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 year ended 30 June 2003.

Principal activity

Telstra's principal activity during the financial year was to provide telecommunications services for domestic and international customers. There has been no significant change in the nature of this activity during the year.

Results of operations

Telstra's net profit for the year was A$3,429 million (2002: A$3,661 million). This was after:

- deducting income tax expense of A$1,534 million (2002: A$1,796 million); and
- allowing for net losses attributable to outside equity interests in controlled entities of A$35 million (2002: A$11 million).

Earnings before interest and income tax expense was A$5,723 million, representing a 7.9% decrease from the prior year's result of A$6,216 million.

Earnings per share decreased by 6.3% from 28.5 cents per share in fiscal 2002 to 26.6 cents per share in the current year. Year on year results have been impacted by a number of factors as described below.

Review of operations

Profit before income tax expense for fiscal 2003 declined by 9.5% from the prior year to A$4,928 million primarily due to the write off of the investment in our 50% owned joint venture Reach Ltd (REACH), amounting to A$965 million. The investment was written down due to depressed conditions in the global market for international data and internet capacity, resulting in high levels of excess capacity, intense price competition and lower than expected revenues.

During the year, we continued to develop our full service telecommunications model and focus on cost control. We have seen growth in many areas of the business including mobiles, internet and IP products, advertising and directories and intercarrier services.

Sales revenue increased by A$299 million to A$20,495 million in fiscal 2003. The increase was mainly due to the inclusion of TelstraClear Limited (TelstraClear) revenue for the full twelve months, contributing A$548 million to revenue. TelstraClear was acquired in December 2001 and therefore only seven months of sales revenue was included in fiscal 2002, amounting to A$294 million.

Total revenue (excluding interest revenue) increased by A$814 million to A$21,616 million in fiscal 2003, which included revenue from the sale of assets and investments of A$859 million compared with A$302 million in the prior year. The sale of assets in fiscal 2003 included revenue from the sale of seven office properties of A$570 million.

Operating expenses (before borrowing costs and share of net losses of associates and joint venture entities) increased by A$363 million to A$14,868 million. The increase was due mainly to:

- the inclusion of TelstraClear expenses of A$609 million for a full year, compared with A$364 million in the prior year; and
- the carrying value of assets and investments sold during the year of A$661 million, compared with A$307 million in the prior year.

Net borrowing costs increased by 3.2% to A$795 million in fiscal 2003 primarily due to reduced interest received from the PCCW converting note. The original note in fiscal 2002 amounted to US$750 million compared to a US$53 million converting note we now hold as at 30 June 2003.

Directors' report

Income tax expense decreased by 14.6% to A$1,534 million in fiscal 2003, giving an effective tax rate of 31.1%. The income tax expense benefited from the introduction of tax consolidation legislation from 1 July 2002. The benefit to income tax expense was A$201 million and resulted from the net increase in the tax value of tax depreciable assets.

Our free cash flow increased by 18.9% to A$4,565 million as a result of higher proceeds from asset and investment sales and a decrease in capital expenditure. Operating capital expenditure declined by 6.6% to A$3,261 million due to tight control of our capital expenditure program. Proceeds from the sale of property, plant and equipment increased by A$603 million to A$797 million mainly as a result of the sale of seven office properties. Investment expenditure amounted to only A$71 million in fiscal 2003, which included the acquisition of the remaining 41.6% of share capital in TelstraClear for A$25 million to give us a 100% ownership interest.

Events occurring after the end of the financial year

The directors are not aware of any matter or circumstance that has arisen since the end of the financial year that, in their opinion, has significantly affected or may significantly affect in future years Telstra's operations, the results of those operations or the state of Telstra's affairs other than:

- On 28 August 2003, plans were announced to spend between A$800 million and A$1,000 million to buy-back a portion of the Telstra Entity's share capital, subject to regulatory approval. The share buy-back will be an off market buy-back and is the first step of a capital management program. The financial effect of the buy-back cannot be reliably estimated as yet;
- On 27 August 2003, we entered into an agreement to sell our 22.6% shareholding in our associated entity IBM Global Services Australia Limited (IBM GSA), subject to regulatory approvals. Revenue from the sale of this investment amounted to A$154 million resulting in a profit before income tax expense of A$149 million. We also modified a 10 year contract with IBM GSA to provide information technology services. This modification will result in an expense of A$130 million being recorded in our fiscal 2004 statement of financial performance and the removal of A$1,596 million of expenditure commitments disclosed as at 30 June 2003. In fiscal 2004, the net impact on our profit before income tax expense of this transaction will be A$19 million; and
- On 18 July 2003, we sold our 16.4% remaining interest in Commander Communications Limited for A$24 million.

The financial effect of the above events after balance date have not been recognised in our statements of financial performance, financial position or cash flows for the year ending 30 June 2003.

Dividends

The directors have declared a final ordinary dividend for the year ended 30 June 2003 of 12 cents per share (A$1,544 million) fully franked. The tax rate at which the dividend is franked is 30%. The record date for the final dividend will be 26 September 2003 with payment being made on 31 October 2003.

Directors' report

During fiscal 2003, the following dividends were paid:

Dividend	Date declared	Date paid	Dividend per share	Total dividend
Final ordinary dividend for the year ended 30 June 2002	28 August 2002	28 October 2002	11 cents franked to 100%	A$1,415 million
Interim ordinary dividend for the year ended 30 June 2003	27 February 2003	30 April 2003	12 cents franked to 100%	A$1,544 million
Interim special dividend for the year ended 30 June 2003	27 February 2003	30 April 2003	3 cents franked to 100%	A$386 million

Under current legislation, 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 our ability to pay dividends depends upon, among other factors, our earnings, Government legislation and our tax position.

Significant changes in the state of affairs

There have been no significant changes in the state of affairs of Telstra during the financial year other than:

- During the first half of fiscal 2003, we wrote off the carrying value of our 50% investment in REACH, amounting to A$965 million. This write off reduced the value of our investments accounted for using the equity method;
- On 9 April 2003, we acquired an additional 41.6% interest in TelstraClear, giving us 100% ownership of TelstraClear and its controlled entities; and
- During the year, interest-bearing liabilities decreased by A$1,822 million due to the net repayment of borrowings from available cash flow.

Likely developments

The directors believe, on reasonable grounds, that Telstra would be likely to be unreasonably prejudiced if the directors were to provide more information than there is in this report or the financial report about:

- the likely developments in Telstra's operations; or
- the expected results of those operations in the future.

Details about directors and executives

There have been no changes to the directors of Telstra Corporation Limited during the financial year and up to the date of this report.

Information about directors is provided as follows and forms part of this directors' report:

- names of directors and details of their qualifications, experience and special responsibilities are given on pages 113 to 115;
- number of board and committee meetings and attendance by directors at these meetings is provided on page 172;
- details of directors' shareholdings in Telstra are shown on page 127; and
- details of directors' emoluments are given on pages 118 to 120.

Directors' report

Senior executive emoluments

This information is provided on pages 120 to 125 and forms part of this report.

Share options

Telstra's equity based compensation includes performance rights, restricted shares, options and deferred shares. Performance rights, restricted shares, and options have performance hurdles. If the hurdles are not met there is no vesting entitlement to acquire Telstra shares. From 1 July 2002, Telstra suspended its option plan and replaced it with a deferred share plan. Generally, deferred shares will only vest when a specified service period is completed.

Telstra expenses the fair value of all performance rights, restricted shares, share options and deferred shares in the results reported under United States generally accepted accounting principles (USGAAP). Consistent with Australian generally accepted accounting principles (AGAAP), the company only expenses options and employee shares when it is certain that there is an actual cost that will be realised by Telstra. When an International Accounting Standard is issued and adopted as AGAAP, Telstra will apply this standard to the accounting for its option and employee share plans.

Since inception, A$285 million has been expensed in the company's USGAAP financial statements in relation to the shares allocated under TESOP97 and TESOP99. Performance rights, restricted shares, options and deferred shares have given rise to a further expense of A$78 million in the USGAAP financial statements since inception. In the AGAAP financial statements, an amount of A$31 million has been expensed in relation to the performance rights and restricted shares. In fiscal 2003, the company has issued performance rights and deferred shares, with A$19 million expensed under USGAAP and A$19 million under AGAAP. Refer to note 19 of the financial statements for an explanation of the option and employee share plans and the accounting treatment applied to each plan.

The Telstra Corporation Act 1991 (Cth) prohibits the Commonwealth's shareholding falling below 50.1%. In order to fulfil its obligations under this Act and under any option or share plan, the trustee of the plan must purchase shares on market for cash to the extent of the assessed liability, for which Telstra provides funding to the trustee. Telstra expenses immediately the funding of the purchase of shares to underpin the allocation of performance rights, restricted shares and deferred shares. The purchase of shares to underpin options is accounted for as a receivable in Telstra's balance sheet as funding is provided to the trustee by Telstra.

Directors' and officers' indemnity

Constitution

Our constitution provides for us to indemnify each officer to the maximum extent permitted by law for any liability incurred as an officer provided that:

- the liability is not owed to us or a related body corporate;
- the liability is not for a pecuniary penalty or compensation order made by a Court under the Corporations Act 2001; and
- the liability does not arise out of conduct involving a lack of good faith.

Our constitution also provides for us to indemnify each officer, to the maximum extent permitted by law, for legal costs and expenses incurred in successfully defending civil or criminal proceedings.

Directors' report

If one of our officers or employees is asked by us to be a director or alternate director of a company which is not related to us, our constitution provides for us to indemnify the officer or employee out of our property for any liability he or she incurs. This indemnity only applies if the liability was incurred in the officer's or employee's capacity as a director of that other company. It is also subject to any corporate policy made by our Chief Executive Officer. Our constitution also allows us to indemnify employees and outside officers in some circumstances. The terms "officer", "employee" and "outside officer" are defined in our constitution.

Deeds of indemnity in favour of directors, officers and employees

Telstra has also executed deeds of indemnity in favour of:

- directors (including past directors);
- executive officers (other than directors) and certain employees generally; and
- employees (including executive officers other than directors) involved in the formulation, entering into or carrying out, of a Telstra Sale Scheme (as defined in the Telstra Corporation Act 1991(Cth)).

Each of these deeds provides an indemnity on substantially the same terms as the indemnity provided in the constitution in favour of officers. The indemnity in favour of directors also gives directors a right of access to board papers and requires Telstra to maintain insurance cover for the directors.

The indemnity in favour of employees relating to Telstra Sale Schemes is confined to liabilities incurred as an employee in connection with the formulation, entering into or carrying out, of a Telstra Sale Scheme.

Directors' and officers' insurance

Telstra maintains a directors' and officers' insurance policy that, subject to some exceptions, provides worldwide insurance cover to past, present or future directors, secretaries or executive officers of the Telstra Entity and its subsidiaries. The directors' and officers' insurance policy prohibits disclosure of the premium payable under the policy and the nature of the liabilities insured.

Environmental regulation and performance

Performance in relation to particular and significant environmental legislation

Telstra's operations are subject to some significant environmental regulation under Commonwealth, State and Territory law, particularly with regard to:

- the impact of the rollout of telecommunications infrastructure;
- site contamination; and
- waste management.

Telstra has established procedures to monitor and manage compliance with existing environmental regulations and new regulations as they come into force.

The directors are not aware of any significant breaches of environmental regulation during the financial year.

Legal and Regulatory Compliance

Telstra is committed to conducting its business in compliance with all of its legal and regulatory obligations. Compliance with these obligations is not just a legal requirement but is integral to Telstra's commitment to its customers, employees, shareholders and the community.

Directors' report

Whilst we have always had in place systems to ensure compliance with our legal and regulatory obligations, we now have a more formal compliance program in place. Under this compliance program each business unit has a plan setting out how they intend to achieve legal and regulatory compliance in their operations through initiatives such as training, dissemination of information and monitoring of compliance outcomes. A Legal and Regulatory Compliance and Risk Report is also prepared for the Audit Committee every quarter.

This report provides the Audit Committee with an oversight of the initiatives being taken to achieve legal and regulatory compliance and with information on the significant legal cases in which Telstra is currently involved.

Tax Consolidation

Effective 1 July 2002, for the purposes of income taxation, Telstra Corporation Limited and its Australian resident wholly owned subsidiaries have formed a tax consolidation group. The entities within the tax consolidated group have entered into a tax sharing agreement. The terms of this agreement specify the methods of allocating any tax liability in the event of default by the Telstra Entity on its group payment obligations and the treatment where a subsidiary member exits the group. The tax liability of the group otherwise remains with the Telstra Entity.

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
28 August 2003

Directors' report

Directors' meetings

Each director attended the following meetings and board committees during the year as a member of the board or relevant committee:

	Board		Committees			
			Audit		Appointments and Compensation	
	a	b	a	b	a	b
R C Mansfield	9	9	-	-	3	3
J T Ralph	9	9	4	4	3	3
Z E Switkowski [(1)]	9	9	-	-	2	2
S H Chisholm	9	7	-	-	-	-
A J Clark	9	9	4	4	-	-
J E Fletcher	9	9	-	-	-	-
B J Hutchinson [(2)]	9	9	2	2	-	-
C B Livingstone [(3)]	9	9	-	-	-	-
C Macek	9	9	4	4	-	-
D G McGauchie	9	9	-	-	3	3
W A Owens	9	8	-	-	-	-
J W Stocker	9	9	4	4	-	-

Column a: number of meetings held while a member.
Column b: number of meetings attended.
(1) *Retired as a member of the Appointments and Compensation Committee on 26 August 2002.*
(2) *Retired as a member of the Audit Committee on 17 February 2003.*
(3) *Appointed as a member of the Audit Committee on 2 June 2003.*