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 2003. Financial comparisons used in this report are of results for the half-year ended 31 December 2003 compared with the half-year ended 31 December 2002.

Results of operations

Telstra’s net profit for the half-year was $2,293 million (2002: $1,184 million). This was after:

- deducting income tax expense of $874 million (2002: $968 million); and
- adjusting for net losses attributable to outside equity interests in controlled entities of $nil (2002: $34 million).

Earnings before interest and income tax expense was $3,522 million, representing a $972 million (38.1%) increase on the prior corresponding period result of $2,550 million.

Review of operations

Our net profit increased by $1,109 million to $2,293 million. This increase arose largely because of the $965 million previous comparable period write down of the investment in our 50% owned joint venture Reach Limited.

Sales revenue decreased by $12 million to $10,456 million in the half-year ended 31 December 2003, attributable to:

- the continuing impact of our rebalancing initiatives, resulting in an increase in basic access ($54 million) partly offset by a decrease in local call ($18 million) and international direct revenues ($22 million). Fixed to mobile revenues also increased ($55 million) due to continued strong growth in the number of mobile services; and
- growth in mobile services and handsets ($115 million), internet and IP solutions ($72 million) and Sensis® (advertising and directories) revenues ($38 million). Offsetting this growth is a decline in ISDN (access and calls) ($25 million) and revenues from various controlled entities ($136 million), in particular the Hong Kong CSL Group and Telstra Multimedia Pty Ltd. Other sales and services also declined ($80 million) primarily due to reduced external construction revenues.

Other revenue decreased by $529 million to $370 million, primarily due to the decline in revenue from the sale of assets and investments. Included in the prior corresponding half-year was revenue from the sale of seven office properties for $570 million. In the current half-year we recognised revenue from the sale of our 22.6% shareholding in our associated entity IBM Global Services Australia Limited (IBMGSA) of $154 million.

Operating expenses (excluding borrowing costs, share of net loss from associates and joint venture entities and income tax expense) decreased by $573 million to $7,275 million. The decrease in the half-year ended 31 December 2003 was due to:

- lower goods and services purchased of $321 million, attributable to reduced network payments, a reduction in handset subsidies and our cost reduction programs;
- lower other expenses mainly due to the decline in the carrying value associated with assets and investments sold. Included in other operating expenses in the prior corresponding half-year was the carrying value of the seven office properties sold of $439 million. This decline was partially offset in the current half-year by a modification to an information technology services contract with IBMGSA that resulted in a $130 million expense being recognised upon sale of our shareholding in this entity; and
• the increase in depreciation and amortisation of $99 million due to continued growth in our communications plant asset base and capitalised software development.

Net borrowing costs decreased by $77 million to $355 million, primarily due to lower borrowing costs as a result of the maturity of some of our interest-bearing liabilities offset by lower interest derived from the PCCW converting note. We also incurred additional borrowing costs in the prior corresponding period due to the close out of interest rate swaps.

Income tax expense decreased by $94 million to $874 million, giving an effective tax rate of 27.6%. The income tax expense benefited from a final adjustment as part of our election to enter tax consolidation. The benefit to income tax expense in the half-year ended 31 December 2003 amounted to $58 million, which was attributable to a further reset of tax values.

Our free cash flow decreased by $289 million to $1,827 million, primarily due to lower proceeds from asset and investment sales, offset by a decrease in capital expenditure. Operating capital expenditure declined by 10.1% to $1,376 million due to continued tight control of our capital expenditure program. Proceeds from assets and investment sales also declined due to the prior corresponding half-year including proceeds of $570 million from the sale of seven office properties. This decrease was partially offset in the current half-year by the sale of our investment in IBMGSA for $154 million.

Our cash flow used in financing activities increased by $744 million, predominantly due to the share buy-back undertaken. On 24 November 2003, we completed an off-market share buy-back of 238,241,174 ordinary shares as part of our ongoing capital management program. The cost of the share buy-back comprised purchase consideration of $1,001 million and associated transaction costs of $8 million.

Dividends

The directors have declared a fully franked interim ordinary dividend of 13 cents per share ($1,642 million). The dividend will be franked at a tax rate of 30%. The interim ordinary dividend will have a record date of 26 March 2004 with the payment to be made on 30 April 2004.

Our fully franked final ordinary dividend for the financial year ended 30 June 2003 of 12 cents per share ($1,544 million) was provided for and paid during the half-year. The dividend was franked at a tax rate of 30%. The final ordinary dividend had a record date of 26 September 2003 and the payment was made on 31 October 2003.

At present, it is expected that Telstra will be able to fully frank declared ordinary dividends out of fiscal 2004 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:

Robert C Mansfield - chairman and director
John T Ralph - deputy chairman and director
Zygmunt E Switkowski - chief executive officer and managing director
Samuel H Chisholm
Anthony J Clark
John E Fletcher
Belinda J Hutchinson
Catherine B Livingstone
Charles Macek
Donald G McGauchie
William A Owens
John W Stocker

There were no changes to the directors holding office at the annual general meeting held on 14 November 2003.

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.

Robert C Mansfield
Chairman

Ziggy Switkowski
Chief Executive Officer and Managing Director
12 February 2004