# Telstra Corporation Limited and controlled entities

Australian Business Number (ABN): 33 051 775 556

## Half-Year Financial Report

for the half-year ended 31 December 2006

Page number

### Half-Year Financial Statements



### Notes to the Half-Year Financial Statements

# Income Statement

for the half-year ended 31 December 2006

| | Note | Telstra Group Half-year ended 31 December 2006 $m | 2005 $m |
|---|---|---|---|
| **Income** | | | |
| Revenue (excluding finance income) | | **11,645** | 11,415 |
| Other income | | **152** | 129 |
| | | **11,797** | 11,544 |
| **Expenses** | | | |
| Labour | | **1,996** | 2,053 |
| Goods and services purchased | | **2,566** | 2,195 |
| Other expenses | | **2,318** | 2,011 |
| | | **6,880** | 6,259 |
| **Share of net loss from jointly controlled and associated entities** | | **1** | 1 |
| | | **6,881** | 6,260 |
| Earnings before interest, income tax expense, depreciation and amortisation (EBITDA) | | **4,916** | 5,284 |
| Depreciation and amortisation | | **1,978** | 1,800 |
| Earnings before interest and income tax expense (EBIT) | | **2,938** | 3,484 |
| Finance income | | **29** | 41 |
| Finance costs | | **549** | 481 |
| Net finance costs | | **520** | 440 |
| **Profit before income tax expense** | | **2,418** | 3,044 |
| Income tax expense | | **706** | 902 |
| **Profit for the period** | | **1,712** | 2,142 |
| Minority interests in net (profit)/loss | | **(8)** | 1 |
| **Profit for the period available to Telstra Entity shareholders** | | **1,704** | 2,143 |
| **Earnings per share (cents per share)** | | **cents** | cents |
| Basic | | **13.8** | 17.3 |
| Diluted | | **13.7** | 17.3 |
| **Total interim dividends declared (cents per share)** | 4 | **14.0** | 20.0 |

The notes following the half-year financial statements form part of the half-year financial report.

# Balance Sheet

as at 31 December 2006

| | Telstra Group as at 31 Dec 2006 $m | 30 June 2006 $m |
|---|---|---|
| **Current assets** | | |
| Cash and cash equivalents | **457** | 689 |
| Trade and other receivables | **3,952** | 3,752 |
| Inventories | **371** | 224 |
| Derivative financial assets | **26** | 21 |
| Prepayments | **221** | 244 |
| Total current assets | **5,027** | 4,930 |
| **Non current assets** | | |
| Trade and other receivables | **221** | 172 |
| Inventories | **17** | 20 |
| Investments - accounted for using the equity method | **23** | 23 |
| Property, plant and equipment | **23,413** | 23,503 |
| Intangibles | **6,265** | 6,122 |
| Deferred tax assets | **2** | 1 |
| Derivative financial assets | **286** | 391 |
| Defined benefit assets | **1,298** | 1,029 |
| Total non current assets | **31,525** | 31,261 |
| **Total assets** | **36,552** | 36,191 |
| **Current liabilities** | | |
| Trade and other payables | **2,781** | 3,570 |
| Borrowings | **3,033** | 1,982 |
| Current tax liabilities | **324** | 428 |
| Provisions | **694** | 737 |
| Derivative financial liabilities | **97** | 12 |
| Revenue received in advance | **1,212** | 1,161 |
| Total current liabilities | **8,141** | 7,890 |
| **Non current liabilities** | | |
| Trade and other payables | **201** | 197 |
| Borrowings | **11,280** | 11,434 |
| Deferred tax liabilities | **1,679** | 1,700 |
| Provisions | **901** | 974 |
| Derivative financial liabilities | **832** | 768 |
| Revenue received in advance | **402** | 405 |
| Total non current liabilities | **15,295** | 15,478 |
| **Total liabilities** | **23,436** | 23,368 |
| **Net assets** | **13,116** | 12,823 |
| **Equity** | | |
| Share capital | **5,590** | 5,569 |
| Reserves | **(142)** | (160) |
| Retained profits | **7,414** | 7,168 |
| Equity available to Telstra Entity shareholders | **12,862** | 12,577 |
| Minority interests | **254** | 246 |
| **Total equity** | **13,116** | 12,823 |

The notes following the half-year financial statements form part of the half-year financial report.

# Statement of Recognised Income and Expense

for the half-year ended 31 December 2006

| | Telstra Group Half-year ended 31 December 2006 $m | 2005 $m |
|---|---|---|
| **Foreign currency translation reserve** | | |
| Equity accounting our interest in jointly controlled and associated entities | **-** | 1 |
| Translation of financial statements of non-Australian controlled entities | **(12)** | 81 |
| Transfer to profit for the period on sale of jointly controlled and associated entities | **(1)** | - |
| **Cash flow hedging reserve** | | |
| Net hedging gains/(losses) recognised directly in equity | **(60)** | 75 |
| Net hedging gains/(losses) removed from equity and included in profit for the period | **107** | (129) |
| **Retained profits** | | |
| Actuarial gain on our defined benefit plans | **399** | 298 |
| | **433** | 326 |
| Income tax on equity items | **(133)** | (71) |
| **Net income recognised directly in equity** | **300** | 255 |
| **Profit for the period** | **1,712** | 2,142 |
| **Total recognised income for the period** | **2,012** | 2,397 |
| **Attributable to:** | | |
| Telstra Entity | **2,004** | 2,398 |
| Minority interest | **8** | (1) |
| | **2,012** | 2,397 |
| **Effects of changes in accounting policy attributable to Telstra Entity** | **-** | 76 |

The notes following the half-year financial statements form part of the half-year financial report.

# Statement of Cash Flows

for the half-year ended 31 December 2006

| | Note | Telstra Group Half-year ended 31 December 2006 $m | 2005 $m |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Receipts from customers (inclusive of goods and services tax (GST)) | | **12,736** | 12,417 |
| Payments to suppliers and to employees (inclusive of GST) | | **(8,339)** | (7,466) |
| Net cash generated from operations | | **4,397** | 4,951 |
| Income taxes paid | | **(966)** | (1,003) |
| **Net cash provided by operating activities** | | **3,431** | 3,948 |
| **Cash flows from investing activities** | | | |
| Payments for: | | | |
| - property, plant and equipment | | **(2,114)** | (1,761) |
| - intangibles | | **(395)** | (282) |
| Capital expenditure (before investments) | | **(2,509)** | (2,043) |
| - shares in controlled entities (net of cash acquired) | 6 | **(314)** | (7) |
| - adjustment to net proceeds from CSL New World Mobility Group merger | 6 | **(21)** | - |
| - payments for other investments | | **(2)** | (12) |
| Total capital expenditure | | **(2,846)** | (2,062) |
| Proceeds from: | | | |
| - sale of property, plant and equipment | | **25** | 20 |
| - sale of shares in controlled entities (net of cash disposed) | 6 | **222** | - |
| Proceeds from share buy-back by jointly controlled and associated entities | | **-** | 16 |
| Interest received | | **30** | 34 |
| **Net cash used in investing activities** | | **(2,569)** | (1,992) |
| **Operating cash flows less investing cash flows** | | **862** | 1,956 |
| **Cash flows from financing activities** | | | |
| Proceeds from borrowings | | **2,810** | 3,869 |
| Proceeds from Telstra bonds | | **373** | - |
| Repayment of borrowings | | **(1,987)** | (3,623) |
| Repayment of Telstra bonds | | **-** | (13) |
| Repayment of finance lease principal amounts | | **(17)** | (4) |
| Staff repayments of share loans | | **11** | 11 |
| Purchase of shares for employee share plans | | **-** | (6) |
| Finance costs paid | | **(540)** | (470) |
| Dividends paid | 4 | **(1,739)** | (2,485) |
| **Net cash used in financing activities** | | **(1,089)** | (2,721) |
| **Net decrease in cash** | | **(227)** | (765) |
| Foreign currency translation on opening balances | | **(5)** | 4 |
| Cash at the beginning of the period | | **689** | 1,534 |
| **Cash at the end of the period** | 6 | **457** | 773 |

The notes following the half-year financial statements form part of the half-year financial report.

# Notes to the Half-Year Financial Statements

## 1. Basis of preparation

In this financial report, we, us, our, Telstra and the Telstra Group - all mean Telstra Corporation Limited, an Australian corporation and its controlled entities as a whole. Telstra Entity is the legal entity, Telstra Corporation Limited.

Our half-year financial report is a general purpose financial report and is to be read in conjunction with our Annual Financial Report as at 30 June 2006. This should also be read together with any public announcements made by us in accordance with the continuous disclosure obligations arising under Australian Stock Exchange listing rules and the Corporations Act 2001, up to the date of the Directors' Declaration.

### 1.1 Basis of preparation of the financial report

This half-year financial report has been prepared in accordance with the requirements of the Australian Corporations Act 2001 and Accounting Standards applicable in Australia, including AASB 134: "Interim Financial Reporting".

Our half-year financial report does not include all notes of the type normally included in the Annual Financial Report. Therefore, it cannot be expected to provide as full an understanding of the income statement, balance sheet and cash flows of the Telstra Group as the full financial report.

This half-year financial report is prepared in accordance with historical cost, except for some categories of investments, which are equity accounted and some financial assets and liabilities (including derivative instruments) which are recorded at fair value. Cost is the fair value of the consideration given in exchange for net assets acquired.

In preparing this half-year financial report, we are required to make judgments and estimates that impact:

- income and expenses for the half-year;
- the reported amounts of assets and liabilities; and
- the disclosure of off balance sheet arrangements, including contingent assets and contingent liabilities.

We continually evaluate our judgements and estimates. We base our judgements and estimates on historical experience, various other assumptions we believe to be reasonable under the circumstances and, where appropriate, practices adopted by international telecommunications companies. Actual results may differ from our estimates.

For the purpose of preparing this half-year financial report, each half-year has been treated as a discrete reporting period.

### 1.2 Further clarification of terminology used in our income statement

Under the requirements of AASB 101: "Presentation of Financial Statements", we must classify all of our expenses (apart from any finance costs and our share of net (gain)/loss from jointly controlled and associated entities) according to either the nature (type) of the expense or the function (activity) to which the expense relates. We have chosen to classify our expenses using the nature classification as it more accurately reflects the type of operations we undertake.

Earnings before interest, income tax expense, depreciation and amortisation (EBITDA) reflects our profit for the year prior to including the effect of net finance costs, income taxes, depreciation and amortisation. We believe that EBITDA is a relevant and useful financial measure used by management to measure the company's operating profit.

Our management uses EBITDA, in combination with other financial measures, primarily to evaluate the company's operating performance before financing costs, income tax and non-cash capital related expenses. In consideration of the capital intensive nature of our business, EBITDA is a useful supplement to net income in understanding cash flows generated from operations that are available for payment of income taxes, debt service and capital expenditure.

In addition, we believe EBITDA is useful to investors because analysts and other members of the investment community largely view EBITDA as a key and widely recognised measure of operating performance.

Earnings before interest and income tax expense (EBIT) is a similar measure to EBITDA, but takes into account the effect of depreciation and amortisation.

When a specific item from ordinary activities is of such a size, nature or incidence that its disclosure is relevant in explaining our operating performance for the reporting period, its nature and amount is disclosed separately in note 3.

### 1.3 Rounding

All dollar amounts in this financial report (except where indicated) have been rounded to the nearest million dollars ($m) for presentation. This has been done in accordance with Australian Securities and Investments Commission (ASIC) Class Order 98/100, dated 10 July 1998, issued under section 341(1) of the Corporations Act 2001.

# Notes to the Half-Year Financial Statements (continued)

## 2. Summary of accounting policies

### 2.1 Accounting policies

Our accounting policies are consistent with those disclosed in the Annual Financial Report as at 30 June 2006, with the exception of those detailed below.

### 2.2 Change in accounting policies

The following accounting policy changes occurred during the half-year ended 31 December 2006.

**(i) Financial guarantees**

AASB 2005-9: "Amendments to Australian Accounting Standards" became applicable to annual reporting periods beginning on or after 1 January 2006. We have applied this interpretation in our financial report for the half-year ended 31 December 2006.

These amendments require that liabilities arising from the issue of financial guarantee contracts be recognised on the balance sheet. The amendments have resulted in no impact on our balance sheet, income statement or statement of cash flows.

**(ii) Lease arrangements**

UIG 4: "Determining Whether an Arrangement Contains a Lease" (UIG 4) became applicable to annual reporting periods beginning on or after 1 January 2006. We have applied this interpretation in our financial report for the half-year ended 31 December 2006 including the restatement of our comparative information.

UIG 4 requires entities to assess whether arrangements they enter into contain leases. An arrangement contains a lease if fulfilment of the arrangement is dependent on the use of specific assets and conveys a right to use those assets to the customer. The lease component of the arrangement is then separated and accounted for as either a finance or operating lease depending on the nature of the arrangement.

Some of our solutions management and outsourcing arrangements that we enter into as a service provider meet the requirements of UIG 4 as we provide the customer with the right to use dedicated equipment. We have applied this new accounting policy to these arrangements in existence at the start of our comparative period (1 July 2005). We have assessed that all embedded leases in existence at 1 July 2005 were finance leases in accordance with our current accounting policy for leases and AASB 117: "Leases" as substantially all of the risks and benefits incidental to ownership of this equipment are transferred to the customer. This required property, plant and equipment identified as part of an UIG 4 arrangement to be transferred to finance lease receivable and for lease accounting to be applied post this date.

The following impacts were recorded on the transition to UIG 4:

| | Telstra Group Adjustments as at 1 July 2005 $m |
|---|---|
| **Assets** | |
| Trade and other receivables (current) | 25 |
| Trade and other receivables (non current) | 93 |
| Property, plant and equipment | (102) |
| Intangibles | (1) |
| | 15 |
| **Liabilities** | |
| Borrowings (current) | 8 |
| Revenue received in advance (current) | (15) |
| Borrowings (non current) | 25 |
| Deferred tax liability | (1) |
| | 17 |
| **Equity** | |
| Retained profits | (2) |

Before UIG 4 applied, we did not separately account for embedded leases within our service agreements. Fixed and leased assets were previously recognised in our balance sheet and these assets were depreciated or amortised over their economic lives. Revenue associated with the entire service agreement was accounted for in accordance with our accounting policy on service revenue.

Details of the UIG 4 adjustments required to our comparative information is shown in 2.4 below.

### 2.3 Amendments to A-IFRS transition adjustments disclosed at 31 December 2005

During the second half of fiscal 2006, we made certain amendments to the impacts of adopting A-IFRS on the Telstra Group. These amendments impacted our comparatives for the half-year ended 31 December 2005 as set out below:

**(i) Determination of tax bases**

The tax base of our defined benefit asset changed as a result of an interpretation on the treatment of the contribution tax adjustment made to the carrying value of the asset. As a result there was a decrease in income tax expense of $4 million and a decrease in net income recognised directly in equity of $13 million associated with the defined benefit asset for the six months ended 31 December 2005.

# Notes to the Half-Year Financial Statements (continued)

## 2. Summary of accounting policies (continued)

### 2.4 Impact of our changes in accounting policies and amendments to A-IFRS transition adjustments

The following tables show the impact of our changes in accounting policies and amendments to A-IFRS transition adjustments to our previously reported income statements and balance sheet.

| | Telstra Group | | | |
|---|---|---|---|---|
| **Income Statement** | **Previously reported 31 Dec 2005 $m** | **UIG 4 $m** | **Defined benefit tax $m** | **Restated 31 Dec 2005 $m** |
| **Income** | | | | |
| Revenue (excluding finance income) | 11,449 | (34) | - | 11,415 |
| Other income | 129 | - | - | 129 |
| | 11,578 | (34) | - | 11,544 |
| **Expenses** | | | | |
| Labour | 2,053 | - | - | 2,053 |
| Goods and services purchased | 2,214 | (19) | - | 2,195 |
| Other expenses | 2,011 | - | - | 2,011 |
| | 6,278 | (19) | - | 6,259 |
| **Share of net loss from jointly controlled and associated entities** | 1 | - | - | 1 |
| | 6,279 | (19) | - | 6,260 |
| Earnings before interest, income tax expense, depreciation and amortisation (EBITDA) | 5,299 | (15) | - | 5,284 |
| Depreciation and amortisation | 1,810 | (10) | - | 1,800 |
| Earnings before interest and income tax expense (EBIT) | 3,489 | (5) | - | 3,484 |
| Finance income | 36 | 5 | - | 41 |
| Finance costs | 479 | 2 | - | 481 |
| Net finance costs | 443 | (3) | - | 440 |
| **Profit before income tax expense** | 3,046 | (2) | - | 3,044 |
| Income tax expense | 907 | (1) | (4) | 902 |
| **Profit for the period** | 2,139 | (1) | 4 | 2,142 |
| Minority interests in net loss | 1 | - | - | 1 |
| **Profit for the period available to Telstra Entity shareholders** | 2,140 | (1) | 4 | 2,143 |

There has been no impact on basic and diluted earnings per share for the half-year ended 31 December 2005 as a result of the adoption of UIG 4.

# Notes to the Half-Year Financial Statements (continued)

## 2. Summary of accounting policies (continued)

### 2.4 Impact of our changes in accounting policies and amendments to A-IFRS transition adjustments (continued)

| | Telstra Group | | |
|---|---|---|---|
| **Income Statement** | **Previously reported 30 June 2006 $m** | **UIG 4 $m** | **Restated 30 June 2006 $m** |
| **Income** | | | |
| Revenue (excluding finance income) | 22,772 | (68) | 22,704 |
| Other income | 328 | - | 328 |
| | 23,100 | (68) | 23,032 |
| **Expenses** | | | |
| Labour | 4,364 | - | 4,364 |
| Goods and services purchased | 4,730 | (33) | 4,697 |
| Other expenses | 4,427 | - | 4,427 |
| | 13,521 | (33) | 13,488 |
| **Share of net gain from jointly controlled and associated entities** | (5) | - | (5) |
| | 13,516 | (33) | 13,483 |
| Earnings before interest, income tax expense, depreciation and amortisation (EBITDA) | 9,584 | (35) | 9,549 |
| Depreciation and amortisation | 4,087 | (20) | 4,067 |
| Earnings before interest and income tax expense (EBIT) | 5,497 | (15) | 5,482 |
| Finance income | 66 | 9 | 75 |
| Finance costs | 1,002 | 4 | 1,006 |
| Net finance costs | 936 | (5) | 931 |
| **Profit before income tax expense** | 4,561 | (10) | 4,551 |
| Income tax expense | 1,380 | (3) | 1,377 |
| **Profit for the year** | 3,181 | (7) | 3,174 |

There has been no impact on basic earnings per share for the year ended 30 June 2006 as a result of the adoption of UIG 4. Diluted earnings per share for the year ended 30 June 2006 has decreased by 0.1 cents.

# Notes to the Half-Year Financial Statements (continued)

## 2. Summary of accounting policies (continued)

### 2.4 Impact of our changes in accounting policies and amendments to A-IFRS transition adjustments (continued)

| | Telstra Group | | |
|---|---|---|---|
| **Balance Sheet** | **Previously reported 30 June 2006 $m** | **UIG 4 $m** | **Restated 30 June 2006 $m** |
| **Current assets** | | | |
| Cash and cash equivalents | 689 | - | 689 |
| Trade and other receivables | 3,701 | 51 | 3,752 |
| Inventories | 224 | - | 224 |
| Derivative financial assets | 21 | - | 21 |
| Prepayments | 244 | - | 244 |
| Total current assets | 4,879 | 51 | 4,930 |
| **Non current assets** | | | |
| Trade and other receivables | 87 | 85 | 172 |
| Inventories | 20 | - | 20 |
| Investments - accounted for using the equity method | 23 | - | 23 |
| Property, plant and equipment | 23,622 | (119) | 23,503 |
| Intangibles | 6,123 | (1) | 6,122 |
| Deferred tax asset | 1 | - | 1 |
| Derivative financial assets | 391 | - | 391 |
| Defined benefit assets | 1,029 | - | 1,029 |
| Total non current assets | 31,296 | (35) | 31,261 |
| **Total assets** | 36,175 | 16 | 36,191 |
| **Current liabilities** | | | |
| Trade and other payables | 3,570 | - | 3,570 |
| Borrowings | 1,969 | 13 | 1,982 |
| Current tax liabilities | 428 | - | 428 |
| Provisions | 737 | - | 737 |
| Derivative financial liabilities | 12 | - | 12 |
| Revenue received in advance | 1,170 | (9) | 1,161 |
| Total current liabilities | 7,886 | 4 | 7,890 |
| **Non current liabilities** | | | |
| Trade and other payables | 197 | - | 197 |
| Borrowings | 11,409 | 25 | 11,434 |
| Deferred tax liabilities | 1,704 | (4) | 1,700 |
| Provisions | 974 | - | 974 |
| Derivative financial liabilities | 768 | - | 768 |
| Revenue received in advance | 405 | - | 405 |
| Total non current liabilities | 15,457 | 21 | 15,478 |
| **Total liabilities** | 23,343 | 25 | 23,368 |
| **Net assets** | 12,832 | (9) | 12,823 |
| **Equity** | | | |
| Share capital | 5,569 | - | 5,569 |
| Reserves | (160) | - | (160) |
| Retained profits | 7,177 | (9) | 7,168 |
| Equity available to Telstra Entity Shareholders | 12,586 | (9) | 12,577 |
| Minority interest | 246 | - | 246 |
| **Total equity** | 12,832 | (9) | 12,823 |

# Notes to the Half-Year Financial Statements (continued)

## 3. Items requiring specific disclosure

Our profit for the period has been calculated after charging specific expense items from our continuing operations as detailed below:

| | Telstra Group Half-year ended 31 December | |
|---|---|---|
| | **2006** | 2005 |
| | **$m** | $m |
| **Depreciation and amortisation** | | |
| - accelerated amortisation of intangibles | **14** | - |
| - accelerated depreciation of property, plant and equipment | **134** | - |
| | **148** | - |
| Income tax benefit | **(44)** | - |
| Net items after income tax benefit | **104** | - |

As part of our transformation a decision was made last financial year to shut down certain networks, platforms and applications. This has resulted in the accelerated depreciation and amortisation of certain assets that, while currently in use, will be decommissioned.

# Notes to the Half-Year Financial Statements (continued)

## 4. Dividends

Our dividends provided for and paid during the half-year are listed below:

| | Telstra Group | |
|---|---|---|
| | Half-year ended 31 December | |
| | **2006** **$m** | 2005 $m |
| **Dividends paid** | | |
| Final dividends for the financial year ended 30 June provided for and paid during the interim period | | |
| Final dividend | **1,739** | 1,739 |
| Special dividend paid with the final dividend | **-** | 746 |
| | **1,739** | 2,485 |
| **Dividends per ordinary share paid** | **¢** | ¢ |
| Final dividends for the financial year ended 30 June provided for and paid during the interim period | | |
| Final dividend | **14.0** | 14.0 |
| Special dividend paid with the final dividend | **-** | 6.0 |
| | **14.0** | 20.0 |

Our dividends provided for and paid during the interim period are fully franked at a tax rate of 30%.

### Dividends per ordinary share declared

Our dividends declared per share in respect of the half-year as disclosed on the face of our income statement is detailed below:

| | Telstra Group | |
|---|---|---|
| | Half-year ended 31 December | |
| | **2006** **¢** | 2005 ¢ |
| **Dividends declared per ordinary share** | | |
| Interim dividend (a) | **14.0** | 14.0 |
| Special dividend paid with the interim dividend | **-** | 6.0 |
| | **14.0** | 20.0 |

(a) As the interim dividend for the half-year ended 31 December 2006 was not declared, determined or publicly recommended by the Board as at 31 December 2006, no provision for dividend was raised prior to, or as at, that date in the balance sheet. The declaration of the interim dividend is reported as an event after balance date (refer to note 8 for further information).

# Notes to the Half-Year Financial Statements (continued)

## 5. Segment information

### Business segments

We report our segment information on the basis of business segments as our risks and returns are affected predominantly by differences in the products and services we provide through those segments.

During the half-year ended 31 December 2006 there were no adjustments to our business segments.

In our segment financial results, the "Other" segment consists of various business units that do not qualify as reportable segments in their own right. These include:

- Telstra Country Wide;
- Telstra BigPond;
- Telstra Media;
- Strategic Marketing; and
- our corporate areas.

### Segment financial results

For segment reporting purposes, we have reallocated certain items between the respective business segments pursuant to the definitions of segment revenues and segment expenses contained in the applicable accounting standard, where a reasonable allocation basis exists.

Where no reasonable allocation basis exists, we have not reallocated individual items to alternative segments. For segment reporting purposes, these items are reported within the same business segment as for internal management reporting. As a result, our segment revenues and segment expenses do not reflect actual operating results achieved for our business segments in certain circumstances.

The following narrative explains our segment results for those individual items where no reasonable allocation basis exists:

- Sales revenue associated with mobile handsets for Telstra Consumer Marketing and Channels (TC&C), Telstra Business (TB) and Telstra Enterprise and Government (TE&G) are allocated totally to the TC&C segment, with the exception of some products sold which are allocated to TB and TE&G. Ongoing prepaid and postpaid mobile revenues derived from our mobile usage is recorded in TC&C, TB and TE&G depending on the type of customer serviced. In addition, the majority of goods and services purchased associated with our mobile revenues are allocated to the TC&C segment.

These allocations reflect management's accountability framework and internal reporting system and accordingly no reasonable basis for reallocation to the respective business segments exists.

In addition, revenue derived from our BigPond Internet products are recorded in the customer facing business segments of TC&C, TB and TE&G. Certain distribution costs in relation to these products are recognised in these three business segments. Telstra Operations recognise certain expenses in relation to the installation and running of the broadband cable network. In accordance with our application of the business segment definition in relation to customer type, we have not reallocated these items to the Telstra BigPond business segment.

### Inter-segment transfers

We account for all transactions of entities within the Telstra Group, including international transactions between Australian and non-Australian businesses, at market value. For segment reporting purposes, transfer pricing is not used within the Company. As such the inter-segment revenue line purely relates to intercompany revenue.

The Asset Accounting Group does not allocate depreciation expense related to the use of assets owned at the corporate level to other business segments.

## Notes to the Half-Year Financial Statements (continued)

## 5. Segment information (continued)

The following tables detail the results of our business segments, based on the reporting structure as at 31 December 2006:

**Telstra Group**

| | Telstra Consumer Marketing & Channels | Telstra Business | Telstra Enterprise & Government | Telstra International | Telstra Operations | Telstra Wholesale | Sensis | Other (a) | Eliminations | Total of all segments |
|---|---|---|---|---|---|---|---|---|---|---|
| | $m | $m | $m | $m | $m | $m | $m | $m | $m | $m |
| **Half-year ended 31 December 2006** | | | | | | | | | | |
| Revenue from external customers | **4,679** | **1,608** | **2,185** | **807** | **93** | **1,337** | **885** | **51** | **-** | **11,645** |
| Inter-segment revenue | **-** | **-** | **29** | **13** | **22** | **150** | **-** | **1** | **(215)** | **-** |
| **Total segment revenue** | **4,679** | **1,608** | **2,214** | **820** | **115** | **1,487** | **885** | **52** | **(215)** | **11,645** |
| **Segment result** | **2,763** | **1,299** | **1,247** | **26** | **(1,912)** | **1,451** | **362** | **(2,343)** | **(2)** | **2,891** |
| Share of equity accounted net losses | **-** | **-** | **-** | **-** | **-** | **-** | **(1)** | **-** | **-** | **(1)** |
| Net gain on sale of investment | **-** | **-** | **44** | **-** | **-** | **-** | **4** | **-** | **-** | **48** |
| **Earnings before interest and income tax expense (EBIT)** | **2,763** | **1,299** | **1,291** | **26** | **(1,912)** | **1,451** | **365** | **(2,343)** | **(2)** | **2,938** |

**Telstra Group**

| | Telstra Consumer Marketing & Channels | Telstra Business | Telstra Enterprise & Government | Telstra International | Telstra Operations | Telstra Wholesale | Sensis | Other (a) | Eliminations | Total of all segments |
|---|---|---|---|---|---|---|---|---|---|---|
| | $m | $m | $m | $m | $m | $m | $m | $m | $m | $m |
| **Half-year ended 31 December 2005** | | | | | | | | | | |
| Revenue from external customers | 4,481 | 1,597 | 2,219 | 694 | 92 | 1,281 | 1,002 | 49 | - | 11,415 |
| Inter-segment revenue | - | - | 29 | 15 | 31 | 146 | 10 | 1 | (232) | - |
| **Total segment revenue** | 4,481 | 1,597 | 2,248 | 709 | 123 | 1,427 | 1,012 | 50 | (232) | 11,415 |
| **Segment result** | 3,041 | 1,302 | 1,302 | 27 | (1,785) | 1,318 | 509 | (2,260) | 31 | 3,485 |
| Share of equity accounted net profits/(losses) | - | - | - | 5 | - | - | - | (6) | - | (1) |
| **Earnings before interest and income tax expense (EBIT)** | 3,041 | 1,302 | 1,302 | 32 | (1,785) | 1,318 | 509 | (2,266) | 31 | 3,484 |

(a) The Asset Accounting Group is the main contributor to the segment result for this segment, which is primarily depreciation and amortisation charges.

# Notes to the Half-Year Financial Statements (continued)

## 6. Notes to the statement of cash flows

### Reconciliation of cash balances

| | Telstra Group | |
|---|---|---|
| | Half-year ended 31 December | |
| | 2006 $m | 2005 $m |
| Cash and cash equivalents | 457 | 817 |
| Bank overdraft | - | (44) |
| | 457 | 773 |

### Acquisitions and disposals

During the half-year ended 31 December 2006 we made the following significant acquisitions and disposals of investments:

### Acquisitions

#### SouFun Holdings Limited (SouFun)

On 31 August 2006, we acquired 55% (on an undiluted basis) of the issued capital of SouFun for a total consideration of $337 million including acquisition costs.

SouFun is China's largest online real estate, home furnishings and home improvements portal.

Our accounting for the acquisition and the assignment of fair values to SouFun's identifiable assets, liabilities and contingent liabilities has not been finalised and has been determined on a provisional basis as the completion balance sheet has not been finalised.

| | SouFun | |
|---|---|---|
| | 2006 $m | 2006 $m |
| Consideration for acquisition | | |
| Cash consideration for acquisition | 333 | |
| Costs of acquisition | 4 | |
| **Total purchase consideration** | **337** | |
| Cash balances acquired | (23) | |
| **Outflow of cash on acquisition** | **314** | |
| | Fair value | Carrying value |
| Assets/(liabilities) at acquisition date | | |
| Cash and cash equivalents | 23 | 23 |
| Trade and other receivables | 9 | 9 |
| Property, plant and equipment | 1 | 1 |
| Intangible assets | 38 | - |
| Other assets | 1 | 1 |
| Deferred tax assets | 1 | 1 |
| Trade and other payables | (9) | (9) |
| Current tax liabilities | (2) | (2) |
| Deferred tax liabilities | (9) | - |
| Revenue received in advance | (6) | (6) |
| Net assets | 47 | 18 |
| Adjustment to reflect minority interests acquired | (21) | |
| **Goodwill on acquisition** | 311 | |
| | 337 | |
| Profit from acquisition date until 31 December 2006 | 2 | |

We have recognised goodwill of $311 million on acquisition of SouFun. The following factors contributed to the recognition of goodwill:

- forecast revenues and profitability of SouFun; and
- strategic benefits to the operations of the Telstra Group.

We have identified and measured any significant intangible assets separately from goodwill on acquisition of SouFun.

If the SouFun acquisition had occurred on 1 July 2006, our adjusted consolidated income and consolidated profit after minority interests for the half-year ended 31 December 2006 for the Telstra Group would have been $11,807 million and $1,706 million respectively.

# Notes to the Half-Year Financial Statements (continued)

## 6. Notes to the statement of cash flows (continued)

### CSL New World Mobility Group

During fiscal 2006, we merged our 100% owned Hong Kong mobile operations (Telstra CSL Group) with the Hong Kong mobile operations of New World PCS Holdings Limited and its controlled entities (New World Mobility Group) to form the CSL New World Mobility Group.

Under the merger agreement, Telstra CSL Limited (Telstra CSL) issued new shares to New World Mobility Holdings Limited (NWMHL) in return for 100% of the issued capital of the New World Mobility Group and $44 million in cash. The share issue diluted Telstra's ownership in the merged group to 76.4%.

Following finalisation of the subscription amount, we were required to make a cash payment of $21 million to NWMHL during fiscal 2007, which represented an adjustment to the $44 million cash received in fiscal 2006. In accordance with the terms of the merger, this adjustment was primarily based on the final working capital position of the New World Mobility Group at the completion date.

### Disposals

### Australian Administration Services Group Pty Ltd (AAS)

On 31 August 2006, our controlled entity Kaz Group Pty Limited sold its 100% shareholdings in controlled entities Australian Administration Services Pty Ltd and Atune Financial Solutions Pty Ltd for a total consideration of $235 million.

The sale of AAS included the following controlled entities:

- Australian Administration Services Pty Ltd;
- AAS Superannuation Services Pty Ltd; and
- Atune Financial Solutions Pty Ltd.

It also included AAS's 50% shareholding in a jointly controlled entity Money Solutions Pty Ltd.

| | AAS |
|---|---|
| | **2006** |
| | **$m** |
| Consideration on disposal | |
| Cash consideration for disposal | **235** |
| | |
| Cash and cash equivalents disposed of | **(23)** |
| **Inflow of cash on disposal** | **212** |

### Platefood Limited (Platefood)

On 28 November 2006, our controlled entity Sensis Pty Ltd sold its 61% shareholdings in controlled entity Platefood for a total consideration of $10 million.

# Notes to the Half-Year Financial Statements (continued)

## 7. Contingent liabilities, contingent assets and expenditure commitments

### Contingent liabilities

There have been no significant changes from 30 June 2006 to guarantees, indemnities and support provided by us, or to legal actions we are involved in, apart from:

#### FOXTEL

On 31 July 2006, our 50% owned pay television joint venture FOXTEL entered into a new $600 million syndicated secured term loan facility to fund the refinancing of previous loan facilities (including the $550 million syndicated facility), and to enable it to meet future cash flow and expenditure requirements.

The equity contribution deed (ECD) entered into by us and FOXTEL's other ultimate shareholders, News Corporation Limited and Publishing and Broadcasting Limited has been terminated. As a result of the refinancing, we no longer have a contingent liability under the ECD, which amounted to $100 million as at 30 June 2006.

#### Unconditioned Local Loop Service (ULLS) and Line Sharing Service (LSS)

ULLS is a declared service by which competitors effectively rent the copper pairs or "loops" connecting Telstra exchanges to almost all residential and business premises in Australia. The ULLS is connected to Telstra's competitors' equipment in Telstra's exchanges allowing them to provide voice and broadband services to retail customers. Once connected, no Telstra services can be provided over the ULLS. The ACCC has indicated that Telstra should charge different prices in different areas for ULLS, despite the fact that it is required to charge the same residential and business retail prices for a basic line rental service throughout Australia.

In December 2005, Telstra submitted an ULLS access undertaking with a single (or averaged) price of $30 per month for all areas. In August 2006 the ACCC issued a final decision, rejecting the undertaking on the basis that it was not satisfied that Telstra's estimate of its costs and the averaging of those costs were reasonable. Telstra appealed that rejection to the Australian Competition Tribunal.

A number of Telstra's competitors have notified access disputes in relation to ULLS. In August 2006, the ACCC made binding interim decisions in several of these arbitrations that prices remain deaveraged and that the price in band 2 (the metropolitan area - where the greatest number of ULLS services will be provided) be reduced from $22 to $17.70 per month.

On 14 September 2006, Telstra lodged an appeal to the Australian Competition Tribunal. The Tribunal is required to make its decision by 14 March 2007, or if it extends the decision making period, by 14 June 2007. There is also a risk of the ACCC making final determinations in the access disputes at a lower price.

LSS is a service whereby the copper wire connecting our exchanges to almost all residential and business premises in Australia is shared with a Telstra competitor. Telstra will typically provide voice services to the customer while the competitor will provide broadband services over the same copper wire.

In December 2004, Telstra submitted a LSS access undertaking at $9 per month. This was rejected by the ACCC in December 2005, with the Australian Competition Tribunal upholding the ACCC's rejection in June 2006.

A number of Telstra competitors have notified access disputes in relation to LSS. On 21 December 2006, the ACCC made an interim decision in these disputes that the access charge for LSS be set at $3.20 per month.

When the ACCC make their final determination on these ULLS and LSS access disputes, they may find that it is reasonable for Telstra to reimburse the access seekers for the difference in the access price charged from the date in which the various access seekers lodged their access dispute or from a point prior to that time when negotiations between Telstra and the access seeker commenced.

Telstra made submissions to the ACCC on the appropriate course of action going forward with the ULLS and LSS access disputes having regard to the Constitutional Challenge which Telstra has recently commenced. The ACCC has subsequently advised that it will be proceeding with the access disputes notwithstanding this challenge. Refer to note 8 for further details regarding the Constitutional Challenge.

#### Competition Notice

In December 2005, we increased our prices for line access provided to our competitors to prices closer to our average costs of providing that access. The ACCC appears to allege that these increases left insufficient margin for our competitors in respect of a "lower spend" segment of the retail market. The ACCC somehow considers that our conduct has or is likely to have the effect of substantially lessening competition across the retail market and therefore that we are in breach of the competition rule. On 12 April 2006, the ACCC issued a competition notice against us to this effect.

## Notes to the Half-Year Financial Statements (continued)

# 7. Contingent liabilities, contingent assets and expenditure commitments (continued)

### Contingent liabilities (continued)

#### Competition Notice (continued)

The ACCC has yet to commence enforcement proceedings against us but, should the ACCC elect to commence such proceedings and should they be successful, the maximum potential penalties which had accrued as at 31 December 2006 exceed $760 million (30 June 2006: exceeded $200 million) and continue to accrue at $3 million per day. Optus has issued proceedings against Telstra in the Federal Court which, in part, rely on the competition notice and seek damages, a refund and an injunction preventing us from charging the increased prices and recovering our costs. Telstra will vigorously defend the Optus proceedings and any future enforcement proceedings should they, be commenced by the ACCC.

Telstra has challenged the validity of the ACCC's decision to issue the competition notice (and the preceding consultation notice) in the Federal Court on administrative law grounds. Amongst other things, we allege that the competition notice (and the preceding consultation notice) should be set aside for uncertainty and that the ACCC did not accord us procedural fairness by failing to properly consult with us prior to the issue of the competition notice. The ACCC argues that it does not owe us any duty of procedural fairness or natural justice when issuing competition notices. This challenge was heard by the Federal Court in August 2006. Judgement was reserved.

### Expenditure commitments

There have been no significant changes from 30 June 2006 to our expenditure commitments, apart from:

- FOXTEL no longer has commitments relating to digital set top box units, which reduced our share of the commitments by $141 million;
- we entered into a contract with IBM Australia Ltd for procurement, operational and accounts payable functions for $370 million expiring in August 2013. The commitment remaining at 31 December 2006 was $366 million;
- Sensis entered into a contract for IT services for $165 million with AMDOCS USA Inc. This commitment expires in June 2011. The amount of the commitment outstanding at 31 December 2006 was $138 million; and
- we have entered into a contract for fixed line transformation with Alcatel Australia Ltd for $461 million. This commitment expires in June 2007. The amount of this commitment remaining at 31 December 2006 was $265 million.

# Notes to the Half-Year Financial Statements (continued)

## 8. Events after balance date

The directors are not aware of any matter or circumstance that has occurred since 31 December 2006 that, in their opinion, has significantly affected or may significantly affect in future years:

- our operations;
- the results of those operations; or
- the state of our affairs;

other than:

### Dividends declaration

On 15 February 2007, the directors of Telstra Corporation Limited declared a fully franked interim dividend of 14 cents per ordinary share. The record date for the interim dividend is 2 March 2007 with payment to be made on 30 March 2007. Shares will trade excluding entitlement to the dividends on 26 February 2007.

A provision for dividend payable has been raised as at the date of declaration, amounting to $1,740 million. The interim dividend will be fully franked at a tax rate of 30%. The financial effect of the dividend declaration was not brought to account as at 31 December 2006.

### Constitutional Challenge

On 24 January 2007, Telstra commenced proceedings in the High Court against the Commonwealth, the ACCC and eleven access seekers who had, prior to 24 January 2007, notified access disputes in respect of ULLS and/or LSS. Telstra is seeking declarations from the High Court that Part XIC of the Trade Practices Act is invalid as it applies to ULLS and LSS, together with administrative relief directed at each of the specific access disputes. The matter was heard (for first directions only) on 8 February 2007 and orders were made for the filing of pleadings and particulars. The matter has been relisted on 20 March 2007.

## Directors' Declaration

The directors of Telstra Corporation Limited have made a resolution that declared:

(a) the financial statements and notes, set out on pages 2 to 19, of the Telstra Group:

(i) comply with Accounting Standard AASB 134 Interim Financial Reporting and the Corporations Regulations 2001;

(ii) give a true and fair view of the financial position as at 31 December 2006 and performance, as represented by the results of the operations and cash flows, for the half-year ended 31 December 2006; and

(iii) in the directors' opinion, have been made out in accordance with the Corporations Act 2001.

(b) at the date of this declaration, in the directors' opinion, there are reasonable grounds to believe that Telstra Corporation Limited will be able to pay its debts as and when they become due and payable.

This declaration is made in accordance with a resolution of the Directors.

Donald G McGauchie AO
**Chairman**

Solomon D Trujillo
**Chief Executive Officer**

15 February 2007
Melbourne, Australia

# Independent Review Report

To the members of Telstra Corporation Limited

**Report on the Half-Year Financial Report**

We have reviewed the accompanying half-year financial report of the Telstra Group (Telstra Corporation Limited and the entities it controlled during the period), which comprises the balance sheet as at 31 December 2006, and the income statement, statement of recognised income and expense and cash flow statement for the half-year ended on that date, a summary of accounting policies, other selected explanatory notes and the directors' declaration.

**Directors' Responsibility for the Half-Year Financial Report**

The directors of the Telstra Group are responsible for the preparation and fair presentation of the half-year financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Act 2001. This responsibility includes designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of the half-year financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

**Auditor's Responsibility**

Our responsibility is to express a conclusion on the half-year financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 Review of an Interim Financial Report Performed by the Independent Auditor of the Entity, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the financial report is not in accordance with the Corporations Act 2001 including: giving a true and fair view of the Telstra Group's financial position as at 31 December 2006 and its performance for the half-year ended on that date; and complying with Accounting Standard AASB 134 Interim Financial Reporting and the Corporations Regulations 2001 and other mandatory financial reporting requirements in Australia. As the auditor of the Telstra Group, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of a half-year financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

**Independence**

In conducting our review, we have complied with the independence requirements of the Corporations Act 2001. We have given to the directors of the company a written Auditor's Independence Declaration, a copy of which is included in the Directors' Report.

**Conclusion**

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the interim financial report of the Telstra Group is not in accordance with:

(a) the Corporations Act 2001, including:

(i) giving a true and fair view of the financial position of the Telstra Group at 31 December 2006 and of its performance for the half-year ended on that date; and

(ii) complying with Accounting Standard AASB 134 "Interim Financial Reporting" and the Corporations Regulations 2001; and

(b) other mandatory financial reporting requirements in Australia.

Ernst & Young

Ernst & Young

Mirco Bardella
Partner

15 February 2007
Melbourne, Australia