BELLSOUTH CORP
Form 10-Q
November 02, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2004

OR

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

For the transition period from to

Commission file number 1-8607

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

Georgia (State of Incorporation)	58-1533433 (I.R.S. Employer Identification Number)
1155 Peachtree Street, N. E., Atlanta, Georgia (Address of principal executive offices)	30309-3610 (Zip Code)

Registrant's telephone number 404-249-2000

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

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

At October 31, 2004, 1,831,761,229 common shares were outstanding.

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PART I - FINANCIAL INFORMATION

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2003 (As Adjusted - Note C)	2004	2003 (As Adjusted - Note C)	2004
Operating Revenues:				
Communications group	$ 4,626	$ 4,585	$ 13,679	$ 13,632
Advertising and publishing	501	495	1,515	1,481
All other	14	15	40	41
Total Operating Revenues	5,141	5,095	15,234	15,154

Operating Expenses:				
Cost of services and products (excludes depreciation and amortization shown separately below)	1,789	1,881	5,229	5,468
Selling, general, and administrative expenses	889	905	2,797	2,744
Depreciation and amortization	959	908	2,861	2,720
Provisions for restructuring	51	-	189	21
Total Operating Expenses	3,688	3,694	11,076	10,953
Operating income	1,453	1,401	4,158	4,201
Interest expense	234	220	725	646
Net earnings (losses) of equity affiliates	79	73	427	328
Gain on sale of operations	-	-	-	462
Other income (expense), net	82	63	279	200
Income from Continuing Operations Before Income Taxes, Discontinued Operations and Cumulative Effect of Changes in Accounting Principle	1,380	1,317	4,139	4,545
Provision for Income Taxes	486	465	1,487	1,604
Income from Continuing Operations Before Discontinued Operations and Cumulative Effect of Changes in Accounting Principle	894	852	2,652	2,941
Income (Loss) from Discontinued Operations, Net of Tax	42	(53)	150	453
Income Before Cumulative Effect of Changes in Accounting Principle	936	799	2,802	3,394
Cumulative Effect of Changes in Accounting Principle, Net of Tax	-	-	315	-
Net Income	$ 936	$ 799	$ 3,117	$ 3,394
Weighted-Average Common Shares Outstanding:				
Basic	1,847	1,831	1,851	1,832
Diluted	1,851	1,835	1,854	1,836
Dividends Declared Per Common Share	$0.23	$0.27	$ 0.67	$0.79
Basic Earnings Per Share:				
Income from Continuing Operations Before Discontinued Operations and Cumulative Effect of Changes in Accounting Principle	$ 0.48	$ 0.47	$ 1.43	$ 1.61
Income (Loss) from Discontinued Operations, Net of Tax	0.02	(0.03)	0.08	0.25
Cumulative Effect of Accounting Changes, Net of Tax	-	-	0.17	-
Net Income*	$ 0.51	$ 0.44	$ 1.68	$ 1.85
Diluted Earnings Per Share:				

Income from Continuing Operations Before Discontinued Operations and Before Cumulative Effect of Changes in Accounting Principle	$ 0. 48	$ 0.46	$ 1.43	$ 1.60
Income (Loss) from Discontinued Operations, Net of Tax	0.02	(0.03)	0.08	0.25
Cumulative Effect of Accounting Changes, Net of Tax	-	-	0.17	-
Net Income*	$ 0.51	$ 0.44	$ 1.68	$ 1.85

*Net income per share does not sum due to rounding

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

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

	December 31, 2003	September 30, 2004
		(unaudited)
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 4,556	$ 9,200
Accounts receivable, net of allowance for uncollectibles of $496 and $331	2,870	2,546
Material and supplies	375	316
Other current assets	1,048	842
Assets of discontinued operations	--	3,977
Total current assets	8,849	16,881
Investments and advances	8,552	8,768
Property, plant and equipment, net	23,807	21,971
Deferred charges and other assets	5,855	6,113
Goodwill	342	249
Intangible assets, net	2,297	1,507
Total assets	$ 49,702	$ 55,489
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Debt maturing within one year	$ 3,491	$ 3,048
Accounts payable	1,339	970
Other current liabilities	3,628	3,150
Liabilities of discontinued operations	--	2,674
Total current liabilities	8,458	9,842

Long-term debt	11,489	13,142
Noncurrent liabilities:		
Deferred income taxes	5,349	6,314
Other noncurrent liabilities	4,694	4,327
Total noncurrent liabilities	10,043	10,641
Shareholders' equity:		
Common stock, $1 par value (8,650 shares authorized; 1,830 and 1,831 shares outstanding)	2,020	2,020
Paid-in capital	7,729	7,790
Retained earnings	16,540	18,421
Accumulated other comprehensive income (loss)	(585)	(470)
Shares held in trust and treasury	(5,992)	(5,897)
Total shareholders' equity	19,712	21,864
Total liabilities and shareholders' equity	$ 49,702	$ 55,489

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

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

	For the Nine Months Ended September 30, 2003	2004
Cash Flows from Operating Activities:	As Adjusted - Note C)	
Income from continuing operations before discontinued operations and cumulative effect of changes in accounting principles	$ 2,652	$ 2,941
Adjustments to reconcile income to cash provided by operating activities from continuing operations:		
Depreciation and amortization	2,861	2,720
Provision for uncollectibles	398	285
Net losses (earnings) of equity affiliates	(427)	(328)
Net (gains) losses on sale or		

impairment of equity securities	7	9
Deferred income taxes and investment tax credits	800	740
Pension income	(401)	(363)
Pension settlement (gains) losses	87	--
Stock-based compensation expense	92	87
Gain on sale of operations	--	(462)
Asset impairments	52	--
Net Change in:		
Accounts receivable and other current assets	8	(271)
Accounts payable and other current liabilities	288	(4)
Deferred charges and other assets	253	(58)
Other liabilities and deferred credits	(133)	48
Other reconciling items, net	18	144
Net cash provided by operating activities from continuing operations	6,555	5,488
Cash Flows from Investing Activities:		
Capital expenditures	(1,978)	(2,134)
Proceeds from sale of operations	--	525
Proceeds from sale of debt and equity securities	27	40
Investments in debt and equity securities	(27)	(503)
Proceeds from repayment of loans and advances	1,899	129
Settlement of financial derivatives	(352)	(17)
Other investing activities, net	(11)	(3)
Net cash (used in) investing activities from continuing operations	(442)	(1,963)
Cash Flows from Financing Activities:		
Net borrowings (repayments) of short-term debt	(423)	(266)
Proceeds from the issuance of long-term debt	--	3,689
Repayments of long-term debt	(1,836)	(745)
Dividends paid	(1,183)	(1,407)
Purchase of treasury shares	(322)	(99)
Other financing activities, net	29	48
Net cash (used in) provided by financing activities from continuing operations	(3,735)	1,220
Net increase (decrease) in cash and cash equivalents from continuing operations	2,378	4,745
Net increase (decrease) in cash and cash equivalents from discontinued operations	165	(101)
Net increase (decrease) in cash		

and cash equivalents	2,543	4,644
Cash and cash equivalents at beginning of period	2,482	4,556
Cash and cash equivalents at end of period	$ 5,025	$ 9,200

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

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

	Number of Shares		Amou			
	Common Stock	(a) Shares Held in Trust and Treasury	Common Stock	Paid-in Capital	Retained Earnings	Acc Oth Com hen Inc (Lo
Balance at December 31, 2002	2,020	(160)	$ 2,020	$ 7,546	$ 14,531	$ (
Net Income					3,117	
Other comprehensive income, net of tax						
Foreign currency translation adjustment (b)						
Net unrealized losses on securities						
Net unrealized gains on derivatives (c)						
Total comprehensive income (d)						
Dividends declared					(1,237)	
Share issuances for employee benefit plans		3		(14)	(50)	
Purchase and sales of treasury stock by grantor trust					(112)	
Purchase of treasury stock		(15)				
Stock-based compensation				102		
Tax benefit related to stock options				22		
ESOP activities and related tax benefit					2	
Balance at September 30, 2003	2,020	(172)	$ 2,020	$ 7,656	$ 16,251	$ (

Balance at December 31, 2003	2,020	(190)	$ 2,020	$ 7,729	$ 16,540	$ (
Net Income					3,394	
Other comprehensive income, net of tax						
Foreign currency translation adjustment(b)						
Net unrealized losses on securities						
Net unrealized gains on derivatives (c)						
Total comprehensive income (d)						
Dividends declared					(1,440)	
Purchase and sales of treasury stock by grantor trust				2		
Purchase of treasury stock		(4)				
Share issuances for employee benefit plans		5		(60)	(73)	
Stock-based compensation				93		
Tax benefit related to stock options				26		
Balance at September 30, 2004	2,020	(189)	$ 2,020	$ 7,790	$ 18,421	$ (

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

BELLSOUTH CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS AND AS OTHERWISE INDICATED)
(Unaudited)

NOTE A - PREPARATION OF INTERIM FINANCIAL STATEMENTS

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

The accompanying unaudited consolidated financial statements have been prepared based upon Securities and Exchange Commission (SEC) rules that permit reduced disclosure for interim periods. In our opinion, these statements include all adjustments necessary for a fair presentation of the results of the interim periods presented. All adjustments are of a normal recurring nature unless otherwise disclosed. Revenues, expenses, assets and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those for the full year. For a more complete discussion of our significant accounting policies and other information, you should read this report in conjunction with the consolidated financial statements included in our latest annual report on Form 10-K, as modified by the current report on Form 8-K dated July 30, 2004.

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

NOTE B - EARNINGS PER SHARE

Basic earnings per share is computed on the weighted-average number of common shares outstanding during each period. Diluted earnings per share is based on the weighted-average number of common shares outstanding plus net incremental shares arising out of employee stock options and benefit plans. The earnings amounts used for per-share calculations are the same for both the basic and diluted methods. Options with an exercise price greater than the average market price of the common stock or that have an anti-dilutive effect on the computation are excluded from the calculation of diluted earnings per share. The following is a reconciliation of the weighted-average share amounts (in millions) used in calculating earnings per share:

Amounts in millions	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2003	2004	2003	2004
Basic common shares outstanding	1,847	1,831	1,851	1,832
Incremental shares from stock options and benefit plans	4	4	3	4
Diluted common shares outstanding	1,851	1,835	1,854	1,836
Stock options excluded from computation	94	79	92	80

NOTE C - DISCONTINUED OPERATIONS

In March 2004, we signed an agreement with Telefonica Moviles, the wireless affiliate of Telefonica, S.A. (Telefonica), to sell all our interests in our Latin American operations. Total after-tax proceeds of the sale to Telefonica of our interests in the 10 properties, including shareholder loans, are expected to be approximately $4.9 billion including a 5% escrow for potential purchase price adjustments. Under the terms of the agreement, the escrow will be received within six months after the respective closings. The remaining proceeds are not dependent or variable based upon the sold business' earnings or performance. We will transfer approximately $1.1 billion of cash to Telefonica as part of the Latin American operations, resulting in a net cash inflow to BellSouth related to the Latin American divestitures of approximately $3.8 billion. Based on the net book value of our investment and the anticipated proceeds, we expect to record an after-tax gain of approximately $1.3 billion upon closing all 10 properties.

Under the agreement, Telefonica has agreed to purchase any and all equity interests that we purchase from the minority shareholders in various Latin American operations. Since the deal announcement, we have purchased or reached agreements to purchase interests and other rights of minority partners in Argentina, Ecuador, Nicaragua, Uruguay, and Venezuela for a combined total of $756.

During October 2004, we closed on the sale of 8 of the 10 properties including Venezuela, Colombia, Ecuador, Peru, Guatemala, Nicaragua, Uruguay and Panama. We received total proceeds of $3.7 billion and will recognize an after-tax gain of $920 in the fourth quarter of 2004. The transfer of BellSouth's interest in the operations in the remaining two Latin American countries (Argentina and Chile) is subject to obtaining all requisite governmental approvals. We are working diligently to obtain those approvals, and we expect to obtain them either in the fourth quarter of 2004 or first quarter of 2005.
In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," we have

classified the results of our Latin American segment as discontinued operations. The presentation of discontinued operations includes revenues and expenses of the Latin American operations as one line item on the income statement. Beginning with the second quarter of 2004, long-lived assets of the Latin America group ceased to be depreciated (amortized) in accordance with SFAS No. 144.

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

NOTE C - DISCONTINUED OPERATIONS (Continued)

Summary Financial Information

The assets and liabilities of our Latin American operations are aggregated and presented as current assets and current liabilities in the consolidated balance sheet at September 30, 2004. Additional detail related to the assets and liabilities of our discontinued operations follows:

At September 30, 2004:	
Current assets (excluding cash of $1,065)	$1,380
Property, plant and equipment, net	1,395
Investments and advances	293
Intangible assets, net	883
Other non-current assets	26
Total Assets	$3,977
Current liabilities	$1,891
Long-term debt	420
Other non-current liabilities	363
Total Liabilities	$2,674

Summarized results of operations for the discontinued operations are as follows:

	For the Three Months Ended September 30, 2003	For the Three Months Ended September 30, 2004	For the Nine Months Ended September 30, 2003	For the Nine Months Ended September 30, 2004
Operating revenue	$ 587	$ 724	$ 1,659	$2,080
Operating income	$ 101	$ 247	$ 211	$ 530
Income before income taxes	$ 62	$ (55)	$ 165	$ 97
Provision (benefit) for income taxes	$ 20	$ (2)	$ 15	$ (356)
Net income from discontinued operations	$ 42	$ (53)	$ 150	$ 453

Tax over Book Basis Differential

Our tax basis in the Latin America investments exceeds the book basis by approximately $1.6 billion. No US tax benefit was previously recognized on losses generated by the Latin American operations due to the essentially permanent duration of those investments. The agreement with Telefonica provides evidence that the temporary difference will reverse in the foreseeable future and, accordingly, in the first quarter of 2004 we recorded a $424 tax benefit in accordance with SFAS No. 109, "Accounting for Income Taxes." Basis differential created in the second and third quarters of 2004 resulted in a net decrease of $67 to the deferred tax asset bringing the year-to-date tax benefit related to basis differential to $357. In addition, a tax benefit of $192 has been recorded for the year-to-date period directly to equity related to the cumulative currency translation balance associated with the discontinued operations.

Buyout of Minority Partners

In March and April 2004, we purchased interests and other rights of minority partners in Argentina, Ecuador and Colombia. These purchases brought our ownership interests to 100% in Argentina and Ecuador and to 77.6% in Colombia. The aggregate purchase price for these acquisitions, including payment of minority shareholder loans, was $177. The assignment of the purchase price to the estimated fair values of assets acquired and liabilities assumed resulted in an increase to intangible assets of $55 and an increase to goodwill of $81. In connection with the purchase of our minority partner in Argentina, the consideration paid exceeded the fair value by approximately $33. Accordingly, this amount was recognized as a charge to income (loss) from discontinued operations in the second quarter 2004.

In October 2004, to facilitate the transfer of ownership to Telefonica we purchased interests of minority partners in Nicaragua and Uruguay. These purchases brought our ownership interests to 100% in Nicaragua and 68% in Uruguay. The aggregate purchase price for these acquisitions was $37, which approximated the proceeds received in the sale to Telefonica.

Venezuelan Arbitration and Settlement

Prior to the sale of Telcel, our Venezuelan operation, to Telefonica on October 28, 2004, we owned a 78.2% interest in Telcel. Telcel's other major shareholder held an indirect 21.8% interest in Telcel. Under a Stock Purchase Agreement, that shareholder had the right to initiate a process that could require us to purchase (the puts), and we had the right to initiate a process that could require that shareholder to sell (the calls) to us, the shareholder's interest in Telcel.

NOTE C - DISCONTINUED OPERATIONS (Continued)

In 2000, the shareholder initiated a process for appraising the value of approximately half of its interest in Telcel, but the process was not completed. The shareholder also sent a letter purporting to exercise the balance of the puts under the Stock Purchase Agreement. The matter was taken before an arbitration panel over alleged breaches by BellSouth and the shareholder of the Stock Purchase Agreement, including the timing of the valuation and whether the process was properly initiated in 2000. The shareholder was seeking damages and specific performance, and BellSouth was seeking, among other things, unspecified damages and a ruling that it had not breached the Stock Purchase Agreement in any respect. The arbitration also related to an alleged oral agreement to buy out the shareholder's entire interest in Telcel, which agreement we argued did not exist. Hearings on these matters occurred in January and April 2004.

In a 2 to 1 decision issued on October 13, 2004, the arbitration panel ordered BellSouth to purchase an 11.1% in Telcel associated with the first put and directed the parties to negotiate a price for the second put. In addition, the arbitration panel ordered us to pay this shareholder approximately $25 to satisfy its claims that we breached certain Investment Tax Credit Contracts. A provision for this $25 payment had already been provided for in BellSouth's financial statements. The arbitration panel rejected the shareholder's claim that BellSouth breached an oral agreement to buy out the shareholder's entire interest in Telcel, and denied all other claims raised by the parties.

In response to the arbitration ruling, on October 18, 2004, BellSouth reached an agreement in principle with this shareholder whereby we would purchase its 21.8% interest in Telcel and settle all outstanding claims for an aggregate payment of $617. The aggregate payment of $617 includes all the amounts that the arbitration panel ordered BellSouth to pay to this shareholder. While the agreement is subject to the negotiation and execution of definitive agreements, closing is expected to be completed in the fourth quarter of 2004. Upon closing, BellSouth will transfer the interest to Telefonica for approximately $300. Because the settlement amount allocable to this interest exceeded the fair value, BellSouth recognized a pre-tax charge of approximately $293 ($190 after-tax) in income (loss) from discontinued operations in the third quarter of 2004.

Colombia Put-Call

Until the recent acquisition by Telefonica, we were the majority shareholder in BellSouth Colombia, a wireless operator in Colombia. We had previously agreed with our partner to a put and call agreement whereby we could acquire, or could be compelled by our partner to acquire, additional shares of the Colombian operation held by our partner for a price equal to the appraised fair value. Under the remaining put/call option, the residual balance of our partner's shares could be called by us or put to us beginning in 2006 until 2009. In connection with the acquisition by Telefonica, the shareholders agreement was assigned to Telefonica and all of our obligations under the shareholders agreement ceased.

Venezuela Currency

Our third quarter and year-to-date results from discontinued operations reflect consolidation of the operations of Telcel in Venezuela in accordance with SFAS No. 94, "Consolidation of All Majority-Owned Subsidiaries." There are currency restrictions in place in Venezuela that limit the conversion of local currency to US Dollars. Due to the currency controls, there is no free market currency exchange rate. Therefore, in preparing our consolidated financial statements, we used the exchange rate established by the Venezuelan government of 1,920 Bolivars to the US Dollar to translate the local currency financial statements into our reporting currency, the US Dollar.

Argentina Debt

As of September 30, 2004, CRM, our subsidiary in Argentina, entered into an agreement with creditors holding approximately 78% of $525 of CRM's outstanding debt. This debt is currently in default. The participating creditors have agreed to customary provisions to forebear from enforcing their rights under the debt agreements until June 30, 2005. If the sale of CRM to Telefonica closes, BellSouth has agreed to cause the participating creditors to receive the par value of their debt plus accrued interest less an aggregate discount of $5. If the sale does not close, the participating creditors will have all their rights to proceed against CRM under the credit documents with respect to CRM's defaults.

NOTE D - COMMUNICATIONS WORKERS OF AMERICA CONTRACT RATIFICATION

In September 2004, the Communications Workers of America (CWA) ratified the tentative agreement reached in August 2004, on new five-year contracts covering approximately 42,000 employees. The contracts include basic wage increases of 1% in year one, 2% in year two and annual increases of 2.5% in years three through five totaling 10.5% over the contract term. The contracts also provide for a 4% lump-sum payment upon ratification by the membership. The lump-sum payment will be amortized over the five-year contract period ratably on a straight-line basis. In addition, the agreement provides for a standard incentive award of 2% of base salary and overtime compensation in the first three years of the contract increasing to 3% in years four and five. Other terms of the agreement include pension band increases and pension plan cash balance improvements for active employees. The agreement is expected to give us the workforce planning flexibility needed to respond to changing marketplace conditions.

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

NOTE E - EMPLOYEE BENEFIT PLANS

Substantially all of our employees are covered by noncontributory defined benefit pension plans, as well as postretirement health and life insurance welfare plans ("other benefits").

The following details pension and postretirement benefit costs that are included in operating expenses (in cost of sales and selling, general and administrative expenses) in the accompanying Consolidated Statements of Income with the exception of approximately 10% of these costs which are capitalized in connection with labor related to network construction. We account for these costs in accordance with SFAS No. 87, "Employers' Accounting for Pensions" and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" (SFAS No. 106) Components of net periodic benefit costs for the three months and nine months ended September 30 were as follows:

	Pension Benefits		Other Benefits	
	For the Three Months Ended September 30,		For the Three Months Ended September 30,	
	2003	2004	2003	2004
Service cost	$ 45	$ 44	$ 13	$ 12
Interest cost	185	174	121	107
Expected return on plan assets	(347)	(330)	(78)	(80)
Amortizations:				
Unrecognized net obligation	(1)	--	19	18
Unrecognized prior service cost	(9)	(10)	40	40
Unrecognized (gain) loss	(7)	1	26	24
Net periodic benefit cost (income)	(134)	(121)	141	121

Settlements	--	--	--	--
Net periodic benefit cost (income), adjusted	$ (134)	$(121)	$141	$ 121

	Pension Benefits		Other Benefits	
	For the Nine Months Ended September 30,		For the Nine Months Ended September 30,	
	2003	2004	2003	2004
Service cost	$ 136	$ 132	$ 38	$ 35
Interest cost	556	522	362	323
Expected return on plan assets	(1,040)	(989)	(234)	(240)
Amortizations:				
Unrecognized net obligation	(3)	--	55	61
Unrecognized prior service cost	(29)	(32)	121	133
Unrecognized (gain) loss	(21)	4	80	69
Net periodic benefit cost (income)	(401)	(363)	422	381
Settlements	89	--	--	--
Net periodic benefit cost (income), adjusted	$ (312)	$ (363)	$422	$381

In 2003, lump-sum distributions from the pension plans exceeded the settlement threshold equal to the sum of the service cost and interest cost components of net periodic pension cost resulting in an additional charge to income of $89. Of the $89 in pension settlement charges, $87 was recognized in operating results because a portion of the settlement charges was capitalized in connection with labor related to network construction.

Medicare Prescription Drug Subsidy

In December 2003, the Medicare Prescription Drug Act was signed into law. The Act allows companies that provide certain prescription drug benefits for retirees to receive a federal subsidy beginning in 2006. We accounted for the government subsidy provided for in the Medicare Act in the calculation of our 2003 retiree medical obligation, resulting in a reduction to the liability of $575. We had previously accounted for the subsidy provided under the Act as a plan amendment under SFAS No. 106. Effective January 1, 2004, we changed the method to treat the subsidy as an actuarial gain. The cumulative effect of the change in method was $6. This change did not affect the retiree medical obligation.

Retiree Medical Obligation

Our non-management labor contract with the CWA contains contractual limits on the company-funded portion of retiree medical costs (referred to as "caps"). We have waived the premiums in excess of the caps during the current and past contract periods and, therefore have not collected contributions from those non-management retirees. We previously

NOTE E - EMPLOYEE BENEFIT PLANS (Continued)

calculated the obligation for non-management retiree medical costs based on the terms of the written agreement with the CWA.

The recent agreement with the CWA includes an increase in the amount of the caps. We have determined that this increase in the caps combined with BellSouth's history of increasing the caps in prior agreements creates a substantive plan that is an uncapped plan, which differs from the written plan. Accordingly, we began calculating the obligation for non-management retiree medical costs as if there were no caps, effective with the ratification of the contract.

The change in the calculation will result in an increase to the retiree medical accumulated postretirement benefit obligation of approximately $3.5 billion, which will be recognized over the remaining years of future service to full eligibility of the active plan participants. Net periodic benefit cost will increase $117 during the fourth quarter of 2004, or $60 net of tax. As a result of this change, we re-measured the retiree medical obligation as of September 30, 2004. The annual impact on net periodic benefit expense due to the re-measurement is approximately $460. The annual impact of the change on net periodic benefit expense will be partially offset by reductions in other retirement benefits.

Employer Contributions

For the quarter ended September 30, 2004 we made no contributions to our pension plans and anticipate no funding for the remainder of 2004. As of September 30, 2004, we have contributed $339 to fund other benefits (primarily retiree medical) and expect to contribute approximately $85 of funding for other benefits during the remainder of 2004.

Cash-Balance Pension Plan

In July 2003, a Federal district court in Illinois ruled that the benefit formula used in International Business Machines Corporation's cash balance pension plan violated the age discrimination provisions of ERISA. The IBM decision conflicts with decisions of at least two other district courts, including most recently a June 2004 decision of the federal district court in Maryland in a case involving ARINC, Inc. Proposed regulations validating the cash balance design were recently withdrawn by the Treasury Department while Congress considers legislative action to clarify the legal status of cash balance plans under age discrimination rules. At this time, it is unclear what effect, if any, these decisions or Congressional action may have on our tax-qualified cash balance pension plans or our financial condition.

NOTE F - INVESTMENTS AND ADVANCES

Cingular

We own an approximate 40% economic interest in Cingular, a joint venture with SBC Communications (SBC). Because we exercise influence over the financial and operating policies of Cingular, we use the equity method of accounting for this investment. The following table presents summarized financial information of Cingular for the periods indicated.

	December 31, 2003	September 30, 2004
Balance Sheet Information:		
Current assets	$ 3,300	$ 2,329
Noncurrent assets	$22,226	$23,678
Current liabilities	$ 3,187	$ 2,850
Noncurrent liabilities	$13,196	$13,328
Minority interest	$ 659	$ 631
Members' capital	$ 8,484	$ 9,198

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2003	2004	2003	2004
Income Statement Information:				
Operating revenues	$ 4,059	$ 4,257	$ 11,571	$12,354
Operating income	$ 488	$ 461	$ 1,960	$ 1,700
Net income	$ 177	$ 145	$ 1,006	$ 723

As of September 30, 2004, our book investment exceeded our proportionate share of the net assets of Cingular by $232.

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

NOTE F - INVESTMENTS AND ADVANCES (Continued)

On October 26, 2004 Cingular completed its previously announced acquisition of AT&T Wireless, creating the largest wireless carrier in the United States based on number of customers. Cingular's cash purchase price for AT&T Wireless shares totaled approximately $41 billion. That amount was funded by equity contributions from Cingular's two owners in proportion to their equity ownership of Cingular - 60% for SBC and 40% for BellSouth - with the remainder provided from cash on hand at AT&T Wireless. BellSouth's portion of the funding, which will be reflected as an increase in our investment in Cingular, was approximately $14.4 billion. We funded the equity infusion through cash on hand, including proceeds from the Latin America closings, the issuance of $3 billion in long-term debt in September, and the issuance of commercial paper.

Sonofon

On February 12, 2004, we closed on a previously announced agreement to sell our interest in Danish wireless provider, Sonofon, for 3.68 billion Danish Kroner to Telenor ASA. We received 3.05 billion Danish Kroner, or $525, for our 46.5% equity stake and 630 million Danish Kroner, or $109, for our shareholder loan and accrued interest, reduced by a settlement of $17 associated with foreign currency swap contracts. As a result of these transactions, we recorded a gain of $462, or $295 net of tax, which included the recognition of cumulative foreign currency translation gains of $13.

NOTE G - DEBT

Issuances

On September 13, 2004, BellSouth Corporation sold $1,500 of 5-year, 4.20% notes, due September 15, 2009, at a discounted rate of 99.826% and $1,500 of 10-year, 5.20% notes, due September 15, 2014, at a discounted rate of 99.768%. These sales resulted in aggregate net proceeds of $2,994. In addition, we incurred aggregate debt issuance costs of $13 related to these transactions.

On June 22, 2004, BellSouth Corporation sold $700 of 30-year, 6.55% notes, due June 15, 2034, at a discounted rate of 99.367%, resulting in net proceeds of $696. In addition, we incurred debt issuance costs of $6 related to this transaction.

Early Redemption

On August 1, 2004, we redeemed $517 of 40-year, 7.375% quarterly interest bonds, due August 1, 2039. The redemption price was 100% of the principal amount, and resulted in recognition of a loss in Other income (expense), net of $14, or $9 net of tax, associated with fully expensing remaining discount and deferred debt issuance costs.

NOTE H - PURCHASE OF TREASURY SHARES

During the second quarter of 2004, we purchased 3.9 million shares of our common stock for an aggregate cost of $99. There were no purchases in the first or third quarters of 2004. During the first quarter of 2003, we purchased 14.8 million shares of our common stock for an aggregate cost of $322. There were no purchases during the second or third quarters of 2003.

NOTE I - WORKFORCE REDUCTION AND RESTRUCTURING

Based on ongoing challenges in the telecom industry, continued economic pressures, the uncertainty resulting from Federal Communications Commission (FCC) regulatory rulings, as well as productivity improvements, we have made adjustments to our force levels to match lower demand. During the first half of 2004, we initiated a workforce reduction of approximately 1,100 positions, primarily in network operations where the volume of work continues to decline. As of September 30, 2004, approximately 420 employees from previously announced reductions remain employed. However, 260 of those 420 have received partial severance payments. Charges in earnings have been recognized in accordance with the provisions of SFAS No. 112, "Employers Accounting for Postemployment Benefits" and consisted primarily of cash severance and related payroll taxes under pre-existing separation pay plans.

The following table summarizes activity associated with the workforce reduction and restructuring liability for the nine months ended September 30, 2004:

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

NOTE I - WORKFORCE REDUCTION AND RESTRUCTURING (Continued)

	Type of Cost		
	Employee Separations	Other Exit Costs	Total
Balance at December 31, 2003	$ 66	$ 6	$ 72

Additions	33	--	33
Deductions	(84)	(5)	(89)
Balance at September 30, 2004	$ 15	$ 1	$16

The $33 in additions to the accrual associated with employee separations relates to accruals for estimated payments for the current year workforce reductions. Deductions to the accrual of $84 consist of $72 in cash severance payments and $12 for adjustment to the accrual due to estimated demographics being different than actual demographics of employees that separated from the Company. Deductions from the accrual for other exit costs consist primarily of changes to prior estimates.

NOTE J - SEGMENT INFORMATION

As a result of the pending sale of our Latin American operations, we now have three reportable operating segments: (1) Communications group; (2) Domestic wireless (representing our 40% interest in Cingular); and (3) Advertising and publishing. The following table provides information for each operating segment:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2003	2004	2003	2004
Communications group				
External revenues	$ 4,626	$ 4,585	$ 13,679	$ 13,682
Intersegment revenues	42	42	151	123
Total segment revenues	4,668	4,627	13,830	13,805
Segment operating income	1,244	1,217	3,656	3,579
Segment net income	727	714	2,115	2,103
Domestic wireless				
Total segment revenues	$ 1,624	$ 1,702	$ 4,628	$ 4,941
Segment operating income	195	213	784	709
Segment net income	44	54	249	202
Advertising and publishing				
External revenues	$ 501	$ 495	$ 1,515	$ 1,481
Intersegment revenues	4	3	13	10
Total segment revenues	505	498	1,528	1,491
Segment operating income	238	229	733	715
Segment net income	147	141	453	438

RECONCILIATION TO CONSOLIDATED FINANCIAL INFORMATION

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2003	2004	2003	2004
Operating revenues				
Total reportable segments	$ 6,797	$ 6,827	$ 19,986	$ 20,237
Cingular proportional consolidation	(1,624)	(1,702)	(4,628)	(4,941)
South Carolina settlement	-	-	-	(50)
Corporate, eliminations and other	(32)	(30)	(124)	(92)
Total consolidated	$ 5,141	$ 5,095	$ 15,234	$ 15,154

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

NOTE J - SEGMENT INFORMATION (Continued)
RECONCILIATION TO CONSOLIDATED FINANCIAL INFORMATION (Continued)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2003	2004	2003	2004
Operating income				
Total reportable segments	$ 1,677	$ 1,659	$ 5,173	$ 5,003
Cingular proportional consolidation	(195)	(213)	(784)	(709)
Hurricane Expenses	-	(38)	-	(38)
South Carolina settlement	-	-	-	(53)
Restructuring charge	(52)	-	(106)	(21)
Pension settlement loss	-	-	(87)	-
Corporate, eliminations and other	23	(7)	(38)	19
Total consolidated	$ 1,453	$ 1,401	$ 4,158	$ 4,201
Net Income				
Total reportable segments	$ 918	$ 909	$ 2,817	$ 2,743
Hurricane expenses	-	(23)	-	(23)
Cingular merger integration planning costs & fair value adjustment	-	(17)	-	(17)
Net gain (loss) on sale of operations	-	-	-	295
South Carolina settlement	-	-	-	(33)
Net losses on sale or impairment of securities	1	-	(4)	(4)
Cumulative effect of changes in accounting principle	-	-	315	-
Restructuring charge	(32)	-	(65)	(14)
Pension settlement loss	-	-	(53)	-
Discontinued operations	42	(53)	150	453
Corporate, eliminations and other	7	(17)	(43)	(6)
Total consolidated	$ 936	$ 799	$ 3,117	$ 3,394

Reconciling items are transactions or events that are included in reported consolidated results but are excluded from segment results due to their nonrecurring or nonoperational nature.

NOTE K - RELATED PARTY TRANSACTIONS

Advances
We have advances to Cingular that totaled $3,792 at September 30, 2004 and

$3,812 at December 31, 2003. The advance bears annual interest of 6% that is payable monthly. In addition, effective August 1, 2004, we and SBC have agreed to finance Cingular's capital and operating cash requirements to the extent Cingular requires funding above the level provided by operations. Borrowings under this agreement bear interest at 1-Month LIBOR plus 0.05% payable monthly. Cingular's Board of Directors also approved the termination of its bank credit facilities and its intention to cease issuing commercial paper and long-term debt. Excess cash generated by Cingular is applied to the outstanding advance monthly. During the third quarter of 2004, Cingular repaid $20 on the advances.

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2003	2004	2003	2004
Interest income on advances	$ 57	$ 57	$ 198	$ 171
Revenues	$ 105	$ 131	$ 306	$ 377

Receivables and payables incurred in the ordinary course of business recorded in our balance sheets at:

	December 31, 2003	September 30, 2004
Receivable from Cingular	$ 57	$ 76
Payable to Cingular	$ 33	$ 37

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

NOTE L - CONTINGENCIES

GUARANTEES

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

RECIPROCAL COMPENSATION

The Telecommunications Act of 1996 requires local telephone carriers to establish "reciprocal compensation" arrangements for the termination of telephone calls. The requirement exists to appropriately compensate local carriers whose networks are used to transport and terminate calls that originated on another local carrier's network. The requirement has been interpreted to apply to local telephone calls, and has been differentiated from switched access charges that apply to long distance calls. We began entering into reciprocal compensation arrangements with competitors that serve our region soon after the Act was adopted.

The interpretation of the requirement and early contractual arrangements generated industry disputes and litigation. In response to the disputes, the FCC, in 2001, more specifically defined reciprocal compensation and prescribed a new compensation structure for traffic directed to internet service providers (ISPs). That structure prescribed rates and set limits on compensation that could be earned through the growth of traffic in existing markets served by a CLEC and through traffic received in new markets. In 2002, the DC Circuit Court of Appeals found the FCC's reasoning flawed, and remanded the new structure to the FCC with instructions to conform it to the Act's requirements. The 2001 structure has remained in place while the FCC reconsiders its actions.

In October 2004, in response to a petition from one CLEC, the FCC decided that the growth limits and new market limits were no longer in the public interest. The FCC's action on the request did not disturb the rate structure prescribed in 2001. We do not expect this action to materially increase our future expenses. The FCC likely will issue one or further orders that address reciprocal compensation arrangements. If the FCC redefines the rate methodology in a manner that increases the prescribed rates and requires retroactive application, payments to CLECs could be material to our results of operations.

LEGAL PROCEEDINGS

Employment Claim

On April 29, 2002 five African-American employees filed a putative class action lawsuit, captioned Gladys Jenkins et al. v. BellSouth Corporation, against the Company in the United States District Court for the Northern District of Alabama. The complaint alleges that BellSouth discriminated against current and former African-American employees with respect to compensation and promotions in violation of Title VII of the Civil Rights Act of 1964 and 42 USC Section 1981. Plaintiffs purport to bring the claims on behalf of two classes: a class of all African-American hourly workers employed by BellSouth at any time since April 29, 1998, and a class of all African-American salaried workers employed by BellSouth at any time since April 29, 1998 in management positions at or below Job Grade 59/Level C. The plaintiffs are seeking unspecified amounts of back pay, benefits, punitive damages and attorneys' fees and costs, as well as injunctive relief. At this time, the likely outcome of the case cannot be predicted, nor can a reasonable estimate of the amount of loss, if any, be made.

Securities and ERISA Claims

From August through October 2002 several individual shareholders filed substantially identical class action lawsuits against BellSouth and three of its senior officers alleging violations of the federal securities laws. The cases have been consolidated in the United States District Court for the Northern District of Georgia and are captioned In re BellSouth Securities Litigation. Pursuant to the provisions of the Private Securities Litigation Reform Act of 1995, the court has appointed a Lead Plaintiff. The Lead Plaintiff filed a Consolidated and Amended Class Action Complaint on or about July 15, 2003 and named four outside directors as additional defendants. The Consolidated and Amended Class Action Complaint alleges that during the period November 7, 2000 through February 19, 2003, the Company (1) overstated the unbilled receivables balance of its advertising and publishing subsidiary; (2) failed to properly implement SAB 101 with regard to its recognition of advertising and publishing revenues; (3) improperly billed CLECs to inflate revenues, (4) failed

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

to take a reserve for refunds that ultimately came due following litigation over late payment charges and (5) failed to properly write down goodwill of its Latin American operations. The plaintiffs are seeking an unspecified amount of damages, as well as attorneys' fees and costs. At this time, the likely outcome of the case cannot be predicted, nor can a reasonable estimate of loss, if any, be made.

In February 2003, a similar complaint was filed in the Superior Court of Fulton County, Georgia on behalf of participants in BellSouth's Direct Investment Plan alleging violations of Section 11 of the Securities Act. Defendants removed this action to federal court pursuant to the provisions of the Securities Litigation Uniform Standards Act of 1998. On or about July 3, 2003, the federal court issued a ruling that the case should be remanded to Fulton County Superior Court. The plaintiffs are seeking an unspecified amount of damages, as well as attorneys' fees and costs. At this time, the likely outcome of the case cannot be predicted, nor can a reasonable estimate of loss, if any, be made.

In September and October 2002 three substantially identical class action lawsuits were filed in the United States District Court for the Northern District of Georgia against BellSouth, its directors, three of its senior officers, and other individuals, alleging violations of the Employee Retirement Income Security Act (ERISA). In January 2004, a fourth ERISA class action lawsuit was filed in the same court. All the cases have been consolidated and an Amended Consolidated Complaint was filed on April 2, 2004. The plaintiffs, who seek to represent a putative class of participants and beneficiaries of BellSouth's 401(k) plans (the "Plans"), allege in the Consolidated Complaint that the company and the individual defendants breached their fiduciary duties in violation of ERISA, by among other things, (1) failing to provide accurate information to the Plans' participants and beneficiaries; (2) failing to ensure that the Plans' assets were invested properly; (3) failing to monitor the Plans' fiduciaries; (4) failing to disregard Plan directives that the defendants knew or should have known were imprudent and (5) failing to avoid conflicts of interest by hiring independent fiduciaries to make investment decisions. All the cases have been consolidated and an Amended Consolidated Complaint was filed on April 2, 2004. The plaintiffs are seeking an unspecified amount of damages, injunctive relief, attorneys' fees and costs. Certain underlying factual allegations regarding BellSouth's advertising and publishing subsidiary and its Latin American operation are substantially similar to the allegations in the putative securities class action captioned In re BellSouth Securities Litigation, which is described above. At this time, the likely outcome of the cases cannot be predicted, nor can a reasonable estimate of loss, if any, be made.

Antitrust Claims
In December 2002, a consumer class action alleging antitrust violations of Section 1 of the Sherman Antitrust Act was filed against BellSouth, Verizon, SBC and Qwest, captioned William Twombley, et al v. Bell Atlantic Corp., et al, in the United States District Court for the Southern District of New York. The complaint alleged that defendants conspired to restrain competition by "agreeing not to compete with one another and otherwise allocating customers and markets to one another." The plaintiffs are seeking an unspecified amount of treble damages and injunctive relief, as well as attorneys' fees and expenses. In October 2003, the district court dismissed the complaint for failure to state a claim and the case is now on appeal.

In June 2004, the U.S. Court of Appeals for the 11th Circuit affirmed the District Court's dismissal of most of the antitrust and state law claims brought by a plaintiff competitive local exchange carrier in a case captioned Covad Communications Company, et al v. BellSouth Corporation, et al. The appellate court, however, permitted a price squeeze claim and certain state tort claims to proceed. At this time, the likely outcome of the case cannot be predicted, nor can a reasonable estimate of loss, if any, be made.

OTHER CLAIMS

We are subject to claims arising in the ordinary course of business involving allegations of personal injury, breach of contract, anti-competitive conduct, employment law issues, regulatory matters and other actions. BellSouth Telecommnunications, Inc. (BST) is also subject to claims attributable to pre-divestiture events involving environmental liabilities, rates, taxes, contracts and torts. Certain contingent liabilities for pre-divestiture events are shared with AT&T Corp. While complete assurance cannot be given as to the outcome of these claims, we believe that any financial impact would not be material to our results of operations, financial position or cash flows.

NOTE M - SUBSIDIARY FINANCIAL INFORMATION

We have fully and unconditionally guaranteed all of the outstanding debt securities of BST, which is a 100% owned subsidiary of BellSouth. In accordance with SEC rules, BST is no longer subject to the reporting requirements of the Securities Exchange Act of 1934, and we are providing the following unaudited condensed consolidating financial information. BST is listed separately because it has debt securities, registered with the SEC, that we have guaranteed. The BST and Parent columns reflect the application of equity method accounting for investments in their subsidiaries. The

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

Other column represents all other wholly owned subsidiaries excluding BST and BST subsidiaries. The Adjustments column includes the necessary amounts to eliminate the intercompany balances and transactions between BST, Other and Parent and to consolidate wholly owned subsidiaries to reconcile to our consolidated financial information.

Condensed Consolidating Statements of Income

	For the Three Months Ended Septe		
	BST	Other	Parent
Total operating revenues	$ 4,361	$ 1,477	$ --
Total operating expenses	3,724	1,077	(37)
Operating income (loss)	637	400	37
Interest expense	133	20	139
Equity in earnings	262	60	1,374

Other income (expense), net	6	540	(422)
Income from continuing operations before income taxes, discontinued operations, and cumulative effect of changes in accounting principle	772	980	850
Provision (benefit) for income taxes	187	191	(44)
Income from continuing operations before discontinued operations and cumulative effect of changes in accounting principle............	585	789	894
Income (loss) from discontinued operations, net of tax......................................	--	42	42
Cumulative effect of changes in accounting principle, net of tax.......................	--	--	--
Net income (loss)	$ 585	$ 831	$ 936

	For the Three Months Ended Septe		
	BST	Other	Parent
Total operating revenues	$ 4,208	$ 1,659	$ --
Total operating expenses	3,711	1,163	14
Operating income (loss).........................	497	496	(14)
Interest expense	131	6	141
Equity in earnings	302	58	1,107
Other income (expense), net	2	339	(257)
Income from continuing operations before income taxes, discontinued operations, and cumulative effect of changes in accounting principle......	670	887	695
Provision (benefit) for income taxes	135	315	(157)
Income from continuing operations before discontinued operations and cumulative effect of changes in accounting principle............	535	572	852
Income (loss) from discontinued operations, net of tax......................................	--	(53)	(53)
Cumulative effect of changes in accounting principle, net of tax.......................	--	--	--
Net income (loss)	$ 535	$ 519	$ 799

	For the Nine Months Ended Septe		
	BST	Other	Parent
Total operating revenues	$ 13,093	$ 4,137	$ --
Total operating expenses	11,168	3,036	(1)

Operating income (loss)	1,925	1,101	1
Interest expense	414	65	436
Equity in earnings	798	422	3,279
Other income (expense), net	(15)	681	(316)
Income from continuing operations before income taxes, discontinued operations, and cumulative effect of changes in accounting principle	2,294	2,139	2,528
Provision (benefit) for income taxes	558	595	(124)
Income from continuing operations before discontinued operations and cumulative effect of changes in accounting principle	1,736	1,544	2,652
Income (loss) from discontinued operations, net of tax	--	150	150
Cumulative effect of changes in accounting principle, net of tax	816	(501)	315
Net income (loss)	$ 2,552	$ 1,193	$ 3,117

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

NOTE M - SUBSIDIARY FINANCIAL INFORMATION (Continued)

Condensed Consolidating Statements of Income (Continued)

	For the Nine Months Ended Sept		
	BST	Other	Parent
Total operating revenues	$ 12,639	$ 4,775	$ --
Total operating expenses	11,045	3,358	(5)
Operating income (loss)	1,594	1,417	5
Interest expense	379	16	416
Equity in earnings	833	309	3,283
Other income (expense), net	6	906	(193)
Income from continuing operations before income taxes, discontinued operations, and cumulative effect of changes in accounting principle	2,054	2,616	2,679
Provision (benefit) for income taxes	444	943	(262)
Income from continuing operations before discontinued operations and cumulative effect of changes in accounting principle	1,610	1,673	2,941
Income (loss) from discontinued operations, net of tax	--	453	453

Cumulative effect of changes in accounting principle, net of tax........................	--	--	--
Net income (loss)	$ 1,610	$ 2,126	$ 3,394

Condensed Consolidating Balance Sheets

	December 31, 2003						
	BST	Other	Parent	Adjust-ments	Total	BST	Ot
ASSETS							
Current assets:							
Cash and cash equivalents	$ 5	$ 1,190	$ 3,227	$ 134	$4,556	$ 17	$ 1
Accounts receivable, net	68	1,143	3,204	(1,545)	2,870	72	
Other current assets	393	831	81	118	1,423	444	
Assets of discontinued operations	--	--	--	--	--	--	3
Total current assets	466	3,164	6,512	(1,293)	8,849	533	7
Investments and advances	3,464	7,913	22,609	(25,434)	8,552	3,451	7
Property, plant and equipment, net	21,818	1,947	4	38	23,807	21,315	
Deferred charges and other assets	5,029	287	72	467	5,855	5,211	
Intangible assets, net	1,036	1,460	5	138	2,639	1,014	
Total assets	$31,813	$14,771	$29,202	$(26,084)	$49,702	$31,524	$15
LIABILITIES AND SHAREHOLDERS' EQUITY							
Current liabilities:							
Debt maturing within one year	$ 2,454	$ 920	$ 2,470	$(2,353)	$ 3,491	$2,309	$
Other current liabilities	3,942	1,724	916	(1,615)	4,967	4,052	
Liabilities of discontinued operations.................	--	--	--	--	--	--	2
Total current liabilities	6,396	2,644	3,386	(3,968)	8,458	6,361	3
Long-term debt	4,970	845	6,301	(627)	11,489	4,139	
Noncurrent liabilities:							
Deferred income taxes	4,408	1,519	(751)	173	5,349	4,977	1
Other noncurrent liabilities .	2,991	1,074	554	75	4,694	2,943	

Total noncurrent liabilities .	7,399	2,593	(197)	248	10,043	7,920	2
Shareholders' equity..........	13,048	8,689	19,712	(21,737)	19,712	13,104	9
Total liabilities and shareholders' equity	$31,813	$14,771	$29,202	$(26,084)	$49,702	$31,524	$15

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

NOTE M - SUBSIDIARY FINANCIAL INFORMATION (Continued)

Condensed Consolidating Cash Flow Statements

	For the Nine Months Ended Sept		
	BST	Other	Parent
Cash flows from continuing operations:			
Cash flows from operating activities	$ 4,217	$ 856	$ 3,283
Cash flows from investing activities	(2,044)	181	674
Cash flows from financing activities	(2,173)	(1,031)	(1,582)
Cash flows from discontinued operations	--	165	--
Net (decrease) increase in cash	$ --	$ 171	$ 2,375

	For the Nine Months Ended Sept		
	BST	Other	Parent
Cash flows from continuing operations:			
Cash flows from operating activities	$ 4,472	$ 487	$ 2,437
Cash flows from investing activities	(2,058)	232	1,007
Cash flows from financing activities	(2,402)	(654)	1,318
Cash flows from discontinued operations........	--	(101)	--

Net (decrease) increase in cash	$ 12	$ (36)	$ 4,762

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

BELLSOUTH CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

For a more complete understanding of our industry, the drivers of our business and our current period results, you should read the following Management's Discussion and Analysis of Financial Condition and Results of Operations in conjunction with our latest annual report on Form 10-K, as amended by the current report on Form 8-K dated July 30, 2004, and our other filings with the SEC.

OVERVIEW

We are a Fortune 100 company with annual revenues of over $20 billion. Our core business is wireline communications and our largest customer segment is the retail consumer. We have significant interests in wireless communications through our ownership of approximately 40% of Cingular Wireless (Cingular), the nation's largest wireless company based on number of customers. We also operate one of the largest directory advertising businesses in the United States. The great majority of our revenues are generated based on monthly recurring services.

We operate much of our business in one of the country's strongest regional economies, where the population is increasing, real income growth is outpacing the national average and a diverse mix of businesses require advanced information and communication technology solutions. The Southeast is a positive net migration region, with net migration averaging almost 500 thousand annually. The region's real income is expected to grow 10% to 15% faster than the national average in the next five years.

REGULATION AND COMPETITION

The Telecommunications Act of 1996 required local telephone companies to open their existing facilities for use by competitors on "non-discriminatory" terms and prices under what is referred to as unbundled network elements (UNE), including the UNE platform, or UNE-P. This requirement has distorted the competitive landscape by allowing competitors to rent access lines at deeply discounted rates that are generally below our historical cost. Utilizing UNE-P, competitors are able to market telephone service and generate reasonable margins with little to no capital investment at risk.

A judicial decision that became effective in mid-June invalidated certain FCC rules that governed the provision of wholesale access to our network by local service competitors. In response to the Court's mandate, the FCC adopted an interim order designed to maintain interconnection contracts as they existed on June 16, 2004, and to propose a transition to new unbundling rules. The FCC chairman has scheduled a decision on new rules for December 2004. We are participating in FCC and court proceedings related to the interim order, and we have offered competitors commercial and tariffed services that would replace the services required by the invalidated rules at market-based prices. During the third quarter we experienced a decline in UNE-P lines provisioned to competitors although it is too early to predict if this will evolve into a trend.

For years, BellSouth has invested in deploying fiber deeper into our network including the use of an architecture referred to as fiber-to-the-curb or "FTTC." FTTC is cost-effective, and less dependent than fiber-to-the-premise ("FTTP") on commercial power to deliver services in the event of a power outage. In October 2004, in response to a BellSouth request, the FCC adopted a new rule that frees installations of fiber optic technology within 500 feet of a residential customer's premises from the FCC's wholesale access requirements. By eliminating the requirement to provide access to competitors at deeply discounted prices, the FCC's ruling reduces the business risk associated with deploying fiber technology more broadly in the local loop. BellSouth plans to equip 100,000 to 150,000 newly constructed homes with FTTC in 2004.

ACQUISITIONS AND DISPOSITIONS

On October 26, 2004 Cingular completed its previously announced acquisition of AT&T Wireless. With the close of the transaction, Cingular management moved immediately to take initial steps toward integrating the two companies. Key focus areas over the next 60 days include customer communications, immediate training for all sales and service personnel, relaunch of the Cingular brand, transitioning to a common order system, and beginning the work that over time will integrate support systems and network functions. This acquisition will substantially increase BellSouth's participation in the domestic wireless industry.

On March 5, 2004, we signed an agreement with Telefonica Moviles, the wireless affiliate of Telefonica, S.A., to sell all our interests in our Latin American operations. During October 2004, we closed on the sale of 8 of the 10 properties including Venezuela, Colombia, Ecuador, Peru, Guatemala, Nicaragua, Uruguay and Panama. The transfer of BellSouth's interest in the operations in the remaining two Latin American countries (Argentina and Chile) is subject to obtaining all requisite governmental approvals. We are working diligently to obtain those approvals, and we expect to obtain them either in the fourth quarter of 2004 or first quarter of 2005.

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

HIGHLIGHTS AND OUTLOOK

Consolidated revenues for the first nine months of 2004 were down slightly compared to the first nine months of 2003 reflecting top line pressures caused by the loss of 1.4 million retail access lines to UNE-P competitors and technology substitution. Revenue contraction due to line loss and pricing pressures was substantially offset by revenue growth in long distance and DSL. Through the first nine months of the year, we added approximately 1.7 million long distance customers to total 5.7 million at September 30, 2004, while net new DSL subscriber additions of 410,000 brought our total to 1.9 million. Our cost structure is heavily weighted towards labor and fixed asset related costs. In order to sustain margins, we have to adjust our workforce as market share of access lines shifts. Since the beginning of 2001, we have reduced our workforce in the Communications group by 15,700 employees or 22%. Earlier in 2004, we announced additional force reductions of nearly 1,100 employees reflecting continued pressures on access lines. Maintaining operating margins going forward will be challenging as competition intensifies and we are forced to achieve continued increases in productivity. This was evident in the third quarter 2004 as operating income margins were down 80 basis points from the third quarter 2003. While there have been some encouraging developments on the regulatory front, there will be other events such as healthcare costs, continued line losses to wireless substitution and the roll-out of Voice over internet protocol (VoIP) telephony by cable providers that may continue to put pressure on margins.

BellSouth differentiates itself from its competition through its commitment to customer service. Our customers depend on us, especially when disaster strikes. Over the last two months, BellSouth's customer service met the challenges presented by the most active and destructive Atlantic hurricane season in years. During the third quarter of 2004, we incurred $38 of incremental labor and material costs related to service restoration and network repairs due to the four major hurricanes that hit during the quarter. We expect to incur additional costs in the $90 range during the fourth quarter as we complete network repairs.

In September 2004, the Communications Workers of America (CWA) ratified Bellsouth's new contracts. The agreement, which covers approximately 42,000 BellSouth employees and expires August 8, 2009, will continue to give us the workforce planning flexibility needed to respond to changing marketplace conditions. The longer 5-year agreement increases stability and certainty for employees, customers, and investors.

Operating free cash flow from continuing operations (cash flow from operating activities less capital expenditures) of $3.4 billion for the first nine months of 2004 is down compared to the corresponding period in the prior year primarily due to higher income tax payments. In the next few years, operating cash flow will continue to be negatively impacted by higher cash taxes as we see a reversal of the benefit derived in recent years associated with legislated tax incentives that provided for accelerated depreciation deductions that are set to expire this year.

Consolidated Results of Operations

Key financial and operating data for the three and nine months ended September 30, 2003 and 2004 are set forth below. All references to earnings per share are on a diluted basis. The discussion of consolidated results should be read in conjunction with the more detailed discussion of results by segment directly following this section.

Following generally accepted accounting principles (GAAP), our financial statements reflect results for the Latin American operations as Discontinued Operations. Accordingly, the operational results and other activity associated with the Latin American segment have been presented on one line item in the income statement separate from Continuing Operations.

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

	For the Three Months Ended September 30,		%
	2003	2004	Change

Results of operations:

Total operating revenues	$ 5,141	$5,095	-0.9%
Total operating expenses	3,688	3,694	0.2%
Operating income	1,453	1,401	-3.6%
Income from continuing operations before income taxes and cumulative effect of changes in accounting principle, net of tax	1,380	1,317	-4.6%
Provision for income taxes	486	465	-4.3%
Income from continuing operations before discontinued operations and cumulative effect of changes in accounting principle	894	852	-4.7%
Income from discontinued operations, net of tax	42	(53)	-226.2%
Income before cumulative effect of changes in accounting principle	936	799	-14.6%
Cumulative effect of changes in accounting principle, net of tax	-	-	*
Net (loss) income	$ 936	$ 799	-14.6%

* Not meaningful

Operating Revenues

Consolidated revenues were down $46 during the third quarter and $80 in the year-to-date period in 2004 compared to the corresponding periods in 2003. Communications group revenues decreased $41 in the third quarter and $47 in the year-to-date period compared to the corresponding periods in 2003. Both the quarter and year-to-date comparisons reflect the impact of revenue declines associated with competitive line losses and related pricing pressures offset by growth in the DSL and long distance products. Revenues from DSL and long distance combined increased $194 in the third quarter 2004 and $677 in the year-to-date 2004 period compared to corresponding periods in 2003. In addition, the year-to-date 2004 period was negatively affected by a $50 customer refund accrual associated with a settlement agreement with the South Carolina Consumer Advocate. Advertising and Publishing group revenues were down $34 in the year-to-date period compared to the corresponding period in 2003 impacted by a reduction in print revenues due to lower overall spending by our advertisers. Revenue trends are discussed in more detail in the Communications group and Advertising & Publishing group segment results sections.

Operating Expenses

Total operating expenses increased $6 in the third quarter of 2004 as compared to the corresponding period in the prior year. The quarter-over-quarter increase was impacted by restructuring charges of $51 recognized in the third quarter 2003. The residual increase was driven by activity at the Communications Group as expenses in the Advertising & Publishing group were flat. Communications Group expense change drivers included increases in costs of goods sold of $60 primarily for the provision of long distance services associated with the growth in subscribers, and labor costs increases of $71, which includes a substantial increase in overtime associated with the four major hurricanes that occurred in August and September of 2004. These increases were somewhat offset by lower depreciation and amortization expense of $51 attributable to lower depreciation rates, lower access fees of $21 driven by CLEC interconnect volume declines, and lower commissions and rents of $23 impacted by pole rental adjustments in the third quarter of 2003.

For the year-to-date period 2004, total operating expenses decreased $123 compared to the corresponding period in 2003. The incremental impact of restructuring charges attributed to a $168 decline. The remaining increase was driven primarily by activity at the Communications Group segment. Communications Group expense change drivers included increases in the costs of goods of $164 primarily for the provision of long distance services associated with the growth in subscribers, and labor costs increase of $139, which includes a substantial increase in overtime associated with the four major hurricanes and advertising costs increases of $25 driven by increased competition and growth of DSL and long distance products. These increases were somewhat offset by lower depreciation and amortization expense of $141 attributable to lower depreciation rates, lower access fees of $71 driven by CLEC interconnect volume declines, and lower commissions and rents of $23 impacted by pole rental adjustments in the third quarter of 2003.

The provision for restructuring charges of $21 in the 2004 year-to-date period represents net severance activity related to workforce reductions. During the first half of 2004, we initiated a workforce reduction of approximately 1,100 positions, primarily in network operations where the volume of work continues to decline. The $51 restructuring amount in the third quarter of 2003 represents an asset impairment associated with an abandoned software project. In addition, 2003 includes $138 in charges related to workforce reductions as we made adjustments to our business model adapting to economic, regulatory, and competitive pressures.

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

Interest Expense

Interest expense decreased $14 for the third quarter and $79 for the year-to-date period compared to the same periods in the prior year. Interest expense associated with interest-bearing debt was up $4 for the third quarter reflecting higher average debt balances for the quarter and down $34 in the year-to-date period reflecting lower average debt balances for the year. Our effective interest rate on interest-bearing debt was 5.8% in the third quarter of 2004 compared to 6.7% in the third quarter of 2003. The lower effective interest rate is due to our interest rate swap program and refinancing higher-rate debt with lower-rate debt. The remaining variances relate to interest accruals on other liabilities and contingencies.

Interest expense is expected to increase over the next year due to higher incremental borrowings associated with equity contributions to Cingular to fund its acquisition of AT&T Wireless.

Net earnings (losses) of equity affiliates

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,		
	2003	2004	Change	2003	2004	Change
Cingular	$ 70	$ 57	$(13)	$ 401	$ 293	$ (108)
Other equity investees	9	16	7	26	35	9
Total	$ 79	$ 73	$ (6)	$ 427	$ 328	$(99)

Earnings from Cingular in the 2004 periods were lower compared to the same periods in 2003 primarily due to significant growth in customers and the costs related to that growth, as well as integration planning costs related to the AT&T Wireless acquisition and a fair value adjustment related to the sale of Cingular Interactive.

Gain (loss) on sale of operations

The gain on sale of operations in 2004 relates to the sale of our interest in Danish wireless provider, Sonofon, for 3.68 billion Danish Kroner to Telenor ASA. We received 3.05 billion Danish Kroner, or $525, for our 46.5% equity stake and 630 million Danish Kroner, or $109, for our shareholder loan and accrued interest, reduced by a settlement of $17 associated with foreign currency swap contracts. As a result of these transactions, we recorded a gain of $462, or $295 net of tax, which included the recognition of cumulative foreign currency translation gains of $13.

Other income (expense), net

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,		
	2003	2004	Change	2003	2004	Change
Interest Income	$ 72	$ 77	$ 5	$ 246	$ 216	$ (30)
Foreign currency transaction gains (losses)	1	-	(1)	30	(1)	(31)
Loss on early extinguishment of debt	-	(14)	(14)	-	(14)	(14)
Other, net	9	-	(9)	3	(1)	(4)
Total Other Income (Expense), net	$ 82	$ 63	$ (19)	$ 279	$ 200	(79)

The decrease in interest income reflects a lower rate on our advance to Cingular and to a lesser extent the loss of income on an advance to Dutch telecommunications provider Royal KPN N.V. (KPN) due to early repayment in 2003. Foreign currency transaction gains in 2003 relate primarily to the advance to KPN. On August 1, 2004, we redeemed $517 of 40-year, 7.375% quarterly interest bonds, due August 1, 2039. The redemption price was 100% of the principal amount, but resulted in recognition of a loss of $14, or $9 net of tax, associated with fully expensing remaining debt discount and deferred debt issuance costs.

Provision for income taxes

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,		
	2003	2004	Change	2003	2004	Change
Provision for income taxes	$ 486	$ 465	$ (21)	$1,487	$1,604	$ 117
Effective tax rate	35.2%	35.3%	0.1%	35.9%	35.3%	(0.6%)

The effective tax rates in 2004 were reduced by a favorable permanent difference for the Medicare Part D subsidy and an adjustment to taxes payable associated with divested operations.

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

Income (loss) from discontinued operations, net of tax

Income from discontinued operations, net of tax, decreased $95 in the third quarter of 2004 compared to the same period in 2003 primarily due to an after tax charge of $190 related to the arbitration ruling and settlement for Venezuela and $59 in tax expense associated with tax basis differential, both of which are further detailed in Note C to the quarterly financial statements. Partially offsetting these decreases was an increase in income of $95 due to improved operating income in 2004 driven by strong revenue growth and the cessation of depreciation and amortization expense in the second quarter of 2004 for the assets of the discontinued operations as required by GAAP. In addition, foreign currency exchange gains of $20 in third quarter of 2004 improved from foreign exchange losses of $9 in third quarter of 2003.

Income from discontinued operations, net of tax, increased $303 in the year-to-date-period of 2004 compared to the same period in 2003 primarily due to a $357 tax benefit recorded in 2004 related to excess tax basis over book basis in our Latin America investments. Income from discontinued operations also increased due to the cessation of depreciation beginning in second quarter 2004 of $140, a $73 loss on the sale of Brazil in 2003, and higher revenues. Partially offsetting the increases were the $190 charge related to Venezuela noted above, foreign exchange gains of $101 in 2003 compared to losses of $3 in 2004, and a $33 loss in the second quarter of 2004 related to the purchase of additional ownership share in Argentina.

From an operational perspective, these operations experienced strong growth in both customers and revenue. Operating revenue in the Latin America operations for the year-to-date period in 2004 increased $421 or 25.4% over the year-to-date 2003 period due to growth in customers and traffic throughout the portfolio. End-of-period customers increased 29% and total billed minutes of use increased 23% compared to September 30, 2003.

Cumulative effect of changes in accounting principle

Asset Retirement Obligations

Effective January 1, 2003, we adopted SFAS No. 143, "Accounting for Asset Retirement Obligations" (SFAS No. 143). In connection with the adoption of this standard, we recorded the cumulative effect of accounting change that increased 2003 net income by $816.

Revenue Recognition for Publishing Revenues

Effective January 1, 2003, we changed our method for recognizing revenues and expenses related to our directory publishing business from the publication and delivery method to the deferral method. The cumulative effect of the change in accounting method is reflected in the income statement as a decrease to 2003 net income of $501.

Results by Segment

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

- Communications group;
- Domestic wireless; and
- Advertising & Publishing group.

Management evaluates the performance of each business unit based on net income, exclusive of internal charges for use of intellectual property and adjustments for unusual items that may arise. Unusual items are transactions or events that are included in reported consolidated results but are excluded from segment results due to their nonrecurring or nonoperational nature. In addition, when changes in our business affect the comparability of current versus historical results, we will adjust historical operating information to reflect the current business structure. See Note J to the quarterly financial statements for a reconciliation of segment results to the unaudited consolidated financial information.

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

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

Communications Group

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

During 2004, the Communications group continued to emphasize interLATA