

Telstra Corporation Limited

Interim results and operations' review

Half-year ended 31 December 1999

Growth continues as Telstra transitions

Financial highlights

Profit after tax and minorities

- up 15.6% to \$2.1 billion after the benefit of some one-off items.

EBIT

- up 9.3% which is as foreshadowed in December 1999.

Earnings per share up from 14.1 to 16.3 cents per share.

Dividend

- interim dividend up by 1 cent to 8 cents per share (and instalment receipt) franked to 49.17%;

Revenue

- **sales revenue** increased 5.3% to \$9.3 billion; and
- **total revenue** showed an increase of 4.6% and, for the first time, revenue from "non-traditional" sources represented 50.0% of total revenue.

Expenses

- **operating expenses (before depreciation, amortisation and interest)** increased by 0.7% to \$5 billion. No employer superannuation contributions were made in this half-year while the prior corresponding period included a cost of \$100 million for superannuation. Due to a change in accounting policy, a net amount of \$134 million of mobile handset subsidies has been deferred over the life of the contracts where these are for two years or more.
- **total expenses (before interest)** increased by 2.2% to \$6.3 billion.

Capital expenditure and investments

- **operational capital expenditure** increased by \$0.4 billion (or 22.5%) to \$2.2 billion mainly due to work on the customer access network which will assist with improvements in customer service and the future broadband delivery through the rollout of ADSL. The new digital CDMA network also contributed to the increase.
- **investments** of \$0.4 billion were made mainly in Computershare Limited, Solution 6 Holdings Limited and Sausage Software Limited.

Cash flow

- **free cash flow** decreased by 59.5% to \$0.6 billion with \$0.4 billion of the decrease attributable to new investments.

Profit & Loss Summary

for the half-year ended 31 December 1999

	Half-year ended 31 December		Growth
	1999	1998	
	A\$m	A\$m	
Sales revenue ⁽¹⁾	9,285	8,819	5.3%
Other revenue ⁽¹⁾	382	420	
Total revenue	9,667	9,239	4.6%
Less: interest income	(34)	(24)	
Revenue excluding interest	9,633	9,215	4.5%
Operating expenses (before depreciation/amortisation & interest)	(5,006)	(4,973)	0.7%
EBITDA	4,627	4,242	9.1%
Depreciation & amortisation	(1,320)	(1,215)	8.6%
EBIT	3,307	3,027	9.3%
Net interest expense	(231)	(280)	(17.5)%
Profit before tax	3,076	2,747	12.0%
Income tax expense	(988)	(933)	5.9%
Profit after tax	2,088	1,814	15.1%
Minority interests	5	(4)	
Profit after tax and minority interests	2,093	1,810	15.6%
Dividend provided for or paid	1,029	901	14.2%
Earnings per share (cents)	16.3	14.1	
Dividend per share (cents)	8.0	7.0	

Ratio analysis	Half-year ended 31 December	
	1999	1998
EBITDA margin (on sales revenue)	49.8%	48.1%
EBIT margin (on sales revenue)	35.6%	34.3%
Interest cover ⁽²⁾	11.4x	9.4x
Return on equity	37.0%	31.5%

Notes:

- (1) Where necessary, comparative figures have been adjusted to conform to changes in presentation in the current half-year.
- (2) Interest cover calculation includes \$59 million of interest that was capitalised in the half-year ended 31 December 1999 compared with \$42 million in the prior corresponding period.

Cash Flow Summary

for the half-year ended 31 December 1999

	Half-year ended 31 December		Growth
	1999	1998	
	A\$m	A\$m	
Receipts from customers	9,179	8,553	7.3%
Payments to suppliers	(5,531)	(4,917)	12.5%
Income tax paid	(499)	(459)	8.7%
Net interest and finance charges	(207)	(268)	(22.8)%
Other	5	12	
Operating cash flow	2,947	2,921	0.9%
Capital expenditure and investments ⁽¹⁾	(2,576)	(1,782)	44.6%
Receipts from asset sales/other proceeds	190	245	
Cash flow used in investing activities	(2,386)	(1,537)	55.2%
Free cash flow ⁽²⁾	561	1,384	(59.5)%
Free cash flow excluding new investments	999	1,414	(29.3)%
Movements in borrowings/finance leases	2,143	(765)	
Dividends paid	(3,346)	(901)	
Net financing activities	(1,203)	(1,666)	(27.8)%
Net cash flow	(642)	(282)	

Notes:

1. Total capex for the half-year ended 31 December 1999 including interest capitalised of \$59 million was \$2,635 million (Prior corresponding period: \$1,824 million).
2. **Free cash flow** = operating cash flow - cash flow used in investing activities (capital expenditure and investments).

Balance Sheet Summary

	As at 31 December	
	1999	1998
	A\$m	A\$m
Current assets	4,457	4,173
Intangibles	481	479
Property, plant and equipment	21,528	19,998
Total non-current assets	24,160	22,165
Net debt	8,592	6,004
Gross debt	9,726	7,121
Net assets/shareholders' funds	11,332	11,994

Statistical Data Summary

for the half-year ended 31 December 1999

	Half-year ended 31 December		% change
	1999	1998	
Billable traffic data (millions)			
Local calls (number of calls)	5,645	5,555	1.6%
National long distance minutes			
Fixed-to-fixed	4,819	4,669	3.2%
Fixed-to-mobile	1,533	1,406	9.0%
Total	6,352	6,075	4.6%
International outgoing minutes	451	339	33.0%
International incoming minutes	502	398	26.1%
Mobile telephone minutes	2,123	1,572	35.1%
Network and operations data			
Basic access lines in service (millions)			
Residential	6.7	6.9	(2.9)%
Business (includes all wholesale)	3.2	2.8	14.3%
Total	9.9	9.7	2.1%
Faxstream® services access lines (thousands)	417	396	5.3%
ISDN access lines (basic access lines equivalent) (thousands)	861	605	42.3%
Mobile telephone customers (thousands)			
Analogue	291	1,047	(72.2)%
GSM Digital	3,322	2,183	52.2%
CDMA Digital	154	-	
Total	3,767	3,230	16.6%
Payphones (Telstra owned & operated)	36,432	36,565	(0.4)%
Broadband network - homes passed (millions)	2.5	2.5	
Foxtel cable subscribers	443,000	375,000	18.1%
Foxtel DTH satellite subscribers	132,000	40,000	230.0%
Value added services (% penetration)			
Easycall® call waiting	57%	47%	
Mobile Messagebank®	70%	54%	
Employee data			
Full-time employees	51,667	54,710	(5.6)%

Summary of Operating Result

for the half-year ended 31 December 1999

Profit after tax and minorities

- increase of 15.6% to \$2.1 billion after the benefit of some one-off items.
- represents the highest interim result achieved by Telstra and is equivalent to 16.3 cents earnings per share for Telstra's 2.1 million shareholders and instalment receipt holders compared with earnings per share of 14.1 cents in the prior corresponding period.

Sales revenue

- increased by \$466 million or 5.3% to \$9,285 million during a period of continued strong competition;
- **non-traditional product revenue** continued to grow and represented 50.0% of total revenue for the current period compared with 46.2% in the prior corresponding period and 48.0% in the year ended 30 June 1999. Non-traditional revenue is represented by the following streams:
 - mobiles; fixed-to-mobile; intercarrier; data, text and Internet; inbound calling; and
 - other sales and service.Fixed-to-mobile revenue (included under national long distance) was relatively stable during the period even though preselection for these calls was introduced.
- **revenue from traditional products** continued to come under pressure. International call revenue continued the decline noted in last year's annual results with a decrease of 19.2% or \$115 million in the half-year. Domestic long distance (fixed-to-fixed) revenue declined even though there were higher minutes of use, as this did not offset the impact of lower prices. Local calls, excluding enhanced services (such as call return and calling number display), remained flat, reflecting the stronger competition in this market.

Operating expenses

- **operating expenses (before depreciation, amortisation and interest)** increased by \$33 million or 0.7%.
- **direct cost of sales** increased by 13.4% or \$193 million due primarily to increases in domestic network payments to other carriers and increased costs associated with mobile handset sales and dealer commissions. Due to a change in accounting policy, the current period does not include \$134 million in mobile handset subsidies that have been deferred.
- **labour costs** declined by \$157 million with \$100 million of this due to employer contributions being included in the December 1998 results prior to agreement with the superannuation fund that employer contributions could be suspended. No contributions were made in the six months to 31 December 1999.

Cash flow

- Operating cash flow showed an increase of 0.9% to \$2,947 million.
- Capital expenditure during the period was \$2,197 million for operational capital (increase of \$403 million or 22.5%) and another \$438 million for investments which represented an increase of \$408 million over the prior corresponding period. The increases were mainly due to:
 - Higher operational capital expenditure requirements for the customer access network and the roll-out of CDMA as well as increased demand for software development; and
 - Strategic investments in Computershare Limited, Solution 6 Holdings Limited and Sausage Software Limited.
- Free cash flow, represented by operating cash flow less cash flow used in investing, decreased by 59.5% to \$561 million as a result of relatively flat operating cash flow and higher capital expenditure and investments during the period.

Income tax expense

- income tax expense of \$988 million is \$98 million less than would otherwise be the case as a result of the decrease in the company income tax rate from 36% in the current fiscal year to 34% for fiscal 2001 and 30% in future years.

Dividend

- interim dividend of 8 cents per share (and instalment receipt) has been declared with ex-dividend trading commencing on 20 March 2000, a record date of 24 March 2000 and payment date of 28 April 2000. The dividend will be 49.17% franked.

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Operating revenues

	Half-year ended 31 December				% change
	1999		1998		
	A\$m	% of total revenue	A\$m	% of total revenue	
Basic access	948	10	926	10	2.4
Local calls	1,407	15	1,376	15	2.3
National long distance calls	1,355	14	1,389	15	(2.5)
International telephone services	483	5	598	7	(19.2)
Mobiles goods and services	1,452	15	1,239	14	17.2
Data, text and Internet services	1,378	14	1,207	13	14.2
Directory services	609	6	594	6	2.5
Customer premises equipment	181	2	196	2	(7.7)
Intercarrier services	382	4	315	3	21.3
Inbound calling products	212	2	202	2	5.0
Payphones	96	1	108	1	(11.1)
Other sales and services	782	8	669	7	16.9
Sales revenue	9,285	96	8,819	95	5.3
Other revenue	382	4	420	5	(9.0)
Operating revenue	9,667	100	9,239	100	4.6
Growth over prior corresponding period	4.6%		6.2%		

The overall growth rate of sales revenue for the current half-year of 5.3% was stronger than the prior corresponding period of 4.8% mainly due to the continuing growth in mobile revenues and data, text and Internet revenues.

Growth for total revenue for the current half-year slowed compared with the prior corresponding period mainly due to reduced asset sales in the current period. National long distance revenue also declined in the highly competitive fixed-to-fixed market while fixed-to-mobile calls, a growth product in prior periods, remained relatively stable. This reflected the introduction of preselection for these calls during the current period. Revenue from local calls, excluding value-added services, remained flat during the period reflecting the more competitive market for this product. Increased penetration of alternative price offerings, where lower prices for local calls combined with a higher basic access fee, also had impact in the current period.

While other revenue showed a decline of \$38 million or 9% during the period, each period was affected by one-off items. The prior corresponding period included \$166 million for the sale and lease back of personal computers and revenue from the sale of the small business systems business. In the current period, \$87 million relates to sales of listed shares of which \$75 million was from the sale of a proportion of our shareholding in Infonet Services Corporation, a U.S. company which undertook an initial public offering towards the end of calendar 1999.

Basic access

	Half-year ended 31 December		
	1999 (in millions)	1998	(% change)
Basic access revenue ¹	A\$948	A\$926	2.4
Basic access lines in service (at half-year end)			
- Residential	6.7	6.9	(2.9)
- Business lines (includes wholesale lines .. - for both residential and business customers of wholesalers)	3.2	2.8	14.3
Total	9.9	9.7	2.1

(1) Approximately 7% in half-year ended 31 December 1999 and 5% in half-year ended 31 December 1998 of basic access revenue was derived from wholesale activities.

Increases in basic access revenue during the period are mainly attributable to:

- increase in basic access lines resold to other carriers for their residential and business customers which has caused, in particular, the number of our retail residential lines to decline;
- increasing demand for retail business lines which are generally available under pricing packages that allow customers to pay lower local call prices, but higher monthly access fees; and
- the movement of flexible pricing packages into the residential market whereby higher monthly access fees provide an offset by a reduction in local call prices.

The overall increase in both revenue and services is after taking into account the transfer of some of our customers to other access services such as ISDN and Faxstream[®] which are included under the category "Data, text and Internet services".

Local calls

	Half-year ended 31 December		
	1999 (in millions)	1998	(% change)
Local call revenue ⁽¹⁾	A\$1,290	A\$1,294	(0.3)
Value added services	117	82	42.7
Total local call revenue	1,407	1,376	2.3
Number of local calls	5,645	5,555	1.6

(1) Approximately 7% in half-year ended 31 December 1999 and 6% in half-year ended 31 December 1998 of local call revenue was derived from wholesale activities.

During the half-year, revenue from local calls remained flat reflecting the increased competition for this product. Increased competition in the local call market also affected the growth in the number of local calls made over our network.

The revenue was also negatively impacted by the increased penetration of pricing packages that allow customers to pay lower local calls when higher monthly access fees are paid. This was offset by the growth in the use of Priority[®] One3 and Priority[®] 1300 call centres where the calling party is charged for the call.

The use of value-added products such as call return and calling number display improved the total revenue performance for local calls. These Easycall® features derive their own connection-based revenue, which is showing strong growth. Growth in these products also stimulates call completion and hence contributes to local call volumes and revenue.

In the current period, there were over 5.61 million customers using Easycall® call waiting services and 324,000 customers using calling number display services.

National long distance

	Half-year ended 31 December		
	1999 (in millions)	1998	(% change)
Fixed-to-fixed revenue	A\$727	A\$754	(3.6)
Fixed-to-mobile revenue	628	635	(1.1)
National long distance calls revenue ⁽¹⁾	1,355	1,389	(2.5)
Fixed-to-fixed minutes	4,819	4,669	3.2
Fixed-to-mobile minutes	1,533	1,406	9.0
National long distance minutes	6,352	6,075	4.6

(1) Approximately 3% in half-year ended 31 December 1999 and 5% in half-year ended 31 December 1998 of national long distance revenue was derived from wholesale activities.

This revenue consists of:

- revenue from national long distance calls made from our PSTN network to a fixed network (fixed-to-fixed); and
- calls made from our PSTN network to a mobile network (fixed-to-mobile).

Fixed-to-fixed revenue continued to decline in this highly competitive market. Even though fixed-to-fixed minutes have increased, this has not been sufficient to offset the lower prices charged for these calls. Growth in minutes has been assisted by special promotions during the half-year including the permanent seven days per week \$3 rate for national long distance (fixed-to-fixed) calls made between 7pm and midnight.

Despite the introduction of fixed to mobile call preselection during the period fixed-to-mobile revenues decreased only slightly ie by 1.1%. While market share and prices for fixed-to-mobile calling declined there is still strong growth in this market due to the continuing growth in the mobiles market.

Revenue for this service in the current period has also been affected by the churn out of customers through increased competition in the local call market. Where the customer changes their provider for local call services they tend to preselect the same provider for long distance services.

International telephone services

	Half-year ended 31 December		
	1999 (in millions)	1998	(% change)
International telephone services revenue ⁽¹⁾	A\$483	A\$598	(19.2)
International outgoing minutes	451	339	33.0
International incoming minutes	502	398	26.1

(1) Approximately 49% in half-year ended 31 December 1999 and 47% in half-year ended 31 December 1998 of international telephone services revenue was derived from wholesale activities.

Our revenue for this service continued to decline even though volumes increased quite significantly.

The 33% increase in volume in international outgoing minutes was achieved through competitive offerings such as Easy 1/2 Hours®. Easy 1/2 Hours® calls now represent 36% of all outbound minutes and 50% of all calls to the United Kingdom and Ireland are made using this product. Significant price reductions have been made and are reflected in the lower revenues.

Revenue from transit or refile traffic continued to decline as competition and declining margins reduced opportunities to make adequate returns on some traffic routes. Therefore, while volumes increased, the overall stream mix and prices have led to a reduction in revenue.

More international traffic is being sent under “send or pay” contracts. Under these contracts, fixed volumes of traffic are agreed between two carriers for a set price and incremental rates are payable for additional traffic.

While international incoming calls increased in volume, the revenue declined primarily due to lower international settlement rates driven by increased deregulation worldwide.

Mobiles goods and services

	Half-year ended 31 December		
	1999 (in millions, except customers in thousands)	1998	(% change)
Mobile handset sales	A\$205	A\$143	43.4
Mobile services revenue	1,247	1,096	13.8
Mobiles goods and services revenue	1,452	1,239	17.2
GSM digital mobile telephone customers	3,322	2,183	52.2
CDMA digital mobile telephone customers	154		
Analogue mobile telephone customers	291	1,047	(72.2)
Total mobile telephone customers	3,767	3,230	16.6
Mobile telephone minutes	2,123	1,572	35.1
	(in A\$ per service in operation)		
Average revenue per user per month	A\$57.15	A\$57.16	

Revenue from mobile services principally comprises access and airtime fees for originating traffic.

The increased number of services in operation is due to:

- revised pricing tariffs and promotional offerings that enhance value and make our services more affordable to a greater number of customers. This included targeting analogue customers moving to digital services as well as the launch of CDMA;
- an expanded range of channels to market;
- the successful launch of the new prepaid phone pack offering; and
- overall market growth.

Revenue growth has been mainly in airtime use, gross handset sales and monthly access fees. This has been achieved through periods when connection fees have been waived and increased handset subsidies have been necessary. Average revenue per user has remained flat when compared with the previous corresponding period.

Data, text and Internet services

	Half-year ended 31 December		
	1999 (in millions, except access lines in thousands)	1998	(% change)
Data, text and Internet services revenue ⁽¹⁾	A\$1,378	A\$1,207	14.2
FaxStream® services access lines	417	396	5.3
ISDN access lines (basic access line equivalents)	861	605	42.3

(1) Approximately 15% in half-year ended 31 December 1999 and 13% in half-year ended 31 December 1998 of data, text and Internet services revenue was derived from wholesale activities.

The increased revenue during the period is mainly due to increases in ISDN, domestic and international frame relay and Internet services.

The growth continues to be mostly due to:

- increased customer demand for flexible, high capacity data transmission; and
- increased penetration and use of the Internet.

Customers migrating from basic access services contributed to the growth in ISDN services. The increase in the number of access services in operation and the strong growth in call revenue have lead to increased ISDN revenue.

Revenue from Big Pond® Home and Business increased during the period due to an increase in subscriber numbers with revenue per subscriber remaining fairly constant.

The impact of the significantly higher data and Internet volumes has been partially offset by price reductions necessary to compete or the realignment of prices to ensure price consistency across our range of products.

Most of our revenue in this product category stems from integrated services, including ISDN (approximately 41%) and traditional dedicated data lines and leased lines (approximately

21% in aggregate). Only a small component (less than 9%) relates to Internet access and service provider revenue. Over time, we expect our operating revenue from Internet access and service provider services to become a larger component of this product category.

Directory services

	Half-year ended 31 December		
	1999 (in millions)	1998	(% change)
Directory services revenue	<u>A\$609</u>	<u>A\$594</u>	2.5

Through concentrated sales efforts, directories services revenue grew moderately during the period from increased revenue for White Pages™ and the Yellow Pages® NetSelect™ product which provides customers with priority Internet listings and hyperlink services. Revenue from printed Yellow Pages® remained flat.

Customer premises equipment

	Half-year ended 31 December		
	1999 (in millions)	1998	(% change)
Customer premises equipment revenue	<u>A\$181</u>	<u>A\$196</u>	(7.7)

The decline in revenue from customer premises equipment during the half-year is mainly due to the sale of our small business systems business at the end of July 1998. Excluding this effect the current half-year revenue from customer premises equipment increased marginally mainly due to increased sales of advanced equipment products reflecting growth in ISDN and other advanced access services.

Intercarrier services revenue

	Half-year ended 31 December		
	1999 (in millions)	1998	(% change)
Intercarrier services revenue	<u>A\$382</u>	<u>A\$315</u>	21.3

The increase in intercarrier services revenue is mainly due to:

- increased originating traffic on our network by customers of other carriers; and
- increased terminating calls by other carriers on both our mobile and fixed networks.

This has been influenced by growth in the overall mobile telecommunications market, our competitors' share of the national long distance market and, particularly in the current period, increases in provision of services for local calls by our competitors. In addition to this, the introduction of fixed-to-mobile preselection has led to an increase in traffic from other carriers' customers, originating on our fixed network and terminating on our mobile network.

The growth has been offset in part by a reduction in our operating revenue for providing wholesale analogue mobile services to Cable & Wireless Optus in the lead up to the closure of our analogue network in all major metropolitan areas by December 1999.

Inbound calling products

	Half-year ended 31 December		
	1999 (in millions)	1998	(% change)
Inbound calling products	<u>A\$212</u>	<u>A\$202</u>	5.0

Inbound calling revenue is principally from:

- subscription and call charges;
- charges for inbound calling services, such as Freecall™1800, Priority® One and Priority®1300; and
- revenue for enhanced call centre products using network voice processing, which provides access to advanced call-handling capabilities without customers having to purchase and maintain their own networks.

Revenue growth slowed compared with that experienced during the last fiscal year with the main growth in the current half-year being attributable to Priority® 1300 products. Priority® 1300, introduced in fiscal 1998, is used by larger customers as a call centre product and is also a cost effective alternative to the 1800 service for medium size businesses. The revenue for inbound calling services refers to:

- the fees charged to the business customer for the provision of the inbound calling numbers; as well as
- the difference between the price of the call made and the cost of the call charged to the party making the call (ie party A).

For example, under Priority® One and Priority®1300, the calling party (party A) incurs a cost of a local call whereas calls made under the Freecall™1800 service are all charges to the B party (the party called) with no cost incurred by the caller.

Payphones

	Half-year ended 31 December		
	1999 (in millions)	1998	(% change)
Payphones	<u>A\$96</u>	<u>A\$108</u>	(11.1)

The decrease in revenue during the period represents the continued shift to other products such as mobile telephones, calling card products and increased competition for phonocard services.

Other sales and services

	Half-year ended 31 December		
	1999 (in millions)	1998	(% change)
Other sales and services	A\$782	A\$669	16.9

The principal components of other sales and services revenues are:

- revenue from various controlled entities;
- ship-to-shore services;
- radio services;
- facilities management;
- international roaming;
- domestic operator-assisted calls;
- commercial works; and
- voicemail, recorded services and other enhanced call products.

The increased revenue from other sales and services was principally due to increased revenues from facilities management, radio services and voicemail for fixed lines.

There are now 934,000 customers using voicemail for fixed lines compared with 410,000 at the end of the prior corresponding period.

Operating expenses (before interest expense and abnormals)

	Half-year ended 31 December				
	1999		1998		% change
	A\$m	% of revenues	A\$m	% of revenues	
Labour expense	1,607	16.6	1,764	19.1	(8.9)
Direct cost of sales	1,638	16.9	1,445	15.6	13.4
Depreciation and amortisation	1,320	13.7	1,215	13.2	8.6
Other operating expenses	1,761	18.2	1,764	19.1	(0.2)
Operating expenses (before interest expense)	6,326	65.4	6,188	67.0	2.2
Growth over prior corresponding period	2.2%		3.4%		

Our operating expenses (before interest expense) increased by 2.2% over the prior corresponding period and fell as a percentage of revenue from 67.0% to 65.4%. These results need to take into consideration the following:

- labour expense for the prior corresponding period included employer contributions to Telstra's superannuation fund of \$100 million prior to agreement that employer contributions could be suspended. No contributions were made in the six months to 31 December 1999; and
- direct cost of sales increased by \$193 million during the period. However, this does not include an amount of \$134 million for mobile handset subsidies that,

due to a change in accounting policy, has been deferred over the life of the contract where the contract is for two years or more. If the subsidies had not been deferred, the direct cost of sales would have increased by 22.6%.

Labour expense

Labour cost declined by \$157 million or 8.9% with \$100 million due to employer contributions to the superannuation fund being included in expense for the half-year ended 31 December 1998 but no similar contribution being made in the current period. The remaining reduction in labour expense is mainly attributable to the decrease in our full-time employees from 54,710 at 31 December 1998 to 51,667 at 31 December 1999. As announced, reduction in staff numbers will accelerate over the next two years. The proposed acquisition of the remaining 50% interest in Advantra Pty Ltd will add to our total staff numbers (approximately 600 staff).

In both half-years, where redundancies have occurred over and above those included in the approved plan for which provision was made in fiscal 1997 and subsequently "topped-up" in fiscal 1998, these costs have been charged to labour expense in the year in which the redundancies have taken place. There was an additional charge for this in the current period of \$24 million compared with \$26 million in the prior corresponding period.

Staff on individual contracts received an average increase of 4% from 1 October 1999 and increases under the new enterprise agreement to other staff averaged 3% from 23 December 1999.

Provisions for employee entitlements such as annual leave and long service leave decreased during the period as a result of lower numbers of full-time staff.

Direct cost of sales

Direct cost of sales increased by 13.4% over the prior corresponding period primarily due to:

- higher domestic network payments to other carriers for increased traffic terminating on our competitors' networks; and
- increased costs for mobile handsets and dealer commissions in line with the higher sales volumes.

Combined, payments to international carriers for interconnect and transit traffic were relatively flat over the period. A decrease in handset subsidies occurred during the half-year due to the change in accounting policy whereby handset subsidies are deferred over the life of the contract where a contract is for two years or more. In the current period, direct cost of sales included \$20 million for the recognition of some of the subsidies that had been deferred. After this charge to expense, the balance of the deferred subsidies at 31 December 1999 was \$134 million. Due to the highly competitive nature of the mobiles market, we expect these subsidies to continue.

Depreciation and amortisation

The increase of 8.6% in depreciation and amortisation is mainly due to the higher levels of capital expenditure on communication assets as well as the increases in capitalised software development. Minor reductions occurred as a consequence of lower numbers of owned vehicles in the current period compared with the prior period and, due to the sale and lease back of personal computers in December 1998, depreciation for these is only included for July–November 1998 and not for later periods.

Other operating expenses

Other operating expenses remained relatively flat during the period. Increases were generally due to:

- outsourcing of maintenance and installations;
- promotion and advertising for the roll-out of CDMA and Olympics 2000;
- vendor support for more products in data and Internet areas; and
- increased lease-back payments for computers and motor vehicles.

Other operating costs decreased as the cost of personal computers subject to sale and lease back and costs of the sale of our small business systems business were included in the prior half-year with no significant costs for asset sales in the current period. Provisions for debtors, particularly in the wholesale area, were generally lower in this half-year.

Borrowing costs

Borrowing costs as per the financial statements is the net amount of:

- interest and related borrowing costs; reduced by
 - interest income; and
 - interest capitalised on constructed assets.

Borrowing costs reduced mainly due to gains on close out of interest rate swaps and increased capitalised interest on higher capital expenditure incurred during the period.

Income tax expense

Income tax expense increased by 5.9% to \$988 million. This was \$98 million less than would otherwise have been the case as a result of the lowering of company tax rates from 36% in the current year, to 34% in fiscal 2001 and 30% in future years.

Dividends

It is our current policy to declare ordinary dividends of at least 60% of operating profit attributable to shareholders, subject to taking into consideration a number of commercial factors, including the interests of shareholders, cash requirements for future capital expenditures and investments, as well as relevant industry practice.

After consideration of these issues, directors have declared an interim dividend of 8 cents per share (and instalment receipt), a total of \$1,029 million, franked to 49.17%. The tax rate at which the dividend is franked is 36%. The dividend will have a record date of 24 March 2000 with payment being made on 28 April 2000.

It remains the intention of the directors to pay total dividends of at least 60% of operating profit for the full financial year. The income tax payments anticipated in the future should be sufficient to allow full franking of the final dividend from earnings in the current year. The final dividend is scheduled to be paid in October 2000 and will be franked at a rate of 34% reflecting the new company tax rate.

At present, it is expected that Telstra will be able to fully frank declared ordinary dividends out of fiscal 2001 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.

Cash flow

	Half-year ended 31 December	
	1999	1998
	(in A\$ millions)	
Net cash provided by operating activities ⁽¹⁾	2,947	2,921
Net cash used in investing activities	(2,386)	(1,537)
Net cash used in financing activities	(1,203)	(1,666)
Net increase/(decrease) in cash	(642)	(282)

(1) Net cash provided by operating activities is after interest paid

Net cash provided by operating activities

While receipts from trade and other debtors increased by \$626 million or 7.3% to \$9,179 million, payments of accounts payable and to employees increased by a greater proportion of 12.5% or \$614 million to \$5,531 million resulting in minimal growth of 0.9% in operating cash flow. The increase in cash outflows is principally due to:

- higher direct cost of sales;
- higher levels of inventory caused by a build-up of mobile handsets, stock for the new CDMA network and increases in stores needed for network construction activities; and
- mobile handset subsidies.

Net cash used in investing activities

Net cash used in investing activities consists of:

- amounts paid for property, plant and equipment, intangibles such as trademarks and licences, capitalised software; and
- investments; reduced by
- proceeds from sales of non-current assets.

The following table gives details of capital expenditure incurred during the period:

	Half-year ended 31 December	
	1999	1998
	(in A\$ millions)	
Switching	297	389
Transmission	293	281
Customer access	605	323
Mobile telecommunications networks	340	150
Broadband network	16	21
International telecommunications infrastructure	91	32
Capitalised software	263	175
Other	233	381
Capital expenditures⁽¹⁾	2,138	1,752
Investments	438	30
Capital expenditures and investments⁽¹⁾	2,576	1,782
Sale of capital equipment, investments and other	(190)	(245)
Net cash used in investing activities	2,386	1,537
Capital expenditures (including interest)	2,197	1,794
Capital expenditures and investments (including interest)	2,635	1,824

(1) Excludes A\$59 million in the half-year ended 31 December 1999 and A\$42 million in the half-year ended 31 December 1998 of capitalised interest that is reflected in net cash provided by operating activities.

Investments acquired during the current period totalled \$0.4 billion and were principally for strategic investments in Computershare Limited \$207 million (taking our interest to 15%); Solution 6 Holdings Limited \$100 million (26.3% interest) and Sausage Software Limited \$19 million (11.1% interest).

Proceeds from the sale of property, plant and equipment of \$94 million in the current period were mainly for sales of properties with a small amount for motor vehicle sales. In the prior corresponding period, the higher amount was due to the proceeds from sale of personal computers as well as the sale of our small business systems business. There were no similar transactions in the current period. Proceeds from the sale of listed shares relates primarily to \$75 million from the sale of a minor proportion of our shareholding in Infonet Services Corporation, a U.S. company which undertook an initial public offering near the end of calendar 1999.

Net cash used in financing activities

In the current period, cash used in financing was down by \$463 million to \$1,203 billion. Dividends paid during the current period were \$2,445 million more than in the prior corresponding period. This was due to the payment of a special dividend of 16 cents per share and an ordinary dividend of 10 cents per share in the current period compared with an ordinary dividend of 7 cents per share in the half-year ended 31 December 1998. After the payment of dividends we replenished our working capital by increasing borrowings so that in the current period net borrowings were \$2,143 million. This is to be contrasted with the net repayment of debt of \$765 million in the prior corresponding period.

Year 2000

The primary objective of our extensive year 2000 programme was to achieve a smooth transition to the year 2000 for both our customers and our staff. We are pleased to report that this objective has been successfully achieved. In addition, the rationalisation and process improvements carried out as part of the programme are expected to provide ongoing benefits.

While the focus of attention has been on the December/January transition period there are other dates during 2000 that may present some risk. Some limited year 2000 work including post-event testing is therefore continuing during the year.

As at 31 December 1999, the year 2000 programme had incurred total direct expenditures of \$311 million. We estimate that the cost of the remaining work in the year 2000 programme will be up to \$24 million and that this will be incurred during the remainder of this calendar year. The estimated total cost of the year 2000 programme is therefore approximately \$335 million which is significantly less than the previous estimate of up to \$400 million.

Segment results

	Half-year ended 31 December		
	1999	1998	% change
	(in A\$ millions)		
Sales revenue from external customers			
Commercial & Consumer	2,954	2,950	0.1
Telstra Business Solutions	2,690	2,608	3.1
Telstra OnAir	1,561	1,310	19.2
Wholesale & International	1,323	1,237	7.0
Convergent Business	718	675	6.4
Network & Technology Group	2	-	-
Earnings before interest and tax⁽¹⁾			
Commercial & Consumer	873	757	15.3
Telstra Business Solutions	1,095	1,036	5.7
Telstra OnAir	446	414	7.7
Wholesale & International	481	318	51.3
Convergent Business	128	78	64.1
Network & Technology Group	218	282	(22.7)

(1) Generally, most internal charges between business segments are charged on a direct cost recovery basis.

Commercial & Consumer

Sales revenue remained relatively flat during the period. Growth in the residential market was primarily due to the increased demand for value-added products such as call return and calling number display (shown under local call product revenue) increased fixed-to-mobile revenue and fixed-line voicemail (Messagebank[®]) included under other sales and services product revenue. However, this was offset by the general decline in the residential market due to competition for most other products -local, international calls and domestic long distance (fixed-to-fixed) revenue.

The improvement in **earnings before interest and tax** in the current period is primarily due to lower labour expense and a reduction in internal charges that were made under the previous organisation structure by the former Products and Marketing business unit. Commercial & Consumer has the largest work-force of all the business segments and therefore the impact of no superannuation employer contributions in the current period and the general reduction in full-time staff, are the most significant of many factors which have influenced the improvement in the segment result. The Products and Marketing business unit was absorbed into other business units at the beginning of this financial year resulting in net savings in total marketing expenses.

Telstra Business Solutions

The overall improvement of 3.1% in **sales revenue** was primarily due to increases in the non-traditional product areas such as data, text and Internet with ISDN having strong growth. Managed services also showed improvement, however, reduced yield impacted international and national long distance calls, whilst preselection reduced fixed-to-mobiles revenue.

Earnings before interest and tax in the prior corresponding period included the profit on sale of the small business systems business. There were no similar asset sales or profits in the current period. The main reason for the improvement in segment result was a reduced labour expense. This resulted from lower employee numbers and no superannuation contributions being required in the current period. This has been offset somewhat by increased interconnect activity associated with increased competition which has resulted in higher intercarrier internal charges.

Telstra OnAir

Sales revenue includes not only product revenue for mobiles goods and services but also international roaming, radio services revenue, mobile Messagebank[®], mobile data and other minor services. The strong growth of 19.2% was principally due to:

- higher handset sales;
- increased access and airtime for originating mobiles traffic; and
- a new radio services contract for a major customer in the current period.

This strong growth in sales was achieved with reduced margins as is reflected in the growth in **earnings before interest and tax** growth of 7.7%. Additional costs during the period included:

- costs associated with the closure of part of the analogue network and the transfer of customers to a digital service;
- the set up and marketing of the new CDMA network and handset requirements;
- the targeting of customers whose contracts were nearing completion to encourage their continued custom on our network;
- increased costs for mobile handsets and dealer commissions in line with the higher sales volumes.

Due to the change in accounting policy for handset subsidies, there was a decrease in handset subsidies included in segment result in the current period.

Wholesale & International

During the current period, strong competition saw an increase in customers moving from our retail base to wholesale. Consequently, **sales revenue** from interconnect increased but this growth was tempered to some extent by declines in our outbound and international transit traffic revenues.

The primary reason for very high growth in **earnings before interest and tax** was due to the sale of a proportion of our share holding in the recently listed U.S. company Infonet. These shares had been acquired some years ago at a cost that is minimal compared with the proceeds of sale during the period. Decreases in international settlement rates also contributed to the improved segment result during the period.

Convergent Business

Sales revenue increased during the period primarily due to the growth in revenue from the Big Pond[®] Home product and increased revenue from the existing FOXTEL customer base. Directory advertising revenue grew moderately when compared with the prior period.

Earnings before interest and tax increased significantly due to a slowing of new connections to FOXTEL, resulting in reduced charges from Commercial and Consumer and Network & Technology Group who undertake this work on behalf of Convergent Business. The increase in sales revenue also added to the growth in the segment result.

Network & Technology Group

Earning before interest and tax reduced in the current period primarily due to additional expenses incurred on year 2000 issues and other information technology development costs that remained with this segment rather than being charged to other areas.

Balance Sheet and Key Ratios

as at 31 December 1999.

	As at 31 December	
	1999	1998
	A\$m	A\$m
Current assets	4,457	4,173
Non-current assets	24,160	22,165
Total assets	28,617	26,338
Current liabilities	8,274	7,325
Non-current liabilities	9,011	7,019
Total liabilities	17,285	14,344
Net assets/shareholders' funds	11,332	11,994
Gross debt	9,726	7,121
Net debt	8,592	6,004
Gross debt to capitalisation ⁽¹⁾	46.2%	37.3%
Net debt to capitalisation ⁽²⁾	43.1%	33.4%

(1) Based on gross debt (total current and non-current borrowings) as a percentage of gross debt plus shareholders' equity.

(2) Based on net debt (gross debt less interest bearing assets and loans to employees) as a percentage of net debt plus shareholders' equity.

Major cost reduction programme

The results for the period have been considered in light of the current competitive environment together with market share and prices in general. Margin pressures in the traditional areas of the businesses are expected to continue during the time that new growth areas of the business, particularly in the “new economy”, mature. Major cost reductions will be necessary during this period of transition for Telstra to achieve similar earnings growth as in recent years.

Consequently, a major “next generation” cost reduction programme has been developed. It is anticipated that over the next two years this programme, together with other initiatives, will lead to an overall reduction of around 10,000 staff including 220 executive positions. These reductions will occur through a combination of natural attrition, outsourcing and redundancies during a time when re-skilling of the workforce will also occur.

Actions have already commenced on the cost reduction initiatives that involve nine major projects and are expected to give expense savings of about \$650 million and more than \$200 million in savings in operational capital expenditure.

The projects are:

- optimisation of:
 - call centres; and
 - channels to market;
- improved IT effectiveness;
- rationalisation of:
 - our products and platforms;
 - service support activities;
 - our management layers;
 - shared support functions;
 - our use of property; and
- finalisation of a strategic sourcing process.

The cost of redundancies and restructuring will be taken into the accounts in the current fiscal year. While redundancies will commence immediately, it is intended by 30 June 2000, to take up a provision for the estimated cost of remaining redundancies and related restructuring costs and, if appropriate, record this as an abnormal item in the profit and loss statement for fiscal 2000.

Furthermore, advisers have been appointed to assess the options for sale of Telstra’s major construction unit, Network Design and Construction Limited, which, if it occurs, would further reduce Telstra staff levels.