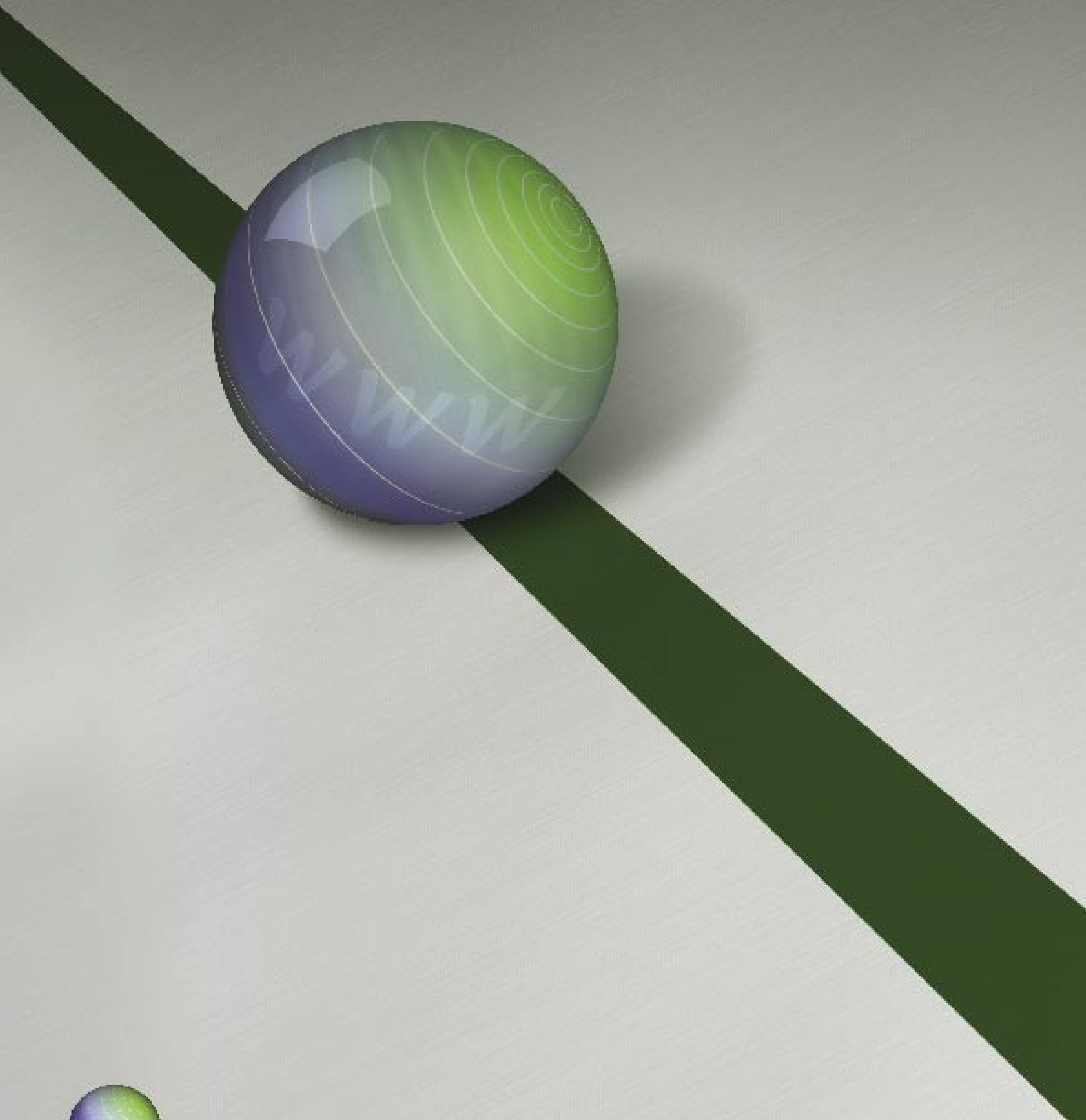


PIPEX COMMUNICATIONS PLC

ANNUAL REPORT AND ACCOUNTS 2005

BROADBAND SERVICES

Broadband is the Internet access method of choice for the residential and SME market place. 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 encompass 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 hosting services is the delivery of domain names and security.

NETWORK SERVICES

Network services cover all aspects of network support for medium and large businesses involving Virtual Private Networks, dedicated access, voice, security and complex hosting solutions. PIPEX supplies tailored, managed solutions integrating any or all of these.

PIPEX IS ONE OF THE UK'S LEADING TELECOM NETWORK OPERATORS AND A HIGHLY RESPECTED TIER ONE INTERNET SERVICE PROVIDER (ISP). PIPEX PROVIDES BROADBAND, VOICE, DATA CONNECTIVITY, HOSTING AND SECURITY SERVICES.

PIPEX EXPERTISE

SUMMARY

- Acquisition of Donhost in April 2005 strengthens position as the UK's largest dedicated and shared hosting and domain names business.
- Around 50% of all new PIPEX Internet broadband subscribers also sign up to take voice services.
- Acquisition of Homecall takes PIPEX to over one million customers.
- The first migration of customers onto our unbundled exchanges will start in April 2006.
- Creation of wireless broadband company with Intel.

OVERVIEW

I am pleased to report another record year for PIPEX with strong organic growth in broadband and hosting services supported by accretive acquisitions in both these areas. Revenues increased by 30% to £133 million (FY 2004: £102 million) and adjusted EBITDA (pre-integration and UITF 17 and 25 charges) increased to £17.0 million (FY 2004: £13.7 million). Free cash flow generated in the year was £7.9 million compared to £1.3 million in 2004.

PIPEX's focus is on selling multiple products to its new customers, particularly those subscribing initially for broadband. High demand for broadband provides the opportunity to deliver a range of complementary services (particularly voice and line rental) to both our residential and business customers. The post year end acquisition of Homecall gives the group scale and additional capability in this fundamentally important area.

The acquisition of Donhost in April 2005 strengthened our position as the UK's largest dedicated and shared hosting and domain names business. Donhost was particularly successful in the reseller market, skills which have been added to PIPEX's Web Fusion and 123Reg brands.

On 17 October 2005 we acquired Freedom to Surf for a cash consideration of £10 million. Freedom to Surf was a UK ADSL business with in excess of 40,000 customers, consolidating PIPEX's position in this market as the fifth largest broadband provider. The increased customer density from the acquisition enabled the company to expand its LLU target to 100 exchanges.

“WITH AN INCREASING NUMBER OF OUR CUSTOMERS BUYING MULTIPLE SERVICES, WE ARE PROTECTING MARGINS AND REDUCING CUSTOMER CHURN.”

BROADBAND SERVICES

We ended the year with 283,000 customers up 47%, from 192,000 at the end of 2004. Average revenue per customer reduced in the year from £25 to £23, in line with market pricing. Business customers continue to comprise 20% of the total.

Following a successful trial, around 50% of all new PIPEX Internet broadband subscribers also sign-up to take voice services. From the second quarter these customers will also be offered line rental in our bundle of services, thereby removing their billing relationship with BT. We believe that the sale of these bundled services will increase average revenues per customer over the year and help protect margins. We also know that the average life of a customer is extended by 44 months for a customer who takes all three services (broadband, voice and line rental) compared to a single service voice customer.

HOSTING SERVICES

The division enjoyed good organic growth in the year and benefited from the acquisition of Donhost to close with 290,000 hosting and 1.3 million domain name customers up from 154,000 and 935,000 respectively at the end of 2004.

During the year we closed three UK data centres to focus our resources on our three remaining, world class, UK facilities. The closure costs are included within integration costs shown on the face of the 2005 profit and loss account. In Germany, strong organic growth was maintained throughout 2005 requiring us to secure a second data centre in Cologne.

NETWORK SERVICES

We continue to believe that the increase in broadband penetration in the UK will drive the demand for more complex access, hosting and security products amongst corporate customers; a trend which is evident from the behaviour of many of our network services customers.

This division also provides infrastructure and network management for the rest of the business, with all of the company’s key technical sites sitting on a common backbone. During 2005 the division took on responsibility for the implementation of PIPEX’s LLU roll out.

OPERATIONAL PERFORMANCE

Turnover increased in the year by 30% to £133 million, with just £4 million coming from 2005 acquisitions (compared to £24 million from acquisitions in 2004). Gross profit increased to £61.2 million, from £48.5 million in 2004; the slight gross margin decline, of 1.4 percentage points, being in line with market reductions in broadband pricing. Going forward, our broadband margins should be maintained by the sale of bundled

PIPEX
EXCELLENT

products (broadband, voice and line rental) to our customers. EBITDA, pre-integration and UITF 17 and 25 charges, rose to £17.0 million from £13.7 million in 2004. Free cash flow for the year was £7.9 million compared to £1.3 million in 2004.

POST PERIOD-END UPDATE

ACQUISITION OF HOMECALL

On 23 March 2006 the company announced the acquisition of Caudwell Communications Limited, trading as Homecall, for consideration in the form of assumed bank debt of £43 million.

Homecall is one of the UK's leading providers of voice, line rental and broadband services with over 500,000 customers, taking PIPEX to over one million customers in total. The acquisition is a major milestone towards the company's stated objective of selling multiple services to its customers in order to strengthen average revenues per customer and to reduce churn. With over 350,000 of Homecall's customers buying more than one service, the company now has 29% of its customer base subscribing to multiple services.

Homecall has a retail presence through Phones4U's 363 high street shops and has a strong outbound telesales function which complements PIPEX's existing web based sales channels.

Homecall is trading profitably and is expected to add approximately £2 million to group EBITDA in 2006. It is not expected to have a significant impact on current capital expenditure forecasts for the year.

CREATION OF WIRELESS BROADBAND COMPANY WITH INTEL

Today the company announces the formation, with Intel Capital, of PIPEX Wireless, to deliver wireless broadband to the UK's major metropolitan areas. Intel is initially investing US$25 million in the new company and PIPEX, which retains a majority interest, has transferred its 3.6GHz spectrum licence into the venture.

PIPEX Wireless will deploy high speed broadband services based on the WiMAX standard starting, it anticipates, in London and Manchester in 2007 and expanding to reach the top eight population centres by 2008.

Intel brings to the venture a strong brand and second-to-none industry knowledge and technical expertise.

FUNDING

On 19 January 2006 the company announced a placing of 109,000,000 ordinary shares at a price of 13p per share to raise £14.2 million, before expenses of £0.6 million.

“ANOTHER RECORD YEAR FOR PIPEX WITH STRONG ORGANIC GROWTH IN BROADBAND AND HOSTING SERVICES SUPPORTED BY ACCRETIVE ACQUISITIONS IN BOTH THESE AREAS.”

The funds are to be used to fund future growth opportunities in the UK market.

On 23 March 2006 PIPEX Finance (Jersey) Limited announced the private placement of £80 million 3.875% Guaranteed Convertible Bonds 2011. In addition, Lehman Brothers (International) Europe was granted the option to increase the size by an additional £20 million. At the time of this announcement, subscriptions for £80 million of the bonds have been received. The bonds represent senior unsecured debt subordinated, up to a limit of £60 million, to future senior secured debt. 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 certain period.

The proceeds of the issue were used to repay a £40 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 when repaid.

It is intended that an application will be made for the bonds to be listed on the Professional Securities Market (PSM) of the London Stock Exchange.

OUTLOOK

The first migration of customers onto our unbundled exchanges will start in April 2006. As we have previously indicated, the group’s current intention is to unbundle 100 exchanges where we have sufficient existing customers to ensure payback within two years. Homecall’s broadband customer base would allow us to extend our LLU programme whilst maintaining our strict payback criterion.

The group has traded well in the first quarter of 2006 and the addition of Homecall has strengthened our service portfolio. With an increasing number of our customers buying multiple services, we are protecting margins and reducing customer churn. These factors lead us to believe that PIPEX should enjoy strong growth across its consumer and SME businesses.

We look forward to working with Intel, who we believe is an ideal partner for PIPEX, to roll out new wireless broadband services across the UK.

PETER DUBENS
CHAIRMAN
31 MARCH 2006

Q PIPEX has continued with its acquisition strategy in 2005 – how have these acquisitions altered the group's composition?

A 2005 has seen a number of telecom company consolidations, and PIPEX is no exception. As previously mentioned, we have added Freedom to Surf, with its 40,000 broadband customers, and Donhost with 92,000 end user customers for hosting services.

Both acquisitions have helped to add further depth to our company, and have brought new skills, incremental efficiencies and economies of scale. Our product mix is now even better balanced, with a weighting in the high growth areas of the market.

After the year end close, we also acquired Caudwell Communications Limited, a company with over 500,000 voice, broadband and line rental customers. These products are sold to customers under the "Homecall" brand.

AN INTERVIEW WITH CHIEF EXECUTIVE, MIKE READ CONTINUED

PIPEX

EXPANSIVE

SUMMARY

- Acquisition of Donhost, Freedom to Surf and Homecall.
- Organic growth and acquisition results in PIPEX becoming the UK's largest dedicated and shared hosting and domain names business, second largest supplier of wholesale line rental and carrier pre-select voice services and fifth largest broadband provider.
- Network integration is complete, providing significant cost savings from cancelled redundant connectivity and Points of Presence (PoPs), as well as increased buying power within the market.
- Addition of LLU product into the broadband network and planned roll out of 100 exchanges.
- PIPEX partners with Intel Capital to rapidly accelerate WiMAX plans following initial trials in Stratford-upon-Avon.

How has the group performed over the last year?

It has been a very productive year in terms of customer growth, new product launches and acquisitions. As you will see, the financial review confirms that we have achieved all our key financial targets and, from an operational point of view, we have continued to focus on the three business units I outlined last year:

BROADBAND SERVICES

We continue to be a major broadband player in the UK, with over 280,000 customers, and continue to grow in line with our expectations. The broadband unit as a whole has performed strongly and has not only grown our business and consumer bases, but has also delivered a white labelled wholesale product, which is proving very popular with resellers. In addition, we added a voice product to the broadband offering in the summer and this has resulted in between 40-50% of all new sign-ups buying a voice/broadband bundle. The success in this area has supported our view that providing customers with a bundle of products is what the market wants and needs.

The acquisition of Freedom to Surf towards the end of the year further enhanced our position, by adding a well respected and innovative brand which was at the forefront of the launch of high speed Internet products such as 8Mb broadband and bonded SDSL.

HOSTING SERVICES

The hosting business has gone from strength to strength. The acquisition of Donhost in April 2005, with over 92,000 customers, now gives a total of 290,000 customers. In addition to a strong, growing customer base, the Donhost acquisition delivered a hosting reseller product that had been missing from our hosting portfolio. More recently, Hosting

“IN 2005 WE ALSO BECAME INTEL’S FIRST EVER SERVER CENTRE OF EXCELLENCE; THIS UNIQUE STATUS IS TRULY A TESTAMENT TO THE QUALITY OF OUR HOSTING PRODUCTS AND SERVICES.”

has launched a very popular Virtual Private Server product which enables customers to bridge the gap between our shared and dedicated hosting services.

In 2005 we also became Intel’s first ever Server Centre of Excellence; this unique status is truly a testament to the quality of our hosting products and services.

The German hosting business has also continued to grow. To meet demand for our services we added a second data centre in Cologne so that we now have three state-of-the-art data centres in the UK and two in Germany.

NETWORK SERVICES

Network Services provides the core infrastructure serving the group. Specialising in mission critical, industrial grade IP delivery with strong service level agreements and high availability guarantees, this pure “business to business” unit provides a wide range of access, hosting, security and voice services for our medium to large enterprise customers. In addition, we have been able to utilise the engineering and project management strength within Network Services to enable our Local Loop Unbundling (LLU) roll out.

How is the integration of all these companies progressing?

We have made considerable progress with the integration since last year’s annual report. Following on from the previous acquisitions it was important to build on the identified synergies and lay the path for full unification.

PEOPLE

The people from all the acquisitions are now integrated into their appropriate business units and, in a number of cases, have moved location to improve efficiency.

NETWORK

The broadband networks have been brought together and we have employed Juniper routers, together with traffic prioritisation equipment, to further enhance the quality of service that we are able to offer to our customers. The network integration has delivered considerable savings in terms of unit costs, as well as operational benefits and reliability.

PIPEX announced last year that, under the LLU programme, we would deploy network elements into BT exchanges to support areas where we have a high density of broadband customers. This project has progressed well and 10% of customers should be on these exchanges by the end of the year.

In order to consolidate the data centre portfolio, the Nottingham and Park Royal data centres were closed during the reporting year

Q

How is the integration of all these companies progressing?

A

We have made considerable progress with the integration since last year's annual report. Following on from the previous acquisitions it was important to build on the identified synergies and lay the path for full unification.

PIPEX

EXPERIENCED

and, as a result, all customers now reside in carrier class data centres in Manchester, Leeds, London Docklands, and two in Cologne. On average our data centres are 75% full.

SYSTEMS

This has been a major task. Important areas being addressed include the optimisation of the infrastructure, alignment of back office system and portfolio management with business process enhancement. The task for 2006 will be to integrate our CRM systems across the group. This is required as we have added our LLU product into the broadband network together with the addition of the Homecall business post year end.

The integration programme will continue to form an important part of our development.

What do you think are the key strengths of the group?

The three key areas are:

1. Our people: PIPEX staff are dedicated to putting the customer first. I am confident that their expertise, and more importantly, their desire to understand our customers and their communications needs is the reason we enjoy such a high proportion of new business coming to us as a result of a referral from existing customers.

2. Our customers: We have built a strong financial business with over 500,000 customers, and, with the acquisition of Homecall, this has increased to over one million customers. PIPEX is now the second largest supplier of wholesale line rental and carrier pre-select voice services, and the fifth largest UK ADSL broadband supplier. We are also one of the largest providers of domain names and hosting to small and medium size companies.

3. Product bundles: The key to our future success will be to continue selling bundled services to customers; for example, many customers buying broadband would also like a good voice service from the same provider. We have been able to demonstrate this in our broadband divisions, as I outlined earlier. Our Network Services unit also sells bundles, such as access with hosting. This is a key strength as it enables our customers to buy all of their telecoms services from us and, hence, intensifies their relationship with PIPEX.

Has the network developed through the acquisitions?

Yes. The PIPEX network, on which all services are carried, is built using the very best-of-breed suppliers for each specific task,

ensuring the resulting service offering is robust, secure and readily available. We maintain excellent partnerships with Juniper, Cisco and Cienna, which ensure timely support and advice when it is required.

During the past twelve months, we have invested selectively in the consolidation and future proofing of the network, as well as enhancing the core network capacity to 10Gbit/s to ensure we continue to deliver the same high level of service.

This consolidation has resulted in the networks gained through recent acquisitions becoming completely integrated, providing significant cost savings from cancelled redundant connectivity and Points of Presence (PoPs), as well as increased buying power within the market. The management of all networks within the PIPEX group is now monitored and repaired from a central, 24x7 state-of-the-art Networks Operations Centre, where the engineers have gained the necessary qualifications in vendor accreditation schemes.

We are therefore better placed than we have ever been to target public and private market sectors covering the spectrum of customers from professional home users, home workers to large corporates.

WiMAX and LLU are hot topics in the press at the moment. What is PIPEX doing in these areas?

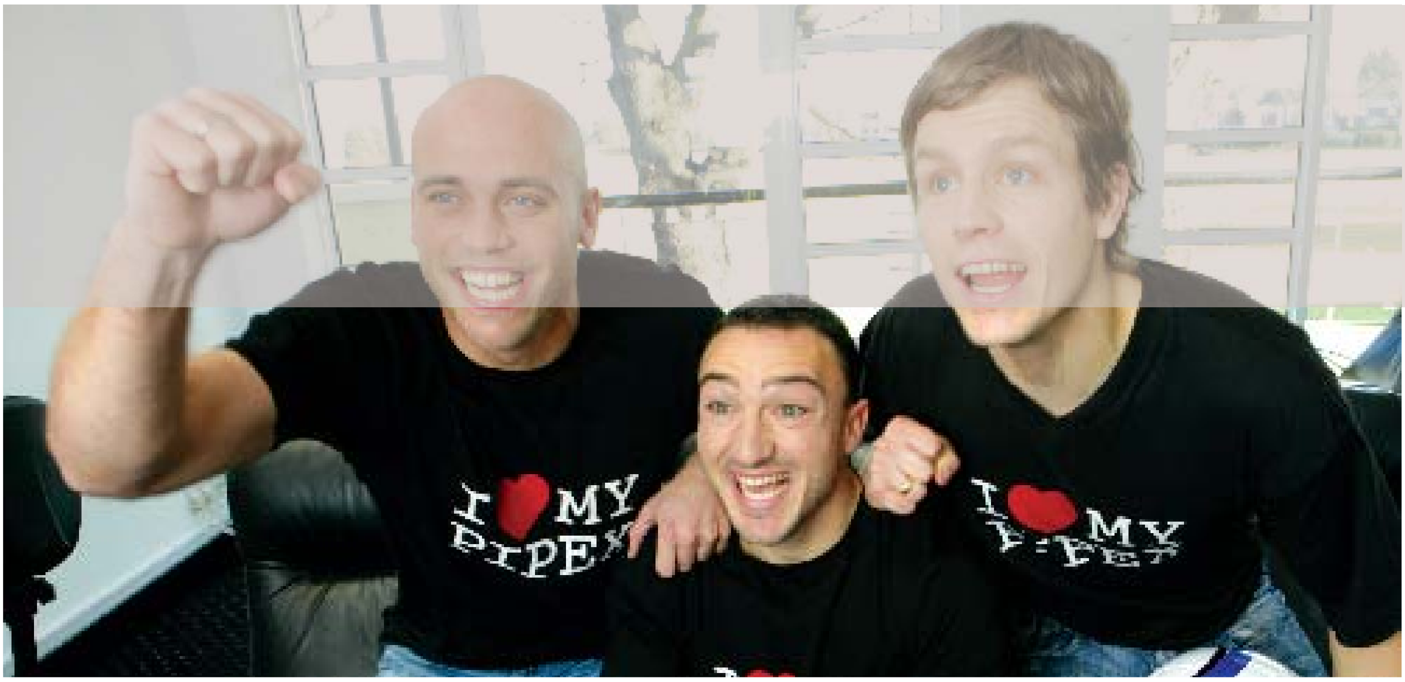
There has been much talk in the press about both of these subjects; let me cover them one by one.

LLU

Prior to 2005 I felt that there was no need for us to unbundle BT's exchanges, but now the landscape is a little different:

- Ofcom's telecoms strategic review had outlined that BT could not change its wholesale broadband costs until 1.5 million local loops were unbundled;
- BT's Openworld was set up as part of this process to help unbundlers achieve faster penetration; and
- A new generation of LLU equipment became available at a price and functionality to meet our needs.

We needed to be able to maintain our margin and still compete in a market that had seen price reductions in low end broadband products. In addition, we wanted to launch the higher speed products that customers are rightly demanding. Whilst we can offer the 8Mbit/s broadband product, we also wanted to be able to offer our customers new services such as ADSL 2+ (24Mbit/s). For these



PIPEX
EXCEEDING

reasons we will be participating in a limited roll out of LLU exchanges.

We have, however, followed a slightly different model to that of our competitors. We have set ourselves some financial targets to determine where we will unbundle. We demand a two year pay back on each exchange and this is translated into needing approximately 400 of our residential customers on each exchange. Because of this, we have only announced our intention to unbundle 100 exchanges for the time being.

WIMAX

We have a nationwide wireless spectrum that is suitable for handling the WiMAX service. WiMAX is an outdoor version of WiFi – the service that you use from your laptop at home, or in a coffee shop or even at a service station. You can, therefore, see the potential of having a single provider of a WiMAX service that could operate anywhere in the UK.

During 2005 the technical standard for WiMAX has been set and we are undertaking a trial in Stratford-upon-Avon. Post year end, we have announced our partnership with Intel Capital to rapidly accelerate our plans.

What is the PIPEX stance on corporate and social responsibility?

We understand that we have an important role to play in conducting business in a social, ethical and environmentally responsible way. PIPEX is committed to being a responsible company and aims to improve its performance in all areas of corporate responsibility. We define corporate responsibility as taking actions that will impact positively on our stakeholders (including customers, employees, shareholders, suppliers and local communities) and the environment in which we live and work. We will adhere to all legal and regulatory obligations in this regard and, where possible, exceed them.

Recognising that the industry has some way to go to improve customer service, we have improved our processes for dealing with customer complaints and any queries relating to the way we do business. Our customers recognise that we are not afraid to challenge the norms of the industry in order to try and provide them with the best products, service and value for money. Through offering choice and value, we put the power into our customers' hands, and once again, we are in the Which? Top 10 for having "the most satisfied customers" in the UK market.

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

“THROUGH OFFERING CHOICE AND VALUE, WE PUT THE POWER INTO OUR CUSTOMERS’ HANDS, AND ONCE AGAIN, WE ARE IN THE WHICH? TOP 10 FOR HAVING ‘THE MOST SATISFIED CUSTOMERS’ IN THE UK MARKET.”

Standards Institute) as compliant with the internationally recognised standard. This certification is verified though audits every six months, where continuing certification can either be confirmed or denied.

It is the policy of PIPEX to provide and maintain safe and healthy working conditions, equipment and safe working practices for all its employees, and to provide all necessary information, training and supervision. We also accept our responsibility for the health and safety of other people who may be affected by our work activities.

As an equal opportunities employer, we have taken steps to ensure that our recruitment practices do not disadvantage applicants on the basis of race, age, gender, sexuality, physical ability or religion. PIPEX also supports a number of projects and charities around the country including Comic Relief and RNLI.

We believe in working towards a safer Internet. 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.

What is the strategy for the group going forward?

The strategy going forward into 2006 is simple:

a. Complete the developments and integrations that we began in 2005;

b. Continue to grow all our customer bases and provide multiple bundled services;

c. Look to acquire companies that add to our financial and operational position;

d. Roll out our LLU and provide firm plans for WiMAX; and

e. Meet our financial expectations.

You should see a much greater PIPEX presence in 2006.

MIKE READ
CHIEF EXECUTIVE OFFICER
31 MARCH 2006

PIPEX

EXCEPTIONAL

TRANSACTIONS

DONHOST

On 27 April 2005 the company acquired Donhost Limited for a consideration of £5.9 million. This was satisfied by a cash consideration of £4.1 million and the issue of 22,840,000 ordinary shares in the company at a price of 7.75p per share.

The total cost of acquisition was £6.4 million and net assets acquired were £1.0 million giving rise to goodwill of £5.4 million. Included in net assets were cash balances of £1.4 million.

FREEDOM TO SURF

On 17 October 2005 the company acquired Freedom to Surf plc, Freedom to Surf Consumer Services Ltd and Freedom to Surf Registration Services Ltd for a cash consideration of £10.0 million. This was financed by a bank loan of £8.0 million with the balance coming from the company's own resources.

The total cost of the acquisition was £10.5 million, with neutral net assets giving rise to goodwill of £10.5 million. Freedom to Surf had cash balances of £1.2 million on the date of acquisition.

PERFORMANCE

PROFIT AND LOSS

Turnover for the year was £132.9 million, an increase of 30% over 2004, from organic growth and the full year impact of Host Europe and Nildram acquired mid year in 2004. Current year acquisitions contributed just £4.1 million compared to £23.9 million last year.

Within overall turnover, each of the group's operating divisions enjoyed organic growth in the year. Broadband Services, which accounts for 56% of 2005 turnover, increased to £74.0 million from £53.6 million, an improvement of 38%.

In Hosting Services turnover grew by 57% to £25.9 million, representing 19% of total revenues. Organic growth was 19%.

Organic revenue growth in Network Services was 3%, with turnover growing to £33.0 million from £32.2 million last year. Network Services represents 25% of total turnover in 2005.

The group continues to operate out of two countries, the UK and Germany. Turnover in the UK increased by 28%, to £125.6 million, and in Germany by 75%, to £7.3 million. The improvement in Germany is attributable to organic growth, 44%, and to a full twelve months' trading for Host Europe GmbH in 2005, 31%.

Gross profit for the year was £61.2 million, a margin on sales of 46.0%. This is a fall of 1.4 percentage points on the equivalent margin in 2004. The biggest contributor to the small decline in margin percentage was the fall in average revenue per broadband

"WITHIN OVERALL TURNOVER, EACH OF THE GROUP'S OPERATING DIVISIONS ENJOYED ORGANIC GROWTH IN THE YEAR."

customer, from £25 at the end of 2004 to £23 at the end of 2005, in line with market pricing. Within Hosting and Network Services gross margins have been maintained.

Operating expenses before amortisation, depreciation, integration costs and UITF 17 and 25 charges have increased to £44.2 million from £34.9 million, a rise of 27%. Of this increase, £5.4 million arises from having a full twelve months' costs in 2005 for those acquisitions completed in 2004. The 2005 acquisitions added a further £0.6 million to operating expenses.

Adjusted EBITDA* (EBITDA before integration costs and UITF 17 and 25 charges) is therefore £17.0 million, an increase over last year of 24%. The ratio of Adjusted EBITDA to turnover has decreased slightly in 2005 to 12.8% (2004: 13.4%), the small decline in gross margin, discussed above, being substantially offset by the continuing cost benefits generated by our business integration programme.

*Note: EBITDA represents operating profit or loss before depreciation and amortisation. Adjusted EBITDA is defined as EBITDA excluding integration costs and UITF 17 and 25 charges. A reconciliation of Adjusted EBITDA to EBITDA and reported operating loss is set out on page 16.

The increase in depreciation, a rise of 21% to £7.1 million, reflects the impact of current year acquisitions together with a full year charge of prior year acquisitions.

Net interest payable has increased in the year from £1.6 million to £2.8 million. The charge includes a full twelve months' cost of service of the £13.0 million debt taken on in August 2004 to fund the acquisition of Nildram. On top of this, an additional £2.0 million was added to our debt facilities in April 2005, associated with Donhost, and a further £8.0 million added in October 2005 to part-finance Freedom to Surf. Finally, the group has taken on additional net finance lease obligations in 2005 amounting to £1.9 million.

Adjusted PBT (PBT before amortisation, integration costs and UITF 17 and 25 charges) was £7.1 million, compared to £6.2 million in 2004.

Amortisation of intangibles primarily relates to goodwill, which is written off over ten years, and amounts to £11.0 million in 2005 (2004: £8.7 million). The relatively steep rise in the year is driven by the full year effect of the 2004 acquisitions (which added an incremental £1.5 million) and the 2005 acquisitions (£0.6 million).

Integration costs are the one-off costs incurred by the group to assimilate acquired businesses and to eliminate unnecessary or overlapping costs. In 2005 the group engaged in a number

*RECONCILIATION OF ADJUSTED EBITDA TO OPERATING LOSS

	2005 £000	2004 £000
Operating profit before amortisation, depreciation, UITF 17 and 25 charges and integration costs ("Adjusted EBITDA")	**16,954**	13,667
Integration costs	**(1,986)**	(1,749)
UITF 17 and 25 charges	**(935)**	(506)
Operating profit before amortisation and depreciation ("EBITDA")	**14,033**	11,412
Depreciation	**(7,055)**	(5,852)
Amortisation of goodwill and other intangible assets	**(11,236)**	(9,001)
Operating loss	**(4,258)**	(3,441)

PIPEX EXTRAORDINARY

of significant integration projects, in particular; closed three UK data centres acquired through Host Europe and Donhost; vacated its former head office; and made substantial further progress harmonising back office systems. The cost of these activities, together with a number of smaller projects, was £2.0 million, which compares to £1.7 million in 2004. Whilst the company continues to be acquisitive, there will be costs incurred in bringing these businesses into the group.

In the annual report and accounts for 2004 it was estimated that the 2005 UITF 17 and 25 charges would be £1.0 million. In the event the actual charge for the year was £0.9 million (2004: £0.5 million). As previously reported, the charge arises, principally, as a result of share option and warrant grants made to certain directors and senior managers on dates broadly coincident with two share placings associated with the PIPEX Internet and Host Europe acquisitions. The grants were made at the same price as the placings, which represented a small discount to the market price of the shares on the dates of grant. Under UITF 17 the company is required to account for the notional increase in value through the profit and loss account, apportioning the charge over the estimated vesting period.

The loss for the year includes a small taxation charge arising in our German business. The loss has deepened from £5.1 million to £7.1 million, principally because of the increase in amortisation of intangibles of £2.2 million.

BALANCE SHEET

Goodwill arising on acquisitions in 2005 was £15.9 million. This, less amortisation discussed above, has given rise to the increase of £4.4 million in the net carrying value of goodwill. In 2004 the group made a fair value assessment of its Fixed Wireless Access Licence in the 3.6-4.2 GHz frequency range. This range is adjacent to and overlaps the range designated by the WiMAX Forum as compatible spectrum. No adjustment has been made to the value of the licence in 2005 except that the carrying value has been reduced by an additional year's amortisation. The value of the licence is being amortised over twenty years.

Tangible fixed assets have increased in the year by £3.7 million to £25.3 million. In 2005 the group invested in Local Loop Unbundling (LLU) infrastructure and broadband network equipment over and above its usual replacement and growth capital expenditure.

Debtors have increased to £19.0 million from £16.4 million in 2004 as a result of increased billing and the impact of the two new acquisitions.

The biggest contributor to the growth in creditors falling due within one year, which increased by £15.8 million to £59.9 million, was the bank loan of £8.0 million taken out to part fund the Freedom to Surf acquisition and which is due for

“PIPEX IS VALUED BY INVESTORS FOR ITS SOLID CORE BUSINESS PROVIDING BROADBAND INTERNET, NETWORK SERVICES AND WEBSITE HOSTING FOR CONSUMERS AND SMALL COMPANIES.” **THE SUNDAY TELEGRAPH**, 15 JANUARY 2006

repayment in July 2006 . Freedom to Surf and Donhost added a further £3.2 million to creditors. Deferred income, arising from billing in advance, also grew in line with billing, by £1.2 million.

Within creditors falling due after one year was an increase in bank loans of £0.7 million and additional finance lease obligations amounting to £1.3 million.

In the year the company issued 22,840,000 shares in relation to the Donhost acquisition and a further 5,048,000 as a result of share option exercises. These gave rise to increases of £0.3 million to called up share capital, £0.3 million to share premium and £1.5 million to other reserves.

CASH FLOW

Cash balances at the year end were £14.0 million, up from £11.3 million at the end of 2004. The group generated £7.9 million free cash flow in the year compared to £1.3 million in 2004. Free cash flow is the cash flow before management of liquid resources and financing and acquisitions. Capital expenditure of £7.1 million (2004: £6.1 million) excludes tangible fixed assets purchased with finance leases, amounting to an additional £3.3 million. Of the £12.5 million cash outflow for acquisitions, £3.3 million arose in relation to Donhost and £9.2 million for Freedom to Surf.

Net debt at the year end was £27.7 million (2004: £20.6 million) and comprised; balance sheet cash of £14.0 million less; bank debt of £35.2 million; property mortgage of £1.7 million; and finance leases of £4.8 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 23 March 2006 PIPEX Finance (Jersey) Limited announced the private placement of £80 million 3.875% Guaranteed Convertible Bonds 2011. The proceeds of the issue were used to repay a £40 million bridging loan, obtained to fund the purchase of Homecall, and to repay all of the company’s existing bank debt, amounting to £35.2 million at the year end.

It is intended that an application will be made for the bonds to be listed on the Professional Securities Market (PSM) of the London Stock Exchange.

In the year the remaining loan notes issued in relation to the Transigent acquisition in 2002, amounting to £2.0 million, were redeemed.

STEWART PORTER
CHIEF FINANCIAL OFFICER
31 MARCH 2006

DIRECTORS

PETER DUBENS
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 is also Executive Vice Chairman of ukbetting plc, the largest UK online sports content and gaming company. He is also the co-founder of Palmer Capital Management, a hedge fund introductory business, and a number of other privately held companies.

MIKE READ
CHIEF EXECUTIVE OFFICER

Mike has 30 years' experience in the Communications and Internet Industry. He started his career in British Telecom where he gained considerable experience in international activities including: Product Management, Product Development, Engineering & Planning, Marketing and Advertising. This culminated in him working in the USA in the joint venture with MCI where he led the operational and engineering aspects of Concert. He later returned to the UK to become 'Chief of Global Engineering' which covered all engineering aspects of BT worldwide (with the exception of the UK).

During the initial 'launch phase' of the Internet Mike left BT and joined ANS in the USA – one of the first Internet companies. His responsibilities covered Sales, Marketing, Product Management and Business Development.

In 1998 he moved to Florida to become CEO of Pacer International, a company that designed and built communication networks and systems for clients worldwide. Mike was headhunted by Pacer to run as President and COO of a consumer ISP 'roll up' in the USA called One Main. During the first eighteen months over 30 companies were purchased and rolled into one company.

In 2000 Mike moved back to the UK to become CEO/MD of XO Europe, the UK arm of which was acquired by GX Networks in October 2002.

STEWART PORTER
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
NON-EXECUTIVE DIRECTOR

Christina Kennedy has a Masters degree in Business Administration and is a Fellow of the Chartered Institute of Secretaries. 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
NON-EXECUTIVE DIRECTOR

A former Chairman of the Internet Service Providers' Association (ISPA), Laurence Blackall has a Masters degree in Marketing and over twenty years' experience in 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 was, in turn, acquired by Zipcom plc. This was renamed GX Networks plc, before becoming PIPEX Communications plc in 2003.

DIRECTORS' REPORT

The directors present their annual report and the audited financial statements for the year ended 31 December 2005.

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, an interview with the Chief Executive on pages 6 to 13 and the financial review on pages 14 to 17.

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

Stewart Porter and Christina Kennedy 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 29 March 2006 the company had been notified of the following significant shareholdings:

	%
UBS Warburg	18.20
Fidelity International & FMR Corp	14.28
P Dubens	5.95
Goldman Sachs International	4.72
M&G Recovery IF3 Fund	4.29
L Blackall	3.00

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 2005 as a proportion of amounts invoiced by suppliers during the period represent 49 days (2004: 51 days) for the existing business and 44 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.

DIRECTORS' REPORT CONTINUED

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.

ANNUAL GENERAL MEETING

The Annual General Meeting will be held on Wednesday 7 June 2006 at 11.00am at the offices of Financial Dynamics, Holborn Gate, 26 Southampton Buildings, London WC2A 1PB.

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 31 March 2006.

STEWART PORTER
CHIEF FINANCIAL OFFICER

CORPORATE GOVERNANCE

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 2005 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 2005.The board considers that the current composition provides a reasonable balance of independence. L Blackall, while a substantial shareholder, brings an independent view of the telecoms industry to board discussions. The board however accepts that C Kennedy is considered to be the only current independent non-executive director as defined under the Code.

An evaluation of board performance was undertaken during the year. 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. A further review will be undertaken at the same time next year.

The board, which meets on average six times a year, 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.

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.

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 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 judgement, 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 (AGM), and annual and interim reports. In addition further details on the strategy and performance of the company can be found at its website (www.pipex.net) which includes copies of the company's press releases.

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 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. In light of the increased size of the group following the recent acquisition of Homecall this will now be subject to further review.

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.

BOARD REPORT ON DIRECTORS' REMUNERATION

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
- 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 19 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	Benefits £'000	Bonus £'000	**Total 2005 £'000**	Total 2004 £'000	**Pension 2005 £'000**	Pension 2004 £'000
Executive							
M Read	227	—	123	**350**	373	**22**	21
S Porter	187	—	108	**295**	306	**31**	29
P Dubens	250	—	133	**383**	350	**–**	—
Non-executive							
L Blackall	25	—	—	**25**	25	**–**	—
C Kennedy	25	—	—	**25**	25	**–**	—
Former directors							
D Rickards	—	—	—	**–**	54	**–**	—
	714	—	364	**1,078**	1,133	**53**	50

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 2005 are as follows:

DIRECTORS' SHAREHOLDINGS

	1p ordinary shares at 31 December 2005	1p ordinary shares at 31 December 2004
M Read	**—**	—
S Porter	**174,500**	174,500
P Dubens	**138,888,889**	138,888,889
L Blackall	**138,888,889**	138,888,889
C Kennedy	**167,800**	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.

DIRECTORS' SHARE OPTIONS

	Note	At 1 January 2005	Awarded during the year	Cancelled during the year	**At 31 December 2005**	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
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
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
L Blackall		—	—	—	**—**		
C Kennedy		—	—	—	**—**		

(i) EMI Scheme – no performance criteria attached.

(ii) Unapproved Scheme – no performance criteria attached.

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

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

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

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

No directors in office at 31 December 2005 exercised any share options during the year.

DIRECTORS' SHARE OPTIONS CONTINUED

At 31 December 2005 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 only be exercised after 1 January 2006, when the company is EBITDA positive for a twelve month period and the company's share price has reached 12.00p.

Warrants at 10.50p are exercisable in two stages. 50% may be exercised when the company's share price has reached 16.00p and the remaining 50% on the share price reaching 21.00p.

The mid-market price for the company's shares at 31 December 2005 was 11.95p. The high and low mid-market prices of the ordinary shares during the year to 31 December 2005 were 11.95p and 7.25p respectively.

On behalf of the board

STEWART PORTER
CHIEF FINANCIAL OFFICER
31 MARCH 2006

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 the directors have elected to prepare the group and parent company financial statements in accordance with UK Accounting Standards.

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 judgements 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.

REPORT OF THE INDEPENDENT AUDITORS
TO THE MEMBERS OF PIPEX COMMUNICATIONS PLC

We have audited the group and parent company financial statements (the "financial statements") of PIPEX Communications plc for the year ended 31 December 2005 which comprise the group profit and loss account, the group and company balance sheets, the group cash flow statement, the group statement of total 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 Annual Report and Accounts in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the statement of directors' responsibilities on page 26.

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

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if 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 other information contained in the Annual Report and Accounts and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

BASIS OF AUDIT OPINION

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

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

OPINION

In our opinion the financial statements:

- give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the group's and the parent company's affairs as at 31 December 2005 and of the group's loss for the year then ended; and
- have been properly prepared in accordance with the Companies Act 1985.

KPMG AUDIT PLC
CHARTERED ACCOUNTANTS
REGISTERED AUDITOR
8 Salisbury Square
London EC4Y 8BB
United Kingdom

31 MARCH 2006

CONSOLIDATED PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2005

	Note	Existing operations 2005 £'000	Acquisitions 2005 £'000	Total 2005 £'000	2004 £'000
Turnover	1, 2	**128,863**	**4,076**	**132,939**	102,289
Cost of sales		**(69,421)**	**(2,361)**	**(71,782)**	(53,774)
Gross profit		**59,442**	**1,715**	**61,157**	48,515
Operating expenses before amortisation, depreciation and integration costs		**(44,497)**	**(641)**	**(45,138)**	(35,354)
Amortisation of intangibles		**(10,657)**	**(579)**	**(11,236)**	(9,001)
Depreciation		**(6,927)**	**(128)**	**(7,055)**	(5,852)
Integration costs	3	**(1,986)**	**—**	**(1,986)**	(1,749)
Operating expenses		**(64,067)**	**(1,348)**	**(65,415)**	(51,956)
Operating profit before amortisation, depreciation and integration costs		**14,945**	**1,074**	**16,019**	13,161
Amortisation of intangibles		**(10,657)**	**(579)**	**(11,236)**	(9,001)
Depreciation		**(6,927)**	**(128)**	**(7,055)**	(5,852)
Integration costs		**(1,986)**	**—**	**(1,986)**	(1,749)
Operating (loss)/profit	3	**(4,625)**	**367**	**(4,258)**	(3,441)
Other interest receivable and similar income	5			**303**	465
Interest payable and similar charges	6			**(3,068)**	(2,058)
Loss on ordinary activities before taxation				**(7,023)**	(5,034)
Tax on loss on ordinary activities	7			**(48)**	(29)
Loss for the financial year				**(7,071)**	(5,063)
Loss per ordinary share – basic	26			**0.32p**	0.25p
– diluted	26			**0.32p**	0.25p

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 2005

	Note	2005 £'000	2004 £'000
Loss for the financial year		**(7,071)**	(5,063)
Translation difference in respect of net investment in overseas subsidiary undertaking	23	**(28)**	60
Total recognised losses in the year		**(7,099)**	(5,003)

CONSOLIDATED BALANCE SHEET
AT 31 DECEMBER 2005

	Note	2005 £'000	2005 £'000	2004 £'000	2004 £'000
Fixed assets					
Intangible assets					
Positive goodwill	8	**99,231**		94,714	
Negative goodwill	8	**–**		(94)	
Patents	8	**7**		8	
Wireless licence	8	**4,417**		4,667	
			103,655		99,295
Tangible assets	9		**25,251**		21,581
			128,906		120,876
Current assets					
Stock	11	**63**		21	
Debtors	12	**18,953**		16,386	
Cash at bank and in hand	13	**13,964**		11,309	
		32,980		27,716	
Creditors: amounts falling due within one year	14	**(59,866)**		(44,094)	
Net current liabilities			**(26,886)**		(16,378)
Total assets less current liabilities			**102,020**		104,498
Creditors: amounts falling due after one year	15		**(24,871)**		(22,861)
Provisions for liabilities and charges	16		**(2,004)**		(2,251)
Net assets			**75,145**		79,386
Capital and reserves					
Called up share capital	19, 23		**22,101**		21,822
Share premium account	23		**84,127**		83,868
Other reserves	23		**13,023**		10,703
Profit and loss account	23		**(44,106)**		(37,007)
Equity shareholders' funds			**75,145**		79,386

The accounts on pages 28 to 52 were approved by the board of directors on 31 March 2006 and were signed on its behalf by:

PETER DUBENS
CHAIRMAN

STEWART PORTER
CHIEF FINANCIAL OFFICER

COMPANY BALANCE SHEET
AT 31 DECEMBER 2005

	Note	2005 £'000	2005 £'000	2004 £'000	2004 £'000
Fixed assets					
Investments	10		**127,891**		64,798
Current assets					
Debtors	12	**6,807**		65,114	
Cash at bank and in hand	13	**16**		2,126	
		6,823		67,240	
Creditors: amounts falling due within one year	14	**(16,255)**		(39,528)	
Net current (liabilities)/assets			**(9,432)**		27,712
Total assets less current liabilities			**118,459**		92,510
Creditors: amounts falling due after one year	15		**(21,875)**		(21,200)
Provisions for liabilities and charges	16		**(348)**		(191)
Net assets			**96,236**		71,119
Capital and reserves					
Called up share capital	19, 23		**22,101**		21,822
Share premium account	23		**84,127**		83,868
Other reserves	23		**12,816**		10,496
Profit and loss account	23		**(22,808)**		(45,067)
Equity shareholders' funds			**96,236**		71,119

The accounts on pages 28 to 52 were approved by the board of directors on 31 March 2006 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 2005

	Note	2005 £'000	2004 £'000
Cash inflow from operating activities	24	**17,440**	7,643
Returns on investment and servicing of finance			
Interest paid		**(2,346)**	(1,523)
Interest received		**303**	465
Interest element of finance lease payments		**(288)**	(377)
		(2,331)	(1,435)
Taxation (paid)/received		**(182)**	217
Capital expenditure and financial investment			
Purchase of tangible fixed assets		**(7,067)**	(6,086)
Proceeds from disposals of tangible fixed assets		**–**	939
		(7,067)	(5,147)
Acquisitions			
Purchase of subsidiary undertakings	21	**(15,100)**	(46,537)
Net cash acquired with subsidiary undertakings	21	**2,591**	5,842
Prior year acquisitions	22	**812**	(163)
		(11,697)	(40,858)
Cash outflow before management of liquid resources and financing		**(3,837)**	(39,580)
Management of liquid resources			
Movement in restricted deposits		**2,632**	(693)
Financing			
Issue of ordinary share capital		**–**	33,000
Expenses on issue of ordinary share capital		**–**	(1,227)
Exercise of share options		**310**	785
Repayment of loan notes		**(1,989)**	(1,501)
Drawdown of new loan		**10,000**	13,000
Repayment of loan		**(129)**	(2,890)
Capital element of finance lease payments		**(1,700)**	(3,545)
Net cash inflow from financing		**6,492**	37,622
Increase/(decrease) in cash in the year		**5,287**	(2,651)

CONSOLIDATED CASH FLOW STATEMENT CONTINUED FOR THE YEAR ENDED 31 DECEMBER 2005

RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT FOR THE YEAR ENDED 31 DECEMBER 2005

	2005 £'000	2004 £'000
Increase/(decrease) in cash in the year	**5,287**	(2,651)
Net movement in liquid resources	**(2,632)**	693
Payment of loan note	**1,989**	1,501
Drawdown of new loan	**(10,000)**	(13,000)
Repayment of loan	**129**	2,890
Cash outflow from lease financing	**1,700**	3,545
Change in net debt resulting from cash flows	**(3,527)**	(7,022)
New finance leases	**(3,302)**	(486)
Finance leases acquired with subsidiary	**(276)**	(504)
Finance lease fair value adjustment	**—**	(950)
Movement in net debt	**(7,105)**	(8,962)
Opening net debt	**(20,617)**	(11,655)
Closing net debt	**(27,722)**	(20,617)

ANALYSIS OF NET DEBT AT 31 DECEMBER 2005

	At 1 January 2005 £'000	Cashflow £'000	Acquisitions (excluding cash) £'000	Other £'000	At 31 December 2005 £'000
Cash	8,191	**5,287**	**—**	**—**	**13,478**
Restricted deposits	3,118	**(2,632)**	**—**	**—**	**486**
Cash at bank and in hand per balance sheet	11,309	**2,655**	**—**	**—**	**13,964**
Bank loans	(26,989)	**(9,871)**	**—**	**—**	**(36,860)**
Finance leases	(2,948)	**1,700**	**(276)**	**(3,302)**	**(4,826)**
Loan notes	(1,989)	**1,989**	**—**	**—**	**—**
Net debt	(20,617)	**(3,527)**	**(276)**	**(3,302)**	**(27,722)**

The movement of £3,302,000 in "Other" relates to new finance leases.

RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS FOR THE YEAR ENDED 31 DECEMBER 2005

	Group 2005 £'000	Group 2004 £'000	**Company 2005 £'000**	Company 2004 £'000
(Loss)/profit for the financial year	**(7,071)**	(5,063)	**22,259**	(3,046)
New share capital subscribed (net of issue costs)	**310**	32,558	**310**	32,558
Share capital issued on acquisitions during the year	**1,770**	—	**1,770**	—
Translation difference in respect of net investment in overseas subsidiary undertaking	**(28)**	60	**—**	—
Granting of options/UITF 17 charge reversed	**778**	451	**778**	451
Net (decrease)/increase in shareholders' funds	**(4,241)**	28,006	**25,117**	29,963
Opening shareholders' funds	**79,386**	51,380	**71,119**	41,156
Closing shareholders' funds	**75,145**	79,386	**96,236**	71,119

NOTES TO THE FINANCIAL STATEMENTS

1 ACCOUNTING POLICIES

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the group's financial statements.

BASIS OF PREPARATION

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

BASIS OF CONSOLIDATION

The consolidated financial statements include the financial statements of the company and its subsidiary undertakings made up to 31 December 2005. 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.

GOING CONCERN

As at 31 December 2005 the group had cash of £13,964,000 including £486,000 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 2005.

On 19 January 2006 the company announced a placing of 109,000,000 shares at 13p per share to raise £13.6 million after expenses. Then on 23 March 2006 PIPEX Finance (Jersey) Limited announced the private placement of £80 million 3.875% Guaranteed Convertible Bonds 2011. The proceeds of the issue were used to repay a £40 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 when repaid. These post balance sheet events further support the going concern assumption.

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.

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 measured reliably.

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
Indefeasible rights of use	Life of the contract
Office equipment	Three to five years
Leasehold improvements	Life of the lease
Plant and machinery	Three to five years
Freehold property	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 OPTIONS
The cost of awards to employees that take the form of shares or rights to shares are recognised over the period of the employee's related performance.

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.

	2005 £'000	2004 £'000
Turnover		
Broadband services	**74,005**	53,619
Hosting services	**25,908**	16,515
Network services	**33,026**	32,155
	132,939	102,289

Turnover and loss before interest and tax, together with net assets by country of origin, are set out below.

	Net assets 2005 £'000	Net assets 2004 £'000	**Turnover 2005 £'000**	Turnover 2004 £'000	**Loss before interest and tax 2005 £'000**	Loss before interest and tax 2004 £'000
UK	**68,216**	72,250	**125,616**	98,096	**(3,814)**	(3,135)
Germany	**6,929**	7,136	**7,323**	4,193	**(444)**	(306)
	75,145	79,386	**132,939**	102,289	**(4,258)**	(3,441)

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

3 OPERATING LOSS

	2005 £'000	2004 £'000
Operating loss is stated after charging/(crediting):		
Auditors' remuneration:		
– audit	**250**	215
– other services	**115**	107
Depreciation and other amounts written off tangible fixed assets:		
– owned assets	**5,908**	3,280
– under finance leases	**1,147**	2,572
Loss/(profit) on disposal of fixed assets	**43**	(53)
Amortisation of:		
– negative goodwill (see note 8)	**(94)**	(225)
– positive goodwill (see note 8)	**11,079**	8,892
– patents (see note 8)	**1**	1
– wireless licence (see note 8)	**250**	333
Rentals payable under operating leases:		
– land and buildings	**2,312**	2,246
– other operating leases	**16,408**	7,001
Integration costs	**1,986**	1,749
UITF 17 charge	**778**	451

The auditors' remuneration includes £20,000 (2004: £18,000) for the company. Remuneration for non-audit services represents fees for tax compliance and advice. In addition £66,000 of fees were paid to the auditors in connection with the acquisition of Donhost Limited and Freedom to Surf. These are included in the cost of investment.

4 STAFF NUMBERS AND COSTS

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

	2005 Number	2004 Number
Full time operations staff	**586**	446
Executive and administrative	**197**	128
	783	574

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

	2005 £'000	2004 £'000
Wages and salaries	**24,774**	18,696
Share related awards	**935**	506
Social security costs	**3,648**	2,164
Pension costs	**573**	468
Staff costs capitalised (note 9)	**(566)**	—
	29,364	21,834

Remuneration of directors:

	2005 £'000	2004 £'000
Emoluments for services as a director	**1,078**	1,133
Pension contributions	**53**	50
	1,131	1,183

Emoluments of the highest paid director (excluding pension contributions) were £383,000 (2004: £373,000). Amounts paid by the group in respect of their pension contributions were £nil (2004: £21,000).

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.

5 OTHER INTEREST RECEIVABLE AND SIMILAR INCOME

	2005 £'000	2004 £'000
Bank interest receivable	**303**	465

6 INTEREST PAYABLE AND SIMILAR CHARGES

	2005 £'000	2004 £'000
Interest payable on finance leases	**288**	377
Bank interest payable	**2,213**	1,523
Loan note interest payable	**22**	158
Other interest payable	**545**	—
	3,068	2,058

7 TAX ON ORDINARY ACTIVITIES

	2005 £'000	2004 £'000
United Kingdom corporation tax at 30% (2004: 30%)	**—**	—
Overseas tax on profit for the year	**48**	29
Total current tax	**48**	29

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

	2005 £'000	2004 £'000
Loss on ordinary activities before tax	**(7,023)**	(5,034)
Loss on ordinary activities at standard rate of UK corporation tax of 30% (2004: 30%)	**(2,107)**	(1,510)
Non deductible amortisation	**3,371**	2,700
Capital allowances in excess of depreciation	**(61)**	(16)
Permanent disallowable items	**427**	57
Difference between UK and overseas standard tax rates	**(10)**	(5)
Utilisation of tax losses brought forward	**(1,572)**	(1,197)
Total current tax (as above)	**48**	29

At 31 December 2005 there were unrelieved losses in the group of approximately £65.3 million (2004: £70.5 million).

7 TAX ON ORDINARY ACTIVITIES CONTINUED

DEFERRED TAX

The amounts of unrecognised deferred taxation assets comprise:

	2005 £'000	2004 £'000
Unrelieved tax losses	**19,573**	21,145

8 INTANGIBLE FIXED ASSETS

Group	Wireless licence £'000	Positive goodwill £'000	Negative goodwill £'000	Patents £'000	Total £'000
Cost					
At 1 January 2005	5,000	105,708	(901)	10	109,817
Additions (see note 21)	—	15,852	—	—	15,852
Fair value adjustments (see note 22)	—	(256)	—	—	(256)
At 31 December 2005	**5,000**	**121,304**	**(901)**	**10**	**125,413**
Amortisation					
At 1 January 2005	333	10,994	(807)	2	10,522
Charge for the year	250	11,079	(94)	1	11,236
At 31 December 2005	**583**	**22,073**	**(901)**	**3**	**21,758**
Net book value					
At 31 December 2005	**4,417**	**99,231**	**—**	**7**	**103,655**
At 31 December 2004	4,667	94,714	(94)	8	99,295

Negative goodwill arose on the acquisition of HighwayOne Corporation Limited in 2001 and has been fully released. Positive goodwill arising in the year relates to the acquisitions of Donhost Limited, Freedom to Surf plc and Freedom to Surf Consumer Services Limited (see note 21), and is being amortised over ten years. The wireless licence was acquired with Firstnet Services Limited and is being amortised over twenty years and is stated at a directors' valuation at the acquisition of Firstnet on 28 August 2003.

The company held no intangible fixed assets at 31 December 2005 or 31 December 2004.

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 2005	2,087	2,190	27,097	2,052	1,107	34,533
Acquisitions (see note 21)	—	4	396	4	31	435
Additions	—	10	9,805	489	126	10,430
Disposals	—	—	(54)	(114)	(23)	(191)
Fair value adjustment (see note 22)	—	—	—	(38)	—	(38)
Exchange difference	—	—	(49)	(16)	—	(65)
At 31 December 2005	**2,087**	**2,204**	**37,195**	**2,377**	**1,241**	**45,104**
Depreciation						
At 1 January 2005	117	552	11,400	651	232	12,952
Charge for the year	107	294	6,150	403	101	7,055
Disposals	—	—	(26)	(114)	(8)	(148)
Exchange difference	—	—	(5)	(1)	—	(6)
At 31 December 2005	**224**	**846**	**17,519**	**939**	**325**	**19,853**
Net book value						
At 31 December 2005	**1,863**	**1,358**	**19,676**	**1,438**	**916**	**25,251**
At 31 December 2004	1,970	1,638	15,697	1,401	875	21,581

Included in the total net book value of £25,251,000 are assets of £4,376,000 held under finance leases as follows: network infrastructure £4,366,000 (2004: £2,462,000), office equipment £nil (2004: £12,000) and plant and machinery £10,000 (2004: £65,000). Depreciation for the year on these assets was as follows: network infrastructure £1,080,000 (2004: £2,394,000), office equipment £12,000 (2004: £118,000) and plant and machinery £55,000 (2004: £60,000).

Included within network infrastructure additions above are capitalised incremental staff costs of £566,000 (2004: £nil).

The company held no tangible fixed assets at 31 December 2005 or 31 December 2004.

10 FIXED ASSET INVESTMENTS

Company	Interest in subsidiary undertakings £'000
Cost	
1 January 2005	65,538
Additions – Donhost Limited, Freedom to Surf plc and Freedom to Surf Consumer Services Limited (see note 21)	16,870
Additions – issue of share capital by existing group companies (i)	92,760
Adjustment in consideration – Host Europe plc (ii)	(812)
Disposals (iii)	(45,725)
At 31 December 2005	**128,631**
Amounts provided	
1 January 2005	740
At 31 December 2005	**740**
Net book value	
At 31 December 2005	**127,891**
At 31 December 2004	64,798

(i) During the year the company disposed of two directly owned subsidiary companies to other group companies in exchange for the issue of share capital of £45,260,000 in the acquiring companies. In addition a third group company issued share capital of £47,500,000 in satisfaction of an intercompany receivable balance.

(ii) Consideration for the acquisition of Host Europe plc has been adjusted following final confirmation of the number of option holders of Host Europe plc eligible for settlement by the company.

(iii) Disposal of directly owned subsidiary companies to fellow group members.

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 (ii)	100%	Telecommunications
PIPEX Broadband Limited (iii)	100%	Telecommunications
PIPEX Communications UK Limited	100%	Telecommunications
GXN Limited	100%	Holding company
Compulink Information eXchange Limited	100%	Telecommunications
XTML Limited	100%	Telecommunications
PIPEX Communications Business Solutions Limited (i)	100%	Telecommunications
Donhost Limited (i)	100%	Telecommunications
Freedom to Surf Limited (i)	100%	Telecommunications
Host Europe GmbH	100%	Telecommunications

(i) directly held by the company.

(ii) on 31 January 2006 the name of the company was changed from Nildram Limited.

(iii) on 31 January 2006 the name of the company was changed from PIPEX Internet Limited.

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

11 STOCK

	Group 2005 £'000	Group 2004 £'000	Company 2005 £'000	Company 2004 £'000
Finished goods for sale	**63**	21	**—**	—

12 DEBTORS

	Group 2005 £'000	Group 2004 £'000	Company 2005 £'000	Company 2004 £'000
Trade debtors	**10,199**	7,188	**—**	—
Amounts due from subsidiary undertakings	**—**	—	**6,756**	64,863
Other debtors	**498**	1,079	**18**	79
Prepayments and accrued income	**8,256**	8,119	**33**	172
	18,953	16,386	**6,807**	65,114

Included in other debtors are rent deposits of £132,000 (2004: £356,000) 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.

Included in group cash at bank and in hand are £316,000 (2004: £520,000) of deposits with credit card companies. Of this sum £300,000 will be accessed within twelve months.

A further £170,000 (2004: £170,000) is held in restricted deposit as a guarantee over future rental payments. This sum cannot be accessed within the next twelve months.

The balance of group cash at bank and in hand, being £13,478,000 (2004: £8,191,000) is held in current accounts, overnight money market accounts and no-notice deposit accounts.

The group has no monies held on restricted deposit either in respect of guarantees over loan notes (2004: £2,100,000) or as security for telecommunications contracts (2004: £328,000).

Cash at bank and in hand per the company balance sheet comprises £16,000 (2004: £26,000) held in current accounts, overnight money market accounts and no-notice deposit accounts. The company has no monies held on restricted deposit (2004: £2,100,000).

14 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	Group 2005 £'000	Group 2004 £'000	Company 2005 £'000	Company 2004 £'000
Bank loans (see notes 15,18)	**14,985**	5,789	**13,300**	3,975
Loan notes (see note 18)	**—**	1,989	**—**	1,989
Obligations under finance leases (see note 15)	**1,830**	1,287	**—**	—
Trade creditors	**23,262**	18,791	**504**	1,052
Amounts owed to group undertakings	**—**	—	**1,703**	32,307
Taxation and social security	**1,937**	2,299	**—**	27
Other creditors	**821**	556	**24**	155
Corporation tax	**446**	68	**—**	—
Deferred tax	**77**	—	**—**	—
Accruals and deferred income	**16,508**	13,315	**724**	23
	59,866	44,094	**16,255**	39,528

15 CREDITORS: AMOUNTS FALLING DUE AFTER ONE YEAR

	Group 2005 £'000	Group 2004 £'000	**Company 2005 £'000**	Company 2004 £'000
Bank loan (see note 18)	**21,875**	21,200	**21,875**	21,200
Obligations under finance leases	**2,996**	1,661	**—**	—
	24,871	22,861	**21,875**	21,200

Bank loans are repayable as follows:

	Group 2005 £'000	Group 2004 £'000	**Company 2005 £'000**	Company 2004 £'000
Within one year	**14,985**	5,789	**13,300**	3,975
Between two and five years	**21,875**	21,200	**21,875**	21,200
	36,860	26,989	**35,175**	25,175

The bank loans comprise a loan of £35,175,000 carrying interest at a rate of LIBOR +2.75% and loan of £1,685,000 carrying interest at a rate of bank base rate +1.35%. The loan of £1,685,000 is repayable on demand.

The maturity of obligations under finance leases is as follows:

Group	**2005 £'000**	2004 £'000
Within one year	**1,830**	1,287
In the second to fifth years	**2,799**	1,661
After five years	**197**	—
	4,826	2,948

The company does not hold any assets under finance leases.

16 PROVISIONS FOR LIABILITIES AND CHARGES

Group	Onerous leases £'000	Dilapidations £'000	UITF 25 £'000	Total £'000
At 1 January 2005	2,010	50	191	2,251
Fair value adjustment (see note 22)	—	138	—	138
Arising during the year	—	—	157	157
Utilised during the year	(492)	(50)	—	(542)
At 31 December 2005	**1,518**	**138**	**348**	**2,004**

The UITF 25 provision relates to National Insurance payable on exercise of share options. This will be 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. Dilapidations relate to three properties. £88,000 will be utilised upon the expiration of two of the leases in October 2006, the remaining provision of £50,000 will be utilised at the expiry of the lease on the third property in October 2007.

Company	2005 £'000
At 1 January 2005	191
Arising during the year	157
At 31 December 2005	**348**

Provisions relate to National Insurance payable on exercise of share options according to UITF 25. This will be 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 2005 £'000	**Other 2005 £'000**	Short leasehold property 2004 £'000	Other 2004 £'000
Within one year	**297**	**4,251**	260	6,561
Within two to five years	**1,880**	**10,223**	1,159	1,551
After five years	**604**	**—**	701	—
	2,781	**14,474**	2,120	8,112

In addition to the above, the group had an annual commitment in respect of telecom circuits of £10,911,000 (2004: £11,134,000). Typically these leases are twelve months in length and cancellable at one months' notice.

The group also had a future commitment in respect of a sponsorship agreement with Fulham Football Club. A total of £1,100,000 is payable during 2006 with a further payment of £550,000 due on 1 January 2007.

18 FINANCIAL INSTRUMENTS

The group's financial instruments comprise cash and liquid resources, 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.

As permitted by Financial Reporting Standard 13, short-term debtors and creditors have been excluded from the following disclosures (with the exception of note (iii)).

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

	Fixed 2004 £'000	Floating 2004 £'000	Nil 2004 £'000	Total 2004 £'000
Sterling	5,559	5,499	176	11,234
US Dollars	—	14	—	14
Euro	—	61	—	61
	5,559	5,574	176	11,309

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

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 2005 £'000	Floating 2005 £'000	Nil 2005 £'000	Total 2005 £'000
Sterling	**12,546**	**24,314**	**4,826**	**41,686**

	Fixed 2004 £'000	Floating 2004 £'000	Nil 2004 £'000	Total 2004 £'000
Sterling	16,000	12,978	2,948	31,926

(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 draw down of new loan facilities.

	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**

	Debt 2004 £'000	Other financial liabilities 2004 £'000	Total 2004 £'000
Financial liabilities maturing:			
in one year or less or on demand	7,778	1,287	9,065
in more than one year but not more than two years	5,300	704	6,004
in more than two years but not more than five years	15,900	604	16,504
after five years	—	353	353
	28,978	2,948	31,926

All of the above debt and other financial liabilities for both years are secured by means of fixed or floating charges over the group's assets.

(iii) FOREIGN CURRENCY RISK

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

(iv) FAIR VALUES

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

	Book value 2005 £'000	Fair value 2005 £'000	Book value 2004 £'000	Fair value 2004 £'000
Primary financial instruments:				
Cash at bank and in hand	**13,964**	**13,964**	11,309	11,309
Bank loans	**(36,860)**	**(36,860)**	(26,989)	(26,989)
Loan notes	**—**	**—**	(1,989)	(1,989)
Finance leases due within one year	**(1,830)**	**(1,830)**	(1,287)	(1,287)
Finance leases due after more than one year	**(2,996)**	**(2,996)**	(1,661)	(1,661)
	(27,722)	**(27,722)**	(20,617)	(20,617)

19 CALLED UP SHARE CAPITAL

AUTHORISED AND ALLOTTED SHARE CAPITAL

	2005 £'000	2004 £'000
Authorised		
Equity: 4,000,000,000 ordinary shares of 1p each		
At start of year	**40,000**	30,000
Authorised during the year	**—**	10,000
At end of year	**40,000**	40,000
Allotted, called up and fully paid		
Equity: ordinary shares of 1p each		
At start of year 2,182,171,488 (2004: 1,814,074,072) ordinary shares of 1p each	**21,822**	18,141
Issued during the year 27,888,000 (2004: 368,097,416) ordinary shares of 1p each	**279**	3,681
At end of year 2,210,059,488 (2004: 2,182,171,488) ordinary shares of 1p each	**22,101**	21,822

Share capital issued at nominal value in the year relates to the exercise of share options (5,048,000 shares for consideration of £310,000), and shares allotted in respect of the acquisition of Donhost Limited (22,840,000 shares at a fair value of £1,770,100).

SHARE OPTIONS

At 31 December 2005 rights to options over 196,143,712 ordinary shares of the company were outstanding as follows:

At 1 January 2005	Granted	Exercised/ lapsed	Cancelled	**At 31 December 2005**	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
27,374,000	—	(220,000)	—	**27,154,000**	6.25p	24 October 2003 to 23 October 2013
10,000,000	—	(5,000,000)	—	**5,000,000**	6.25p	28 October 2003 to 27 October 2013
75,350,000	—	(20,250,000)	—	**55,100,000**	10.50p	21 June 2004 to 20 June 2014
10,000,000	—	—	—	**10,000,000**	8.50p	4 August 2004 to 3 August 2014
21,500,000	—	(2,500,000)	—	**19,000,000**	7.50p	20 October 2004 to 19 October 2014
—	16,500,000	(250,000)	—	**16,250,000**	8.25p	29 January 2005 to 28 January 2015
—	14,099,999	—	—	**14,099,999**	7.50p	11 April 2005 to 10 April 2015
—	5,500,000	—	—	**5,500,000**	7.75p	27 April 2005 to 26 April 2015
EMI Scheme						
989,130	—	—	—	**989,130**	1.00p	20 November 2001 to 19 November 2011
650,000	—	(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
14,535,000	—	(4,503,000)	—	**10,032,000**	6.25p	24 October 2003 to 23 October 2013
193,091,713	36,099,999	(33,048,000)	—	**196,143,712**		

19 CALLED UP SHARE CAPITAL CONTINUED

SHARE WARRANTS

At 1 January 2005 and 31 December 2005 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 for the previous months and the company's share price has reached 12p.

At 1 January 2005 and 31 December 2005 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 16p and the remaining 50% when the share price has reached 21p.

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 £573,000 (2004: £468,000).

The outstanding contributions to the pension scheme were £nil (2004: £nil).

21 ACQUISITIONS

(i) SUMMARY

Below is a summary of the acquisitions made by PIPEX Communications plc in the year ended 31 December 2005.

	2005 £'000
Fair value of assets acquired	**1,018**
Goodwill	**15,852**
Consideration	**16,870**
Satisfied by:	
22,840,000 ordinary shares at a market price of 7.75p per share	**1,770**
Cash	**14,130**
Costs of acquisition	**970**
	16,870
Effects on group cash flow:	
Cash consideration	**14,130**
Costs of acquisition	**970**
Cash balances on acquisition	**(2,591)**
Net cash outflow	**12,509**

(ii) DONHOST LIMITED

On 27 April 2005 PIPEX acquired Donhost Limited for a total consideration of £6,411,000, financed by £4,130,000 in cash and the issue of ordinary share capital of £1,770,000, while the costs of acquisition were £511,000.

Goodwill of £5,430,000 arising on acquisition is being amortised over ten years; the useful life as estimated by the directors.

The acquisition contributed £1,382,000 of turnover in the period since acquisition, an operating profit of £498,000 (after goodwill amortisation of £362,000) and accounted for cash flows from operating activities of approximately £910,000.

The turnover and operating profit of Donhost Limited for the year ended 31 December 2004 were £1,269,000 and £675,000 respectively. The net assets of Donhost Limited at 31 December 2004 were £834,000.

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	123	—	123
Debtors	78	—	78
Cash	1,356	—	1,356
Creditors (falling due within one year)	(512)	(53)	(565)
Provisions	(11)	—	(11)
Net assets/(liabilities)	**1,034**	**(53)**	**981**
Goodwill			5,430
Consideration			**6,411**

Satisfied by:	
22,840,000 ordinary shares at a market price of 7.75p per share	1,770
Cash	4,130
Costs of acquisition	511
	6,411

Effects on group cash flow:	
Cash consideration and costs	4,641
Cash balances on acquisition	(1,356)
Net cash outflow	**3,285**

EXPLANATORY NOTES:

Creditors (falling due within one year)

Creditors have been increased to accrue for all estimated outstanding liabilities.

21 ACQUISITIONS CONTINUED

(iii) FREEDOM TO SURF

On 17 October 2005 the group acquired Freedom to Surf plc, Freedom to Surf Consumer Services Limited and Freedom to Surf Registration Services Limited.

The acquisition was financed by a bank loan of £8,000,000 and cash of £2,000,000, while costs of acquisition were £459,000.

Goodwill of £10,422,000 arising on acquisition is being amortised over ten years; the useful life as estimated by the directors.

Freedom to Surf contributed £2,694,000 of turnover in the period since acquisition, an operating loss of £131,000 (after goodwill amortisation of £217,000) and accounted for cash flows from operating activities of approximately £165,000.

The turnover and operating profit of Freedom to Surf between 1 January 2005 and 17 October 2005 were £8,562,000 and £329,000 respectively.

The net assets of Freedom to Surf plc at 30 November 2004 were £55,000 and the operating profit for the year to 30 November 2004 was £195,000. The net liabilities of Freedom to Surf Consumer Services Limited at 31 July 2005 were £126,000 and the operating loss for the year ended 31 July 2005 was £42,000.

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
Intangible assets	6	(6)	—
Fixed assets	824	(511)	313
Stock	5	—	5
Debtors	345	371	716
Cash	1,235	—	1,235
Creditors (falling due within one year)	(2,232)	—	(2,232)
Net assets/(liabilities)	**183**	**(146)**	**37**
Goodwill			10,422
Consideration			**10,459**
Satisfied by:			
Cash			10,000
Costs of acquisition			459
			10,459
Effects on group cash flow:			
Cash consideration and costs			10,459
Cash balances on acquisition			(1,235)
Net cash outflow			**9,224**

EXPLANATORY NOTES:

Intangible assets

Intangibles assets have been adjusted to write off costs of trademarks.

Fixed assets and debtors

£370,000 of costs relating to short-term telecommunications services recorded in fixed assets were transferred to prepayments on acquisition.

An additional £141,000 was written off fixed assets in order to align with group accounting policies.

22 GOODWILL ON PRIOR YEAR ACQUISITIONS

(i) SUMMARY

	Provisional fair value to the group 2004 £'000	Adjustments 2005 £'000	Final fair value to the group 2005 £'000
Fair value of net assets acquired	2,509	**(556)**	**1,953**
Goodwill	44,028	**(256)**	**43,772**
Consideration	46,537	**(812)**	**45,725**

(ii) HOST EUROPE

	Provisional fair value to the group 2004 £'000	Adjustments 2005 £'000	Final fair value to the group 2005 £'000
Fair value of net assets acquired	2,876	**(420)**	**2,456**
Goodwill	29,250	**(392)**	**28,858**
Consideration	32,126	**(812)**	**31,314**

The adjustments to provisional fair values comprise £120,000 in accrued costs for electrical work to the Data Centre, £115,000 in previously unaccrued secondary lease rentals, £50,000 in respect of a dilapidation provision and £55,000 in other unaccrued liabilities. Fair values have also been adjusted to include a provision for corporation tax payable at acquisition of £80,000. Consideration has been adjusted by £812,000 following final confirmation of the number of option holders of Host Europe plc eligible for settlement by the company at the acquisition date.

(iii) ACCENT UK LIMITED

	Provisional fair value to the group 2004 £'000	Adjustments 2005 £'000	Final fair value to the group 2005 £'000
Fair value of net liabilities acquired	(367)	**(136)**	**(503)**
Goodwill	14,778	**136**	**14,914**
Consideration	14,411	**—**	**14,411**

The adjustments to provisional fair values, and therefore goodwill, comprise predominantly £88,000 in respect of dilapidation provisions on two properties with lease expiry dates of October 2006. Other adjustments include a write down of fixed assets of £38,000 and previously unaccrued liabilities of £10,000.

23 RESERVES

Group	Share capital £'000	Share premium account £'000	Other reserves £'000	Profit and loss account £'000	Total £'000
At 1 January 2005	21,822	83,868	10,703	(37,007)	79,386
Issue of shares	279	259	1,542	—	2,080
Grant of options	—	—	778	—	778
Loss on translation of foreign subsidiary	—	—	—	(28)	(28)
Retained loss for the year	—	—	—	(7,071)	(7,071)
At 31 December 2005	**22,101**	**84,127**	**13,023**	**(44,106)**	**75,145**
Company					
At 1 January 2005	21,822	83,868	10,496	(45,067)	71,119
Issue of shares	279	259	1,542	—	2,080
Grant of options	—	—	778	—	778
Retained profit for the year	—	—	—	22,259	22,259
At 31 December 2005	**22,101**	**84,127**	**12,816**	**(22,808)**	**96,236**

Included within the company profit of £22,259,000 is £26,275,000 in respect of the write back of previously provided intercompany balances.

Other reserves consist of the following:

Group	Merger reserve £'000	Capital reserve £'000	UITF 17 reserve £'000	Other reserves £'000	Total £'000
At 1 January 2005	5,996	207	1,028	3,472	10,703
Issue of shares	1,542	—	—	—	1,542
Grant of options	—	—	778	—	778
At 31 December 2005	**7,538**	**207**	**1,806**	**3,472**	**13,023**
Company					
At 1 January 2005	5,996	—	1,028	3,472	10,496
Issue of shares	1,542	—	—	—	1,542
Grant of options	—	—	778	—	778
At 31 December 2005	**7,538**	**—**	**1,806**	**3,472**	**12,816**

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 Donhost Limited.

24 RECONCILIATION OF OPERATING LOSS TO OPERATING CASH FLOWS

	2005 £'000	2004 £'000
Operating loss	(4,258)	(3,441)
Depreciation charge	7,055	5,852
Amortisation charge	11,236	9,001
Loss/(profit) on sale of fixed assets	43	(53)
UITF 17 charge (non-cash)	778	451
(Increase)/decrease in stock	(37)	35
Increase in debtors	(1,773)	(3,084)
Increase/(decrease) in creditors	4,781	(315)
Decrease in provisions	(385)	(803)
Net cash inflow from operating activities	17,440	7,643

25 RELATED PARTY DISCLOSURES

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

Oakley Capital Limited which provided services to the group of £42,000 (2004: £37,000) of which £10,000 (2004: £3,000) was outstanding at the year end. Oakley Capital Limited was also a customer of PIPEX and accounted for sales of £6,000 (2004: £6,000), of which £3,000 (2004: £nil) was outstanding at the year end.

ukbetting plc and its fellow group companies, which provided services to the group of £162,000 (2004: £nil) of which £142,000 (2004: £nil) was outstanding at the year end. ukbetting plc also accounted for sales of £335,000 (2004: £12,000) of which £330,000 (2004: £nil) was outstanding at the year end.

26 LOSS PER SHARE

	Year ended 31 December 2005	Year ended 31 December 2004
Loss for the financial year attributable to shareholders	£7,071,000	£5,063,000
Weighted average number of equity shares in issue	2,200,084,032	2,063,093,735
Basic/diluted loss per equity share*	0.32p	0.25p

*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 19 January 2006 the company announced a placing of 109,000,000 ordinary shares at a price of 13p per share to raise £14.2 million, before expenses of £0.6 million. The funds are to be used to fund future growth opportunities in the UK market.

On 23 March 2006 the company announced the acquisition of Caudwell Communications Limited, trading as Homecall, for consideration in the form of assumed bank debt of £43 million.

On 23 March 2006 PIPEX Finance (Jersey) Limited announced the private placement of £80 million 3.875% Guaranteed Convertible Bonds 2011. In addition, Lehman Brothers (International) Europe was granted the option to increase the size by an additional £20 million. As at 31 March 2006 subscriptions for £80 million of the bonds have been received. The bonds represent senior unsecured debt subordinated, up to a limit of £60 million, to future senior secured debt. 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 certain period.

The proceeds of the issue were used to repay a £40 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 at the year end.

On 31 March 2006 the group jointly formed PIPEX Wireless with Intel Capital. Intel Capital is investing US$25 million in the new company. PIPEX has transferred its 3.6GHz spectrum licence to PIPEX Wireless and retains a majority stake in that company.

NOTICE OF ANNUAL GENERAL MEETING

Notice is hereby given that the 2006 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 Wednesday 7 June 2006 at 11.00am 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 2005 together with the report of the auditors thereon.
2. To re-elect Stewart Porter as a director, who retires by rotation pursuant to Article 102 of the company's Articles of Association.
3. To re-elect Christina Kennedy 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 Resolution 5 will be proposed as an Ordinary Resolution and Resolutions 6 and 7 will be proposed as Special Resolutions:

5. 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 £7,775,000; 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.
6. That subject to the passing of Resolution 5 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 5 above) and for that period the section 89 amount shall be £2,333,000. This authority and power shall revoke to the extent not previously exercised the power granted in this regard by the company at the Extraordinary General Meeting held on 27 April 2004.
7. 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 233,300,000 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 7 June 2007 (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
3 MAY 2006

REGISTERED OFFICE
1 Triangle Business Park
Stoke Mandeville
Buckinghamshire
HP22 5BL

Registered in England Number: 3974683

NOTICE OF ANNUAL GENERAL MEETING CONTINUED

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) at 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) and the register of interests of directors (and their families) in shares of the company kept in accordance with section 325 of the Companies Act 1985 will be available for inspection at the registered office of the company during usual business hours on any weekday (Saturdays and 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 Wednesday 7 June 2006 at 11.00am 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**
Resolution 1 To receive the Report and Accounts			
Resolution 2 To re-elect Stewart Porter			
Resolution 3 To re-elect Christina Kennedy			
Resolution 4 To re-appoint KPMG Audit Plc			
Resolution 5 To authorise the directors to allot shares			
Special Resolutions			
Resolution 6 To disapply pre-emption rights			
Resolution 7 To authorise the company to purchase its own shares			

Dated 2006

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, Capita Registrars, The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU so as to arrive not later than 48 hours before the time appointed for the Meeting.

Fold 2

BUSINESS REPLY SERVICE
Licence No. MB122

1

Capita Registrars
The Registry
34 Beckenham Road
Beckenham
Kent BR3 4TU

Fold 1

Fold 3 and tuck in

ADVISORS

AUDITORS
KPMG Audit Plc
8 Salisbury Square
London
EC4Y 8BB

STOCKBROKERS
Collins Stewart Limited
9th Floor
88 Wood Street
London
EC2V 7QR

SOLICITORS
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FINANCIAL PR
Financial Dynamics
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26 Southampton Buildings
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designed & produced by THE DESIGN PORTFOLIO
a member of the flathill communications group plc
www.flathillplc.com

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