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Financial results better than guidance for half-year ended 31 December 2006

Dear shareholder

I am writing today to keep you informed, as a shareholder, about the progress we are making in the transformation of Telstra's business and, specifically, to share our half-year results directly with you. I continue to be encouraged by the progress we are making.

Today we announced important achievements in our performance:

- earnings results that are ahead of market guidance;
- market share gains – especially where it matters (e.g. broadband and mobiles);
- gains in fixed-line residential market share and a slowdown in PSTN (fixed line) decline;
- a highly-successful launch of our wireless broadband Next G™ platform;
- strong revenue growth in directories and online content; and
- improved service-level ratings across the board.

These achievements reflect the impact of our transformation process, which is on or ahead of plan on all fronts, touching every element of our business – even though we are only 13 months into a five-year transformation and much remains to be done. Following the recent Telstra share offer ("T3"), we welcomed tens of thousands of new shareholders. Since that time we have seen institutional investors embrace our commitment and, increasingly, our ability, to deliver on plan – including improvement in long-term shareholder value – a result already reflected in the share price. Our record continues to show a consistent alignment between words and deeds, between promises and performance.

The results we released today are a reflection of competing hard, winning where it matters and improving our operational metrics. We have maintained momentum in the past half-year, notching up a string of firsts as we execute our five-year transformation strategy:

- **First:** launched Next G™, our 3GSM 850 nationwide wireless broadband network reaching 98% of the people in Australia;
- **First:** built a Next G™ national network in record time - 10 months;
- **First:** upgraded the network's speeds to 14.4 Mbps - giving Australia the world's fastest nationwide wireless broadband network;
- **First:** extended Next G™ network range up to 200km (at selected sites);
- **First:** reached one million 3G customers in a record-setting 16 months;
- **First:** launched national high-speed ADSL with network speeds up to 20Mbps;
- **First:** maintained retail broadband average revenue per user (ARPU) at second half financial year 2006 levels while growing market share to 45% (up 1%);
- **First:** achieved positive PSTN (fixed line) residential churn (gaining more fixed-line customers from competitors than we lost) since October 2006 – first time since the advent of competition;
- **First:** achieved increase in residential fixed-line market share – first time since the advent of competition;
- **First:** achieved highest customer satisfaction performance on record for Telstra Enterprise and Government; and
- **First:** achieved a reduction of more than 80% in unsatisfied demand for ADSL broadband (called "held orders") from 19,300 in September 2005, despite increasing order volumes.

We have broken new ground with these firsts. Other highlights over the last six months include the following:

- **Improving productivity:** improved service ratings and increasing revenues were achieved while reducing the total workforce by 4,596 (pre acquisitions and investments) since 1 July 2005. We are on track to achieve our target reduction of 6,000 to 8,000 by 30 June 2008. Labour costs are down 2.8%;
- **Improving service:** we increased scheduling flexibility for our customers, meeting more than 90% of our appointments and completing 97% of PSTN service calls completed on the first attempt;
- **Improving the customer experience** in the field, on the phone and online with 6,400-plus staff participating in the Telstra Learning Academy to advance their product knowledge, customer service and technical skills; and
- **Expanding new revenue** where online businesses at Sensis and BigPond continue to fuel growth.

Financial Results

Our sales revenue grew 3.6% (adjusted for deferral in distribution of Melbourne Yellow™ book) which continues the strong run rate of the second half of the previous financial year and also better than our guidance for the full year of 1.5% to 2%.

- **On mobiles**, for example, we added more than 700,000 3GSM customers in the half, a growth rate of 223% on June 2006. This included 280,000 customers to the Next G™ network between October 6 and December 31. This resulted in revenue growth of 11.8% to \$2.8 billion as our 3G customers generate \$20 per month more ARPU than our 2G customers, from higher use of video calling and data services;
- **On Retail broadband, our customer growth rate was 55% and revenue was up 50%** to \$497 million; broadband customers and market share gains continued to drive growth in a very competitive market;
- **Our online usage at Sensis grew 21% with sales revenue up 7%** to \$885 million (on a normalised basis): Sensis is now much more than Yellow and White Pages, with emerging new media revenues growing 68%.

At the full year results in August 2006 and in the T3 prospectus, we forecast half-year earnings before interest and tax (EBIT) to decline between 17% and 20%. Our actual result beat this forecast, with EBIT declining by 15.7% or \$546 million to \$2.9 billion.

We recorded **positive residential churn** volumes each month since October, as we gained fixed line customers from competitors. We continued to **slow the decline in our traditional fixed line** (PSTN) revenues. We improved the rate of retail line loss by 2% as the first half revenue decline slowed to 5.6%, compared with 7.6% in the prior corresponding period.

Given the fact that our top line growth was strong, it was operating expenses – transformation related costs along with marketing, subscriber acquisition and recontracting costs – that contributed to the EBIT decline. However, by incurring these costs now we lay the foundation to **improve earnings** in the future.

Dividend Status

As a result of our strong revenue performance and increased spend in our transformation, we announced a **profit after tax today of \$1.7 billion** for the half, down \$430 million or 20.1% on the prior corresponding period. Telstra's Board of Directors declared a **fully franked interim ordinary** dividend of 14 cents per share, payable on 30th March 2007. Please refer to the attached new look half-year review for a more detailed analysis of the first half financial results.

Outlook ... Guidance

We are raising our financial year 2007 revenue and earnings guidance to reflect trends evident in the first half. Apart from this change **we have not changed our financial year 2007 guidance** from those published in the T3 prospectus, and you should expect¹:

- Full year revenue growth of between plus 2.5% to plus 3.0% (up from plus 1.5% to plus 2%);
- Second half EBIT growth of between plus 37% to plus 40%;
- Full year EBIT growth of between plus 3% and plus 5% (up from plus 2% to plus 4%);
- Full year cash operating capital expenditure of between \$5.4 to \$5.7 billion; and
- Dividends - the Board intends to declare a fully franked final ordinary dividend of 14 cents a share.

As we continue to transform our networks and systems, we are well positioned to take advantage of new media communications opportunities in the coming years due to our portfolio of integrated assets – especially emerging and online businesses within Sensis and BigPond. To maintain the momentum in executing our transformation, **significant investment is required** for the remainder of the financial year - the peak transformation spend year.

¹ Assumes: no FTTN build; a Band 2 ULL price of \$17.70 applying for wholesale customers for the remainder of financial year 2007; no additional redundancy and restructuring provision; and, financial year 2007 being the largest transformational spend year.



However, **we have reached a pivot point in our earnings with positive earnings growth to resume in the second half**. I am proud of the management team and the entire employee base whose tireless work is making it possible for us to execute on our aggressive transformation plan. Our substantial achievements reflect their many talents and their dedication to the tasks before us.

Fixing the regulatory environment

Regulations continue to have a negative effect on our results and create a less-than-friendly investor environment – not only for Telstra but for the industry as a whole. For example, decisions by the regulator taken in August on the Unbundled Local Loop (ULL) and in December on Line Sharing Service (LSS) cut our wholesale prices more than 20% despite the rising costs of copper, fuel, labour and vehicles.

The **backward looking regulations** limit our ability to make investments in high-speed fixed broadband that can create new assets for consumers, businesses, communities and the nation, while at the same time permitting a competitive return for shareholders. That's why we are seeking regulatory reform and why it is so important.

Our reform initiatives include:

- a High Court challenge to protect the interests of shareholders;
- a **Broadband Australia Campaign** (called **BACK Telstra**) to educate the public about these issues; and
- the establishment of **Telstra Active Supporters** to enable shareholders and the public to join together to express their views about the need for high-speed broadband so that Australia will not be left behind.

I invite you to **learn more about these reform issues and their impact on Telstra's financial performance**. An interesting and convenient way is to **visit our website**, www.nowwreatalking.com.au, where you can register your interest, receive regular updates on important reform issues, and find out about ways you can actively help.

The Board and I remain **committed to keeping you informed** about Telstra's transformation with regular updates, special notices when appropriate, and through periodic emails. If you have not already done so, **please send us your email address**. We promise to use it sparingly and only for the most important notices.

For more information **visit our Investor Relations website** at www.telstra.com.au/abouttelstra/investor where you will find share price details and other shareholder services; or www.nowwreatalking.com.au where you can learn more about the digital revolution and engage with others to bring the benefits of high-speed broadband and the digital age to all Australians; or investor.relations@team.telstra.com where you can easily **send us your email address** so we can communicate with you faster with less postage.

Please contact us with any questions or comments at investor.relations@team.telstra.com or write to me directly.

Yours sincerely

A handwritten signature in black ink, appearing to read "Sol Trujillo".

Sol Trujillo
Chief Executive Officer