Directors' report

The directors present their report on the consolidated entity (Telstra Group) consisting of Telstra Corporation Limited and the entities it controlled at the end of or during the half-year ended 31 December 2005. Financial comparisons used in this report are of results for the half-year ended 31 December 2005 compared with the half-year ended 31 December 2004.

This is our first financial report prepared in accordance with Australian equivalents to International Financial Reporting Standards (A-IFRS). When preparing this directors' report, we have amended certain accounting and valuation methods applied in the previous Australian Generally Accepted Accounting Principles (AGAAP) to comply with A-IFRS. With the exception of financial instruments, the comparative figures have been restated to reflect these adjustments.

Results of operations

Telstra's net profit for the half-year was $2,139 million (2004: $2,385 million). This result was after deducting:

- net finance costs of $443 million (2004: $424 million); and
- income tax expense of $907 million (2004: $942 million).

Earnings before interest and income tax expense was $3,489 million, representing a 7.0% or $262 million decrease on the prior corresponding period result of $3,751 million.

Basic earnings per share decreased by 9.4% from 19.1 cents per share in the half-year ended 31 December 2004 to 17.3 cents per share in the current half-year. The lower earnings per share was due to the decrease in net profit.

Review of operations

Our total income (excluding finance income) increased by 1.9% or $218 million to $11,578 million for the half-year (2004: $11,360 million).

The growth in total income was mainly attributable to:

- mobile goods and services revenue - $109 million or 4.6%;
- internet and IP solutions revenue - $264 million or 42.3%;
- advertising and directories revenue - $56 million or 6.3%; and
- pay TV bundling - $35 million or 28.9%.

Mobile goods and services revenue increased largely due to the performance of mobile data revenue and international roaming, as well as the inclusion of revenue from Hutchison for roaming on the Telstra GSM network from April 2005. We continued to experience growth in the number of mobiles in operation of 345,000 in the half-year to 8.6 million, as well as increased revenue from mobile handset sales.

Internet and IP solutions revenue increased mainly due to the growth in the number of retail and wholesale subscribers to our Bigpond broadband product of 593,000 in the half-year to 2.3 million subscribers.

Our advertising and directories revenue increased compared with the prior corresponding period due to growth in Yellow Pages Online advertising, the increase in revenue from our location and navigation products, such as Citysearch and Whereis, and the increase in White Pages revenues.

Pay TV bundling revenue increased due to the migration to FOXTEL digital, and the minimal price installation and upgrade offer during the half-year.

Offsetting the sales growth was a decline in PSTN product revenues of $313 million or 7.6% as the market continues to move towards mobile and broadband products.

Total operating expenses (before depreciation and amortisation, finance costs and income tax expense) increased by 6.8% or $402 million to $6,279 million for the half-year (2004: $5,877 million). This growth was mainly attributable to:

- labour - $171 million or 9.1%, including additional redundancy payments of $75 million;
- goods and services purchased - $73 million or 3.4%; and
- other expenses - $156 million or 8.4%.

Labour costs increased mainly due to:

- an increase in redundancy expense;
- annual salary increases due to enterprise agreements and annual salary reviews; and
- an increase in labour expense of controlled entities as a result of entities acquired during fiscal 2005 being included for the entire current half-year period.

Goods and services purchased increased due to:

- higher network payments as a result of a higher number of terminations on other networks, increased retail activity in TelstraClear and additional operations and maintenance costs associated with our 3G partnership activities;
- purchases of pay TV services to enable us to continue to provide bundled products; and
- higher handset subsidies from a rise in the take up of handsets on subsidised plans.

Other expenses increased largely due to higher service contracts and other agreements as a result of additional network maintenance and use of external constructors for a new 3G network and increased work program particularly to meet broadband growth.

Depreciation and amortisation costs increased by 4.5% to $1,810 million, primarily due to the growth in communications plant and software asset additions required to support the increasing demand for broadband ADSL services. In addition, depreciation and amortisation increased as a result of our recent investments in 3G networks, both domestic and offshore.

Net finance costs increased by 4.5% to $443 million, primarily due to higher borrowings to fund capital expenditure associated with the improvement of our core infrastructure and increased dividend payments. Our borrowings have also been affected by a higher effective interest rate, as a result of refinancing elements of our maturing debt. The net debt gearing level remains within the financial parameters set by the Board.

Income tax expense decreased by $35 million to $907 million as a result of the lower net profit. The effective tax rate of 29.8% was marginally higher than the rate in the prior corresponding period of 28.3%.

Cash flow

Our cash flow before financing activities (free cash flow) position remains robust despite declining to $1,956 million in the half-year from $2,038 million in the prior corresponding period. This position will continue to support our ongoing operating and investing activities combined with our borrowings program within our financial objectives.

Our cash flow from operating activities decreased to $3,948 million for the current half-year compared with $4,393 million in the half-year ended 31 December 2004. The decrease in cash flow from operating activities was due to lower net profit and higher working capital.

Cash used in investing activities was $1,992 million, representing a decrease of $363 million over the prior corresponding period. The decrease was mainly attributable to acquisitions of controlled entities in the prior half-year of $567 million compared with no significant acquisitions in the current half-year. This was partially offset by an increase in our payments for property, plant and equipment as we continue to improve and invest in our core infrastructure. Our payments for property, plant and equipment in the current half-year also included cash payments of $299 million associated with our 50% investment in Hutchison 3G Australia Pty Ltd's 3G radio access network that was deferred from the prior year.

Our cash used in financing activities was $2,721 million for the half-year, which represents an increase of $1,105 million over the prior corresponding period. The increase was mainly due to the net repayment of borrowings and increased dividend payments, partially offset by there being no share buy-back in the current half-year.

Dividends

The directors have declared an interim ordinary dividend of 14 cents per share ($1,739 million) and a special ordinary dividend of 6 cents per share ($746 million). The dividends will be fully franked at a tax rate of 30%. The record date for the interim and special dividend will be 24 February 2006 with payment to be made on 24 March 2006. Shares will trade excluding entitlement to the dividends on 20 February 2006.

Our final ordinary dividend for the financial year ended 30 June 2005 of 14 cents per share ($1,739 million) and special ordinary dividend of 6 cents per share ($746 million) was provided for and paid during the current half-year. These dividends were fully franked at a tax rate of 30%. The final dividend and special dividend paid had a record date of 30 September 2005 and payment was made on 31 October 2005.

At present it is expected that Telstra will be able to fully frank declared ordinary dividends out of fiscal 2006 earnings. However, the directors can give no assurance as to the future level of dividends, if any, or of franking of dividends. This is because it depends upon, among other factors, our earnings, Government legislation and our tax position.

Directors

Directors who held office during the half-year and until the date of this report were:

Donald G McGauchie	- chairman, non-executive director
John T Ralph	- deputy chairman, non-executive director (retired 11 August 2005)
Solomon D Trujillo	- chief executive officer, executive director (appointed 1 July 2005)
Zygmunt E Switkowski	- chief executive officer, managing director (resigned 1 July 2005)
Anthony J Clark	- non-executive director (retired 11 August 2005)
John E Fletcher	- non-executive director
Belinda J Hutchinson	- non-executive director
Catherine B Livingstone	- non-executive director
Charles Macek	- non-executive director
John W Stocker	- non-executive director

Auditors independence declaration

The independence declaration of our auditors is on page 5 and forms part of this report.

Rounding of amounts

The Telstra Entity is a company of the kind referred to in the Australian Securities and Investments Commission class order 98/100, dated 10 July 1998 and issued pursuant to section 341(1) of the Corporations Act 2001. As a result, amounts in this report and the accompanying financial report have been rounded to the nearest million dollars, except where otherwise indicated.

This report is made in accordance with a resolution of the directors.

Donald G McGauchie AO
Chairman

Solomon D Trujillo
Chief Executive Officer

9 February 2006
Sydney, Australia

Auditor's Independence Declaration to the Directors of Telstra Corporation Limited

In relation to our review of the financial report of the Telstra Group (the Telstra Entity and the entities it controlled during the period) for the half-year ended 31 December 2005, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the Corporations Act 2001 or any applicable code of professional conduct.

Ian McPhee

Auditor-General

9 February 2006
Canberra, Australia