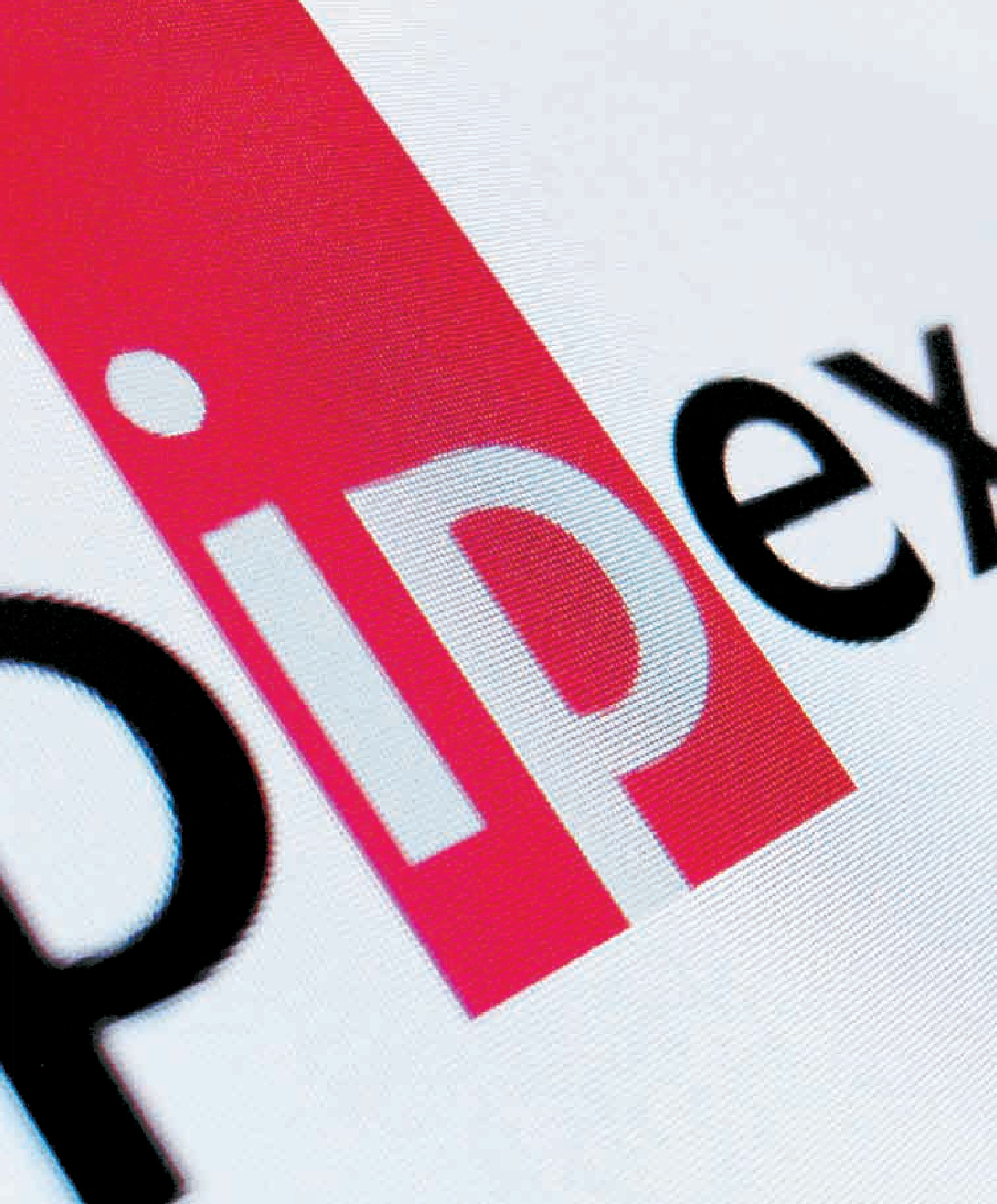


ANNUAL REPORT AND ACCOUNTS 2006

Pipex Communications plc

From being the first commercial ISP in the market, Pipex has grown to become one of the UK's leading and most respected telecoms operators. A 360º portfolio of services includes broadband, voice, data connectivity, hosting, security and WiMAX for home and business users alike.

BROADBAND SERVICES

Broadband is the Internet access method of choice for the residential and SME marketplace. As the fifth largest supplier of DSL services in the UK, Pipex bundles additional services, including voice and security, increasing the value-added appeal of the access services.

HOSTING SERVICES

Hosting Services provides shared hosting, primarily for SMEs to present their business websites. Larger customers are supported via dedicated servers and co-location. A key element of all our Hosting Services is the delivery of domain names and security.

BUSINESS SERVICES

Pipex Business Services provides all aspects of network support for medium and large businesses, with a range of services including voice, enterprise hosting, Internet, IP VPNs and other IP network applications and security solutions.

"WE HAVE BEEN CONSISTENTLY IMPRESSED WITH THE PROFESSIONALISM OF THE PIPEX TEAM AND THEIR ATTITUDE TOWARDS ATTENTION-TO-DETAIL AND DEADLINES. THEY HAVE DELIVERED AGAINST VERY AGGRESSIVE PROJECT TIMELINES AND SUCCESSFULLY TAKEN THIS ADVENTUROUS LARGE-SCALE PROJECT IN THEIR STRIDE."

MARTIN GILL, HEAD OF NEW MEDIA, COMIC RELIEF

PETER DUBENS
CHAIRMAN

The biggest opportunity... is from the integration of the recent acquisitions of Homecall, Toucan and the customers of Bulldog to form a single unified business, eliminating the functional replication existing in the current structure. This process will be completed by the end of 2008 and will deliver a significant improvement in EBITDA margin for the division.

OVERVIEW

I am pleased to report that 2006 was another strong year for Pipex with transformational acquisitions in our broadband business and continuing strong organic growth in hosting. Revenues, including acquisitions, increased by 121% to £294 million (2005: £133 million) and EBITDA (pre share option costs) increased by 55% to £23.2 million (2005: £15.0 million). Free cash flow before freehold purchases of £9.9 million was also strong at £17.6 million compared to £7.9 million in 2005, despite significant capital expenditure in the reported year on our LLU programme.

I have previously reported to you on our focus of providing additional services to customers in order to support prices and margins and to reduce churn. In 2006, we made a step-change to our capabilities in this area with the acquisition, in March, of Homecall. This added a sizable voice and line rental business to our Broadband division and gave us a strong platform from which to launch the sale of additional services into our customer base. Later in the year we added further scale to our Broadband and Voice division with the purchase of the Bulldog customer base, in September, and with the acquisition of Toucan in October. At the end of 2006, Pipex had over one million customers in this division, over 50% of whom take multiple services.

Following such a period of acquisitive growth, Pipex will be progressively integrating and consolidating its broadband and voice businesses over the remainder of this year and throughout 2008. We believe that the efficiency savings available to us from running this division as a unified business will contribute significantly to our bottom line in future periods.

We continue to enjoy strong organic growth in our hosting and domain names division, driven by ever increasing levels of Internet based activity. We are building a state-of-the-art data centre in Cologne to support the rapid expansion of our German business, with the first customers commissioned in the new site in March 2007.

Also in 2006, we embarked on the commercial exploitation of our wireless spectrum licence, in our joint venture with Intel, successfully trialling WiMAX based services in Stratford-upon-Avon.

"FOR THE CUSTOMER EXPERIENCE, OUR FOCUS IS TO PROVIDE EXCELLENT CONNECTION QUALITY BACKED UP BY HIGH QUALITY CUSTOMER SERVICE. WE HAVE STRAIGHTFORWARD PRICING WITH CONSISTENT, UNIFIED PRICES FOR ALL OUR SERVICES NATIONWIDE."

BROADBAND AND VOICE SERVICES

The impact of the acquisitions in this area has lifted customer numbers from 283,000 at the end of 2005 to in excess of one million by the end of 2006. Most importantly, the penetration of multiple service sales into our customers has grown from an insignificant number at the end of 2005 to a year later where each of our customers takes, on average, 1.74 services from us. This has helped us to lift average revenue per customer to £24.70 per month from £23.00 per month last year, in the face of market pricing pressures, particularly in broadband.

For the customer experience, our focus is to provide excellent connection quality backed up by high quality customer service. We have straightforward pricing with consistent, unified prices for all our services nationwide.

We operate a hybrid cost model to help maintain margins. This allows us to optimise service delivery costs to customers by choosing from a number of alternate wholesale providers and, of course, from our own local loop unbundling programme. At the end of 2006 we had unbundled 59 exchanges. A further 41 will be unbundled by April 2007, and the remaining 75 are in the pipeline, and due for completion, in the fourth quarter of 2007. Pipex also benefits from a sizable base of business customers which ensures our broadband network is loaded and generating revenues in the daytime when residential traffic is low.

The biggest opportunity in this division is from the integration of the recent acquisitions of Homecall, Toucan and the customers of Bulldog to form a single unified business, eliminating the functional replication existing in the current structure. This process will be completed by the end of 2008 and will deliver a significant improvement in EBITDA margin for the division.

HOSTING SERVICES

Once again, the division enjoyed good organic growth in the year. In the UK, we are the second largest hosting provider with 413,000 active sites. Domain Names have also performed strongly with UK growth of 33% to 1.38 million. In Germany, the number of Hosting Services grew by 23% and domain names by 29% to 370,000. The division continues to benefit from very attractive margins.

Pipex provides a comprehensive suite of hosting services from shared and virtual private services right up to complex managed hosting solutions.

On the back of strong organic growth in Germany in 2006, we invested in a new purpose-built data centre in Cologne. This will come on-stream in three phases, as driven by demand, and will provide sufficient capacity to meet predicted server requirements for the foreseeable future. The first customers went live in the facility in March 2007.

BUSINESS SERVICES

This division provides medium sized and larger businesses with virtual private networks, dedicated access, voice, security and bundled hosting solutions. During the year, we enhanced the management within the division to take advantage of the underlying growth in this sector. This has met with some early successes with significant customer wins including the British Library, Honda and Comic Relief.

"WE ANTICIPATED INTENSE DEMAND FOR VIEWING THE NEWLY REUNITED LEONARDO DA VINCI'S NOTEBOOKS ONCE THEY WERE LIVE ON THE BRITISH LIBRARY WEBSITE. SUCH ADVANCED TECHNOLOGY REQUIRES A HIGHLY AVAILABLE AND RESILIENT NETWORK WHICH PIPEX HAS DELIVERED WITH GREAT SUCCESS."

CYNTHIA CROSSLEY, DIRECTOR, WINDOWS CLIENT BUSINESS GROUP

WIRELESS

At the end of March 2006 we announced a joint venture with Intel to form Pipex Wireless. The aim of the joint venture is to exploit its wireless spectrum licence in the 3.6 – 4.2 GHz band by providing WiMAX based services through a UK city roll-out. Pipex Wireless owns a perpetual, nationwide licence in the UK. Technical trials have been conducted in Stratford-upon-Avon from which we believe we will be able to deliver data speeds of up to 8 Mbs, synchronously. WiMAX has non-line of sight scalable coverage of up to 5km, similar to cellular networks, which compares to around only 50m for WiFi hotspots. The plan is to roll-out to 50 UK towns and cities by 2009, starting in Manchester later this year.

Pipex Wireless continues to seek out valuable partners in the roll-out of its services, and to this end announced in April 2007 an agreement with Nokia Siemens Networks to co-operate on WiMAX infrastructure and service development to expand the availability of commercial WiMAX services in the UK.

OPERATIONAL PERFORMANCE

Turnover in the year increased by 121% to £294 million, with an increase of 14% in continuing operations, to £152 million, and £142 million contributed by the 2006 acquisitions of Homecall, Toucan and the customers of Bulldog. Gross profit increased by 84% to £112 million. Total gross margin in the year decreased from 46.0% to 38.2%, the decline arising principally from the high volume of line rental revenues in the mix of services in the 2006 acquisitions. This is demonstrated in the gross margin contributed by the acquired businesses of 31.6%. EBITDA (before share option costs) rose in the year by 55% to £23.2 million. Free cash flow generated, before freehold purchases, was £17.6 million, up from £7.9 million last year despite substantial investments in LLU of £5.8 million. In the year we acquired the freeholds of our Manchester office, housing 850 staff, and the site for the new data centre in Germany.

FUNDING

We undertook a small placing in January 2006 raising £13.6 million, net of expenses, at 13p per share to raise funds for future growth opportunities.

In March and April of 2006 we raised £91.5 million (£88.3 million net of expenses) through the private placement of 3.875% Guaranteed Convertible Bonds 2011. The bonds had a price of 15.1p and are convertible at 19p into ordinary shares and are listed on the Professional Securities Market of the London Stock Exchange. The proceeds of the bonds were used to repay a £40.0 million bridging loan, obtained to fund the purchase of Homecall and to repay all of Pipex's existing bank debt, amounting to £35.2 million.

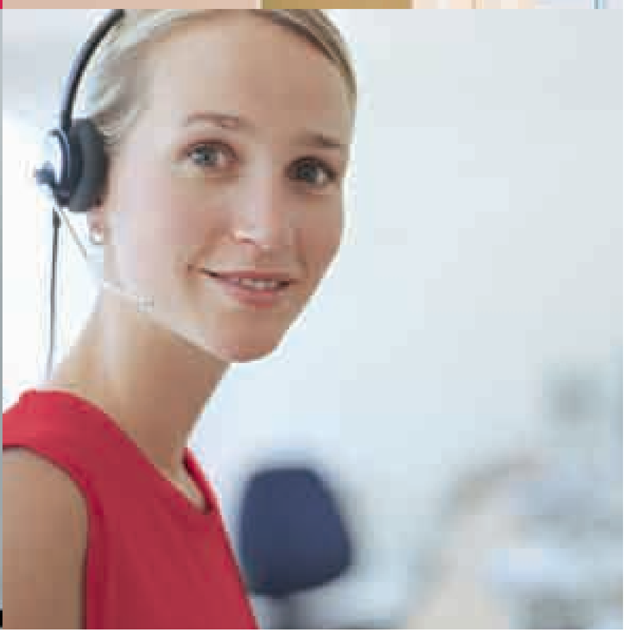
In October 2006, the company entered into a new senior debt facility of £35.0 million to fund the purchase consideration for the Bulldog and Toucan acquisitions.

OUTLOOK

In the first quarter of 2007, we have continued to see an increase in the average number of services bought by our Broadband and Voice customers and this should continue to protect margins whilst inhibiting churn. The opportunity to reduce costs in this division by integrating our acquired operations will, we believe, ensure improving EBITDA margins and cash flow over this year and next.

We look forward in 2007 to launching the first commercial WiMAX services in the UK. These services are currently being trialled in Milton Keynes and Warwick as the forerunner to our first full-scale city roll-out in Manchester in the fourth quarter.

PETER DUBENS
CHAIRMAN
16 APRIL 2007



Summary

- Revenues, including acquisitions, increased by 121% to £294 million.
- EBITDA (pre share option costs) increased by 55% to £23.2 million.
- Free cash flow before freehold purchases of £9.9 million was also strong at £17.6 million compared to £7.9 million in 2005 despite significant capital expenditure in the reported year on our LLU programme.
- We have continued to see an increase in the average number of services bought by our Broadband and Voice customers and this should continue to protect margins whilst inhibiting churn.

"WE CONTINUE TO BE IMPRESSED WITH THE PROFESSIONALISM SHOWN BY THE TEAM AT PIPEX."

DAVID FRANCE, IT DIRECTOR, HONDA F1 RACING TEAM

MIKE READ
CHIEF EXECUTIVE OFFICER

During the last two years, it has become very apparent that the amount of data being used has increased significantly, providing growth opportunities for the key service providers. Pipex has responded to this by enhancing the core network for the requirements today and also the projected growth, as well as deploying innovative hardware and software to guarantee quality of service even during peak times.

It has been another productive year in terms of acquisitions, customer growth, new product launches and integration.

As in previous years, 2006 has seen a number of consolidations in the telecommunications market, and Pipex Communications is no exception. We have added Homecall, Bulldog, and Toucan to our residential division, taking us to over one million residential customers and making Pipex the fourth largest residential voice provider and fifth largest DSL broadband provider in the UK. Pipex Hosting, our specialist hosting division, which encompasses the WebFusion and 123-reg brands, is the second largest shared and dedicated hosting business in the UK and continues to be a Domain Name market leader.

This year's acquisitions, combined with organic growth, contributed significantly to our success over the last year and saw us achieve a turnover in excess of £294 million.

As you will see, the Financial Review confirms that we have achieved all of our key financial targets, and, from an operational point of view, we have continued to focus on our three core business areas, Broadband and Voice, Hosting and Business Services. In 2006 we launched a fourth core business, Pipex Wireless Limited, a joint venture with Intel, to provide WiMAX services nationwide.

BROADBAND SERVICES

With the three major acquisitions completed in 2006, much of our focus through the year has been on laying the foundations for the integration of the legal entities and various customer bases, which, along with Pipex Internet, have been brought together to create Pipex Residential.

HOMECALL

A key element of the Homecall acquisition has been access to Cerillion, a robust and scalable back office system. The first stage of the integration was completed with the successful introduction of Cerillion Phase 1B – moving over half a million customers onto this platform.

"AS YOU WILL SEE, THE FINANCIAL REVIEW CONFIRMS THAT WE HAVE ACHIEVED ALL OF OUR KEY FINANCIAL TARGETS AND, FROM AN OPERATIONAL POINT OF VIEW, WE HAVE CONTINUED TO FOCUS ON OUR THREE CORE BUSINESS AREAS, BROADBAND AND VOICE, HOSTING AND BUSINESS SERVICES. IN 2006 WE LAUNCHED A FOURTH CORE BUSINESS, PIPEX WIRELESS, A JOINT VENTURE WITH INTEL, TO PROVIDE WIMAX SERVICES NATIONWIDE."

Using the technology and processes within Pipex Homecall we have been able to improve the way that we handle customer support queries across our call centres. Additional investment in our people and our telephony technology has resulted in lower average call waiting times by the end of the year.

A further benefit from the Homecall acquisition has been the introduction of a large highly skilled telemarketing and telesales unit and a new retail channel, via Phones 4U shops. This has opened up new routes through which our customers can buy our services in addition to our online sales channel.

The rebranding of the acquired companies is progressing as planned: Pipex Homecall was launched in May and has been positioned alongside Pipex Internet as "Pipex" during the year.

The recent "Hoff" campaign, starring David Hasselhoff has proved highly successful in promoting the Pipex brand and was one of the first steps towards the introduction of our one brand and one product portfolio within the residential consumer market.

Awareness of the Pipex brand has been further strengthened by our sponsorship of Fulham FC for a second season. The new LED system at the ground proved to be an excellent secondary advertising channel for Pipex during televised matches.

BULLDOG

Since acquiring the Bulldog customer base from Cable & Wireless in September 2006, we have implemented a number of initiatives that have significantly enhanced the performance of the business unit. As part of our commitment to improving service, we are now answering customers' queries faster and providing more first time resolution to enquiries than ever before. There are still some areas which will require ongoing improvement but we are proceeding to plan and the management of the transition and integration is progressing smoothly.

TOUCAN

The Pipex group acquired IDT Direct Limited and IDT Ireland trading as Toucan in October 2006. Since the acquisition we have been following a plan of integration and cost reduction.

The Toucan customer base has a very high "service per customer" ratio, with many customers taking multiple services including voice, line rental, broadband (or dial-up) and mobile. As a result of the maturing base, churn has also been reduced significantly.

With added focus Toucan has shown a 40% increase in mobile customers from September to the end of December; this was largely due to a campaign aimed at existing Toucan customers.

HOSTING SERVICES

Pipex Hosting continues to be the second largest shared and dedicated hosting business in the UK (as researched by Webhosting.info) and the third largest in Germany.

The hosting base grew by 14% in 2006 to 330,000 customers, and our domain name business grew from 1.3 million to 1.75 million, equating to 34% growth. We continue to lead the Domain Name market with over 20% of all ".co.uk" domains being bought via our 123-reg.co.uk website.

123-reg, traditionally a domain name provider, has successfully entered the consumer hosting market with instant site and blog products, a success which we intend to build upon in 2007.

The German hosting business has also continued to grow in both size and prestige. We became the first Red Hat Premier Hosting Partner in Europe, increased our market share in server virtualisation and saw a significant growth in revenue.

To meet demand for our services we have added a third data centre in Cologne.

"PIPEX ARE THE KEY-STONE WITHIN OUR TEAM OF TECHNICAL PARTNERS AND HAVE LED ALL THE PLANNING TO DETERMINE HOW THE TECHNOLOGY WORKS TOGETHER FOR OUR BEST RED NOSE DAY YET."

MARTIN GILL, HEAD OF NEW MEDIA, COMIC RELIEF

BUSINESS SERVICES

Business Services our pure "business to business" unit provides a wide range of access, high-end hosting, security and voice services for our medium to large enterprise customers.

During 2006, Pipex Business Services extended its security portfolio to address business continuity and security for remote workers, which resulted in the successful launch of the 'Boundary Networks' product set. This solution enables businesses to unlock the benefits of mobile working, while keeping their network secure. It protects customers from viruses, hacking and port scanning at the centre of the network rather than on the PC.

The strength of Pipex's business offering was further validated when Comic Relief selected Pipex Business Services to provide connectivity, hosting and management for the infrastructure supporting its online presence and digital donations for Sport Relief 2006 (and Comic Relief in 2007). Pipex provided a secure, high capacity network interface and resilient managed hosting solution to enable the charity's infrastructure to process millions of pounds worth of donations.

WIMAX

Pipex Wireless was set up in March 2006 by Pipex Communications and Intel Capital to develop a national WiMAX business utilising the existing spectrum assets and sales capability within Pipex. Following the recruitment of the senior management team, we now have the necessary skill base to manage the further development of the business.

Pipex Wireless, in partnership with Milton Keynes Council, Ericsson and Airspan, successfully launched the UK's first WiMAX trial service using licensed spectrum. Planning for commercial operations has commenced and all areas of the network roll-out are progressing on schedule.

Our second trial started in Warwick and Leamington Spa in partnership with Warwick District Council, Intel Solution Services and National Grid Wireless.

Further trials are scheduled which will enable us to focus on the development of a wider product range to extend the use of the WiMAX technology.

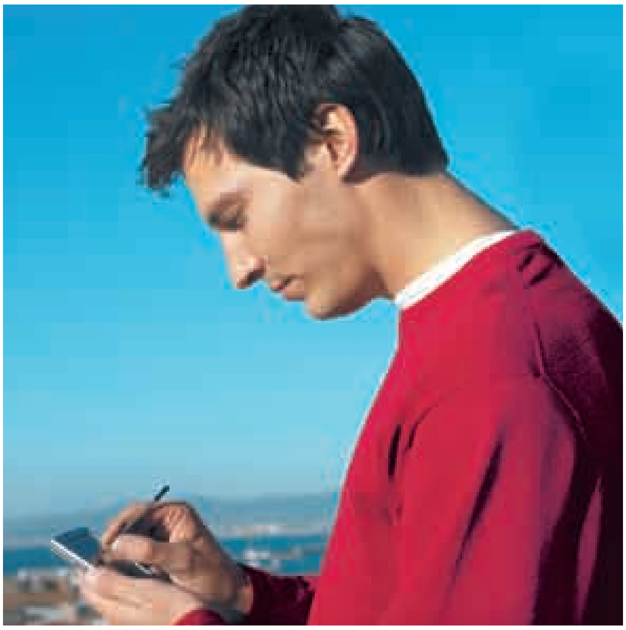
THE NETWORK

The Pipex network has been designed and developed to provide our customers with a cost effective, reliable, secure, and scalable network in order to meet their business needs.

Currently, the Pipex network provides access for its broadband, business and hosting customers at a number of strategically placed aggregation points across the UK, and as such delivers maximum resilience by providing alternative routes for traffic to reach its destination. In London Pipex employs the use of four 'meet me' points where multiple connections, normally at 10 Gb/s, ensure that the relationships with other service providers and suppliers deliver the very best Internet experience for our customers.

During the last two years, it has become very apparent that the amount of data being used has increased significantly, providing growth opportunities for the key service providers. Pipex has responded to this by enhancing the core network for the requirements today and also the projected growth, as well as deploying innovative hardware and software to guarantee quality of service even during peak times. The mixture of traffic within the network from broadband, business and hosting customers provides efficiencies from the interfaces to the Internet. The inbound to outbound and the time of day differences of the aggregated customer base enabled Pipex to reduce costs and develop stronger relationships.

All network and business customer elements are constantly monitored at our 24x7 Network Operations Centre in Oxford. This centre deploys sophisticated monitoring packages to ensure effective traffic flow, together with the monitoring of all network events.



Summary

- ➔ We will continue to look at the opportunities to unbundle additional exchanges as the customer base grows.
- ➔ Pipex Wireless has begun discussions with Nokia Siemens to form a strategic partnership to expand the infrastructure required to offer commercial WiMAX services in the UK.
- ➔ Acquisitions, combined with organic growth, contributed significantly to our success over the last year, which saw us achieve a turnover in excess of £294 million.

"PIPEX HAS THE NECESSARY SKILLS AND EXPERTISE TO PROVIDE A FULLY MANAGED HOSTING SERVICE AND PROVIDE TECHNICAL SUPPORT 24 HOURS A DAY, SEVEN DAYS A WEEK. BRINGING TOGETHER THE EXPERTISE AND POWER OF THE PIPEX SOLUTION MEANT THAT WE WOULD REALISE SIGNIFICANT COST BENEFITS IN A SHORT SPACE OF TIME."

RNLI

LOCAL LOOP UNBUNDLING

The decision to unbundle exchanges and place Pipex owned and operated equipment in BT exchanges was based on reduced cost, improved quality and the capability to develop enhanced products.

Pipex has planned to unbundle a total of 175 exchanges before the end of 2007, employing equipment that can provide broadband, voice, wholesale line rental and advanced services when required. The transfer of customers to this network has been very successful and the business is looking at the prospect of delivering leased line replacement services to further take advantage of the equipment and technology available.

We will continue to look at the opportunities to unbundle additional exchanges as the customer base grows.

SYSTEMS

Pipex has made progress in developing solutions to integrate the acquisitions made in the past twelve months onto common systems. The foundations that we have laid will enable us to move customers to common provisioning, rating, billing and CRM systems during 2007 and 2008. This will deliver further gains in efficiencies in terms of staff training and operations, and will provide the ability to cross-sell all products from the Pipex portfolio over state of the art provisioning interfaces to internal networks and third parties, allowing quicker time to market for new products and services.

CORPORATE SOCIAL RESPONSIBILITY

At Pipex, we understand how important it is to conduct business in a social, ethical and environmentally conscious way. That is why we are committed to being a responsible company and to improving our performance in all areas of corporate responsibility.

That could mean actions that will impact positively on our stakeholders (including customers, employees, shareholders, suppliers and local communities) as well as the environment. We will, naturally, adhere to all legal and regulatory obligations and, where possible, exceed them.

Pipex's continued commitment to quality is reflected in our ISO 9001:2000 certification. This certification demonstrates that we operate using a quality management system that has been independently assessed (by the British Standards Institute) as compliant with the internationally recognised standard. This certification is verified through audits every six months, where continuing certification can either be confirmed or denied. Beyond the day to day running of our business, we're also committed to cutting waste and our carbon footprint. But we feel our corporate responsibility should go further still. That's why we're active supporters of a number of projects and charities around the country including Comic Relief, Sport Aid and RNLI.

Naturally, we believe in a safer Internet. That's why we work closely with organisations and regulatory bodies such as OFCOM, the Internet Service Providers' Association (ISPA) and the Internet Watch Foundation (IWF), as well as the Police and the Home Office, to prevent illegal and inappropriate use of the Web.

THE FUTURE

Our focus is on providing services to our business and residential customers across the UK together with hosting services in Germany. We plan to build upon the success of our marketing campaigns and continue to grow the Pipex Residential, 123-reg, WebFusion and Pipex Business Services brands.

Through our continued product development we are better placed than we have ever been to target all public and private market sectors and cover the spectrum of customers from home users to large enterprise customers.

We have continued to invest in new network technologies to deliver an even better "broadband experience" for all our customers. Using state of the art traffic management techniques and the latest Ellacoya and Juniper software and hardware we have driven network efficiencies in 2006. This process is ongoing and will deliver further cost efficiencies and better service for our customers in 2007 and beyond.

CONSOLIDATION OF CALL CENTRES

The Irish government has approved Pipex to replace IDT (Toucan's previous owner) as the guarantor of the grant agreement. Providing certain conditions are met, the Irish Government makes a contribution for each new position created in our Irish call centre. That, together with the superb quality and lower costs of the Sligo site, will allow us to review our call centre strategy across the wider Pipex group.

COST SAVINGS VIA SYSTEM INTEGRATION

During 2007, our broadband customers will start migrating onto common provisioning, rating, billing and CRM systems.

LAUNCH OF COMMERCIAL SERVICES FOR WIMAX

The launch of commercial WiMAX services in a number of cities will commence later in 2007 and will deliver wireless broadband access through various indirect channels, strategic partners and wholesale partnership agreements, including other businesses within the Pipex group.

WIMAX PARTNERSHIP WITH NOKIA SIEMENS

Pipex Wireless has begun discussions with Nokia Siemens to form a strategic partnership to expand the infrastructure required to offer commercial WiMAX services in the UK.

As one of the world's leading infrastructure and managed services providers, Nokia Siemens is well placed to assist Pipex in the development of WiMAX services. Pipex plans to use Nokia Siemens' radio equipment and networking expertise as it looks to widen its roll-out of WiMAX powered wireless broadband services. A pilot is planned in the last quarter of 2007.

PEOPLE

We have strengthened our management team during 2006 and I believe we now have the team in place to meet the challenges of 2007.

MIKE READ
CHIEF EXECUTIVE OFFICER
16 APRIL 2007

"THE KEY BENEFIT OF THE PIPEX SOLUTION TO US, IS THAT IT IS SPECIFICALLY CUSTOMISED TO EXACTLY FIT OUR REQUIREMENTS. THE FLEXIBILITY ASPECT IS ALSO IMPORTANT, AS WE ARE ABLE TO EXPAND THE PLATFORM AS AND WHEN WE NEED TO, OR THE BANDWIDTH HAS THE CAPACITY TO INCREASE IF WE HAVE A HIGH NUMBER OF VISITORS TO THE SITE."

IAN CASTLETON, IT PROJECT MANAGER, TRINITY MIRROR

STEWART PORTER
CHIEF FINANCIAL OFFICER

Within the segmental analysis each of the divisions enjoyed turnover growth. Broadband and Voice Services has increased from £76.5 million to £231.8 million principally driven by the three substantial acquisitions made in this division in 2006. Even with the high incidence of voice revenues in the group's turnover mix and market pressures on broadband pricing, the group has improved its average revenue per customer to £24.70, from £23.00 last year.

TRANSACTIONS

HOMECALL

On 23 March 2006 the company acquired Caudwell Communications Limited, trading as Homecall. Consideration for the purchase was £43.1 million, in the form of assumed debt, together with costs of acquisition of £1.0 million.

Net liabilities acquired were £51.0 million, including assumed debt, giving rise to goodwill of £52.0 million. In line with group policy, goodwill is being amortised on a straight line basis over ten years.

The acquisition was funded by a bridging loan of £40 million which was subsequently repaid out of the proceeds of the issue of Convertible Bonds.

BULLDOG

On 7 September 2006 the group acquired the Bulldog customer base and brand name from Cable & Wireless. Consideration, which was in respect of the customer base only, was previously announced as £12 million but because of a correction to the number of live customers actually present on the network, has subsequently been reduced to £10.4 million.

With minimal costs of acquisition and no net assets, goodwill arising was £10.4 million. As the entire goodwill amount relates to an intangible asset (the value of the customer base) it is appropriate to shorten the amortisation period from the group's standard ten years to three years.

Funding for the acquisition was initially out of the group's own resources though, subsequently, additional bank debt was taken on.

TOUCAN

On 12 October 2006 the company acquired IDT Direct Limited and IDT Direct Ireland Limited, both trading as Toucan. The cost of investment was £26.0 million comprising the settlement of an intercompany loan with IDT amounting to £20.0 million, the issue of 43,193,435 new Pipex ordinary shares with a value at completion of £4.7 million and acquisition costs of £1.3 million.

Net assets acquired were £2.1 million, including cash balances of £2.0 million, giving rise to goodwill of £23.9 million. Goodwill is being amortised over ten years.

The acquisition was funded from the draw down of new bank debt.

"TURNOVER INCREASED IN THE YEAR TO £294.4 MILLION FROM £132.9 MILLION, AN INCREASE OF 121%. WITHIN THIS, TURNOVER IN EXISTING OPERATIONS GREW BY 14% (AN INCREASE OF £18.8 MILLION) AND ACQUISITIONS CONTRIBUTED THE BALANCE OF £142.7 MILLION."

PIPEX WIRELESS

On 31 March 2006 the group entered into a joint venture with Intel Capital through the formation of Pipex Wireless Limited. The fundamental assets needed by the new company were the 3.8-4.2 GHz spectrum licence residing in Pipex Communications Business Solutions Limited and, of lesser importance, the three 28 GHz licences in Faultbasic Limited. Because of the non-transferability conditions attaching to the licences, these entities were sold by the group to Pipex Wireless in share for share exchanges.

SMALL ACQUISITIONS

In addition to the material acquisitions detailed above, the group made two further small purchases in the year. Switch2 Telecoms Limited, a small voice reseller, was acquired on 29 June from Littlewoods. The purchase consideration was £1.0 million and acquisition costs were £0.1 million. Net liabilities acquired were £0.7 million giving rise to goodwill, which is being amortised over ten years, of £1.7 million.

On 17 July 2006 the group acquired SupaNetwork Limited, a small hosting business based in the Midlands. Consideration was £2.2 million consisting of a cash consideration of £2.1 million and acquisition costs. Net assets acquired were £0.3 million, including cash of £0.5 million, giving rise to goodwill of £1.9 million, also being amortised over ten years.

PERFORMANCE

PROFIT AND LOSS

Turnover increased in the year to £294.4 million from £132.9 million, an increase of 121%. Within this, turnover in existing operations grew by 14% (an increase of £18.8 million) and acquisitions contributed the balance of £142.7 million.

Within the segmental analysis each of the divisions enjoyed turnover growth. Broadband and Voice Services has increased from £76.5 million to £231.8 million principally driven by the three substantial acquisitions made in this division in 2006. Even with the high incidence of voice revenues in the group's turnover mix and market pressures on broadband pricing, the group has improved its average revenue per customer to £24.70, from £23.00 last year. This division accounted for 79% of the group's 2006 turnover.

The comparative numbers for each division have been restated to reflect a logical customer grouping rather than a primarily services denominated grouping.

In Hosting Services, turnover was up by 17% on last year to £35.2 million, the majority of which was organic growth. Hosting Services accounted for 12% of group turnover.

Within Business Services organic growth in the division was on a par with last year at 4%. With 2006 turnover of £27.4 million, the division represented 9% of the group.

The group continues to operate out of two geographic locations, the UK and Germany. All of the group's recent acquisitions have been UK denominated driving the turnover in the UK to £284.8 million in 2006, an increase of 127% over the previous year. Within Germany, which is in Hosting Services, turnover has increased to £9.6 million from £7.3 million, an improvement of 31%, entirely generated by organic growth.

Gross profit for the year was £112.4 million, up from £61.2 million in 2005, an increase of 84%. Gross margin has declined over the same period form 46.0% to 38.2%, a fall of 7.8 percentage points. This has principally arisen because of the impact of high value, low margin, line rental revenues in the 2006 acquisitions. This is demonstrated in the overall gross margin achieved by these businesses in their post-acquisition periods of 31.6%. The full year impact of acquisitions will continue to depress margins a little in 2007, partly offset by the anticipated improvement derived from increasing the ratio of services delivered per customer.

Operating expenses before amortisation, depreciation, and share option costs have risen to £89.2 million from £46.2 million, an increase of 93%. Of this, the 2006 acquisitions account for 74%. Operating expenses have increased in the continuing businesses by £8.9 million making them 19.3% higher than for 2005. The full year cost of the 2005 acquisitions contributed £2.4 million of the increase, £4.0 million arose through higher marketing spend and £2.5 million was attributable to improving customer services and migration to improved systems platforms.

PERFORMANCE CONTINUED

PROFIT AND LOSS CONTINUED

EBITDA before share option costs has risen to £23.2 million, an increase of 54.7% over last year. EBITDA margin, measured as the ratio of EBITDA to turnover, has fallen significantly from 11.3% in 2005 to 7.9%. This decline mirrors the impact of the fall in gross margin percentage due to the impact of line rental revenues in 2006 compounded by cost inefficiencies as a result of acquisitions. It is the group's aim to drive integration savings over the period to the end of 2008 with the intention of restoring EBITDA margins.

Amortisation of intangibles has risen very steeply in the year to £18.9 million from £11.2 million. This reflects the increase in underlying goodwill which has risen to £171 million at the year end (2005: £99 million) as a result of the 2006 acquisitions. Goodwill, in the form of the intangible asset arising from the Bulldog purchase, which is being written off over three years, gave rise to a charge in the year of £1.2 million. In addition, a charge of £0.7 million was taken to write off the carrying value of goodwill remaining from the Firstnet acquisition in 2003. This charge reflects the sale of this legal entity to Pipex Wireless as part of Pipex's contribution to the joint venture with Intel.

Depreciation has also increased in the year, by £5.1 million (up 71.7%) to £12.1 million. The 2006 acquisitions account for £2.4 million of the increase with the balance arising because of depreciation on LLU capital expenditure, on new systems expenditures and on growth.

As required, the company has adopted FRS 20 for accounting for share based incentives in this year. This accounting standard essentially charges the estimated benefit accruing to employees granted options as an employment cost, charged over the anticipated vesting period for the options. The profit and loss cost in 2006 is £2.2 million with an equivalent, restated number in 2005 of £2.5 million. This charge does not represent a cash cost to the company.

Pipex Wireless Limited, our partnership with Intel, is governed by a constitution which requires that for major business decisions the unanimous agreement of shareholders is required. Consequently, Pipex Communications does not have management control of the business and Pipex Wireless is therefore accounted for as a joint venture. In 2006 our share of the operating loss of the joint venture was £1.4 million.

Net interest for the period was £6.3 million, an increase of £3.5 million over 2005. The Convertible Bonds issued by the company at the end of the first quarter account for £4.0 million of the charge in the year. The cash element of this charge is £2.7 million (based on the bond coupon of 3.875%). However, as required for accounting purposes, the bond is split between an equity and debt component, the debt (amounting to £82.9 million at the year end) being required to carry a commercial interest rate for profit and loss reporting.

The loss for the year has increased to £17.8 million from £8.7 million last year. Whilst EBITDA before share option costs has improved by £8.2 million, this has been more than offset by a steep increase in amortisation costs of £7.7 million, the share of Pipex Wireless's losses of £1.4 million and additional interest costs associated with the Convertible Bonds.

BALANCE SHEET

The net book value of goodwill has risen from £99 million to £171 million driven by the goodwill arising in the 2006 acquisitions of £90.5 million, offset by amortisation charged in the period. Group policy is to amortise goodwill over ten years. Intangible assets included £9.2 million of goodwill in respect of the written down value of the Bulldog customer base acquisition, which is being amortised over three years. The wireless licence intangible asset is not in the year end balance sheet (2005: £4.4 million) as this was sold to Pipex Wireless as part of the share for share sale of Pipex Communications Business Solutions.

Tangible assets have increased in the year by £21.7 million to £47.0 million. A major contributor to the increase was the 2006 acquisitions which added £5.9 million. In addition, the group acquired the freehold of its Manchester office at a cost of £6.5 million, invested £3.4 million in the new data centre in Cologne and spent £5.8 million on local loop unbundling.

Pipex Wireless is disclosed in the group balance sheet by way of our share of the gross assets and gross liabilities of the joint venture. Because the equity held by the shareholders in Pipex Wireless is in the form of convertible redeemable preference shares, we are required to divide this capital between its equity and debt components. At the year end the notional debt was assumed to be £10.6 million and this forms part our share in the consolidated balance sheet. The net result is a reported net liability of £5.6 million for the investment in joint ventures whereas, in reality, Pipex Wireless has a strong balance sheet with positive net assets.

Debtors have increased by £25.7 million to £44.7 million with the 2006 acquisitions contributing £26.4 million of this increase.

Cash at bank and in hand at the year end was very strong at £48.3 million, up by £34.4 million from 2005.

Creditors falling due within one year have also increased significantly, by £40.4 million to £100.3 million. The major contributor to this increase was again the 2006 acquisitions, which added £40.9 million at the year end, offset by a bank loan repayment of £8.0 million included in the 2005 balance.

Creditors falling due after one year reflects the impact of the debt component of the Convertible Bonds in long term debt, amounting to £82.9 million with no 2005 comparative. Overall, creditors falling due after one year have increased by £100.1 million to £125.0 million. On top of the increase as a result of the bond issue, the change in bank facilities increased bank loans repayable after one year, net of the repayment from the bond proceeds by £16.0 million.

Pipex Group Brands

"WE HAVE AN EXCELLENT RELATIONSHIP WITH PIPEX, AND FEEL THE COMPANY REALLY LOOKS AFTER OUR BEST INTERESTS. WE CAN'T FAULT THE SUPPORT THEY PROVIDE AS EVERY ISSUE OR PROBLEM IS ALWAYS RESOLVED IMMEDIATELY."

MATTHEW MCGRORY, HEAD OF IT, FULHAM FC

CASH FLOW

The group generated £17.6 million free cash flow in the year, before freehold purchases of £9.9 million, compared to £7.9 million in 2005. Free cash flow is cash flow before management of liquid resources and financing and acquisitions. Strong working capital movements in the year produced a cash inflow from operating activities of £34.0 million, £16.6 million ahead of last year.

Capital expenditure was relatively high in the year although, excluding the freehold purchases, was inside our normal parameters. Capital expenditure was £22.1 million (2005: £7.1 million), excluding fixed assets purchased through finance leases amounting to an additional £5.0 million (2005: £3.3 million). Capital expenditure on the LLU programme amounted to £5.8 million. Freehold purchases of £9.9 million comprised the purchase of an office building in Manchester, housing 850 of our staff, for £6.5 million and the Cologne data centre.

Net debt at the year end was £81.1 million compared to £27.7 million in 2005. This comprises: Convertible Bonds debt of £82.9 million; bank debt of £39.3 million; finance leases of £7.3 million; offset by balance sheet cash of £48.3 million.

TREASURY

The group uses financial instruments to raise finance for its operations and to manage risk arising from those operations. The group does not undertake any speculative trading in financial instruments.

On 19 January 2006 the group issued 109,000,000 new ordinary shares raising £13.6 million, after expenses. The proceeds of the issue were to be used to fund growth opportunities.

On 22 March 2006 Pipex took out a £40 million bridging loan to fund the acquisition of Homecall in anticipation of the repayment of this loan from the proceeds of a Convertible Bond issue.

On 23 March 2006 Pipex Finance (Jersey) Limited announced the private placement of £80 million 3.875% Guaranteed Convertible Bonds 2011 together with an option to issue up to a further £20 million on the same terms. In the event, a total of £91.5 million was placed at an underlying price of 15.1p per share. The bonds are convertible into ordinary shares in the company at a conversion price of 19p. The company has an option to call the bonds after three years should the price of the company's ordinary shares exceed 130% of the conversion price over a fixed period.

The net proceeds from the bonds, amounting to £88.3 million, were used to fund the Homecall acquisition, including repayment of the £40 million bridging loan and to repay existing bank debt of £35.2 million.

On 15 September 2006 the company agreed a new senior debt financing facility comprising £35.0 million which was drawn to fund the Bulldog and Toucan acquisitions and a further £15.0 million facility available to fund future acquisitions which remains undrawn.

STEWART PORTER
CHIEF FINANCIAL OFFICER
16 APRIL 2007

PETER DUBENS (AGED 40)
CHAIRMAN

Peter Dubens has experience in the start-up, development and restructuring of business both in the public and private sectors. He has led the consolidation strategy that has built Pipex Communications plc into what it is today. Peter Dubens was formerly Executive Chairman of 365 Media Group plc, the largest UK online sports content and gaming company which was sold to BskyB in December 2006. He is also the co-founder of Palmer Capital Management, a hedge fund introductory business, and Oakley Capital Management Limited, a fund of hedge funds. Peter Dubens has also co-founded a number of other privately held companies.

MIKE READ (AGED 59)
CHIEF EXECUTIVE OFFICER, PIPEX COMMUNICATIONS PLC AND PIPEX WIRELESS LIMITED

With over 30 years' experience in the Communications and Internet sectors, Mike Read has steered companies through organic growth, acquisition and sale phases.

Mike enjoyed an extensive career at British Telecom, culminating in being appointed Chief of Global Engineering to run all operations outside the UK. Mike moved to the US with BT in the early 1990s, and subsequently joined AOL. He completed a 30-company ISP "roll-up" which was sold to Earthlink in 2000, before returning to the UK in 2000 to run XO Europe – the nucleus of today's Pipex Communications plc.

As Chief Executive Officer of Pipex, Mike sets the agenda for the strategic direction of the company, as well as overseeing the operating divisions. Under his stewardship, Pipex is now the fourth largest voice and line rental provider, the fifth largest broadband provider (DSL) and the second largest hosting provider to the SME market.

In September 2006, in addition to his existing role as Chief Executive Officer of Pipex Communications, Mike became Chief Executive Officer of Pipex Wireless Limited, a joint venture with Intel Capital formed in March 2006. Currently, Mike also holds two advisory board positions: one for Danger Inc., a US mobile communications company, and the other, Quester, one of the UK's leading independent venture capital groups.

STEWART PORTER (AGED 54)
CHIEF FINANCIAL OFFICER

Stewart Porter is a Chartered Accountant and holds a Bachelor of Science degree in Electrical Engineering. Prior to founding Zipcom (now Pipex Communications) as Chief Financial Officer, Stewart was Finance Director for Highpoint Telecommunications Inc, a Canadian listed company, where he was closely involved in the successful establishment of a number of European start-ups. Stewart worked for Cable & Wireless for eight years in a number of senior financial positions, latterly as Director of Finance and Business Development in Global Markets, the business unit responsible for serving the multinational customers of Cable & Wireless.

CHRISTINA KENNEDY (AGED 58)
NON-EXECUTIVE DIRECTOR, CHAIRMAN OF THE REMUNERATION COMMITTEE AND A MEMBER OF THE AUDIT COMMITTEE

Christina Kennedy has a Masters degree in Business Administration and is a Fellow of the Institute of Chartered Secretaries and Administrators. For over twenty years she has worked on a consultancy basis at Board level acting as Company Secretary in a variety of listed companies: AIM, top 250 and overseas companies with a secondary listing.

Industry experience is wide ranging including manufacturing, leisure and service companies. She has a good working knowledge of the Stock Exchange Regulations, Company Law and Corporate Governance. She has also worked in a consultancy capacity as Corporate Governance Advisor for a major UK pension fund and therefore has a good understanding of investors' governance requirements. Her experience has involved her working with boards on acquisitions; restructuring; board compositions and appointments; directors' service contracts and remuneration issues; long term incentive schemes; share options and risk management issues related to internal control requirements.

LAURENCE BLACKALL (AGED 56)
NON-EXECUTIVE DIRECTOR, CHAIRMAN OF THE AUDIT COMMITTEE AND A MEMBER OF THE REMUNERATION COMMITTEE

A former Chairman of the Internet Service Providers' Association (ISPA), Laurence Blackall has a Masters degree in Marketing and over twenty years' experience in the media and telecommunications industries. After an early career that included Virgin and the SEMA group he was a director of Frost & Sullivan and a Vice President at McGraw-Hill. In 1995 he founded Global Internet and took it public as Internet Technology Group in 1996.

He managed the sale of his company to Concentric Network Corporation, which was itself acquired by XO Communications Inc. Together with Peter Dubens, he acquired XO's UK business, which reversed into Zipcom plc. This was renamed GX Networks plc, before becoming Pipex Communications plc in 2003.

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

PRINCIPAL ACTIVITY AND BUSINESS REVIEW

The principal activity of the group during the period was the supply of telecommunication services. A detailed review of the business is set out in the Chairman's Statement on pages 2 to 5, the Chief Executive's Report on pages 6 to 11 and the Financial Review on pages 12 to 16.

FINANCIAL RESULTS AND DIVIDENDS

The results for the group for the year are shown in the profit and loss account on page 28.

The directors do not recommend the payment of a dividend.

DIRECTORS AND DIRECTORS' INTERESTS

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

Peter Dubens	Chairman
Michael Read	Chief Executive Officer
Stewart Porter	Chief Financial Officer
Christina Kennedy	Non-executive
Laurence Blackall	Non-executive

Peter Dubens and Michael Read retire by rotation in accordance with the Articles of Association and, being eligible, offer themselves for re-election.

The directors' remuneration and the interests of the directors in the share capital of the company are detailed in the board report on directors' remuneration on pages 23 to 25.

EMPLOYEES

It is the policy of the group that there should be no unfair discrimination in recruiting and promoting staff, including applicants who are disabled. The directors are committed to maintaining and developing communication and consultation processes with employees, who in turn are encouraged to develop an awareness of the issues affecting the group. The directors place considerable emphasis on employees sharing in the success of the group. This is achieved through the performance related bonus scheme and participation in the share option schemes. The company has established an Employee Consultation Forum in line with the Information and Consultation of Employees Regulatory Directive. This Forum has elected representatives from employee constituencies and meets quarterly with the company's senior management to discuss business issues.

SUBSTANTIAL SHAREHOLDINGS

As of 13 April 2007 the company had been notified of the following significant shareholdings:

	%
UBS AG	15.54
Goldman Sachs Group Inc	10.09
Fidelity International	9.03
Prudential plc group	8.56
M & G Investment Funds 3	7.47
P Dubens	5.79
SR Global Fund	3.11

POLICY ON PAYMENT TO SUPPLIERS

Where the supply of goods and services is satisfactory and in the absence of any dispute, the group and company's policy is to pay suppliers in accordance with the terms agreed prior to the supply of goods and services. Where no such agreement exists the group and company's policy is to pay suppliers in accordance with the terms contained in the invoice. Trade creditors at 31 December 2006 as a proportion of amounts invoiced by suppliers during the period represent 48 days (2005: 49 days) for the existing business and 41 days for the acquired businesses. The company has no material trade creditors.

POLITICAL AND CHARITABLE CONTRIBUTIONS

The company made no political or charitable donations during the year but supported certain charities through the provision of discounted services.

ENVIRONMENTAL POLICY

The group's environmental policy is to meet the statutory requirements placed upon it and to apply good environmental practice in its operations whilst recognising that it is contractually obliged to meet its customers' requirements.

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. Group 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 businesses 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:

	31 December 2006	31 December 2005
Group Revenue	**£294.4m**	£132.9m
Gross Profit Margin	**38.2%**	46.0%
EBITDA (before share option costs)	**£23.2m**	£15.0m
Free Cash Flow (before freehold purchases)	**£17.6m**	£7.9m
Cash at Bank and in Hand	**£48.3m**	£14.0m
ARPU (Broadband and Voice)	**£24.70**	£23.00

The company has provided in the Chairman's Statement, Chief Executive's Report, and Financial Review details of various risks it faces. These include:

- the maintenance of a healthy cash balance and debt facilities to allow investment and future development (refer Financial Review – Treasury page 16);
- not rationalising cost base effectively resulting in inefficiency/duplication of effort (refer Chief Executive's Report – Broadband Services page 6 and Financial Review – Profit and Loss page 14);
- further market pressures on broadband pricing (refer Financial Review – Profit and Loss page 13);
- failure to improve the ratio of services sold re customer putting pressure on ARPUs (refer Chairman's Statement – Broadband and Voice Services page 3);
- further gross margin erosion from the impact of line rental in revenue mix (refer Financial Review – Profit and Loss page 13).

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

- ensuring that the group'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.

CORPORATE AND SOCIAL RESPONSIBILITY

The company embraces corporate and social responsibility and encourages all of its subsidiaries to become involved in local projects and initiatives on an ad hoc basis dependent upon employee interest and participation.

GOING CONCERN

The directors are satisfied that the company and the group have adequate resources to continue to operate for the foreseeable future. For this reason they continue to adopt the "going concern" basis for preparing the accounts.

ANNUAL GENERAL MEETING

The Annual General Meeting will be held on 12 June 2007 at 11am at the offices of Financial Dynamics, Holborn Gate, 26 Southampton Buildings, London WC2A 1PB. The full wording of the resolutions to be tabled at the forthcoming Annual General Meeting is set out in the notice of the meeting on pages 53 to 54. At the Annual General Meeting a resolution will be proposed that the company may send or supply documents to members by making them available on a website or by other electronic means in accordance with the provisions of the Companies Act 2006.

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 they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

AUDITORS

In accordance with section 385 of the Companies Act 1985, a resolution proposing that KPMG Audit Plc be re-appointed as auditors of the group will be put to the Annual General Meeting.

This report was approved by the board on 16 April 2007.

STEWART PORTER
CHIEF FINANCIAL OFFICER
16 APRIL 2007

The board is responsible to shareholders for effective direction and control of the group and this report describes the framework for corporate governance and internal control that the directors have established to enable them to carry out this responsibility. It also explains how the company has applied the Principles of Good Governance. Although, as an AIM listed company, the company is not required to comply with the provisions of the Combined Code ("the Code") and this is not a statement of compliance as required by the Code, the board of directors recognises the importance of, and is committed to, ensuring that effective corporate governance procedures relevant to smaller listed companies are in place.

THE BOARD AND COMMITTEES

At 1 January 2006 the board comprised three executive directors (P Dubens, M Read and S Porter) and two non-executive directors (C Kennedy and L Blackall). No additional appointments were made during the year to 31 December 2006. The board considers that the current composition provides a reasonable balance of independence. L Blackall, whilst a former shareholder, brings an independent view of the telecoms industry to board discussions. C Kennedy is considered to be an independent non-executive director as defined under the Code.

An evaluation of board performance has been undertaken. The executive team discussed the effectiveness and input from the non-executive directors at a management meeting and the Remuneration Committee discussed the performance of the executive team. It was agreed that the workings of the board were currently effective and there was no need to appoint external consultants to undertake a more formal review.

The board is responsible for the overall strategy and financial performance of the group and has a formal schedule of matters reserved for its approval. Each board meeting is preceded by a clear agenda and any relevant information is provided to directors in advance of the meeting. The board met on five occasions during the year to discuss operational business. All directors were in attendance.

Since September 2003 the roles of Chairman and Chief Executive Officer have been separate. The board does not consider it necessary to appoint a senior independent director.

The Remuneration Committee comprises C Kennedy and L Blackall only and is chaired by C Kennedy. The board report on directors' remuneration on pages 23 to 25 contains a detailed description of remuneration and applicable policies. The committee met on four occasions during the year. Both members were present.

Given the small size of the board, and as permitted by the Code, the board has not appointed a Nominations Committee. The board as a whole considers the appointment of all directors and senior managers. The Articles of Association of the company require directors to submit themselves for re-election at the first Annual General Meeting following appointment and then every three years by rotation, but in accordance with good practice one third of the directors will be submitted for re-election each year.

The Audit Committee comprises L Blackall (Chairman) and C Kennedy. C Kennedy is considered by the board to have relevant financial experience. The Committee operates under written terms of reference and is scheduled to meet at least twice a year with the company's external auditors, and the executive directors present by invitation only. The Committee met twice during the year. All members were present. The Committee meets with the external auditors without the executive directors present as it considers appropriate. The Committee is responsible for the independent monitoring of the effectiveness of the system of internal control, compliance, accounting policies and published financial statements on behalf of the board. This is achieved primarily through a review of the annual financial statements and a review of the nature and scope of the external audit. Any significant findings or identified risks are examined so that appropriate action may be taken. The Committee is also responsible for keeping under review the independence and objectivity of the external auditors, including a review of non-audit services provided to the group, consideration of any relationships with the company that could affect independence, and seeking written confirmation from the auditors that, in their professional judgment, they are independent.

RELATIONS WITH SHAREHOLDERS

The company encourages the participation of both institutional and private investors. Communication with private individuals is maintained through the Annual General Meeting, and Annual and Interim Reports. In addition further details on the strategy and performance of the company can be found at its website (www.pipexgroup.com) which includes copies of the company's press releases. The Chairman provides regular updates to the board on his meetings with shareholders and analysts, and brokers opinions are made available to the board. As required by the Combined Code, non-executive directors are available if required to meet major shareholders.

The company's share registrars provide a helpdesk, which members may contact with enquiries regarding their shareholdings. The helpdesk telephone number is 0870 162 3100 (or 0044 20 8639 2157 for overseas callers) and their e-mail address ssd@capitaregistrars.com.

INTERNAL CONTROL

The board has overall responsibility for the group's systems of internal control and for monitoring their effectiveness. Although no system of internal control can provide absolute assurance against material misstatement or loss, the group's systems are designed to provide the directors with reasonable assurance that issues are identified on a timely basis and dealt with appropriately.

The group has an established organisational structure with clearly defined lines of authority, responsibility and accountability, which is reviewed regularly. Group management are responsible for the identification and evaluation of key risks applicable to their areas of business.

The company has contingency and disaster recovery plans, the basis of which were reviewed by the board in early 2007. These have now been extended to cover avian flu and other key risk areas.

The external auditors are engaged to express an opinion on the accounts. They review and test the systems of internal financial controls and data contained in the accounts, and discuss with management the reporting of operational results and the financial condition of the group, to the extent necessary to express their audit opinion.

During the year the board considered the need for an internal audit function but resolved that due to the size of the group, this could not be justified on the grounds of cost effectiveness.

DIRECTORS' AND OFFICERS' LIABILITY INSURANCE AND INDEMNITY

The company has purchased insurance to cover its directors and officers against the costs of defending themselves in legal proceedings taken against them in that capacity, and in respect of any damages resulting in those proceedings. The company also indemnifies its directors and officers to the extent permitted by law. Neither the insurance nor the indemnity provide cover where the director has acted fraudulently or dishonestly.

GOING CONCERN

The directors, having made appropriate enquiries, consider that the company and the group have adequate resources to continue in operational existence for the foreseeable future and therefore it is appropriate to adopt the going concern basis in preparing the accounts on pages 28 to 52.

REMUNERATION COMMITTEE

The Remuneration Committee comprises C Kennedy (Chairman) and L Blackall.

The Committee meets not less than twice a year to determine all aspects of the remuneration of the executive directors and other senior managers. The fees of the non-executive directors are determined by the board as a whole. No director or employee has a role in determining his own remuneration.

REMUNERATION POLICY

The Committee determines overall policy for executive remuneration. The Committee sets levels of remuneration to attract, retain and motivate executive directors and other senior managers and, in doing so, takes into account the level of remuneration throughout the telecommunications industry. Employees throughout the group, including executive directors, have performance reviews annually.

The main components of the executive directors' and senior managers' remuneration are:

- a competitive base salary;
- an annual performance bonus;
- pension provision;
- benefits in kind; and
- share options.

The group operates a discretionary bonus scheme. The scheme applies to directors, senior managers and certain other employees. Individual payments made under the scheme are generally dependent on the company achieving its financial targets and the attainment of individual objectives.

The group makes contributions to money purchase personal pension schemes on behalf of certain executive directors and senior managers.

Other customary benefits, such as car allowances, permanent health insurance and life assurance are made available as appropriate.

The group has three share options schemes, the Unapproved Executive Share Option Scheme, the Approved Executive Share Option Scheme and the EMI Scheme. Details of options granted under these schemes are given in note 4 to the financial statements.

DIRECTORS' SERVICE CONTRACTS

The service contracts of executive directors remain in force until age 65, or age 60 in the case of the Chairman, and continue until terminated by either party giving to the other not less than twelve months' written notice.

The service contracts of non-executive directors remain in force until terminated by either party giving to the other not less than three months' written notice.

DIRECTORS' REMUNERATION

	Salaries and fees £'000	Bonus £'000	**Total 2006 £'000**	Total 2005 £'000	**Pension 2006 £'000**	Pension 2005 £'000
Executive						
M Read	295	300	**595**	350	**28**	22
S Porter	237	237	**474**	295	**32**	31
P Dubens	333	342	**675**	383	**—**	—
Non-executive						
L Blackall	35	—	**35**	25	**—**	—
C Kennedy	35	—	**35**	25	**—**	—
	935	879	**1,814**	1,078	**60**	53

The bonus received by M Read, S Porter and P Dubens was in respect of services during the year.

Shareholdings and option interests of the directors in office at 31 December 2006 are as follows:

DIRECTORS' SHAREHOLDINGS

	1p ordinary shares	
	31 December 2006	31 December 2005
M Read	**—**	—
S Porter	**174,500**	174,500
P Dubens	**138,888,889**	138,888,889
L Blackall	**—**	138,888,889
C Kennedy	**223,355**	167,800

L Blackall sold 69,000,000 shares on 20 January 2006 to satisfy the unexpected volume of demand by institutions, following a placing of 109,000,000 shares on 18 January 2006, resulting in a gain of £7,659,000. The balance of 69,888,889 shares were sold on 7 November 2006 resulting in a gain of £6,464,000.

DIRECTORS' SHARE OPTIONS

	Note	At 1 January 2006	Awarded during the year	Cancelled during the year	**At 31 December 2006**	Exercise price	Exercise period
S Porter	(i)	989,130	—	—	**989,130**	1.00p	20 November 2001 to 19 November 2011
	(ii)	2,693,583	—	—	**2,693,583**	1.00p	20 November 2001 to 19 November 2011
	(ii)	2,602,440	—	—	**2,602,440**	3.00p	27 December 2001 to 26 December 2011
	(iii)	5,253,000	—	—	**5,253,000**	4.50p	27 December 2001 to 26 December 2011
	(i)	3,455,313	—	—	**3,455,313**	2.25p	20 February 2003 to 19 February 2013
	(iv)	17,939,247	—	—	**17,939,247**	2.25p	20 February 2003 to 19 February 2013
	(ii)	750,000	—	—	**750,000**	3.00p	20 February 2003 to 19 February 2013
	(vi)	2,333,333	—	—	**2,333,333**	7.50p	11 April 2005 to 10 April 2015
	(vii)	—	3,368,421	—	**3,368,421**	14.25p	7 April 2006 to 6 April 2016
M Read	(ii)	9,650,000	—	—	**9,650,000**	6.25p	24 October 2003 to 23 October 2013
	(v)	1,600,000	—	—	**1,600,000**	6.25p	24 October 2003 to 23 October 2013
	(vi)	2,933,333	—	—	**2,933,333**	7.50p	11 April 2005 to 10 April 2015
	(vii)	—	4,210,526	—	**4,210,526**	14.25p	7 April 2006 to 6 April 2016
P Dubens	(ii)	8,400,000	—	—	**8,400,000**	6.25p	24 October 2003 to 23 October 2013
	(v)	1,600,000	—	—	**1,600,000**	6.25p	24 October 2003 to 23 October 2013
	(vi)	3,333,333	—	—	**3,333,333**	7.50p	11 April 2005 to 10 April 2015
	(vii)	—	4,912,280	—	**4,912,280**	14.25p	7 April 2006 to 6 April 2016
L Blackall		—	—	—	**—**	—	—
C Kennedy		—	—	—	**—**	—	—

(i) EMI Scheme – no performance criteria attached.

(ii) Unapproved Scheme – no performance criteria attached.

(iii) Unapproved Scheme – were exercisable once the company's market capitalisation reached £25.0 million.

(iv) Unapproved Scheme – 10,697,280 were exercisable when the company's share price reached 5.00p and it is EBITDA positive, measured on a monthly basis. The remaining 7,236,967 were exercisable once the company's share price reached 3.00p and the company was EBITDA positive, measured on a monthly basis.

(v) EMI Scheme – were exercisable once the company's share price reached 9.00p and the company was EBITDA positive, measured on a monthly basis.

(vi) Unapproved Scheme – were exercisable once the company's share price reached 12.00p.

(vii) Unapproved Scheme – exercisable once the company's share price reaches 18.00p and is within three years of date of grant.

No directors in office at 31 December 2006 exercised any share options during the year.

On 17 January 2007 options were granted to the directors, Peter Dubens, 6,792,452, Mike Read, 6,037,735 and Stewart Porter 4,452,830 at 13.25p. 60% of the options are exercisable between 17 January 2008 and 16 January 2017 and 40% are exercisable between 17 January 2009 and 16 January 2017.

DIRECTORS' SHARE OPTIONS CONTINUED

At 31 December 2006 directors of the company held the following warrants over ordinary shares in the company:

	Warrants	Exercise price
M Read	15,000,000	6.25p
P Dubens	50,000,000	6.25p
M Read	10,000,000	10.50p
M Read	10,000,000	10.50p
P Dubens	17,500,000	10.50p
P Dubens	17,500,000	10.50p
S Porter	2,500,000	10.50p
S Porter	2,500,000	10.50p

The above warrants at 6.25p can now be exercised at any time, the performance criteria attaching to the warrants having been met.

Warrants at 10.50p are exercisable in two stages. 50% can now be exercised at any time, the performance criteria attaching to the warrants having been met, with the remaining 50% exercisable on the share price reaching 21.00p.

The mid-market price for the company's shares at 31 December 2006 was 12.75p. The high and low mid-market prices of the ordinary shares during the year to 31 December 2006 were 16.00p and 8.00p respectively.

On behalf of the board

STEWART PORTER
CHIEF FINANCIAL OFFICER
16 APRIL 2007

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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 group and parent company financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

The group and parent company financial statements are required by law to give a true and fair view of the state of affairs of the group and the parent company and of the profit or loss 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 accounting standards have been followed, subject to any material departures disclosed and explained in the Annual Report and accounts; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the parent 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 parent 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 group and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

We have audited the group and parent company financial statements (the "financial statements") of Pipex Communications plc for the year ended 31 December 2006 which comprise the group profit and loss account, the group and company balance sheets, the group cash flow statement, the group statement of recognised gains and losses 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 Directors' Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities on page 26.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (United Kingdom 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. The information given in the Directors' Report includes specific information presented in the Chief Executive's Report and the Financial Review that is cross referred from the Business Review section of the Directors' Report.

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 (United Kingdom 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 included 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 United Kingdom Generally Accepted Accounting Practice, of the state of the group's and the parent company's affairs as at 31 December 2006 and of the group's loss for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

KPMG AUDIT PLC
CHARTERED ACCOUNTANTS
REGISTERED AUDITOR
8 SALISBURY SQUARE
LONDON EC4Y 8BB
UNITED KINGDOM
16 APRIL 2007

CONSOLIDATED PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2006

	Note	Existing operations 2006 £'000	Acquisitions 2006 £'000	Total 2006 £'000	Restated (note 1) 2005 £'000
Turnover	1, 2	**151,706**	**142,653**	**294,359**	132,939
Cost of sales		**(84,438)**	**(97,566)**	**(182,004)**	(71,782)
Gross profit		**67,268**	**45,087**	**112,355**	61,157
Operating expenses before amortisation, depreciation and share option costs		**(55,121)**	**(34,043)**	**(89,164)**	(46,189)
Amortisation of intangibles		**(13,050)**	**(5,889)**	**(18,939)**	(11,236)
Depreciation		**(9,709)**	**(2,404)**	**(12,113)**	(7,055)
Share option costs		**(1,618)**	**(588)**	**(2,206)**	(2,536)
Operating expenses		**(79,498)**	**(42,924)**	**(122,422)**	(67,016)
Operating profit before amortisation, depreciation and share option costs		**12,147**	**11,044**	**23,191**	14,968
Amortisation of intangibles		**(13,050)**	**(5,889)**	**(18,939)**	(11,236)
Depreciation		**(9,709)**	**(2,404)**	**(12,113)**	(7,055)
Share option costs		**(1,618)**	**(588)**	**(2,206)**	(2,536)
Operating (loss)/profit	3	**(12,230)**	**2,163**	**(10,067)**	(5,859)
Share of operating loss of joint ventures		**—**	**(1,421)**	**(1,421)**	—
Total operating (loss)/profit		**(12,230)**	**742**	**(11,488)**	(5,859)
Other interest receivable and similar income	5			**546**	303
Interest payable and similar charges	6			**(6,806)**	(3,068)
Loss on ordinary activities before taxation				**(17,748)**	(8,624)
Tax on loss on ordinary activities	7			**(8)**	(48)
Loss for the financial year				**(17,756)**	(8,672)
Loss per ordinary share					
– basic	26			**0.76p**	0.39p
– diluted	26			**0.76p**	0.39p

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

All of the results above relate to continuing operations.

CONSOLIDATED STATEMENT OF GROUP TOTAL RECOGNISED GAINS AND LOSSES
FOR THE YEAR ENDED 31 DECEMBER 2006

	Note	2006 £'000	2005 £'000
Loss for the financial year		**(17,756)**	(7,071)
Unrealised loss on joint venture	10	**(9,533)**	—
Translation difference in respect of net investment in overseas subsidiary undertaking	23	**(61)**	(28)
Total recognised losses in the year		**(27,350)**	(7,099)
Prior year adjustment (note 1)		**(1,601)**	—
Total losses recognised since last annual report		**(28,951)**	(7,099)

CONSOLIDATED BALANCE SHEET
AT 31 DECEMBER 2006

	Note	**2006 £'000**	**2006 £'000**	2005 £'000	2005 £'000
Fixed assets					
Intangible assets					
– goodwill	8	**170,692**		99,231	
– patents	8	**6**		7	
– wireless licence	8	**—**		4,417	
			170,698		103,655
Tangible assets	9		**46,989**		25,251
Investments in joint ventures					
– share of gross assets	10		**5,457**		—
– share of gross liabilities	10		**(11,077)**		—
			(5,620)		—
			212,067		128,906
Current assets					
Stocks	11	**47**		63	
Debtors	12	**44,679**		18,953	
Cash at bank and in hand	13	**48,328**		13,964	
		93,054		32,980	
Creditors: amounts falling due within one year	14	**(100,308)**		(59,866)	
Net current liabilities			**(7,254)**		(26,886)
Total assets less current liabilities			**204,813**		102,020
Creditors: amounts falling due after one year (including convertible debt)	15		**(125,013)**		(24,871)
Provisions for liabilities	16		**(1,561)**		(2,004)
Net assets			**78,239**		75,145
Capital and reserves					
Called up share capital	19, 23		**23,931**		22,101
Share premium account	23		**98,524**		84,127
Other reserves	23		**23,228**		13,023
Profit and loss account	23		**(67,444)**		(44,106)
Equity shareholders' funds			**78,239**		75,145

The accounts on pages 28 to 52 were approved by the board of directors on 16 April 2007 and were signed on its behalf by:

PETER DUBENS
CHAIRMAN

STEWART PORTER
CHIEF FINANCIAL OFFICER

	Note	2006 £'000	2006 £'000	2005 £'000	2005 £'000
Fixed assets					
Investments	10		**161,135**		127,891
Current assets					
Debtors	12	**72,954**		6,807	
Cash at bank and in hand	13	**8,342**		16	
		81,296		6,823	
Creditors: amounts falling due within one year	14	**(5,121)**		(16,255)	
Net current assets/(liabilities)			**76,175**		(9,432)
Total assets less current liabilities			**237,310**		118,459
Creditors: amounts falling due after one year (including convertible debt)	15		**(117,879)**		(21,875)
Provisions for liabilities	16		**(267)**		(348)
Net assets			**119,164**		96,236
Capital and reserves					
Called up share capital	19, 23		**23,931**		22,101
Share premium account	23		**98,524**		84,127
Other reserves	23		**23,021**		12,816
Profit and loss account	23		**(26,312)**		(22,808)
Equity shareholders' funds			**119,164**		96,236

The accounts on pages 28 to 52 were approved by the board of directors on 16 April 2007 and were signed on its behalf by:

PETER DUBENS
CHAIRMAN

STEWART PORTER
CHIEF FINANCIAL OFFICER

CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2006

	Note	2006 £'000	2005 £'000
Cash inflow from operating activities	24	**34,012**	17,440
Returns on investment and servicing of finance			
Interest paid		**(2,553)**	(2,346)
Bond interest paid		**(1,776)**	—
Interest received		**546**	303
Interest element of finance lease payments		**(668)**	(288)
		(4,451)	(2,331)
Taxation received/(paid)		**230**	(182)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		**(22,077)**	(7,067)
Free cash flow		**7,714**	7,860
Acquisitions			
Purchase of subsidiary undertakings	21	**(25,563)**	(12,509)
Purchase of customer base	21	**(10,368)**	—
Investment in joint venture	10	**(797)**	—
(Net overdraft)/cash acquired on acquisitions	21	**(40,589)**	2,591
Prior year acquisitions	22	**—**	812
		(77,317)	(11,697)
Cash outflow before management of liquid resources and financing		**(69,603)**	(3,837)
Management of liquid resources			
Movement in restricted deposits		**138**	2,632
Financing			
Issue of ordinary share capital (net of issue expenses)		**13,634**	—
Exercise of share options		**2,161**	310
Capital element of finance lease repayments		**(2,543)**	(1,700)
Proceeds from issue of Convertible Bonds (net of issue expenses)		**88,279**	—
Repayment of bank loans		**(74,310)**	(129)
Repayment of loan notes		**—**	(1,989)
Drawdown of new loans		**76,746**	10,000
Net cash inflow from financing		**103,967**	6,492
Increase in cash in the year		**34,502**	5,287

RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT
FOR THE YEAR ENDED 31 DECEMBER 2006

	2006 £'000	2005 £'000
Increase in cash in the year	**34,502**	5,287
Net movement in liquid resources	**(138)**	(2,632)
New loan drawdown	**(76,746)**	(10,000)
Issue of Convertible Bonds	**(82,879)**	—
Repayment of loans	**74,310**	129
Repayment of loan notes	**—**	1,989
Repayments of lease financing	**2,543**	1,700
New finance leases	**(5,016)**	(3,302)
Finance leases acquired	**—**	(276)
Movement in net debt	**(53,424)**	(7,105)
Opening net debt	**(27,722)**	(20,617)
Closing net debt	**(81,146)**	(27,722)

ANALYSIS OF NET DEBT
AT 31 DECEMBER 2006

	At 1 January 2006 £'000	Cash flow £'000	Other £'000	At 31 December 2006 £'000
Cash	13,478	**34,502**	**—**	**47,980**
Restricted deposits	486	**(138)**	**—**	**348**
Cash at bank and in hand per balance sheet	13,964	**34,364**	**—**	**48,328**
Bank loans	(36,860)	**(2,436)**	**—**	**(39,296)**
Finance leases	(4,826)	**2,543**	**(5,016)**	**(7,299)**
Convertible Bonds	—	**(82,879)**	**—**	**(82,879)**
Net debt	(27,722)	**(48,408)**	**(5,016)**	**(81,146)**

The movement of £5,016,000 in "Other" relates to new finance leases.

RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS
FOR THE YEAR ENDED 31 DECEMBER 2006

	Group		Company	
		Restated (note 1)		Restated (note 1)
	2006	2005	**2006**	2005
	£'000	£'000	**£'000**	£'000
(Loss)/profit for the financial year	**(17,756)**	(8,672)	**(7,516)**	20,658
New share capital subscribed (net of issue costs)	**13,634**	310	**13,634**	310
Share capital issued on acquisitions during the year	**4,751**	1,770	**4,751**	1,770
Unrealised loss on disposal to joint venture	**(9,533)**	—	**—**	—
Equity component of Convertible Bonds issue	**7,692**	—	**7,692**	—
Translation difference in respect of net investment in overseas subsidiary undertaking	**(61)**	(28)	**—**	—
Share option costs (note 1)	**2,206**	2,379	**2,206**	2,379
Exercise of share options	**2,161**	—	**2,161**	—
Net increase/(decrease) in shareholders' funds	**3,094**	(4,241)	**22,928**	25,117
Opening shareholders' funds	**75,145**	79,386	**96,236**	71,119
Closing shareholders' funds	**78,239**	75,145	**119,164**	96,236

1. ACCOUNTING POLICIES

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

In these financial statements the following new standards have been adopted for the first time:

- FRS 20 Share based payments;
- The presentation requirements of FRS 25 Financial instruments: presentation and disclosure; and
- FRS 28 Corresponding amounts.

The accounting policies under the new standards are set out below together with an indication of the effects of their adoption. FRS 28 Corresponding amounts has had no material effect as it imposes the same requirements for comparatives as hitherto required by the Companies Act 1985.

Under the adoption of FRS 20 Share based payments, the fair value of share options granted is recognised as an employee expense with a corresponding increase in equity. Fair value has been determined using an appropriate model, taking into account the terms and conditions upon which the options were granted. The amount recognised as an expense in the year is £2,206,000. For prior years the total charge is £2,379,000 including the £778,000 incurred under the superseded UITF17, resulting in an increase on the loss for the year ended 31 December 2005 by £1,601,000.

The corresponding amounts in these financial statements are, other than those covered by the exception permitted by FRS 25, restated in accordance with the new policies. FRS 25 permits the corresponding amounts not to be restated and the group has adopted this approach.

BASIS OF PREPARATION

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

BASIS OF CONSOLIDATION

The consolidated financial statements include the financial statements of the company and its subsidiary undertakings made up to 31 December 2006. Unless otherwise stated, the acquisition method of accounting has been adopted. Under this method, the results of subsidiary undertakings acquired in the year are included in the consolidated profit and loss account from the date of acquisition.

The group financial statements consolidate the financial statements of Pipex Communications plc and all its subsidiary undertakings. As permitted by section 230 of the Companies Act 1985, a separate profit and loss account is not presented in respect of the company.

A joint venture is an undertaking in which the group has a long-term interest and over which it exercises joint control. The group's share of the profits less losses of associates and of joint ventures is included in the consolidated profit and loss account and its interest in their net assets is included in investments in the consolidated balance sheet.

GOING CONCERN

As at 31 December 2006 the group had cash of £48,328,000 including £348,000 of restricted cash. The directors continue to monitor the group's funding strategy and have prepared detailed forecasts for future periods. These forecasts underpin the going concern basis, which the directors have applied in the preparation of the financial statements for the year ended 31 December 2006.

TURNOVER

Turnover comprises the value of telecommunication and related services provided net of value added tax. Where an installation fee is received in respect of line rental this income is recognised in the profit and loss account at the time of installation. All other income is recognised in the period in which the service is provided.

GOODWILL

When the fair value of the consideration for an acquired undertaking exceeds the fair value of its separable net assets, the difference is treated as purchased goodwill and is capitalised and amortised through the profit and loss account over its estimated useful life. The economic life of goodwill has been estimated by the directors to be ten years, with the exception of Bulldog where goodwill is being amortised over three years in line with the estimated useful life of the customers acquired.

Where the fair value of the separable net assets exceeds the fair value of the consideration for an acquired undertaking the difference is treated as negative goodwill and is capitalised and amortised through the profit and loss account in the period in which the non-monetary assets acquired are recovered. In the case of fixed assets this is the period over which they are depreciated, and in the case of current assets, the period over which they are sold or otherwise realised. The economic life of negative goodwill has been estimated by the directors to be four years.

OTHER INTANGIBLE ASSETS AND AMORTISATION

Amortisation is provided to write off the cost of intangible assets by equal instalments over their estimated useful economic lives as follows:

Wireless licence	Twenty years
Patents	Ten years

Intangible assets acquired as part of an acquisition are capitalised at their fair value where this can be reliably measured.

1. ACCOUNTING POLICIES CONTINUED

TANGIBLE 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:

Network infrastructure	Two to ten years
Office equipment	Three to five years
Leasehold improvements	Life of the lease
Plant and machinery	Three to five years
Freehold buildings	Twenty to twenty five years

Incremental costs of staff working on specific network projects are capitalised under network infrastructure costs.

Where assets are financed under finance leases the cost is written off over the shorter of the lease term and the remaining useful economic life.

INVESTMENT IN SUBSIDIARY UNDERTAKINGS

Investments in subsidiary undertakings are initially stated at cost in the balance sheet of the company unless, in the opinion of the directors, there has been an impairment, in which case an appropriate adjustment is made.

FOREIGN CURRENCIES

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the rate of exchange ruling at the balance sheet date and the gains or losses on translation are included in the profit and loss account.

LEASES

Assets acquired under finance leases are capitalised and the outstanding future lease obligations are shown in creditors. Operating lease rentals are charged to the profit and loss account on a straight line basis over the period of the lease.

PENSION COSTS

The pension costs charged in the profit and loss account represent the amounts of contributions payable to the group's defined contribution pension schemes in the accounting period.

SHARE BASED PAYMENTS

The share option programme allows employees to acquire shares of the company. The fair value of options granted after 7 November 2002 and those not yet vested as at 31 December 2006 is recognised as an employee expense with a corresponding increase in equity. The fair value is measured at grant date and spread over the period during which the employees become unconditionally entitled to the options. The fair value of the options granted is measured using an option pricing model, taking into account the terms and conditions upon which the options were granted. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest except where variations are due only to share prices not achieving the threshold for vesting.

TAXATION

The charge for taxation is based on the results for the period 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 required by FRS 19.

CASH AND LIQUID RESOURCES

Cash, for the purpose of the cash flow statement, comprises cash in hand and deposits repayable on demand, less overdrafts payable on demand. Cash for the purpose of the balance sheet includes short-term deposits and restricted deposits.

Liquid resources comprise current asset investments held as readily disposable stores of value as defined by Financial Reporting Standard 1 (Revised 1996) Cash Flow Statements. Liquid resources held in both the current and preceding year include restricted bank deposits.

2. SEGMENTAL INFORMATION

The group operates one class of business, that of telecommunication services, and consequently does not prepare segmental information by class of business. However, to provide useful additional information, turnover is subdivided into three main service categories shown below:

	2006 £'000	2005 £'000
Turnover (excluding joint venture)		
Broadband and Voice Services	**231,759**	76,539
Hosting Services	**35,200**	30,100
Business Services	**27,400**	26,300
	294,359	132,939

The comparative numbers above have been restated to group similar businesses more logically. Turnover and loss before interest and tax, together with net assets by country of origin, are set out below:

	Net assets		Turnover		(Loss)/profit before interest and tax	
	2006 £'000	2005 £'000	2006 £'000	2005 £'000	2006 £'000	2005 £'000
UK	**71,872**	68,216	**284,787**	125,616	**(12,240)**	(5,415)
Germany	**6,367**	6,929	**9,572**	7,323	**752**	(444)
	78,239	75,145	**294,359**	132,939	**(11,488)**	(5,859)

Turnover analysed by destination is not materially different to turnover by origin.

3. OPERATING LOSS

	2006 £'000	2005 £'000
Operating loss is stated after charging/(crediting):		
Fees payable to KPMG for the audit of the group's annual accounts:		
– audit	**295**	230
Fees payable to KPMG for other services:		
– other services in relation to taxation	**322**	115
– other services supplied pursuant to legislation	**25**	20
Depreciation and other amounts written off tangible fixed assets:		
– owned assets	**9,866**	5,908
– assets under finance leases	**2,247**	1,147
Loss on disposal of fixed assets	**13**	43
Amortisation of:		
– negative goodwill (note 8)	**—**	(94)
– positive goodwill (note 8)	**18,152**	11,079
– patents (note 8)	**1**	1
– wireless licence (note 8)	**62**	250
Goodwill impairment (note 8)	**724**	—
Rentals payable under operating leases:		
– land and buildings	**2,698**	2,312
– other operating leases	**1,834**	16,408
Integration costs	**1,426**	1,986
Customer credit balances released	**(812)**	—
Share option costs	**2,206**	2,536

The auditors' remuneration includes £22,000 (2005: £20,000) for the company. In addition KPMG provided other services of £192,000 of which £50,000 related to taxation.

Integration costs are the once-off costs incurred to assimilate acquisitions into the group and to rationalise operations.

Customer credit balances relate to the write back of long standing credit balances in accordance with group policy.

Included in the share option costs prior year figure is £157,000 relating to the movement of the UITF 25 provision.

4. STAFF NUMBERS AND COSTS

The average number of persons (including executive directors) employed by the group during each year was as follows:

	Group	
	2006 Number	2005 Number
Full time operations staff	**1,473**	586
Executive and administrative	**473**	197
	1,946	783

The company employed no members of staff in 2006 (2005: nil).

The aggregate payroll costs (including directors' remuneration) were as follows:

	2006 £'000	2005 £'000
Wages and salaries	**41,707**	24,774
Social security costs	**4,450**	3,648
Pension costs	**595**	573
Staff costs capitalised (note 9)	**(1,592)**	(566)
	45,160	28,429

Remuneration of directors:

	2006 £'000	2005 £'000
Emoluments for services as a director	**1,814**	1,078
Pension contributions	**60**	53
	1,874	1,131

Emoluments of the highest paid director (excluding pension contributions) were £675,000 (2005: £383,000). Amounts paid by the group in respect of their pension contributions were £nil (2005: £nil).

Details of pension contributions are set out in note 20 to the accounts. See the board report on directors' remuneration on pages 23 to 25 for further details.

SHARE OPTIONS

At 31 December 2006 rights to options over 195,218,192 ordinary shares of the company were outstanding as follows:

	At 1 January 2006	Granted	Exercised/ lapsed	Cancelled	**At 31 December 2006**	Exercise price	Exercise period
Unapproved Scheme							
	2,693,583	—	—	—	**2,693,583**	1.00p	20 November 2001 to 19 November 2011
	750,000	—	—	—	**750,000**	3.00p	20 November 2001 to 19 November 2011
	2,602,440	—	—	—	**2,602,440**	3.00p	27 December 2001 to 26 December 2011
	5,253,000	—	—	—	**5,253,000**	4.50p	27 December 2001 to 26 December 2011
	17,939,247	—	—	—	**17,939,247**	2.25p	20 March 2003 to 19 March 2013
	27,154,000	—	(8,152,000)	—	**19,002,000**	6.25p	24 October 2003 to 23 October 2013
	5,000,000	—	(5,000,000)	—	**—**	6.25p	28 October 2003 to 27 October 2013
	55,100,000	—	(12,500,000)	—	**42,600,000**	10.50p	21 June 2004 to 20 June 2014
	10,000,000	—	—	—	**10,000,000**	8.50p	4 August 2004 to 3 August 2014
	19,000,000	—	(11,500,000)	—	**7,500,000**	7.50p	20 October 2004 to 19 October 2014
	16,250,000	—	(7,000,000)	—	**9,250,000**	8.25p	29 January 2005 to 28 January 2015
	14,099,999	—	(3,000,000)	—	**11,099,999**	7.50p	11 April 2005 to 10 April 2015
	5,500,000	—	(5,500,000)	—	**—**	7.75p	27 April 2005 to 26 April 2015
	—	1,500,000	—	—	**1,500,000**	13.50p	27 January 2006 to 26 January 2016
	—	12,491,227	—	—	**12,491,227**	14.25p	7 April 2006 to 6 April 2016
	—	22,394,383	—	—	**22,394,383**	1.00p	11 October 2006 to 10 October 2016
	—	15,260,870	—	—	**15,260,870**	11.50p	27 October 2006 to 26 October 2016
	—	3,000,000	—	—	**3,000,000**	12.50p	14 December 2006 to 13 December 2016
EMI Scheme							
	989,130	—	—	—	**989,130**	1.00p	20 November 2001 to 19 November 2011
	325,000	—	—	—	**325,000**	3.00p	20 February 2003 to 19 February 2013
	3,455,313	—	—	—	**3,455,313**	2.25p	20 February 2003 to 19 February 2013
	10,032,000	—	(2,920,000)	—	**7,112,000**	6.25p	24 October 2003 to 23 October 2013
	196,143,712	54,646,480	(55,572,000)	—	**195,218,192**		

4. STAFF NUMBERS AND COSTS CONTINUED

SHARE OPTIONS GRANTED UNDER UNAPPROVED SCHEME

Number of instruments granted	48,957,142	10,000,000	19,000,000	3,000,000	12,491,227
Grant date	21 June 2004	4 August 2004	20 October 2004	27 April 2005	7 April 2006
Expiration date	20 June 2014	3 August 2014	19 October 2004	26 April 2015	6 April 2016
Contract term year(s)	10	10	10	10	10
Expected life of option	10	10	10	6.5	10
Exercise price	10.50p	8.50p	7.50p	7.75p	14.25p
Share price at granting	9.63p	8.50p	7.75p	7.75p	14.25p
Exercise factor	1.50	1.90	2.10	n/a	1.26
Number of steps	100	100	100	100	100
Annual risk-free rate (%)	5.00%	5.10%	5.00%	4.55%	5.00%
Annual expected dividend yield (%)	0%	0%	0%	0%	0%
Volatility (%) (annualised)	54.11%	53.66%	52.66%	51.65%	44.27%
Fair value per granted instrument	3.18p	3.09p	4.08p	4.36p	3.02p
Vesting conditions	24,478,571 at share price of 16.00p 24,478,571, at share price of 21.00p	5,000,000 at share price of 16.00p 5,000,000, at share price of 21.00p	9,500,000 at share price of 16.00p 9,500,000 at share price of 21.00p	1,500,000 vested immediately followed by 500,000 on subsequent quarters	12,491,227 at share of 18.00p within 3 years of grant date

Number of instruments granted	22,394,383	4,000,000	11,260,870	3,000,000
Grant date	11 October 2006	27 October 2006	27 October 2006	14 December 2006
Expiration date	10 October 2016	26 October 2016	26 October 2016	13 December 2016
Contract term year(s)	10	10	10	10
Expected life of option	1.5	10	10	6.5
Exercise price	1.00p	11.50p	11.50p	12.50p
Share price at granting	11.00p	11.50p	11.50p	12.50p
Exercise factor	n/a	1.40	1.40	n/a
Number of steps	100	100	100	100
Annual risk-free rate (%)	5.00%	4.74%	4.74%	4.74%
Annual expected dividend yield (%)	0%	0%	0%	0%
Volatility (%) (annualised)	45.63%	50.55%	50.55%	50.44%
Fair value per granted instrument	10.07p	4.15p	4.15p	6.97p
Vesting conditions	9,684,057 vest on 11 October 2007 12,710,326 vest up to 11 October 2007 dependent upon achievement of specific business targets in relation to Toucan	4,000,000 at share price of 16.00p	Vesting in instalments of 3,000,000 annually starting at 12 months until 27 October 2009	Vesting in instalments of 1,000,000 annually starting at 12 months until 14 December 2009

5. OTHER INTEREST RECEIVABLE AND SIMILAR INCOME

	2006 £'000	2005 £'000
Bank interest receivable	**534**	303
Other interest receivable	**12**	—
	546	303

6. INTEREST PAYABLE AND SIMILAR CHARGES

	2006 £'000	2005 £'000
Interest payable on finance leases	**668**	288
Bank interest payable	**1,172**	2,213
Loan note interest payable	**671**	22
Convertible Bonds interest payable	**4,068**	—
Other interest payable	**227**	545
	6,806	3,068

7. TAX ON ORDINARY ACTIVITIES

	2006 £'000	2005 £'000
United Kingdom corporation tax at 30% (2005: 30%)	**—**	—
Foreign tax	**10**	48
Adjustment in respect of prior periods	**(2)**	—
Total current tax	**8**	48

The current tax charge for the year is higher than the standard rate of corporation tax in the UK (year end 31 December 2006: 30%, year ended 31 December 2005: 30%). The differences are explained below:

RECONCILIATION OF THE GROUP'S CURRENT TAX CHARGE TO THE UNITED KINGDOM STATUTORY RATE

	2006 £'000	Restated 2005 £'000
Loss on ordinary activities before tax	**(17,748)**	(8,624)
Current tax of 30% (2005: 30%)	**(5,325)**	(2,587)
Effects of:		
Non deductible amortisation	**5,681**	3,371
Other expenses not deductible for tax purposes	**1,138**	26
Capital allowances for the period in excess of depreciation	**(390)**	(61)
Other timing differences	**(41)**	881
Utilisation of tax losses	**(1,129)**	(1,572)
Differences between UK and overseas tax rates	**74**	(10)
Total current tax (as above)	**8**	48

At 31 December 2006, there were unrelieved losses in the group of approximately £93,500,000 (2005: £65,300,000).

At 31 December 2006 the group had potential deferred tax assets of £28,057,000 (2005: £19,573,000) in relation to unrelieved tax losses. These assets have not been recognised in the financial statements as, in the opinion of the directors, there is insufficient evidence that they will be recoverable in the near future.

8. INTANGIBLE FIXED ASSETS

Group	Wireless licence £'000	Positive goodwill £'000	Negative goodwill £'000	Patents £'000	Total £'000
Cost					
At 1 January 2006	5,000	121,304	(901)	10	125,413
Additions (note 21)	—	90,500	—	—	90,500
Fair value adjustments (note 22)	—	20	—	—	20
Disposals	(5,000)	(248)	—	—	(5,248)
At 31 December 2006	**—**	**211,576**	**(901)**	**10**	**210,685**
Amortisation					
At 1 January 2006	583	22,073	(901)	3	21,758
Charge for the year	62	18,152	—	1	18,215
Impairment	—	724	—	—	724
Disposals	(645)	(65)	—	—	(710)
At 31 December 2006	**—**	**40,884**	**(901)**	**4**	**39,987**
Net book value					
At 31 December 2006	**—**	**170,692**	**—**	**6**	**170,698**
At 31 December 2005	4,417	99,231	—	7	103,655

Positive goodwill arising in the year relates to the acquisitions of Homecall, SupaNetwork Limited, Switch2 Telecoms Limited and Toucan Residential Limited (note 21), and is being amortised over ten years. The wireless licence was disposed of as part of the formation of the Pipex Wireless joint venture transactions with Intel Capital (Cayman) Corporation.

During the year, the company impaired the net book value of the goodwill on the investment of Firstnet Limited to £nil. This arose as a result of the transfer of this entity to the joint venture (note 10).

The company held no intangible fixed assets at 31 December 2006 (2005: £nil).

9. TANGIBLE FIXED ASSETS

Group	Freehold buildings £'000	Leasehold improvements £'000	Network infrastructure £'000	Office equipment £'000	Plant and machinery £'000	Total £'000
Cost						
At 1 January 2006	2,087	2,204	37,195	2,377	1,241	45,104
Acquisitions (note 21)	—	421	2	6,351	—	6,774
Additions	9,948	151	13,992	3,711	1	27,803
Disposals	—	—	(748)	(203)	—	(951)
Exchange difference	—	—	(139)	29	(4)	(114)
At 31 December 2006	**12,035**	**2,776**	**50,302**	**12,265**	**1,238**	**78,616**
Depreciation						
At 1 January 2006	224	846	17,519	939	325	19,853
Charge for the year	265	293	7,843	3,694	18	12,113
Disposals	—	—	(116)	(135)	—	(251)
Exchange difference	—	—	(85)	—	(3)	(88)
At 31 December 2006	**489**	**1,139**	**25,161**	**4,498**	**340**	**31,627**
Net book value						
At 31 December 2006	**11,546**	**1,637**	**25,141**	**7,767**	**898**	**46,989**
At 31 December 2005	1,863	1,358	19,676	1,438	916	25,251

Included in the total net book value of £46,989,000 are assets of £6,570,000 held under finance leases as follows: network infrastructure £6,497,000 (2005: £4,366,000), office equipment £73,000 (2005: £12,000) and plant and machinery £nil (2005: £10,000).

Depreciation for the year on these assets was as follows: network infrastructure £2,138,000 (2005: £1,080,000), office equipment £89,000 (2005: £12,000) and plant and machinery £nil (2005: £55,000).

Included within network infrastructure additions above are capitalised incremental staff costs of £1,592,000 (2005: £566,000).

Included within the network infrastructure disposal for 2006, is an amount of £687,000 net book value relating to a sale and leaseback transaction in Host Europe GmbH.

The company held no tangible fixed assets at 31 December 2006 (2005: £nil).

10. FIXED ASSET INVESTMENTS

SUMMARY

Company	2006 £'000	2005 £'000
Investment in subsidiaries	**153,324**	127,891
Investment in joint venture	**7,811**	—
Total	**161,135**	127,891

(I). INVESTMENTS IN SUBSIDIARIES

Company	Interest in subsidiary undertakings £'000
Cost	
1 January 2006	128,631
Additions (note 21)	30,314
Additions – issue of share capital by existing group companies	76,423
Disposals	(81,304)
At 31 December 2006	**154,064**
Amounts provided	
1 January 2006	740
At 31 December 2006	**740**
Net book value	
At 31 December 2006	**153,324**
At 31 December 2005	127,891

During the year the company disposed of three directly owned subsidiary companies to other group companies in exchange for the issue of share capital of £73,923,000 in the acquiring companies. The company also subscribed to additional £2,500,000 share capital of Toucan to improve its balance sheet. Included in the disposals is the disposal of Pipex Business Solutions Limited and Faultbasic Limited to Pipex Wireless Limited, a joint venture with Intel Capital (Cayman) Corporation.

(II). INVESTMENTS IN JOINT VENTURE

Company	Interest in joint venture undertakings £'000
Cost	
1 January 2006	—
Issue of shares by Pipex Wireless Limited	7,014
Cash paid in consideration for the issues of shares in Pipex Wireless Limited	561
Additions – acquisition costs of Pipex Wireless Limited	236
At 31 December 2006	**7,811**
At 31 December 2005	—

10. FIXED ASSET INVESTMENTS CONTINUED

(II). INVESTMENTS IN JOINT VENTURE CONTINUED

Group

On 31 March 2006 the group jointly formed Pipex Wireless Limited with Intel Capital (Cayman) Corporation. Pipex sold its interests in Pipex Communications Business Solutions Limited (the holder of Pipex's 3.6-4.2 GHz Spectrum Licence) and Faultbasic Limited (the holder of Pipex's three 28 Ghz Spectrum Licences) to Pipex Wireless Limited in two share for share exchanges.

Pipex Wireless Limited had no turnover during the year.

The following represents the group's 84% share of the assets and liabilities of Pipex Wireless Limited.

	2006 £'000	2005 £'000
Group share of loss	**(1,421)**	—
Unrealised loss on disposal to joint venture	**(9,533)**	—
Share of assets and liabilities		
Fixed assets	**69**	—
Intangible assets	**3,560**	—
Current assets	**1,828**	—
Share of gross assets	**5,457**	—
Creditors less than one year	**(512)**	—
Liabilities in relation to preference shares	**(10,565)**	—
Share of gross liabilities	**(11,077)**	—
Share of net liabilities	**(5,620)**	—

Under the terms of the shareholder agreement between the company and Intel Capital (Cayman) Corporation, key business decisions in Pipex Wireless Limited require the unanimous approval of the shareholders. As a consequence, Pipex Communications plc does not have management control of the company and therefore accounts for it as a joint venture.

The group share of liabilities includes £10,565,000 arising in relation to the shareholders subscription by way of preference shares. The preference shares are redeemable in five years and are therefore treated as a financial liability, not an equity investment.

The unrealised loss of £9,533,000 arises from aligning the group's share of the joint venture's net liabilities (inclusive of the liability in relation to preference shares), with the carrying value of the investment in Pipex's accounts adjusted for the current period's losses as well as the transfer of the WiMAX licence at net book value rather than fair value.

(III). SUBSIDIARY UNDERTAKINGS

The company's principal subsidiary undertakings included in the financial statements are as follows:

Name	Proportion of ordinary share capital held	Nature of business/activity
Pipex Internet Limited	100%	Telecommunications
Pipex Communications UK Limited	100%	Telecommunications
GXN Limited	100%	Holding company
Pipex Homecall Limited (i) (ii)	100%	Telecommunications
Compulink Information eXchange Limited	100%	Telecommunications
XTML Limited	100%	Telecommunications
Switch2 Telecoms Limited (i)	100%	Telecommunications
SupaNetwork Limited (i)	100%	Telecommunications
Toucan Residential Limited (i) (iii)	100%	Telecommunications
IDT Direct Ireland Limited (i)	100%	Telecommunications
Host Europe GmbH	100%	Telecommunications

(i) Directly held by the company.

(ii) On 5 May 2006 the name of the company was changed from Caudwell Communications Limited.

(iii) On 16 November 2006 the name of the company was changed from IDT Direct Limited.

All subsidiary undertakings are registered in England and Wales with the exception of GXN Limited which is registered in Scotland, Host Europe GmbH which is registered in Germany and IDT Direct Ireland Limited which is registered in Ireland. All subsidiaries operate in the UK with the exception of Host Europe GmbH which operates in Germany and IDT Direct Ireland Limited which operates in Ireland. A full list of the company's subsidiaries will be given in the next annual return.

11. STOCKS

	Group		Company	
	2006 **£'000**	2005 £'000	**2006** **£'000**	2005 £'000
Finished goods for sale	**47**	63	**—**	—

12. DEBTORS

	Group		Company	
	2006 **£'000**	2005 £'000	**2006** **£'000**	2005 £'000
Trade debtors	**26,276**	10,199	**—**	—
Amounts due from subsidiary undertakings	**—**	—	**72,267**	6,756
Other debtors	**9,115**	498	**157**	18
Prepayments and accrued income	**9,288**	8,256	**530**	33
	44,679	18,953	**72,954**	6,807

Included in other debtors are rent deposits of £132,000 (2005: £132,000) which are recoverable after more than one year.

13. CASH AT BANK AND IN HAND

Cash at bank and in hand comprises cash in hand, deposits repayable on demand and restricted deposit accounts.

The group holds a total of £48,328,000 (2005: £13,964,000).

Included in group cash at bank and in hand are £348,000 (2005: £486,000) of restricted deposits, being £329,000 (2005: £316,000) of deposits with credit card companies, £19,000 (2005: £nil) of restricted funds held by the Bank of Scotland as security for company credit cards and £nil (2005: £170,000) of rental deposits.

The balance of group cash at bank and in hand, being £47,980,000 (2005: £13,478,000) is held in current accounts, overnight money market accounts and no-notice deposit accounts.

Cash at bank and in hand per the company balance sheet comprises £8,342,000 (2005: £16,000) held in current accounts, overnight money market accounts and no-notice deposit accounts.

14. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	Group		Company	
	2006 **£'000**	2005 £'000	**2006** **£'000**	2005 £'000
Bank loans (notes 15,18)	**1,445**	14,985	**—**	13,300
Obligations under finance leases (note 15)	**3,016**	1,830	**—**	—
Trade creditors	**57,217**	23,262	**1,440**	504
Amounts owed to group undertakings	**—**	—	**2,597**	1,703
Taxation and social security	**5,795**	1,937	**261**	—
Other creditors	**4,228**	898	**455**	24
Corporation tax	**278**	446	**—**	—
Accruals and deferred income	**28,329**	16,508	**368**	724
	100,308	59,866	**5,121**	16,255

15. CREDITORS: AMOUNTS FALLING DUE AFTER ONE YEAR

	Group		Company	
	2006 £'000	2005 £'000	**2006 £'000**	2005 £'000
Bank loan (note 18)	**37,851**	21,875	**35,000**	21,875
Convertible Bonds (note 18)	**82,879**	—	**82,879**	—
Obligations under finance leases	**4,283**	2,996	**—**	—
	125,013	24,871	**117,879**	21,875

Bank loans are repayable as follows:

	Group		Company	
	2006 £'000	2005 £'000	**2006 £'000**	2005 £'000
Within one year	**1,445**	14,985	**—**	13,300
Between two and five years	**37,851**	21,875	**35,000**	21,875
	39,296	36,860	**35,000**	35,175

The bank loans comprise a loan of £35,000,000 carrying interest at a rate of LIBOR +1.75% and loan of £1,133,000 carrying interest at a rate of bank base rate +1.35% and a loan of € 4,698,000 carrying interest at a fixed rate of 5.19%. The loan of £1,133,000 is repayable on demand.

The maturity of obligations under finance leases is as follows:

Group	**2006 £'000**	2005 £'000
Within one year	**3,016**	1,830
Within one to two years	**2,662**	1,344
Between two and five years	**1,621**	1,455
After five years	**—**	197
	7,299	4,826

The company does not hold any assets under finance leases.

16. PROVISIONS FOR LIABILITIES

Group	Onerous leases £'000	Dilapidations £'000	UITF 25 £'000	Total £'000
At 1 January 2006	1,518	138	348	2,004
Arising during the year	—	12	—	12
Released during the year	—	—	(81)	(81)
Utilised during the year	(324)	(50)	—	(374)
At 31 December 2006	**1,194**	**100**	**267**	**1,561**

The UITF 25 provision relates to national insurance payable on exercise of share options. This is utilised as and when the share options are exercised. The onerous leases provision is in respect of an acquired telecommunications contract and will be utilised up to the end of the contract in August 2010. The dilapidations provision relates to two properties; £88,000 in relation to a lease which has been extended for three years with an option to break in October 2007; and £12,000 in relation to a lease which was acquired in December 2006. £50,000, in relation to a terminated lease, was fully utilised in December 2006.

Company	**2006 £'000**	2005 £'000
At 1 January 2006	**348**	191
(Released)/arising during the year	**(81)**	157
At 31 December 2006	**267**	348

Provisions relate to national insurance payable on exercise of share options according to UITF 25. This is utilised as and when the share options are exercised.

17. OPERATING LEASES

The group had commitments to make annual payments under non-cancellable operating leases which expire as follows:

	Short leasehold property 2006 £'000	**Other 2006 £'000**	Short leasehold property 2005 £'000	Other 2005 £'000
Within one year	**189**	**1,903**	297	1,286
Within two to five years	**1,125**	**184**	1,880	118
After five years	**1,374**	**—**	604	—
	2,688	**2,087**	2,781	1,404

In addition to the above, the group had capital commitments of £13,272,000 (2005: £10,911,000) which comprise telecom circuits of £10,572,000, LLU build for £1,000,000, a data centre in Germany £1,150,000 and a £550,000 commitment in respect of a sponsorship agreement with Fulham Football Club, which was met on 1 January 2007 as per the agreement.

18. FINANCIAL INSTRUMENTS

The group's financial instruments comprise cash and liquid resources, Convertible Bonds and various items such as trade debtors and trade creditors that arise directly from its operations. The main purpose of the financial instruments is to provide finance for the group's operations.

Where it is considered appropriate, the group enters into derivative transactions (principally forward foreign currency transactions). The purpose of such transactions is to manage the currency and interest rate risks arising from the group's operations and its sources of finance.

It is the group's policy that no speculative trading in financial instruments shall be undertaken. The main risks arising from the group's financial instruments are interest rate risk, liquidity risk and foreign currency risk. The directors review and agree policies for managing each of these risks, and they are summarised below.

(I). INTEREST RATE RISK

The group financed its operations throughout the year from bank deposits. The interest rate exposure of the financial assets of the group as at 31 December was:

	Fixed 2006 £'000	**Floating 2006 £'000**	**Nil 2006 £'000**	**Total 2006 £'000**
Sterling	**145**	**47,821**	**—**	**47,966**
US Dollars	**203**	**159**	**—**	**362**
	348	**47,980**	**—**	**48,328**

	Fixed 2005 £'000	Floating 2005 £'000	Nil 2005 £'000	Total 2005 £'000
Sterling	222	13,734	—	13,956
US Dollars	—	8	—	8
	222	13,742	—	13,964

18. FINANCIAL INSTRUMENTS CONTINUED

(I). INTEREST RATE RISK CONTINUED

The interest rate exposure of the financial liabilities of the group as at 31 December was:

	Fixed 2006 £'000	Floating 2006 £'000	Total 2006 £'000
Sterling	**93,341**	**36,133**	**129,474**

	Fixed 2005 £'000	Floating 2005 £'000	Total 2005 £'000
Sterling	17,372	24,314	41,686

(II). LIQUIDITY RISK

The group's objective is to ensure adequate funding for its operations ahead of commitments being made for expansion. This has been achieved in the current year through the issue of Convertible Bonds and draw down of new loan facilities.

	Debt 2006 £'000	Other financial liabilities 2006 £'000	Total 2006 £'000
Financial liabilities maturing:			
– in one year or less or on demand	**1,445**	**3,016**	**4,461**
– in more than one year but not more than two years	**329**	**2,662**	**2,991**
– in more than two years but not more than five years	**119,377**	**1,621**	**120,998**
– after five years	**1,024**	**—**	**1,024**
	122,175	**7,299**	**129,474**

	Debt 2005 £'000	Other financial liabilities 2005 £'000	Total 2005 £'000
Financial liabilities maturing:			
– in one year or less or on demand	14,985	1,830	16,815
– in more than one year but not more than two years	8,925	1,344	10,269
– in more than two years but not more than five years	12,950	1,455	14,405
– after five years	—	197	197
	36,860	4,826	41,686

All of the above debt is secured by means of fixed or floating charges over the group's assets. The Convertible Bonds comprising £82,879,000 (2005: £nil) of other financial liabilities constitutes unsubordinated unsecured obligations of the group.

(III). FOREIGN CURRENCY RISK

The group has occasional transactional currency exposures. Such exposures mainly arise from purchases in US Dollars and Euros.

18. FINANCIAL INSTRUMENTS CONTINUED

(IV). CONVERTIBLE BONDS

On 23 March 2006 Pipex Finance (Jersey) Limited announced the private placement of £80,000,000 3.875% Guaranteed Convertible Bonds 2011. In addition Lehman Brothers (International) Europe was granted the option to increase the size of the issue by an additional £20,000,000. The company received subscriptions for £91,500,000.

The bonds are convertible into ordinary shares of the company at a conversion price of 19p. The company has an option to call the bonds after three years, should the price of the company's ordinary shares exceed 130% of the conversion price over a fixed period.

Expenses of the bonds were £3,221,000 giving rise to net proceeds of £88,279,000.

The fair values of the liability component were determined at the issuance of the bonds. The fair value of the liability component was calculated using a market rate for interest. The residual amount representing the value of the equity conversion component is included in reserves as bond equity (note 23).

The value of the Convertible Bonds recognised in the balance sheet is calculated as follows:

	2006 £'000	2005 £'000
Fair value of bond issued	**91,500**	—
Costs of issue	**(3,221)**	—
Net proceeds	**88,279**	—
Equity component	**(7,692)**	—
Liability component at issue	**80,587**	—
Finance cost	**4,065**	—
Cash interest paid	**(1,773)**	—
Liability component at 31 December 2006	**82,879**	—

Finance cost on the bond is calculated using the effective interest method by applying the effective interest rate of 6%.

(V). FAIR VALUES

The following table sets out the book values and estimated fair values of the group's financial instruments:

	Book value 2006 £'000	**Fair value 2006 £'000**	Book value 2005 £'000	Fair value 2005 £'000
Primary financial instruments:				
Cash at bank and in hand	**48,328**	**48,328**	13,964	13,964
Bank loans	**(39,296)**	**(39,296)**	(36,860)	(36,860)
Convertible Bonds	**(82,879)**	**(81,754)**	—	—
Finance leases due within one year	**(3,016)**	**(3,016)**	(1,830)	(1,830)
Finance leases due after more than one year	**(4,283)**	**(4,283)**	(2,996)	(2,996)
	(81,146)	**(80,021)**	(27,722)	(27,722)

19. CALLED UP SHARE CAPITAL

Authorised and allotted share capital

	2006 £'000	2005 £'000
Authorised		
Equity: 4,000,000,000 ordinary shares of 1p each	**40,000**	40,000
Allotted, called up and fully paid		
Equity: ordinary shares of 1p each		
At start of year 2,210,059,488 (2005: 2,182,171,488) ordinary shares of 1p each	**22,101**	21,822
Issued during the year 183,015,435 (2005: 27,888,000) ordinary shares of 1p each	**1,830**	279
At end of year 2,393,074,923 (2005: 2,210,059,488) ordinary shares of 1p each	**23,931**	22,101

Share capital issued at nominal value in the year relates to the exercise of share options (30,822,000 shares for consideration of £2,161,375), a placing of shares (109,000,000 for consideration of £13,633,525) and shares allotted in respect of the acquisition of Toucan Residential Limited and IDT Direct Ireland Limited (43,193,435 shares at a fair value of £4,751,000).

SHARE WARRANTS

At 1 January 2006 and 31 December 2006 there were outstanding warrants to subscribe to up to 75,000,000 shares of the company. These warrants can only be exercised when the company is EBITDA positive and the company's share price has reached 12.00p.

At 1 January 2006 and 31 December 2006 there were outstanding warrants to subscribe to up to 60,000,000 shares of the company, exercisable in two stages. 50% may be exercised when the company's share price has reached 16.00p and the remaining 50% when the share price has reached 21.00p.

On 16 August 2006, warrants to subscribe to up to 4,000,000 shares in the company, exercisable immediately, were granted at an exercise price of 7.75p.

20. PENSION SCHEME

The group does not operate an occupational pension scheme but makes a percentage contribution of qualifying salary to certain employees' personal pension schemes. The amount charged to the profit and loss account in respect of such contributions was £595,000 (2005: £573,000).

The outstanding contributions to the pension scheme were £nil (2005: £nil).

21. ACQUISITIONS

(I). SUMMARY

Below is a summary of the acquisitions made by Pipex Communications plc in the year ended 31 December 2006:

	2006 £'000
Fair value of assets acquired	**(49,818)**
Goodwill	**90,500**
Consideration	**40,682**
Satisfied by:	
43,193,435 ordinary shares at a market price of 11.00p per share	**4,751**
Cash	**33,386**
Costs of acquisition	**2,545**
	40,682
Effects on group cash flow:	
Cash consideration	**33,386**
Costs of acquisition	**2,545**
Cash balances on acquisition	**40,589**
Net cash outflow	**76,520**

21. ACQUISITIONS CONTINUED

(II). PIPEX HOMECALL LIMITED

The company acquired Caudwell Communications Limited and Homecall Payment Services Limited, (together trading as "Homecall"), on 23 March 2006, for consideration in the form of assumed bank debt of £43,146,000. Costs of acquisition were £990,000.

Goodwill of £51,948,000 arising on acquisition is being amortised over ten years, the useful life as estimated by the directors. The acquisition contributed £116,300,000 of turnover in the period to 31 December 2006 and an operating loss of £5,807,000. The turnover and operating loss of Homecall for the year ended 31 December 2005 were £161,957,000 and £28,534,000 respectively. The net liabilities of Homecall at 31 December 2005 were £102,948,000.

Prior to its acquisition by Pipex, Caudwell Communications Limited issued new shares to its then parent, Phones 4U Group, consideration for which was £48,400,000 million in cash. Caudwell Communications Limited used this cash to pay down part of its overdraft.

Details of the fair values of the assets and liabilities acquired are provisional and are set out below:

	Book value of assets acquired £'000	Fair value adjustments £'000	Fair value £'000
Fixed assets	4,912	911	5,823
Debtors	15,981	2,055	18,036
Overdraft	(43,146)	—	(43,146)
Creditors (falling due within one year)	(31,671)	—	(31,671)
Net (liabilities)/assets	**(53,924)**	**2,966**	**(50,958)**
Goodwill			51,948
Consideration			**990**

Satisfied by:	
Cash	—
Costs of acquisition	990
	990

Effects on group cash flow:	
Cash consideration and costs	990
Cash overdraft on acquisition	43,146
Net cash outflow	**44,136**

EXPLANATORY NOTES:

Fixed Assets

Fixed assets have been adjusted by £911,000 for capitalisation of own labour costs in accordance with Pipex group policy.

Debtors

Debtors have been adjusted by £745,000 in respect of a refund due for discounts on prepaid circuit rentals, £464,000 in respect to adjusting for credit balances. The remaining adjustment of £846,000 is due to a change in accounting policy to prepay connection costs for newly acquired broadband customers.

21. ACQUISITIONS CONTINUED

(III). TOUCAN RESIDENTIAL LIMITED AND IDT DIRECT IRELAND LIMITED

On 12 October 2006 the group acquired Toucan Residential Limited and IDT Direct Ireland Limited (together trading as "Toucan").

The acquisition was financed by a share placement involving 43,193,435 shares at a value of £4,751,000 and cash of £20,000,000, while costs of acquisition were £1,257,000.

Goodwill of £23,924,000 arising on acquisition is being amortised over ten years, the useful life as estimated by the directors.

Toucan contributed £11,723,000 of turnover in the period since acquisition, and operating loss of £1,067,000.

The turnover and operating loss of Toucan as at 31 July 2005 were £23,238,000 and £13,061,000 respectively. Net liabilities were £15,658,000.

Details of the fair values of the assets and liabilities acquired are provisional and are set out below:

	Book value of assets acquired £'000	Fair value adjustments £'000	Fair value £'000
Fixed assets	949	—	949
Debtors	7127	1,216	8,343
Cash	2,049	—	2,049
Creditors (falling due within one year)	(9,230)	(27)	(9,257)
Net assets	**895**	**1,189**	**2,084**
Goodwill			23,924
Consideration			**26,008**

Satisfied by:	
43,193,435 shares at a market price of 11.0p per share	4,751
Cash	20,000
Costs of acquisition	1,257
	26,008

Effects on group cash flow:	
Cash consideration and costs	26,008
Cash balances on acquisition	(2,049)
Net cash outflow	**23,959**

EXPLANATORY NOTES:

Debtors

Debtors have been adjusted due to a change in accounting policy in order to align with group accounting policies.

Creditors

Creditors have been adjusted due to a small overstatement at time of acquisition.

The accounting reference date for Toucan has been changed from 31 July to 31 December in order to bring it in line with the reporting for the group.

(IV). BULLDOG

On 7 September 2006, Pipex Internet Limited acquired from Cable & Wireless Access Limited the active part of the Bulldog customer base together with the Bulldog brand. Initial consideration was £12,000,000, in cash. In January 2007, the number of active customers acquired was reviewed and the consideration lowered to £10,313,000.

Acquisition costs were £55,000 giving rise to goodwill of £10,368,000. Goodwill is being amortised over three years in line with the estimated useful life of the customers acquired. The current year amortisation charge is £1,151,000.

22. GOODWILL ON PRIOR YEAR ACQUISITIONS

(I). SUMMARY – DONHOST

	Provisional fair value to the group 2005 £'000	Adjustments 2006 £'000	Final fair value to the group 2006 £'000
Fair value of net assets acquired	981	**(20)**	**961**
Goodwill	5,430	**20**	**5,450**
Consideration	6,411	**—**	**6,411**

The adjustment to goodwill relates to additional director's remuneration in the pre-acquisition period.

23. RESERVES

Group	Share capital £'000	Share premium account £'000	Other reserves £'000	Profit and loss account £'000	Total £'000
At 1 January 2006	22,101	84,127	13,023	(44,106)	75,145
Issue of shares	1,830	14,397	4,319	—	20,546
Grant of options	—	—	—	2,206	2,206
Issue of Convertible Bonds	—	—	7,692	—	7,692
Loss on translation of foreign subsidiary	—	—	—	(61)	(61)
Unrealised loss on disposal of joint venture	—	—	—	(9,533)	(9,533)
Prior year adjustment due to adoption of FRS 20 (note 1)	—	—	(1,806)	1,806	—
Retained loss for the year	—	—	—	(17,756)	(17,756)
At 31 December 2006	**23,931**	**98,524**	**23,228**	**(67,444)**	**78,239**
Company					
At 1 January 2006	22,101	84,127	12,816	(22,808)	96,236
Issue of shares	1,830	14,397	4,319	—	20,546
Grant of options	—	—	—	2,206	2,206
Issue of Convertible Bonds	—	—	7,692	—	7,692
Prior year adjustment due to adoption of FRS 20 (note 1)	—	—	(1,806)	1,806	—
Retained loss for the year	—	—	—	(7,516)	(7,516)
At 31 December 2006	**23,931**	**98,524**	**23,021**	**(26,312)**	**119,164**

Other reserves consist of the following:

Group	Merger reserve £'000	Capital reserve £'000	UITF 17 reserve £'000	Other reserves £'000	Bond equity £'000	Total £'000
At 1 January 2006	7,538	207	1,806	3,472	—	13,023
Issue of shares	4,319	—	—	—	—	4,319
Issue of Convertible Bonds	—	—	—	—	7,692	7,692
Prior year adjustment due to FRS 20 (note 1)	—	—	(1,806)	—	—	1,806
At 31 December 2006	**11,857**	**207**	**—**	**3,472**	**7,692**	**23,228**
Company						
At 1 January 2006	7,538	—	1,806	3,472	—	12,816
Issue of shares	4,319	—	—	—	—	4,319
Issue of Convertible Bonds	—	—	—	—	7,692	7,692
Prior year adjustment due to FRS 20 (note 1)	—	—	(1,806)	—	—	(1,806)
At 31 December 2006	**11,857**	**—**	**—**	**3,472**	**7,692**	**23,021**

The other reserves represent the premium on shares issued as part of the consideration for the acquisition of Transigent Limited in 2002.

The movement on the merger reserve during the year represents share premium on shares issued to acquire Toucan Residential Limited and IDT Direct Ireland Limited.

As more fully explained in the note 1, classifications within shareholders' funds are determined on different bases in 2006 and 2005 due to the transitional provisions of FRS 25. The adjustments to share premium and reserves to reflect this new policy, and its consequential effects on the profit and loss account, are dealt with above, as a movement in 2006.

24. RECONCILIATION OF OPERATING LOSS TO OPERATING CASH FLOWS

	2006 £'000	2005 £'000
Operating loss	**(11,488)**	(5,859)
Depreciation charge	**12,113**	7,055
Amortisation charge	**18,939**	11,236
Loss on sale of fixed assets	**13**	43
Share of loss of joint venture	**1,421**	—
Share option costs	**2,206**	2,379
Movement in UITF 25 share option provision	**(81)**	157
Decrease/(increase) in stock	**16**	(37)
Decrease/(increase) in debtors	**865**	(1,773)
Increase in creditors	**10,371**	4,781
Non cash credit in respect of provisions	**(363)**	(542)
Net cash inflow from operating activities	**34,012**	17,440

25. RELATED PARTY DISCLOSURES

Peter Dubens, an executive director of the company, was a director of the following companies:

Oakley Capital Limited which provided services to the group of £146,000 (2005: £42,000) of which £39,000 (2005: £10,000) was outstanding at the year end. Oakley Capital Limited was also a customer of Pipex and accounted for sales of £6,000 (2005: £6,000), of which £1,400 (2005: £3,000) was outstanding at the year end.

365 Media Group plc, (formerly ukbetting plc) and its fellow group companies, which provided services to the group in 2006 of £590,000 (2005: £162,000), providing a total of £920,000 (2005: £142,000) that was outstanding at the year end.

365 Media Group plc also accounted for sales by the group in 2006 of £350,000 (2005: £335,000) providing a total of £510,000 (2005: £330,000) that was outstanding at the year end.

Peter Dubens ceased to be a director of 365 Media Group plc as at 23 January 2007.

The group billed the joint venture, Pipex Wireless Limited during the year, £418,000 of which £169,000 was outstanding at the year end.

26. LOSS PER SHARE

	Year ended 31 December 2006	Year ended 31 December 2005
Loss for the financial year attributable to shareholders	**£17,756,000**	£8,672,000
Weighted average number of equity shares in issue	**2,337,117,056**	2,200,084,032
Basic/diluted loss per equity share*	**0.76p**	0.39p

* Since the conversion of potential ordinary shares to ordinary shares would decrease the net loss per share, they are not dilutive. Accordingly diluted loss per share is the same as basic loss per share.

27. POST BALANCE SHEET EVENTS

On 12 January 2007, in accordance with the shareholder agreement, Intel Capital (Cayman) Corporation contributed an additional £10,200,000, and Pipex Communications plc an additional £2,000,000, to the Pipex Wireless Limited joint venture.

Notice is hereby given that the 2007 Annual General Meeting of Pipex Communications plc will be held at the offices of Financial Dynamics, Holborn Gate, 26 Southampton Buildings, London WC2A 1PB on 12 June 2007 at 11am for the following purpose:

As ordinary business to consider and, if thought fit, pass Resolutions 1 to 4 inclusive below which will be proposed as Ordinary Resolutions:

1. To receive, approve and adopt the report of the directors and the financial statements of the company for the financial year ended 31 December 2006 together with the report of the auditors thereon.
2. To re-elect Peter Dubens as a director, who retires by rotation pursuant to Article 102 of the company's Articles of Association.
3. To re-elect Mike Read as a director, who retires by rotation pursuant to Article 102 of the company's Articles of Association.
4. To re-appoint KPMG Audit Plc as auditors to the company to hold office from the conclusion of the meeting until the conclusion of the next Annual General Meeting and to authorise the directors to fix their remuneration.

As special business to consider and, if thought fit, to pass the following Resolutions of which Resolutions 5 and 6 will be proposed as Ordinary Resolutions and Resolutions 7 and 8 will be proposed as Special Resolutions:

5. That the company may send or supply documents or information to members by making them available on a website or other electronic means.
6. That:
   (i) the authority to allot relevant securities and equity securities conferred on the directors by Article 8.2 of the company's Articles of Association be and is hereby granted for the period ending on the date falling fifteen months after the passing of this Resolution or at the conclusion of the next Annual General Meeting of the company to be held after the date of the passing of this Resolution whichever is the earlier (the "prescribed period"), and for the period the section 80 amount shall be £7,994,839; and

   (ii) all previous authorisations given by the company in general meeting or otherwise pursuant to section 80 of the Companies Act 1985 ("the Act") be and are hereby revoked to the extent not previously exercised.
7. That subject to the passing of Resolution 6 above, the power to allot relevant securities and equity securities conferred on the directors by Article 8.2 of the company's Articles of Association be and is hereby granted for the prescribed period (as defined in Resolution 6 above) and for that period the section 89 amount shall be £2,398,451. This authority and power shall revoke to the extent not previously exercised the power granted in this regard by the company at the Annual General Meeting held on 7 June 2006.
8. That the company be and is hereby granted general and unconditional authority (pursuant to section 166 of the Companies Act 1985 ("the Act") and the authorities contained in its Articles of Association) to make market purchases (as defined in section 163 of the Act) of up to in aggregate 239,845,192 of its own ordinary shares of 1p each in the capital of the company ("ordinary shares") provided that:
   (i) the maximum price which may be paid for an ordinary share is an amount equal to not more than 5% above the average of the middle market quotations for the ordinary shares taken from the London Stock Exchange plc Daily Official List for the five business days before the day on which the purchase is made, and the minimum price which may be paid for an ordinary share is 1p, in each case exclusive of expenses payable by the company; and

   (ii) the authority conferred by this Resolution shall expire on the conclusion of the next Annual General Meeting of the company held after the passing of this Resolution, or 12 June 2008 (whichever shall first occur), except that the company may, before such expiry, enter into a contract for the purchase of its own ordinary shares which would or may require to be completed or executed wholly or partly after the expiration of this authority as if the said authority had not expired.

By order of the board

STEWART PORTER
COMPANY SECRETARY
16 APRIL 2007

REGISTERED OFFICE
1 TRIANGLE BUSINESS PARK
STOKE MANDEVILLE
BUCKINGHAMSHIRE
HP22 5BL
REGISTERED IN ENGLAND NUMBER: 3974683

NOTES:

(1) Any member entitled to attend and vote at the Annual General Meeting convened by this notice may appoint one or more proxies to attend and, on a poll, to vote instead of him. A proxy need not be a member of the company.

(2) To appoint a proxy, the form enclosed with this notice should be completed and deposited at the offices of the company's registrars not less than 48 hours before the meeting time of the Annual General Meeting specified above.

(3) In accordance with Regulation 41 of the Uncertificated Securities Regulations 2001, the company gives notice that only those shareholders entered on the relevant register of members (the "Register") for certificated or uncertificated shares of the company (as the case may be) 48 hours before the meeting time (the "Specified Time") will be entitled to attend or vote at the meeting in respect of the number of shares registered in their name at the time. Changes to entries on the Register after the Specified Time will be disregarded in determining the rights of any person to attend or vote at that meeting. Should the meeting be adjourned to a time not more than 48 hours after the Specified Time, that time will also apply for the purpose of determining the entitlement of members to attend and vote (and for the purpose of determining the number of votes they may cast) at the adjourned meeting. Should the meeting be adjourned for a longer period, then to be so entitled, members must be entered on the Register at the time which is 48 hours before the time fixed for the adjourned meeting or, if the company gives notice of the adjourned meeting, at the time specified in the notice.

(4) Copies of the Memorandum and Articles of Association, together with directors' service contracts or memoranda of the terms thereof (other than contracts expiring or determinable by the employing company without compensation within one year), will be available for inspection at the registered office of the company during usual business hours on any weekday (public holidays excluded) from the date of this notice until the close of the Annual General Meeting and will be available for inspection at the place of the Annual General Meeting for at least fifteen minutes prior to and during the meeting.

FORM OF PROXY
Pipex Communications plc

I/We (see note (1) below) ....
BLOCK CAPITALS PLEASE

....

being (a) member(s) of the above-named company, hereby appoint the Chairman of the Meeting or

....

(see note (2) below) as my/our proxy to attend and vote for me/us on my/our behalf at the Annual General Meeting of the company to be held at the offices of Financial Dynamics, Holborn Gate, 26 Southampton Buildings, London WC2A 1PB on 12 June 2007 at 11am and at any adjournment thereof.

In respect of the following Resolutions my proxy is instructed to vote as shown by "X" below (see note (3) below).

Ordinary Resolutions	**For**	**Against**	**Abstain**
1. To receive the Report and Accounts			
2. To re-elect Peter Dubens			
3. To re-elect Mike Read			
4 . To re-appoint KPMG Audit Plc			
5. To authorise the company to send documents electronically			
6. To authorise the directors to allot shares			
Special Resolutions	**For**	**Against**	**Abstain**
7. To disapply pre-emption rights			
8. To authorise the company to purchase its own shares			

Dated..2007

Signature..
(see note (4) below)

Name(s)..
BLOCK CAPITALS PLEASE

Address: ....

....

....
(see note (5) below)

NOTES:

(1) In the case of joint shareholders all should be named but the signature of only the first named holder on the Register is required. If more than one of the joint holders is present at the Annual General Meeting, whether in person or by proxy, that one of the joint holders whose name stands first in the Register shall alone be entitled to vote.

(2) If any other proxy is preferred, please insert the name of the proxy desired in the space provided, delete the words "the Chairman of the Meeting" and initial the alteration. Such other proxy need not be a shareholder.

(3) Please indicate with an "X" in the space provided how you wish your votes to be cast in respect of the Resolutions to be proposed. Unless expressly instructed otherwise in the form as to how the proxy is to vote on any particular matter, the proxy will vote or abstain at his/her discretion.

(4) In the case of a corporation, this form of proxy must be under its common seal or under the hand of an officer or attorney duly authorised in writing.

(5) To be valid this form of proxy and the power of attorney or other authority (if any) under which it is signed or a notarially certified copy thereof must be returned to the company's registrar, not later than 48 hours before the time set for the meeting at the Proxy Processing Centre, Telford Road, Bicester, OX26 4LD. You may also deliver by hand to Capita Registrars, The Registry, 34 Beckenham Road, Beckenham, Kent, BR3 4TU during usual business hours.

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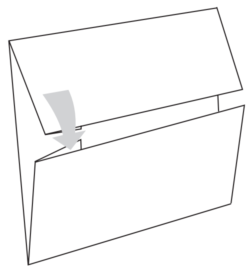

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Proxy Processing Centre
Telford Road
Bicester OX26 4LD

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AUDITORS
KPMG AUDIT PLC
8 Salisbury Square
London EC4Y 8BB

STOCKBROKERS
COLLINS STEWART LIMITED
9th Floor
88 Wood Street
London EC2V 7QR

SOLICITORS
SJ BERWIN
10 Queen Street Place
London EC4R 1BE

REGISTRAR
CAPITA REGISTRARS
The Registry
34 Beckenham Road
Beckenham
Kent BR3 4TU

BANKERS
BANK OF SCOTLAND
110 Queen Street
Glasgow G1 3BY

LLOYDS TSB BANK PLC
3rd Floor
25 Gresham Street
London EC2V 7HN

FINANCIAL PR
FINANCIAL DYNAMICS
Holborn Gate
26 Southampton Buildings
London WC2A 1PB

Pipex Communications plc
1 Triangle Business Park
Stoke Mandeville
Buckinghamshire HP22 5BL

T: 0870 094 6060
F: 0870 160 2719

E: investor@pipex.net
W: www.pipexgroup.com