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 2004. Financial comparisons used in this report are of results for the half-year ended 31 December 2004 compared with the half-year ended 31 December 2003.

Results of operations

Telstra's net profit for the half-year was $2,337 million (2003: $2,293 million). This was after deducting income tax expense of $979 million (2003: $874 million).

Earnings before interest and income tax expense was $3,687 million, representing a 4.7% or $165 million increase from the prior corresponding period result of $3,522 million.

After adjusting to allow like for like comparisons with the half-year ended 31 December 2003, net profit for the half-year was $2,322 million (2003: $2,134 million) and earnings before interest and income tax expense was $3,663 million (2003: $3,458 million).

Review of operations

Telstra's operating results for the half-year ended 31 December 2004 reflected a strong performance. Total revenue (excluding interest revenue) increased by 5.1% or $556 million to $11,382 million. This included revenues of $322 million generated by our recently acquired controlled entities, including the Trading Post Group, the KAZ Group, the Damovo Group and our United Kingdom (UK) subsidiaries, the PSINet Group. Total revenue in the prior corresponding half-year included revenue resulting from the sale of our 22.6% shareholding in an associated entity IBM Global Services Australia Limited (IBMGSA) of $154 million.

Operating expenses (excluding borrowing costs, share of net loss from joint venture entities and associated entities, and income tax expense) increased by 5.8% or $420 million to $7,695 million. Operating expenses for the half-year ended 31 December 2004 included expenses incurred by our recently acquired entities of $307 million. The prior corresponding period included IBMGSA contract exit costs of $130 million recognised on sale of our investment in this entity.

Excluding the impact of our newly controlled entities and other one-off items, our total revenues increased by 4.0% to $11,034 million and operating expenses (excluding borrowing costs, share of net loss from joint venture entities and associated entities, and income tax expense) increased by 3.6% to $7,372 million.

Total revenue (excluding interest revenue) growth was attributable to:
- mobile services and handsets – $168 million or 8.7%;
- internet and IP solutions - $155 million or 33.0%;
- offshore revenues - $41 million or 85.4%;
- pay TV bundling - $56 million or 86.2%; and
- advertising and directories revenues - $45 million or 5.9%.

Partially offsetting the strong sales growth was a decline in PSTN revenues of $75 million or 1.9% as the market continues to move towards newer technologies to satisfy its telecommunications requirements.
The increase in operating expenses was attributable to:

- increased goods and services purchased of $296 million, attributable to increased network payments, handset subsidies and pay TV service fees;
- higher labour expenses of $21 million due mainly to an increase in staff numbers and salaries, partially offset by a decrease in redundancy expenses; and
- an increase in depreciation and amortisation expense for the half-year ended 31 December 2004 by 1.2% or $22 million. The increase was due to higher depreciation and amortisation resulting from growth in our communications plant and software assets.
- there were also further cost reductions across a variety of other expense categories.

Income tax expense was $979 million, giving an effective tax rate of 29.5%.

**Cash flow**

Our cash flow from operating activities increased by $1,068 million to $3,993 million due to strong operating results and timing of certain payments. The increase in cash from operating activities together with funds from additional borrowings during the half-year ended 31 December 2004, was primarily used to purchase our newly acquired controlled entities, and fund dividend payments of $1,642 million and our share buy-back amounting to $756 million (including $6 million in associated transaction costs). Overall, our total cash increased by $420 million, which was the result of the strong operating cash flows and careful management of our borrowing position and investing expenditures.

**Earnings per share**

Earnings per share increased by 3.9% from 17.9 cents per share in the half-year ended 31 December 2003 to 18.6 cents per share in the current half-year. The improved result is due to a reduced number of ordinary shares in circulation following the share buy-back and an improvement in net profit.

**Dividends**

The directors have declared a fully franked interim ordinary dividend of 14 cents per share ($1,742 million) and a fully franked special dividend of 6 cents per share ($747 million). The dividends will be franked at a tax rate of 30%. The interim ordinary dividend and special dividend will have a record date of 1 April 2005, with payment to be made on 29 April 2005. Shares will trade excluding entitlement to the dividend on 24 March 2005.

Our fully franked final ordinary dividend for the financial year ended 30 June 2004 of 13 cents per share ($1,642 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 24 September 2004 and payment was made on 29 October 2004.

At present, it is expected that Telstra will be able to fully frank declared ordinary dividends out of fiscal 2005 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 (appointed 20 July 2004), non-executive director
John T Ralph - deputy chairman, non-executive director
Zygmunt E Switkowski - chief executive officer, managing director
Samuel H Chisholm - non-executive director (resigned 28 October 2004)
Anthony J Clark - non-executive director
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

During the period from 14 April 2004 until 20 July 2004, John T Ralph held the position of interim Chairman.

Zygmunt E Switkowski will step down as chief executive officer (CEO) on 1 July 2005, or earlier if a new CEO is appointed prior to that date. In accordance with his employment contract, Dr Switkowski will receive an agreed payment equal of $2,092,000 plus accrued leave and incentive payments as at the date he steps down. If he steps down prior to 1 July 2005, Dr Switkowski will receive fixed remuneration in lieu of notice.

Auditors independence declaration

The independence declaration of our auditors is on page 4 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
Chairman

Ziggy Switkowski
Chief Executive Officer and Managing Director
10 February 2005
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 2004 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.

P.J. Barrett
Auditor-General

10 February 2005
Canberra, Australia