)</i>
Retained profit/(loss)	5,044	<i>(32,977)</i>
New share capital subscribed (net of issue costs)	48,472	-
Net addition to/(reduction in) shareholders' funds (originally £(34,502,000) restated for prior year adjustment of £1,525,000)	53,516	<i>(32,977)</i>
Opening shareholders' deficit	(103,296)	<i>(70,319)</i>
Closing shareholders' deficit	(49,780)	<i>(103,296)</i>

Notes to the financial statements

1 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the company's financial statements, except as noted below.

Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards and under the historical cost accounting rules.

Under FRS 1 the Company is exempt from the requirement to prepare a cash flow statement on the grounds that a parent undertaking includes the Company in its own published consolidated financial statements.

As the Company is a wholly owned subsidiary of Pipex Communications Plc, the Company has taken advantage of the exemption contained in FRS 8 and has therefore not disclosed transactions or balances with entities which form part of the group (or investees of the group qualifying as related parties). The consolidated financial statements of Pipex Communications Plc, within which this Company is included, can be obtained from the address given in note 18.

Going concern

The financial statements have been prepared on the going concern basis, notwithstanding net current liabilities of £61,948,000 and net liabilities of £49,929,000 which the directors believe to be appropriate for the following reasons.

The company is dependent for its working capital on funds provided to it by Pipex Communications plc, the company's ultimate parent undertaking.

Pipex Communications plc has indicated to the company that for at least 12 months from the date of approval of these financial statements, it will continue to make available such funds as are needed by the company and in particular will not seek repayment of the amounts currently made available. This should enable the company to continue in operational existence for the foreseeable future by meeting its liabilities as they fall due for payment.

Furthermore, as with any company placing reliance on other group entities for financial support, the directors acknowledge that there can be no certainty that this support will continue although, at the date of approval of these financial statements, they have no reason to believe that it will not do so.

Based on this undertaking the directors believe that it remains appropriate to prepare the financial statements on a going concern basis. The financial statements do not include any adjustments that would result from the basis of preparation being inappropriate.

The directors continue to monitor the group's funding strategy and have prepared detail forecasts for future periods. These forecasts underpin the going concern basis for the group.

Fixed assets and depreciation

Depreciation is provided to write off the cost less the estimated residual value of tangible fixed assets by equal instalments over their estimated useful economic lives as follows:

Freehold buildings	4% per annum straight line
Plant and machinery	25% - 50% per annum straight line

No depreciation is provided on freehold land.

Investments

Investments are stated at cost unless, in the opinion of Directors, there has been a permanent diminution in value, in which case an appropriate adjustment is made.

Notes to the financial statements *(continued)*

1 Accounting policies *(continued)*

Prior Year Adjustment

Following the acquisition of the company by Pipex Communications plc on 22 March 2006 a Prior Year Adjustment was made against opening shareholders' funds for the year ended 31 December 2005 in order to align accounting policies with the Pipex Group. The adjustment related to the capitalisation of labour on major IT projects and the capitalisation of Broadband connection costs over twelve months. The adjustment amounted to £1,525,000.

Leases

Operating lease rentals are charged to the profit and loss account on a straight line basis over the period of the lease.

Post-retirement benefits

The company contributes to a group pension scheme operated by Pipex Communications Plc. The amount charged to the profit and loss account represents the contributions payable to the scheme in respect of the accounting period.

Taxation

The charge for taxation is based on the profit or loss for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax is recognised, without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required by FRS 19.

2 Segmental information

All turnover and profit before taxation are derived from the provision of fixed line communication within the United Kingdom and consequently the company does not present a segmental analysis.

3 Operating profit/(loss)

	2006 £000	2005 £000
<i>Operating profit/(loss) is stated after charging:</i>		
Depreciation of tangible fixed assets	2,963	2,676
Provision on inter company balance	609	-
Operating lease rentals – Land and Buildings	502	838
Net loss on disposal of tangible fixed assets	70	-
<i>Auditors' remuneration:</i>		
Audit	29	20
	<hr/> <hr/>	<hr/> <hr/>

Notes to the financial statements (continued)

4 Remuneration of directors

	2006 £000	2005 £000
Directors' emoluments	121	483
Company contributions to a defined contribution pension scheme	2	9
Awards by Trustees for the benefit of directors	-	65
	<u> </u>	<u> </u>
Highest Paid Director:		
Emoluments	73	237
Company Contributions to a defined contribution pension schemes	2	-
	<u> </u>	<u> </u>

5 Staff numbers and costs

The average number of persons employed by the Company (including directors) during the year, analysed by category, was as follows:

	Number of employees	
	2006	2005
Management and Supervision	46	56
Other Employees	803	884
	<u> </u>	<u> </u>
	849	940
	<u> </u>	<u> </u>

The aggregate payroll costs of these persons were as follows:

	2006 £000	2005 £000
Wages and salaries	20,206	17,564
Social security costs	1,945	2,066
Other pension costs	84	62
	<u> </u>	<u> </u>
	22,235	19,692
	<u> </u>	<u> </u>

6 Other interest receivable and similar income

	2006 £000	2005 £000
Bank interest	167	-
	<u> </u>	<u> </u>

Notes to the financial statements (continued)

7 Interest payable and similar charges

	2006 £000	2005 £000
On amounts owed to group undertakings	2,190	4,892

8 Tax on profit/(loss) on ordinary activities

Analysis of charge in period

	2006 £000	£000	2005 £000	£000
<i>UK corporation tax</i>				
Current tax on income for the period	226		-	
Adjustments in respect of prior periods	(781)		(12)	
	-----		-----	
		(555)		(12)
Total current tax		(555)		(12)
<i>Deferred tax</i>				
Origination/reversal of timing differences	246		(383)	
Adjustment in respect of previous years	-		(153)	
	-----		-----	
Total deferred tax		246		(536)
Tax on profit on ordinary activities		309		(548)

Factors affecting the tax charge for the current period

The current tax charge for the period is lower (2005: lower) than the standard rate of corporation tax in the UK of 30% (2005: 30%). The differences are explained below.

	2006 £000	2005 £000
<i>Current tax reconciliation</i>		
Profit/(loss) on ordinary activities before tax	4,735	(35,050)
Current tax at 30% (2005 :30 %)	1,420	(10,515)
<i>Effects of:</i>		
Expenses not deductible for tax purposes	11	150
Income not taxable for tax purposes	(223)	-
Capital allowances for period in excess of depreciation	166	383
Other timing differences	131	-
Utilisation of tax losses	-	9,982
Group relief claimed before payment	(1,279)	-
Adjustments to tax charge in respect of previous periods	(781)	(12)
	-----	-----
Total current tax charge (see above)	(555)	(12)

Notes to the financial statements (continued)

9 Tangible fixed assets

	Land and buildings £000	Plant and machinery £000	Fixtures & Fittings £000	Software £000	Total £000
Cost					
At beginning of year (restated)	-	4,953	818	4,492	10,263
Additions	6,476	185	9	2,260	8,930
Disposals	-	(186)	-	(4)	(190)
At end of year	6,476	4,952	827	6,748	19,003
Depreciation					
At beginning of year (restated)	-	2,487	289	1,365	4,141
Charge for year	151	1,445	207	1,160	2,963
On disposals	-	(120)	-	-	(120)
At end of year	151	3,812	496	2,525	6,984
Net book value					
At 31 December 2006	6,325	1,140	331	4,223	12,019
At 31 December 2005	-	2,466	529	3,127	6,122

Included within Software is a Net Book Value of £1,347,404 (2005: £678,936) in respect of Capitalised Labour on major IT projects.

The opening balances at 1 January 2006 have been restated to include the alignment of this Pipex Group policy which have been adjusted via a Prior Year Adjustment, see note 1 for further explanation.

10 Investments

	2006 £	2005 £
Investments in subsidiary undertakings	2	2

The Company holds 100% of the ordinary share capital of Homecall Payment Services Limited, a company engaged in payment processing services, which is registered and incorporated in England and Wales.

Notes to the financial statements *(continued)*

11 Debtors

	2006	2005
	£000	£000
Trade debtors	5,566	6,681
Amounts owed by group undertakings	135	349
Net deferred tax assets	523	769
Prepayments and accrued income (restated, see note 1)	6,241	7,935
	<u>12,465</u>	<u>15,734</u>

12 Creditors: amounts falling due within one year

	2006	2005
	£000	£000
Trade creditors	19,975	15,092
Amounts owed to group undertakings	56,257	100,175
Taxation and social security	2,522	3,299
Accruals and deferred income	8,914	10,233
	<u>87,668</u>	<u>128,799</u>

13 Commitments

(a) Capital commitments at the end of the financial year for which no provision has been made, are as follows:

	2006	2005
	£000	£000
Contracted	257	1,189
	<u>257</u>	<u>1,189</u>

(b) Annual commitments under non-cancellable operating leases are as follows:

	2006	2005
	Land and buildings	Land and Buildings
	£000	£000
Operating leases which expire:		
Within one year	85	-
Over five years	-	838
	<u>85</u>	<u>838</u>

Notes to the financial statements *(continued)*

14 Pension Scheme

The Company operates a defined contribution pension scheme. The pension cost charge for the period represents contributions payable by the Company to the scheme and amounted to £ 84,000 (2005: £62,000).

15 Called up share capital

	2006 £	2005 £
<i>Authorised</i>		
10,000 ordinary shares of £ 1 each	10,000	10,000
	<hr/>	<hr/>
	10,000	10,000
<i>Allotted, called up and fully paid</i>		
3 ordinary shares of £ 1 each	3	2
	<hr/>	<hr/>
	3	2
	<hr/> <hr/>	<hr/> <hr/>

During the year the Company issued one £1 ordinary share for a consideration of £48,471,682, settled in cash.

16 Reserves

	Share premium £'000	Profit and loss account £'000	Total £'000
At 31 December 2005 (restated note 1)	-	(103,296)	(103,296)
Retained profit for the period	-	5,044	5,044
Issue of a share	48,472	-	48,472
	<hr/>	<hr/>	<hr/>
At 31 December 2006	48,472	(98,252)	(49,780)
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

17 Post balance sheet events

As at the date of approval of the accounts, the parent company, Pipex Communications plc has announced a conditional sale of part of its business; the company is included in the part of the business that relates to the sale.

Notes to the financial statements *(continued)*

18 Ultimate parent company and parent undertaking of larger group of which the company is a member

The Company is a subsidiary undertaking of Pipex Communications Plc which is the ultimate parent company incorporated in England and Wales.

The largest and smallest group in which the results of the Company are consolidated is that headed by Pipex Communications plc. The consolidated accounts of this group are available to the public and may be obtained from:

Pipex Communications plc
1 Triangle Business Park
Stoke Mandeville
Buckinghamshire
HP22 5BL
www.pipex.com