



Philip Rogerson Chairman

This is my first year as Chairman of your Company. It has been a demanding year, full of challenge and change in UK telecommunications and, yet, it has been a year which has presented new opportunities for THUS.

I joined THUS because of the many opportunities, qualities and strengths I saw in your Company. The past five years, including the disappointment of the downgrade to profit expectations in the first half of the financial year ended 31 March 2005, have not been easy and have taken their toll on the THUS share price. Yet over the past five years, THUS has successfully grown its business every year, retained its focus on its business plan and, this year, generated its first full financial year of positive cash flow¹.

Over that same period, trading conditions in the telecommunication market have been very difficult, with too many companies chasing the available business at low prices. A number of companies have suffered financial distress, but nevertheless have maintained their presence in the market, unlike in many other industries where such conditions of over supply would lead to industry consolidation.

The business philosophy I observed in THUS was, simply, to retain focus on profitably selling and managing services on behalf of its customers. THUS has a good track record and is winning larger and more complex contracts every year. The UK national network was the first "next generation network" to offer fully integrated services based on Internet Protocol technology throughout the UK. This investment is paying off as the market transitions from traditional discrete services to the new world where all services are carried over a single operating platform. And this is where THUS is increasing its market share and increasingly differentiating its capability.

It is my duty as Chairman to ensure that your Company retains its strong competitive position. We expect our industry to rationalise its market structure and improve its overall financial viability through consolidation in the UK and internationally. The market will increasingly differentiate and reward companies with the skills to innovate successfully and evolve services for their customers. I believe your Company's track record on innovation, quality, and its ability to leverage its assets to manage complex service requirements will be recognised as the key ingredients for future success.

On behalf of the Board, I would like to take this opportunity to extend my thanks to Roy Brown, your former Chairman who retired this year, for his contribution in leading THUS since its demerger from ScottishPower in 2002. I would also like to thank all our staff who, despite the continued difficult trading environment, have demonstrated unstinting commitment and dedication to the Company and remained focused on serving our customers.

I am confident that I made the right decision to become your Chairman. I do not expect the market to be significantly easier in the year ahead. Our market will remain tough and demanding but I do believe THUS has the integrity, strengths, and capability to succeed.

Philip Rogerson,
Chairman

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William Allan Chief Executive

This has been a challenging year for the UK business telecommunication market. It has been a year of aggressive pricing and revenue substitution as the fight for market share became fiercer, and next generation broadband and Internet Protocol based services increasingly replaced more traditional telecommunication services.

Against this background THUS maintained its focus and increased turnover in its continuing operations by 14% to £340.6m, with strong growth in key managed solutions, data and telecoms, and Internet divisions. Headline turnover grew by 8% to £360.0m and we delivered our first full financial year of positive free cash flow¹ of £3.7m.

In the first half, our profit performance was negatively impacted by two, one-off factors. First, contact centre and interactive divisions moved from a combined operating profit last year to an operating loss following poor trading and asset impairment. Both were successfully disposed. In addition, we made an exceptional impairment of £8.1m on transatlantic cable capacity following a decision by a UK based supplier to place its US subsidiary into bankruptcy.

Price competition was extremely aggressive. Over the course of the year we successfully renewed all 11 of the top 20 customer contracts that came up for renewal. This was a higher than usual number of renewals. Although all were successfully won, in most instances it was with slimmer margins than before.

All of these events, coupled to the revenue substitution of higher margin narrowband Internet access for broadband, triggered our downgrade to full year profit expectations, albeit the Company's cash flow remained in line with market expectations.

THUS's increasing ability to differentiate its capability by building and managing complex services for its customers resulted in the formation of a new managed solutions division. Revenue from managed solutions now accounts for 21% of the Company's continuing operations. This is a key area for future growth as we increasingly manage complex services for our customers and integrate discrete applications such as voice, data, email, video, and Internet, and carry it over a single service platform – we call this "converged services". It was our anticipation of this service evolution which underpinned our network design and service philosophy at the time of the THUS flotation in 1999, and where we focused capital investment to build UK wide service capability.

Our service focus shows that we can win and manage complex contracts: Glasgow City Council is one of the largest e-government local authority initiatives currently in the UK; and our innovative multicast radio broadcast solution for GWR Group² is the first application of its type for the UK broadcast radio industry. Our ability to adapt existing technology for new applications resulted in the deployment of private access DSL technology as part of a network implementation for a major newspaper and Internet publisher throughout the UK.

Indeed, new services growth was encouraging. Ethernet circuits climbed 38% to 2,750 and broadband DSL growth was buoyant with total broadband customers climbing to over 150,000 and UK customers up 59% to 92,000. Of the eight major new contracts we announced in the year, five were for Internet Protocol based services.

In many ways these results reflect an industry in transition. THUS built the UK's first "next generation network". We have

always believed that all telecommunication services would be conveyed over a single service platform – and the pace of change to this technology is now evident in our market. We remain at the forefront of service innovation and we are strongly positioned to benefit as the market increasingly adopts the new generation of services now available.

Our new services growth helped offset intense price competition, and the migration from old to new services, such as narrowband to broadband Internet services. As a result, the Company's continuing operations were stronger in the second half, with full year EBITDA³ and pre-exceptional operating loss held broadly stable at £39.9m and £24.2m respectively.

The year was tough and demanding with its share of success and disappointment. Nevertheless our performance did demonstrate our underlying strengths in winning new customers and successfully transitioning our revenue from old to new services.

We remain cautious on the market structure for telecommunication services in the UK, and we expect the aggressive pricing environment to continue throughout the year. However, we have been encouraged by the strong growth in our core activities and in our capability to win, implement and manage complex integrated telecommunication contracts for our customers. Compared to the year just ended, there are few major contract renewals scheduled, and these contracts are principally focused in the provision of lower margin carrier pre-select services. Against this background, the Board remains confident THUS will continue to grow and generate positive cash flows.

William Allan
Chief Executive

¹ Cash flow before acquisitions and disposals, liquid resources and financing

² GWR Group, who now trade as Gcap Media plc, after their merger with Capital Radio which completed on 9 May 2005

³ Earnings before interest, tax, depreciation (including impairment) and amortisation