NetServices plc

interim report 2006

corporate statement

As the “people behind the people” NetServices provides secure, reliable and efficient converged voice and data solutions to its customers, either through its reseller partners or direct.

NetServices’ solution portfolio complements the service offerings of our reseller channel and partners. It enables them to provide both SMEs and large corporates with the foundations required for business communications.

chairman's statement

I am pleased to report our maiden interim results for the six months to 28 February 2006, since successfully joining AIM in March 2006.

Financial summary

Turnover in the period increased by 80% to £7.8m (2005: £4.3m) with a loss before tax of £1.1m (2005: profit of £0.2m). The 2005 comparative half year did not include any contribution from WAN Services Ltd which was acquired in May 2005. This acquisition changed the group's financial profile because whilst it brought a capability and infrastructure to enable NetServices to deliver its planned VOIP solutions through its core network, WAN Services Ltd had historically achieved significantly lower gross margins.

A consequence of this was a reduction in the group's reported gross margin for the period from 42% in the comparative period to 24%. At the same time administrative overheads have increased by 71% to £2.6m (2005: £1.5m) due to the investment in our internal infrastructure for the launch of Voice4IP and an unforeseen bad debt charge of £0.2m. These factors have contributed to NetServices incurring a greater loss in the first half than anticipated.

Operating review and strategy

NetServices specifically targets the Voice and Data market through its reseller channels. We continue to reduce the exposure to consumer business where margins remain erratic and to grow our higher margin business in wide area networking, by providing complex solutions over our core private network, increasing our data centre revenues from hosting client's equipment and selling development time and creating bespoke solutions for clients.

We have successfully developed the order book and since January this year we have taken new orders for Voice and Data services with an annualised value of £10.8m. This leaves us well placed to enter the next financial year with an annualised order book of at least £30m.

Our wholesale services business, which has over 54,000 connections, generated turnover of approximately £5.5m in the first half. Historically we have built this business on the back of the growth in consumer demand for broadband connectivity. This area has become increasingly commoditised with a consequential impact on margins.

In line with our strategy to enhance shareholder value and to seek to reduce our dependency on the consumer, we are currently investigating a number of strategic options.

We continue to believe that the growing demand for higher margin Voice and Data solutions in the business market will provide significant opportunities for NetServices. In February we began to broaden our target market for Voice solutions, seeing opportunities to attract clients using current technologies where the potential is clear for a future migration to our own Voice4IP technology. The recent orders include a significant proportion of telephony services attached to Voice4IP migration contracts. These orders clearly demonstrate that the market does value, want and need managed VoIP solutions, although delivery times vary and we expect to see the real benefit of this approach in the next financial year.

Inevitably the activity of the largest players in any market can bring rapid and sweeping change. Since the period end we have seen one of the largest mobile telephony retailers announce free DSL to consumers packaged with fixed price international calls, causing massive uncertainty amongst both retail and corporate buyers to defer implementing change and therefore buying decisions.

Financial review

In addition to the £5.5m wholesale services turnover, we generated revenues of £2.2m from our WAN and hosting services and from the sale of equipment to support these sales. We also issued our first invoices through Voice4IP. Whilst only amounting to £0.1m in the period, we remain confident that this revenue will continue to grow on the back of the orders we already have.

In 2006 we have invested further in our on-line customer billing platform. This process has helped identify a number of billing errors, particularly with the WAN clients and has resulted in approximately £0.3m of credits being issued in respect of the period. The issues have now been resolved and a smoother process is operating again.

We launched new wholesale products in the second half of 2005. These have enabled larger resellers to take advantage of reduced prices. However delivery of these has caused network inefficiency and has reduced our margins with these resellers. In May we launched our fair usage policy which will begin to allow us to begin to recover some of this margin loss. We are currently realigning our prices with the market and have this month made available to our resellers the 8Mg BT DSL broadband product set.

Salary costs represent the largest part of the group's overheads and amounted to £1.8m (2005: £1.2m) in the period reflecting the investment we made in the sales and client services teams in anticipation of the growth in business volumes. In the period bad debt provisions were increased through a charge of £225k (2005: £16k).

Following the acquisition of WAN Services Ltd, we retained our data stream pipe capacity a further inefficiency against our reported margins but we believe it is more cost effective/efficient than cancelling and re-commissioning the services when Voice4IP turnover grows.

We have included below a pro forma consolidated statement of net assets of the Group to illustrate the effect of the Placing on 8 March 2006 on the group's bank and cash balances and on its net assets.

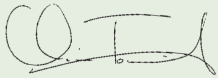
Current trading and outlook

Although trading volumes in March and April were slightly ahead of the first half, the conversion of new orders into invoicing has been slower than anticipated, we are endeavouring to minimise lead times where practicable. We have also undertaken a detailed review of our overhead costs and are taking action to ensure we operate more cost effectively.

We are pleased with the traction that NetServices is developing, particularly in the Voice and Data markets and are satisfied at the rate at which we are now generating new orders. However we now expect the benefit of these will not be fully recognised until the next financial year. Whilst we anticipate some revenue growth in the second half over the first, the result for the full year will be affected by the slower than expected placing of orders and the margin short fall. We therefore currently expect the loss in the second half to be broadly equivalent to that in the first half.

Summary

I would like to thank our employees who, in the past six months have adapted so positively to the changes required from being a private company to one listed on AIM. Similarly I would like to welcome our new shareholders who supported us in our flotation. We look forward to reporting on progress at the time of our full year results.



Chris Townsend
Non-executive Chairman

consolidated profit and loss account

for the period to 28 February 2006

	Note	**Six months ended 28 February 2006 Unaudited £000's**	Six months ended 28 February 2005 Unaudited £000's	Year ended 31 August 2005 Audited £000's
Turnover		**7,796**	4,325	11,068
Cost of sales		**(5,951)**	(2,508)	(7,324)
Gross profit		**1,845**	1,817	3,744
Administrative expenses (before goodwill amortisation, depreciation and research and development)		**(2,441)**	(1,377)	(3,779)
Depreciation		**(285)**	(132)	(381)
Research and development		**(125)**	(121)	(296)
Goodwill amortisation		**(19)**	—	(13)
Total administrative expenses		**(2,870)**	(1,630)	(4,469)
Operating (loss)/profit		**(1,025)**	187	(725)
Net interest payable		**(50)**	(14)	(35)
(Loss)/profit on ordinary activities before taxation		**(1,075)**	173	(760)
Tax on (loss)/profit on ordinary activities	2	**—**	—	21
Retained (loss)/profit for the period/year	6	**(1,075)**	173	(739)
(Loss)/earnings per share				
– basic (p)	3	**(5.13)**	0.84	(3.59)
– diluted (p)	3	**(5.13)**	0.82	(3.59)

consolidated balance sheet

as at 28 February 2006

	Note	**As at 28 February 2006 Unaudited £000's**	As at 28 February 2005 Unaudited £000's	As at 31 August 2005 Audited £000's
Fixed assets				
Intangible assets		**354**	—	373
Tangible assets		**2,231**	1,222	2,224
Investments		**59**	59	59
		2,644	1,281	2,656
Current assets				
Debtors		**5,425**	1,537	3,808
Cash at bank and in hand		**163**	27	1,475
		5,588	1,564	5,283
Creditors				
Amounts falling due within one year		**(6,137)**	(1,483)	(4,898)
Net current (liabilities)/assets		**(549)**	81	385
Total assets less current liabilities		**2,095**	1,362	3,041
Creditors				
Amounts falling due after one year		**(593)**	(424)	(574)
Provisions for liabilities and charges		**(2,440)**	(124)	(2,565)
Net (liabilities)/assets		**(938)**	814	(98)
Capital and reserves				
Called up share capital	7	**53**	51	51
Share premium account	7	**357**	124	124
Profit and loss account		**(1,348)**	639	(273)
Equity shareholders' (deficit)/funds	6	**(938)**	814	(98)

consolidated cash flow statement

for the period to 28 February 2006

	Note	Six months ended 28 February 2006 Unaudited £000's	Six months ended 28 February 2005 Unaudited £000's	Year ended 31 August 2005 Audited £000's
Net cash (outflow) from operating activities	4	**(2,420)**	(29)	(2,020)
Returns on investments and servicing of finance				
Interest received		**4**	1	13
Interest paid		**(43)**	(15)	(27)
Interest element of hire purchase		**(11)**		(21)
Net cash (outflow) from returns on investments and servicing of finance		**(50)**	(14)	(35)
Taxation		**45**	—	(151)
Capital expenditure				
Purchase of tangible fixed assets		**(182)**	(78)	(654)
Receipts from sale of tangible fixed assets		**—**	—	6
Net cash (outflow) from capital expenditure		**(182)**	(78)	(648)
Acquisitions				
Purchase of subsidiary undertakings		**—**	—	(82)
Net cash acquired with subsidiary		**—**	—	4,002
Net cash inflow from acquisitions		**—**	—	3,920
Net cash (outflow)/inflow before financing		**(2,607)**	(121)	1,066
Financing				
Issue of ordinary share capital		**235**	—	—
Capital element of hire purchase		**(20)**	—	(58)
Bank loans taken out in the period		**—**	—	300
Bank loans repaid		**(17)**	—	(10)
Net cash inflow from financing		**198**	—	232
(Decrease)/increase in cash in the period/year	5	**(2,409)**	(121)	1,298

pro forma consolidated statement of net assets of the Group

as at 28 February 2006

	As at 28 February 2006 Unaudited £000's	Adjustments £000's	Pro forma net assets of the Group £000's
Fixed assets			
Intangible assets	**354**		354
Tangible assets	**2,231**		2,231
Investments	**59**		59
	2,644		2,644
Current assets			
Debtors	**5,425**		5,425
Cash at bank and in hand	**163**	4,100	4,263
	5,588	4,100	9,688
Creditors			
Amounts falling due within one year	**(6,137)**		(6,137)
Net current (liabilities)/assets	**(549)**		3,551
Total assets less current liabilities	**2,095**	4,100	6,195
Creditors			
Amounts falling due after one year	**(593)**		(593)
Provisions for liabilities and charges	**(2,440)**		(2,440)
Net (liabilities)/assets	**(938)**	4,100	3,162
Capital and reserves			
Called up share capital	**53**	2	55
Share premium account	**357**	4,098	4,455
Profit and loss account	**(1,348)**		(1,348)
Equity shareholders' (deficit)/funds	**(938)**	4,100	3,162

notes to the interim statement

1. Basis of preparation

The Group's interim results consolidate the results of the Company and its subsidiary undertakings to 28 February 2006.

The interim financial information has been prepared on the basis of the accounting policies set out in the statutory accounts for the year ended 31 August 2005.

The financial information contained in this interim statement does not constitute statutory accounts within the meaning of Section 240 of the Companies Act 1984. The financial information for the full preceding year is based on the financial statements for the year ended 31 August 2005. These accounts upon which the auditors issued an unqualified opinion, which did not contain a statement under Section 237 (2) or (3) of the Companies Act 1985, have been delivered to the Registrar of Companies.

The Board of Directors approved the interim report on 19 May 2006.

2. Taxation

The tax charge is based on the current rate of UK corporation tax applicable to the company and comprises:

	Six months ended 28 February 2006 Unaudited £000's	Six months ended 28 February 2005 Unaudited £000's	Year ended 31 August 2005 Audited £000's
UK corporation tax at 30%	**—**	57	1
Deferred tax	**—**	—	(22)
Adjustment in respect of prior periods	**—**	—	—
	—	57	(21)

3. (Loss)/earnings per share

	Six months ended 28 February 2006 Unaudited £000's	Six months ended 28 February 2005 Unaudited £000's	Year ended 31 August 2005 Audited £000's
(Loss)/earnings per share			
– basic (p)	**(5.13)**	0.84	(3.59)
– diluted (p)	**(5.13)**	0.82	(3.59)

The calculation of diluted loss per ordinary share is identical to that used for the basic loss per ordinary share for the six months ended 28 February 2006 and the year ended 31 August 2005. This is because the exercise of the options would have the effect of reducing the loss per ordinary share and is, therefore, not dilutive under the terms of FRS 22.

3. (Loss)/earnings per share continued

Earnings and the number of shares used in the calculations of earnings per share are set out below:

	Six months ended 28 February 2006 Unaudited £000's	Six months ended 28 February 2005 Unaudited £000's	Year ended 31 August 2005 Audited £000's
(Loss)/profit for the period/year	**(1,075)**	173	(739)

Weighted average number of shares used in the calculations of earnings per share are set out below:

	Six months ended 28 February 2006 Unaudited £000's	Six months ended 28 February 2005 Unaudited £000's	Year ended 31 August 2005 Audited £000's
For basic earnings per share	**20,969,203**	20,577,364	20,577,364
For diluted earnings per share	**20,969,203**	21,104,345	20,577,364

4. Reconciliation of operating (loss)/profit to net cash inflow from operating activities

	Six months ended 28 February 2006 Unaudited £000's	Six months ended 28 February 2005 Unaudited £000's	Year ended 31 August 2005 Audited £000's
Operating (loss)/profit	**(1,025)**	187	(725)
Depreciation	**285**	132	381
Amortisation of intangible assets	**19**	—	13
Profit on disposal of fixed assets	**—**	—	(4)
(Increase) in debtors	**(1,618)**	(133)	(434)
Increase/(decrease) in creditors	**44**	(215)	(896)
(Decrease) in provisions	**(125)**	—	(355)
Net cash (outflow) from operating activities	**(2,420)**	(29)	(2,020)

notes to the interim statement continued

5. Reconciliation of net cash flow to movement in net (debt)/funds

	Six months ended 28 February 2006 Unaudited £000's	Six months ended 28 February 2005 Unaudited £000's	Year ended 31 August 2005 Audited £000's
(Decrease)/increase in cash in the period/year	**(2,409)**	(121)	1,298
Cash flow in respect of new hire purchase	**(111)**	—	(32)
Cash flow in respect of hire purchase and loans	**37**	—	(233)
Movement in net (debt)/funds in the period/year	**(2,483)**	(121)	1,033
Net funds/(debt) at start of period/year	**827**	(206)	(206)
Net (debt)/funds at end of period/year	**(1,656)**	(327)	827

6. Reconciliation of shareholders' (deficit)/funds

	Six months ended 28 February 2006 Unaudited £000's	Six months ended 28 February 2005 Unaudited £000's	Year ended 31 August 2005 Audited £000's
(Loss)/profit for the period/year	**(1,075)**	173	(739)
New share capital subscribed	**2**	—	—
Premium on new share capital subscribed	**233**	—	—
	(840)	173	(739)
Opening shareholders (deficit)/funds	**(98)**	641	641
Closing shareholders (deficit)/funds	**(938)**	814	(98)

7. Share capital

During the period the company issued the following shares:

	Number of shares	Ordinary share capital £000's	Share Premium £000's
At 28 February 2005 and 31 August 2005	5,144,341	51	124
Issued on fund raising during November 2005	147,756	2	233
	5,292,097	53	357
Sub-division of Ordinary Shares 4:1	15,876,291	—	—
At 28 February 2006	**21,168,388**	**53**	**357**

7. Share capital continued

The company granted options, which remain exercisable, to subscribe for Ordinary Shares of £0.01 each. The following information has been restated to reflect the 4:1 subdivision of the share capital effected on 6 February 2006:

Approved share options	Subscription price per share	Period within which options are exercisable	Number of shares for which rights are exercisable: 28 February 2006 Unaudited	28 February 2005 Unaudited	31 August 2005 Audited
6 August 2004 (i), (iii)	1.25p	6/8/04 to 6/8/14	1,028,868	1,028,868	1,028,868
10 May 2005 (ii)	5.00p	1/3/07 to 10/5/15	400,000	—	400,000
21 November 2005	39.75p	21/11/05 to 21/11/15	503,000	—	—

(i) The period of ten years is with the condition that they can only be exercised on sale or flotation of the company.

(ii) 102,887 of these options are exercisable earlier than 1 March 2007 if there is an exit event, such an event including the flotation of part or all of the company.

(iii) All options are exercisable earlier than 1 March 2007 if there is an exit event, such an event being the completion of an agreement to purchase more than 75% of the shares in the company or a substantial change in ownership.

Unapproved share options					
21 November 2005	39.75p	21/11/05 to 21/11/15	503,000	—	—

8. Provisions

At 28 February 2006 a provision of £60,000 (31 August 2005: £114,000) remains for the unavoidable lease payments and dilapidation costs on the now empty premises of WAN Services Limited in London. The Group is seeking to transfer the tenancy agreement or sublet it, but has not done so to date. This is expected to be settled over the next twelve months.

A further provision of £2,279,000 (31 August 2005: £2,350,000) remains in relation to onerous contracts for the provision of internet services with two different suppliers.

	28 February 2006 Unaudited £000's	28 February 2005 Unaudited £000's	31 August 2005 Audited £000's
Other provisions	**2,339**	—	2,464

independent review report to NetServices plc

Introduction

We have been instructed by the company to review the financial information set out in the interim report which comprises the consolidated profit and loss account, consolidated balance sheet, consolidated cash flow statement and related notes and we have read the other information in the interim statement and considered whether it contains any apparent misstatements or material inconsistencies with the financial information.

This report, including the conclusion, has been prepared for and only for the company for the purpose of their interim statement and for no other purpose. We do not, therefore, in producing this report, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Directors' responsibilities

The interim statement, including the financial information contained therein, is the responsibility of, and has been approved by the directors. The directors are responsible for preparing the Interim Statement in accordance with the AIM Market Rules which require that the accounting policies and presentation applied to the interim figures must be consistent with those that will be adopted in the company's annual accounts.

Review work performed

We conducted our review in accordance with guidance contained in Bulletin 1999/4 issued by the Auditing Practices Board as if that Bulletin applied. A review consists principally of making enquiries of group management and applying analytical procedures to the financial information and underlying financial data and based thereon assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit performed in accordance with Auditing Standards and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the financial information.

Review conclusion

On the basis of our review we are not aware of any material modifications that should be made to the financial information as presented for the 6 months ended 28 February 2006.

Baker Tilly
Chartered Accountants
Brazennose House
Lincoln Square
Manchester M2 5BL
19 May 2006

corporate information

Directors
Christopher Peter Townsend
(Non-executive Chairman)
Mark Richard Vickers (Chief Executive Officer)
Steven Michael Hartley ACA (Finance Director)
David Alan Garner (Sales Director)
Graham Richard Norfolk ACA
(Non-executive Director)

Company secretary
Denise Diskin

Registered office and principal place of business
30 Modwen Road
Waters Edge Business Park
Salford
Manchester M5 3EZ

Advisors to the company
Acorn Corporate Finance Ltd
Bollin House
Riveride Park
Wilmslow
Cheshire SK9 1DP

Solicitors to the company
Halliwells LLP
1 Threadneedle Street
London EC2R 8AW

Auditors
Baker Tilly
Brazennose House
Lincoln Square
Manchester M2 5BL

Principal bankers
Barclays Bank plc
City Office Business Centre
51 Mosley Street
PO Box 357
Manchester M60 2AL

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netSERVICES

NetServices plc

Waters Edge Business Park
Modwen Road
Salford
Manchester M5 3EZ
United Kingdom

Tel: 0870 753 0900
Fax: 0870 753 0901

www.netservicesplc.com