Embracing the future

Telecom Corporation of New Zealand Limited
Half Year Report
For the period ended 31 December 2012

telecom nz

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FINANCIAL CALENDAR 2013

KEY DATES

Half-year result announced
22 February 2013

Financial year end
30 June 2013

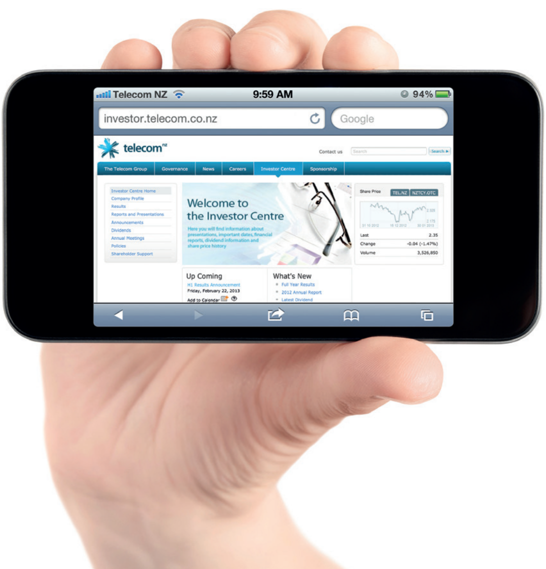
Full-year result announced
23 August 2013

Annual General Meeting
8 November 2013

This report is dated 21 February 2013 and is signed on behalf of the board of Telecom Corporation of New Zealand Limited by Mark Verbiest, Chairman, and Simon Moutter, Chief Executive Officer.

Mark Verbiest
CHAIRMAN

Simon Moutter
CHIEF EXECUTIVE OFFICER



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Highlights

RECENT PRODUCT DEVELOPMENTS

Comprehensive refresh of broadband plans and pricing – data and local calling packages

$19 mobile prepaid pack launch

New flat fee pricing for international data roaming

New open smartphone plans – no fixed-term contract

OUR H1 FY13 FINANCIAL HIGHLIGHTS

NZ$2,135m
Operating revenues and other gains

NZ$516m
EBITDA

NZ$163m
Net earnings for the period

9c
Earnings per share

8c
Dividends per share

NZ$246m
Capital expenditure

OUR H1 FY13 OPERATIONAL HIGHLIGHTS

158k
Growth in WCDMA mobile connections in the period

13k
Growth in retail broadband connections in the period

NZ$283m
Cumulative on-market buyback of shares completed

Dear shareholders,
We are pleased to report on a half year in which Telecom began the strategic shift from a traditional fixed line and mobile infrastructure company to a competitive, future-oriented mobile and data centric service provider.

Total earnings before interest, tax, depreciation and amortisation (EBITDA) of the group for the six month period ending 31 December 2012 were $516 million compared with $1,656 million for the prior comparative period.

Comparisons with previous periods are complicated by the demerger of Chorus which took effect from December 2011. Reporting on continuing operations, after adjusting for non-recurring or unusual items, provides the most meaningful view of Telecom's performance as a separate company. On this basis, adjusted EBITDA was 3.7% higher, as reduced operating costs (principally due to lower labour costs and changes in Chorus trading arrangements) more than offset a decline in operating revenue.

The Directors have declared an interim dividend of 8 cents per share (9 cents in the corresponding half year), carrying 75% imputation credits. The Dividend Reinvestment Plan has been retained and shares will be issued at the prevailing market price applied to ordinary shares.

Behind the headline numbers, our business is changing significantly. Mobile revenue is higher on the back of demand growth and there has been good growth in net customer connections since the closure of the CDMA network. On the other hand, fixed calling revenue has continued to decline in line with industry trends and following a strategic decision by our Australian unit AAPT to rationalise some low margin business.

These revenue shifts reflect the major global trends influencing our industry.

Telecommunications is becoming increasingly focused on mobile and data. Improvements in capacity, speed and reliability mean the possibility of anywhere, anytime broadband connectivity to applications hosted within our network is now a reality. Consumers want access to their data and applications wherever they are, through an ever-expanding range of smartphones and tablets. Businesses want to benefit from mobility, but retain security and control. In future, a key volume metric will be megabytes, not minutes.

Telecom is well poised to take advantage of these trends. Following the Chorus demerger, our business has changed significantly.

Today, Telecom is principally a retailer of services to consumer and business customers, utilising our own state-of-the-art Smartphone mobile network, reselling fixed line services over the Chorus copper network and, in future, over the new ultra-fast broadband (UFB) fibre network being progressively rolled out by Chorus and the local fibre companies.

A focus during the half year was to improve our market share performance in key segments by demonstrating clearly to customers our renewed determination to offer great products at competitive prices.

Mark Verbiest
CHAIRMAN

Simon Moutter
CHIEF EXECUTIVE OFFICER

In mobile, our overall mobile customer base has fallen as expected with the closure of the legacy CDMA network at the end of July, but we have experienced strong growth since August with 103,000 net additional connections. A key growth driver was the introduction of New Zealand's best value prepaid pack, which offers generous allowances of calling, text and data for $19 per month and has proved very popular with customers. In addition, our flanking brand, Skinny, increased its popularity especially among younger consumers. We also focused on managing our subscriber acquisition and retention costs (SARC) to improve margins in our mobile business.

We took further steps to improve our Smartphone mobile network. By December, we completed a programme to upgrade around 50% of the 3G network with Dual Carrier HSPA+ capability, building capacity and doubling download speeds for customers with Dual Carrier capable devices which are becoming more widely available. We are progressively extending coverage further across the 3G network, which already reaches 97% of where New Zealanders live and work, through initiatives such as planned co-location on more than 120 cell sites being developed under the Government's Rural Broadband Initiative. In December, we also began technical trials of next generation 4G LTE network technology, with customer trials commencing in February 2013.

In broadband, we resolved to stabilise our market share after several years of progressive share decline. Our move in September to refresh our portfolio of broadband plans with new sharply-priced offerings met with a pleasing customer response. Over the half year, we acquired a net 13,000 additional customers, a good performance in the context of an intensively competitive marketplace. Although the combination of competitive pressures and our new pricing has impacted margins in the broadband business, we believe the right strategy is to look to consolidate our market share ahead of the rollout of our UFB product offering from the fourth quarter (April to June) of this financial year.

We also showed our new competitive edge in December with a breakthrough approach to pricing for international data roaming. We introduced new flat rates of $6 per day for roaming in Australia and $10 per day in other top travel destinations. The flat fee approach provides certainty and simplicity, encouraging our customers to use their mobile devices overseas as they would in New Zealand and putting an end to any concerns about nasty bill shocks on the return home. The move is resonating strongly with our customers – in January 2013 (the first full month of the new pricing), roaming volumes were nearly three times higher than a year earlier.

Our ICT services division Gen-i experienced continued price-based competition and focused on exiting low margin business and delivering cost reduction initiatives. Gen-i maintains a leadership position in business markets, with a strong market share position in mobile among business customers. We see good opportunities to strengthen the suite of ICT solutions delivered over our networks and, increasingly, via the Cloud – not just for Gen-i's traditional customer base, but also for smaller and medium sized businesses serviced by either Gen-i or our Retail business.

Internationally, Telecom is leading an industry initiative to construct an additional telecommunications cable between Auckland and Sydney. Planned for completion by late 2014, the new cable will significantly improve New Zealand's international connectivity, strengthen links into fast-growing Asian markets as well as provide important redundancy for data traffic to and from New Zealand.

Looking ahead, we anticipate the process of change underway at Telecom will accelerate during the second half of this financial year. In line with the strategic shift in our business focus, management are developing a new corporate strategy and will be moving quickly to implementation over coming months. We intend to share more details about the strategy with investors in May.

Currently, our legacy as a traditional telco means we have a highly complex business and operating costs higher than our industry peers. We believe it is imperative we move quickly to recognise new business realities, simplify the business and ensure Telecom has a competitive cost base to succeed in a fast-changing marketplace.

We do not underestimate the difficult decisions, and challenges involved, in executing the strategy. But we recognise the importance of doing this well. Our products and our services matter to many people and underpin our country's economic success. We must do all we can to realign Telecom for a positive, sustainable future.

Mark Verbiest
CHAIRMAN

Simon Moutter
CHIEF EXECUTIVE

21 February 2013

Directors

Directors who held office during the half year and until the date of the report were:

Mark Verbiest	– Chairman since December 2011
Simon Moutter	– Chief Executive Officer and Executive Director since August 2012
Paul Berriman	– a Director since December 2011
Murray Horn	– a Director since July 2007
Maury Leyland	– a Director since December 2011
Kevin Roberts	– a Director since August 2008
Charles Sitch	– a Director since December 2011
Justine Smyth	– a Director since December 2011

Auditor's independence declaration

The independence declaration of our auditors is on page 34 and forms part of this report.

Key messages

Statutory results [1]

SIX MONTHS ENDED 31 DECEMBER	2012 $M	2011 $M	Change %
Operating revenue and other gains – continuing operations	2,135	2,358	(9.5)
EBITDA – continuing operations	516	519	(0.6)
EBITDA – discontinued operations	–	1,137	NM[2]
Total EBITDA	516	1,656	NM
Depreciation and amortisation expense – continuing operations	269	284	(5.3)
Earnings before tax – continuing operations	225	176	27.8
Net earnings – continuing operations	163	129	26.4
Earnings from discontinued operations, net of tax	–	877	NM
Total net earnings	163	1,006	NM
Diluted EPS (cents)	9	52	NM

1 Statutory results are those prepared in accordance with IFRS. For the differences between statutory and adjusted results, refer to the 'Non-GAAP financial measures' section.

2 NM means Not Meaningful.

The statutory results above are complicated by the demerger of Chorus which took effect from December 2011. Reporting on continuing operations, after adjusting for non-recurring or unusual items and excluding the discontinued operations, provides a more meaningful view of Telecom's performance as a separate company. These results are presented below and the focus throughout this commentary is primarily on the results of Telecom's continuing operations.

Adjusted results

SIX MONTHS ENDED 31 DECEMBER	2012 $M	2011 $M	Change %
Adjusted operating revenue and other gains – continuing operations	2,125	2,322	(8.5)
Adjusted EBITDA – continuing operations	506	488	3.7
Adjusted EBITDA – discontinued operations	–	321	NM
Total adjusted EBITDA	506	809	NM
Adjusted earnings before tax – continuing operations	215	145	48.3
Adjusted net earnings – continuing operations	156	99	57.6
Total adjusted net earnings	156	240	NM
Capital expenditure	246	325	NM
Capital expenditure – continuing operations	246	189	30.2
Adjusted free cash flow – continuing operations	260	299	(13.0)

- Adjusted EBITDA from continuing operations increased by $18 million to $506 million;
- Adjusted net earnings from continuing operations increased by $57 million to $156 million;
- H1 FY13 capital expenditure from continuing operations increased by $57 million to $246 million due to investments in spectrum and capacity;
- H1 FY13 dividend declared of 8.0 cents per share, 75% imputed; and
- On-market share buyback completed totalling $283 million, with $114 million repurchased during H1 FY13.

Group income statement

A breakdown of the group's reported income statement for the period ended 31 December 2012 (H1 FY13) and the prior comparative period is provided in the table below. All information presented in this section refers to the statutory results prepared in accordance with IFRS and is before consideration of any adjusting items.

SIX MONTHS ENDED 31 DECEMBER	2012 $M	2011 $M	Change %
Operating revenues and other gains – continuing operations			
Local service	436	457	(4.6)
Calling	330	394	(16.2)
Interconnection	47	53	(11.3)
Mobile	455	445	2.2
Data	259	268	(3.4)
Broadband and internet	203	238	(14.7)
IT services	266	267	(0.4)
Resale	37	93	(60.2)
Other operating revenue	91	97	(6.2)
Other gains	11	46	(76.1)
	2,135	**2,358**	**(9.5)**
Operating expenses – continuing operations			
Labour	384	411	(6.6)
Intercarrier costs	480	641	(25.1)
Other operating expenses	755	782	(3.5)
Other expenses	–	5	NM
	1,619	**1,839**	**(12.0)**
EBITDA – continuing operations	**516**	**519**	**(0.6)**
Depreciation	167	178	(6.2)
Amortisation	102	106	(3.8)
Earnings before interest and tax – continuing operations	**247**	**235**	**5.1**
Net finance expense	22	59	(62.7)
Earnings before tax – continuing operations	**225**	**176**	**27.8**
Income tax expense	62	47	31.9
Net earnings from continuing operations	**163**	**129**	**26.4**
Earnings from discontinued operations, net of tax	–	877	NM
Net profit after tax	**163**	**1,006**	**NM**

- Operating revenue and other gains for Telecom's continuing operations of $2,135 million in H1 FY13 reduced by $223 million, or 9.5%, when compared to the prior comparative period. Mobile revenue increased in H1 FY13 due to growth in higher-value connections and increased mobile data revenues following further smartphone penetration. However, all other revenue lines declined, primarily due to continued competition and Telecom's rebasing its mobile and broadband pricing. The continued declines in calling revenue primarily related to lower pricing and volumes in both the domestic market and the international carrier services market, combined with the impact of customer churn and managed rationalisation in Australia (which also impacted resale revenue).
- Other gains of $11 million in H1 FY13 comprised $10 million insurance recoveries relating to the Canterbury earthquakes and $1 million of other gains on sale. The insurance receipts are treated as adjusting items as detailed below.
- The decline in operating revenues from continuing operations was more than offset by reductions in operating expenses (excluding non-recurring other expenses), which fell by $215 million, or 11.7%, to $1,619 million in H1 FY13. For H1 FY13 the key drivers of the lower costs were reduced labour costs, lower intercarrier costs due to the effect of lower overall pricing, ongoing focus on cost-out initiatives and the impact of a strong New Zealand dollar. These reductions were partially offset by increased mobile cost of sales arising from increased acquisition volumes and higher average mobile device prices.
- The H1 FY13 combined depreciation and amortisation charges decreased by $15 million to $269 million primarily due to the flow-on effect from significant reductions in capital expenditure in the past two years.
- The net finance expense in H1 FY13 of $22 million was $37 million lower than in H1 FY12 primarily due to reduced debt levels at lower interest rates following Telecom's refinancing in H1 FY12, as well as finance lease income on arrangements with Chorus post-demerger.
- The H1 FY13 tax expense of $62 million was $15 million higher than the tax expense recognised in the prior comparative period primarily due to higher taxable earnings.
- Net earnings after tax from continuing operations of $163 million in H1 FY13 were $34 million higher than the $129 million in H1 FY12, primarily due to the reductions in the net finance expense and depreciation and amortisation charges referred to above.
- Net earnings after tax from discontinued operations of $877 million in H1 FY12 were primarily due to the gain on distribution of Chorus shares to shareholders. This gain is treated as an adjusting item due to its non-recurring nature.

Adjusting items and results

We use the terms 'adjusted operating revenue', 'adjusted EBITDA', 'adjusted net earnings' and 'adjusted free cash flow' to refer to such measures that reflect adjustments to our results to eliminate the effects of significant one-off gains, expenses and impairments. These are non-GAAP financial measures and are not prepared in accordance with IFRS. Management uses adjusted information to measure the underlying trends of the business and monitor performance. We believe that these adjusted financial measures give a helpful view of our results and facilitate comparisons from period to period in light of disposals and other one-off items. Our adjusted results should not be viewed in isolation or regarded as a replacement for corresponding IFRS measures, and we also note that these adjusted measures as defined or presented by us may not be comparable to similarly titled measures reported by other companies. Please refer to the Appendix on page 36 for further details on Telecom's non-GAAP financial measures.

During H1 FY13, the adjusting items were as follows:

- Other income of $10 million of insurance proceeds received in relation to the Canterbury earthquakes; and
- $3 million of related tax effects on the above adjustment.

During H1 FY12, the adjusting items were as follows:

- Costs of $5 million were incurred in relation to the Canterbury earthquakes;
- Other income of $8 million in relation to insurance proceeds in relation to the Canterbury earthquakes;
- One-off gain of $28 million in relation to the non-cash FX gain recycled from the foreign currency translation reserve; and
- $1 million of related tax effects on the above adjustments.

A reconciliation of reported total net earnings to adjusted total net earnings for Telecom's continuing operations is shown in the table below.

SIX MONTHS ENDED 31 DECEMBER	INCOME STATEMENT REPORTING LINE	2012 $M	2011 $M	Change %
Reported net earnings – continuing operations		**163**	**129**	**26.4**
Earthquake insurance claim proceeds	Other gains	(10)	(8)	NM
Gain on windup of foreign operation	Other gains	–	(28)	NM
Natural disaster costs	Other expense	–	5	NM
Related tax effects	Income tax expense	3	1	NM
Adjusted net earnings – continuing operations		**156**	**99**	**57.6**

- Adjusted net earnings from continuing operations of $156 million in H1 FY13 improved by $57 million when compared to the $99 million in H1 FY12 primarily due to the reductions across all operating expense lines more than offsetting revenue declines, a reduction in the net finance expense and reduced depreciation and amortisation expenses.

Segmental results

Telecom's business units comprise Wholesale & International, Retail, Gen-i, and AAPT and they are supported by a technology and shared services unit (T&SS). In addition to these operating segments, the results of which are reported to Telecom's Chief Executive Officer (CEO), there is also a central product group and a corporate centre.

Telecom has reclassified its comparative segment results to reflect the discontinuing of the 'Full Cost Apportionment' (FCA) allocation process with effect from 1 July 2012. While certain costs are still allocated internally, the process of substantially allocating all the costs from T&SS and certain Corporate costs to customer-facing business units has ceased. These costs will instead be reported within the T&SS and Corporate results. Telecom has also reclassified the comparative segment results for certain external interconnection revenues and costs previously recognised in Wholesale and then on-charged to other business units. These costs and revenues are now directly recognised in the relevant business unit. There is no change to the overall Group reported result due to these changes. Certain other comparative information has also been reclassified to conform with the current period's presentation.

The business unit results exclude significant one-off gains, expenses and impairments. These items are not included in the business unit results presented to Telecom's CEO to enable an analysis of the underlying earnings.

An analysis of Telecom's adjusted results by business unit is set out below, with further details available in a separate KPI file on the investor section of Telecom's website.

SIX MONTHS ENDED 31 DECEMBER	2012 NZ$M	2011 NZ$M	Change %
Adjusted operating revenue and other gains			
Wholesale & International	312	337	(7.4)
Retail	928	962	(3.5)
Gen-i	639	672	(4.9)
AAPT	263	370	(28.9)
T&SS	28	38	(26.3)
Corporate	44	45	(2.2)
Eliminations	(89)	(102)	12.7
Adjusted operating revenue and other gains from continuing operations	**2,125**	**2,322**	**(8.5)**
Adjusted EBITDA			
Wholesale & International	113	107	5.6
Retail	357	346	3.2
Gen-i	186	189	(1.6)
AAPT	36	40	(10.0)
T&SS	(152)	(155)	1.9
Corporate	(34)	(39)	12.8
Continuing operations	**506**	**488**	**3.7**
Discontinued operations	–	321	NM
Total adjusted EBITDA	**506**	**809**	**NM**

Key revenue trends:

Adjusted operating revenue and other gains from continuing operations declined by 8.5% to $2,125 million in H1 FY13 when compared to H1 FY12. The explanation of the decline is as described above with further detail of trends by business unit as follows:

- Wholesale & International's revenue decreased by $25 million, or 7.4%, to $312 million in H1 FY13 when compared to the prior comparative period, largely due to calling revenue declines caused by the reduction in minutes and the average price per minute for international calling. This was partially offset by increased local service revenue due to growth in Wholesale connections from 417,000 at 31 December 2011 to 442,000 at 31 December 2012. The H1 FY12 revenue also included other gains of $6 million that arose on the sale of cable capacity.
- Retail's operating revenues in H1 FY13 of $928 million decreased by $34 million, or 3.5%, as mobile revenue growth from connection growth and increased data revenues were more than offset by declines in other revenue lines. Local service and calling revenues declined by a combined $40 million in H1 FY13 primarily due to reductions in calling prices and declines in access lines due to strong competitor activity at entry-level price points. Broadband and internet revenues decreased by $9 million as Retail focused on growing market share, with a 13,000 increase in broadband connections since 30 June 2012 being more than offset by the impact of rebased broadband pricing. Mobile revenues increased by $12 million, despite an unfavourable impact of $21 million on H1 FY13 relative to H1 FY12, when the change in mobile terms and conditions had a more significant impact. Therefore, underlying mobile revenue growth was $33 million, or 10.8%, in H1 FY13 compared to the prior comparative period.
- Telecom's mobile base decreased by 15.2% to 1.723 million customers at 31 December 2012. However, as anticipated, this trend in six-month active connections was significantly impacted by the closure of the CDMA network in July 2012 and associated churn of predominantly low-value customers. H1 FY13 saw strong growth in both postpaid and prepaid connections after the CDMA network closure due to improved sales and marketing. Total ARPU of $34.61 increased by $5.43, or 18.6%, when compared to H1 FY12.
- Gen-i revenues declined by $33 million, or 4.9%, to $639 million, primarily due to reduced data and voice revenues largely driven by decline in legacy copper-based products, substitution and increased price competition.
- AAPT operating revenues decreased by A$83 million to A$206 million in H1 FY13 as revenue declined in all categories. A$54 million of the revenue decline is due to the final transition of services provided to the purchaser of the Consumer division, which affected calling, local service, broadband and internet and resale revenues. The Enterprise, Wholesale and Carrier divisions also experienced a combined A$29 million decrease in revenue when compared to H1 FY12 primarily due to customer churn and the continued rationalisation of low-margin Wholesale customers. Pricing pressure (mostly driven by Telstra) and market consolidation prior to NBN going live has further resulted in some AAPT customers shifting business to other providers.

- T&SS operating revenue decreased by $10 million to $28 million in H1 FY13 primarily due to a reduction in internal revenue from Chorus as a result of transition of staff to Chorus and differences in post demerger trading arrangements. T&SS external revenues increased $14 million due to a combination of new trading arrangements offset by a supplier rebate received in H1 FY12.
- Corporate operating revenue decreased by $1 million in H1 FY13 primarily due to $19 million of Southern Cross dividend income in H1 FY13 being $7 million lower than in H1 FY12, offset by foreign exchange gains and internal revenue increases. Southern Cross dividends vary in amount and timing and are denominated in USD.

Key EBITDA trends:

Adjusted EBITDA from continuing operations increased by 3.7% to $506 million in H1 FY13. Key movements by business unit are as follows:

- Wholesale and International's EBITDA increased by $6 million, or 5.6%, to $113 million in H1 FY13 when compared to H1 FY12. Reduced revenues were more than offset by a decrease in expenses. This was primarily due to a $24 million decrease in intercarrier costs as a result of lower costs per minute and post-demerger trading arrangements with Chorus.
- Retail EBITDA increased by $11 million, or 3.2%, compared to H1 FY12 as cost reductions more than offset revenue declines. Intercarrier costs reduced $44 million due to post-demerger trading arrangements with Chorus and the effect on costs of reduced access lines. Labour costs reduced by $5 million. These cost reductions were partially offset by increased mobile cost of sales arising from sales of more expensive mobile devices.
- Gen-i EBITDA decreased by $3 million, or 1.6%, to $186 million as revenue reductions were largely offset by reduced expenses driven by lower staff numbers and a range of cost-saving initiatives. Gen-i's Telecommunications EBITDA has declined $7 million, or 4.1%, to $163 million due to the decline in local service, calling and data revenues. Gen-i's IT Solutions EBITDA has increased by $4 million, or 21.1%, to $23 million, primarily driven by labour cost reduction.
- AAPT EBITDA reduced by A$4 million as revenue reductions were partially offset by reductions in labour costs, intercarrier costs and other operating expenses being the result of exiting contracts and office space, plus billing system rationalisation.
- T&SS EBITDA improved by $3 million to a $152 million loss in H1 FY13. T&SS's net costs are no longer recovered from other business units with FCA discontinued from 1 July 2012 with comparatives reclassified. The revenue decrease was more than offset by an $8 million decrease in operating expenses, as a result of the CDMA network closure, continued improvements to fixed and mobile operation costs and improved IT sourcing, as well as a $5 million reduction in labour costs due to the transition of staff to Chorus.
- Corporate EBITDA improved by $5 million to a $34 million loss in H1 FY13, due to labour cost savings and the impact of other cost-saving initiatives, partially offset by the decline in Southern Cross dividends received.

Capital expenditure

SIX MONTHS ENDED 31 DECEMBER	2012 $M	2011 $M	Change %
Total transformation and regulation	19	130	(85.4)
Total business sustaining	227	195	16.4
Total	**246**	**325**	**(24.3)**
Capital expenditure related to discontinued operations	–	136	NM
Capital expenditure related to continuing operations	246	189	30.2
Total	**246**	**325**	**(24.3)**

Total capital expenditure for H1 FY13 of $246 million was $79 million, or 24.3%, less than H1 FY12. However, H1 FY12 included $136 million of Chorus-related spend for the five months before demerger.

Investment in transformation and regulation activities decreased by $111 million in H1 FY13 primarily due to Chorus-related spend and Retail NGT investment in the prior comparative period, partially offset by $8 million of new investment in H1 FY13 relating to the simplification and re-engineering of IT systems.

Total business sustaining investment increased by $32 million to $227 million in H1 FY13. This consisted of $39 million increased investment in the WCDMA mobile network largely due to the renewal of spectrum; a $10 million increased investment in Southern Cross capacity due to the purchase of further bandwidth; and a $15 million increase in spend relating to the replacement of billing systems platforms and equipment purchases for optical transport network; partially offset by Chorus-related spend on network maintenance and growth in the prior comparative period.

Adjusted free cash flow

Telecom's adjusted free cash flow from continuing operations is defined as adjusted EBITDA from continuing operations less capital expenditure from continuing operations. This involves removing capital expenditure relating to discontinued operations from the H1 FY12 reported capital expenditure.

SIX MONTHS ENDED 31 DECEMBER	2012 $M	2011 $M	Change %
Total adjusted EBITDA from continuing operations	506	488	3.7
Less: Total capital expenditure	(246)	(325)	(24.3)
Add: Capital expenditure relating to discontinued operations	–	136	NM
Total adjusted free cash flow from continuing operations	**260**	**299**	**(13.0)**

Telecom's adjusted free cash flow from continuing operations in H1 FY13 of $260 million decreased by $39 million, or 13.0%, when compared to $299 million in H1 FY12. The H1 FY13 decrease was attributable to an increase in capital expenditure relating to continuing operations of $57 million over the comparative period, partially offset by an increase in adjusted EBITDA from continuing operations of $18 million.

Group cash flow

SIX MONTHS ENDED 31 DECEMBER	2012 $M	2011[1] $M	Change %
Cash flows from operating activities	424	504	(15.9)
Cash flows from investing activities	(174)	(395)	55.9
Cash flows from financing activities	(121)	(114)	(6.1)
Foreign exchange movement	(3)	1	NM
Net movement in cash[2]	**126**	**(4)**	**NM**

1 Includes cash flows relating to discontinued operations.

2 For further detail of the cash flows in H1 FY13 and H1 FY12, refer to the condensed consolidated cash flows statement on page 23.

Cash flows from operating activities

Net cash from operating activities decreased in H1 FY13 by $80 million to $424 million when compared to H1 FY12, primarily due to Telecom now paying Chorus for services previously treated as internal trading (non-cash), offset by decreased interest payments, driven by reduced debt levels at lower rates, and lower tax payments.

Cash flows from investing activities

The net cash outflow on investing activities of $174 million in H1 FY13 was $221 million lower than the $395 million outflow in H1 FY12, largely due to a $212 million reduction in capital expenditure payments in H1 FY13 (primarily due to the comparative period including Chorus-related spend up to demerger), $10 million of net insurance recoveries and $8 million from the sale of property, plant and equipment in H1 FY13.

Cash flows from financing activities

Telecom's outflows from financing activities largely reflect borrowing activities and dividend payments to shareholders. The net cash outflow for financing activities in H1 FY13 was $121 million, compared to a cash outflow of $114 million in H1 FY12. H1 FY13 includes the payment of dividends and the share buyback, partially offset by the issue of new term debt. H1 FY12 includes the debt restructuring transactions that occurred around demerger, combined with the receipt of released collateral funds.

Long-term capital management and dividend policy

Long-term capital management

Telecom's principal sources of liquidity are operating cash flows and external borrowing from established debt programmes and bank facilities.

The Telecom board continues to be committed to Telecom maintaining an 'A band' credit rating and its capital management policies are designed to ensure this objective is met. To that end, Telecom intends to manage its debt levels to ensure that the ratio of net interest bearing debt (inclusive of associated derivatives) to EBITDA does not materially exceed 1.1 times on a long run basis, which for credit ratings agency purposes equates approximately to debt to EBITDA of 1.5 times. The difference between these two ratios is primarily due to the rating agencies adjusting for items such as cash in the business and the capitalisation of operating leases.

As at 31 December 2012, Telecom had been assigned a credit rating of A-/Stable by Standard & Poor's and A3/Stable by Moody's Investor Services.

On-market buyback

On 24 February 2012, Telecom announced its intention to complete an on-market share buyback of up to $300 million during the 2012 calendar year. During the six months ended 31 December 2012, Telecom repurchased 49.9 million of its own shares at a cost of $114 million. This brought the total shares repurchased as part of the on-market buyback to approximately 119 million at a cost of $283 million (representing an average buyback price of $2.39). Shares repurchased were cancelled immediately on acquisition. The buyback was undertaken to return capital deemed surplus to existing requirements and to achieve a gearing ratio more consistent with Telecom's long-term capital management policies.

FY13 ordinary dividends

In FY13 Telecom has continued with the existing dividend policy of targeting a payout ratio of approximately 90% of adjusted net earnings, subject to there being no material adverse changes in circumstances or operating outlook.

Consistent with this policy, a dividend of 8.0 cents per share has been declared for H1 FY13. This dividend will be partially imputed at the rate of 2.3333 imputation credits per share (which equates to 75% imputation based on the current corporate tax rate). A supplementary dividend of 1.0588 cents per share will be paid to non-resident shareholders.

Subject to there being no adverse change in operating outlook, the dividend for H2 FY13 will be set to reflect the full year policy.

First half ordinary dividends	
Ordinary shares	8.0 cents
American Depositary Shares[1]	32.84 US cents
"Ex" dividend dates	
New Zealand Stock Exchange	13 Mar 2013
Australian Stock Exchange	8 Mar 2013
American Depositary Shares	12 Mar 2013
Record dates	
New Zealand, Australian Stock Exchanges	15 Mar 2013
American Depositary Shares	14 Mar 2013
Payment dates	
New Zealand, Australia	5 Apr 2013
American Depositary Shares	12 Apr 2013

1 Based on an exchange rate at 31 December 2012 of NZ$1.00 to US$0.8210 and a ratio of five ordinary shares per one American Depositary Share. The actual exchange rate used for conversion is determined in the week prior to payment when the Bank of New York performs the physical currency conversion.

Dividend Reinvestment Plan

The Dividend Reinvestment Plan has been retained. For the H1 FY13 dividend, shares issued under the Dividend Reinvestment Plan will be issued at the prevailing market price applied to ordinary shares. The last date for shareholders to elect to participate in the Dividend Reinvestment Plan for the H1 FY13 dividend is 15 March 2013.

For the H1 FY13 dividend Telecom intends to acquire an equivalent number of ordinary shares on-market to those issued under the Dividend Reinvestment Plan. These mechanisms will be reviewed at each dividend date.

Financial Statements

Condensed consolidated income statement

For the six months ended 31 December 2012

(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)	NOTES	SIX MONTHS ENDED 31 DECEMBER 2012 UNAUDITED NZ$	SIX MONTHS ENDED 31 DECEMBER 2011 UNAUDITED NZ$	YEAR ENDED 30 JUNE 2012 AUDITED NZ$
Operating revenues and other gains – continuing operations				
Local service		436	457	905
Calling		330	394	754
Interconnection		47	53	104
Mobile		455	445	904
Data		259	268	527
Broadband and internet		203	238	454
IT services		266	267	544
Resale		37	93	143
Other operating revenue	3	91	97	187
Other gains	4	11	46	54
		2,135	**2,358**	**4,576**
Operating expenses – continuing operations				
Labour		(384)	(411)	(797)
Intercarrier costs		(480)	(641)	(1,160)
Other operating expenses	5	(755)	(782)	(1,535)
Other expenses	4	–	(5)	(5)
Depreciation		(167)	(178)	(363)
Amortisation		(102)	(106)	(213)
		(1,888)	**(2,123)**	**(4,073)**
Finance income		15	8	26
Finance expense		(37)	(67)	(106)
Net earnings before income tax – continuing operations		**225**	**176**	**423**
Income tax expense		(62)	(47)	(112)
Net earnings from continuing operations		163	129	311
Net earnings from discontinued operations		–	877	846
Net earnings for the period		**163**	**1,006**	**1,157**
Net earnings attributable to equity holders of the Company		162	1,005	1,155
Net earnings attributable to non-controlling interest		1	1	2
		163	**1,006**	**1,157**
Basic and diluted net earnings per share (in cents)		9	52	60
Basic and diluted earnings per share from continuing operations (in cents)		9	7	16
Basic and diluted earnings per share from discontinuing operations (in cents)		–	45	44
Weighted average number of ordinary shares outstanding (in millions)		1,851	1,925	1,918

See accompanying notes to the financial statements.

Condensed consolidated statement of comprehensive income

For the six months ended 31 December 2012

(DOLLARS IN MILLIONS)	SIX MONTHS ENDED 31 DECEMBER 2012 UNAUDITED NZ$	SIX MONTHS ENDED 31 DECEMBER 2011 UNAUDITED NZ$	YEAR ENDED 30 JUNE 2012 AUDITED NZ$
Net earnings for the period	**163**	**1,006**	**1,157**
Other comprehensive income/(loss)[1]:			
Items that will not be reclassified to profit or loss:			
Revaluation of long-term investments	(1)	(20)	(68)
Items that may be reclassified to profit or loss:			
Translation of foreign operations	(7)	2	(13)
Net investment hedges	–	(3)	(3)
Reclassified to income statement on disposal of foreign operation	(6)	(28)	(28)
Cash flow hedges	2	52	53
Other comprehensive income/(loss) for the period	(12)	3	(59)
Total comprehensive income for the period	**151**	**1,009**	**1,098**
Attributable to equity holders of the Company	150	1,008	1,096
Attributable to non-controlling interest	1	1	2
Total comprehensive income for the period	**151**	**1,009**	**1,098**

1 Components of other comprehensive income are shown net of tax.

See accompanying notes to the financial statements.

Condensed consolidated statement of changes in equity

For the six months ended 31 December

UNAUDITED (DOLLARS IN MILLIONS)	SHARE CAPITAL NZ$	RETAINED EARNINGS NZ$	HEDGE RESERVE NZ$	SHARE BASED DEFERRED COMPENSATION RESERVE NZ$	REVALUATION RESERVE NZ$	FOREIGN CURRENCY TRANSLATION RESERVE NZ$	TOTAL EQUITY HOLDERS OF THE COMPANY NZ$	NON-CONTROLLING INTEREST NZ$	TOTAL EQUITY NZ$
Balance at 1 July 2011	**1,528**	**1,207**	**(59)**	**14**	**(345)**	**(39)**	**2,306**	**5**	**2,311**
Net earnings for the period	–	1,005	–	–	–	–	1,005	1	1,006
Other comprehensive income/(loss)	–	–	52	–	(20)	(29)	3	–	3
Total comprehensive income/(loss) for the period	**–**	**1,005**	**52**	**–**	**(20)**	**(29)**	**1,008**	**1**	**1,009**
Contributions by and distributions to owners:									
Ordinary dividends	–	(183)	–	–	–	–	(183)	–	(183)
Supplementary dividends	–	(25)	–	–	–	–	(25)	–	(25)
Tax credit on supplementary dividends	–	25	–	–	–	–	25	–	25
Issuance of shares under share schemes	16	–	–	(7)	–	–	9	–	9
Distribution of Chorus shares	(383)	(881)	–	–	–	–	(1,264)	–	(1,264)
Total transactions with owners	(367)	(1,064)	–	(7)	–	–	(1,438)	–	(1,438)
Balance at 31 December 2011	**1,161**	**1,148**	**(7)**	**7**	**(365)**	**(68)**	**1,876**	**6**	**1,882**
Balance at 1 July 2012	**990**	**1,126**	**(6)**	**7**	**(413)**	**(83)**	**1,621**	**5**	**1,626**
Net earnings for the period	–	162	–	–	–	–	162	1	163
Other comprehensive income/(loss)	–	–	2	–	(1)	(13)	(12)	–	(12)
Total comprehensive income/(loss) for the period	**–**	**162**	**2**	**–**	**(1)**	**(13)**	**150**	**1**	**151**
Contributions by and distributions to owners:									
Ordinary dividends	–	(204)	–	–	–	–	(204)	–	(204)
Supplementary dividends	–	(20)	–	–	–	–	(20)	–	(20)
Tax credit on supplementary dividends	–	20	–	–	–	–	20	–	20
Dividend reinvestment plan	15	–	–	–	–	–	15	–	15
Issuance of shares under share schemes	8	–	–	(6)	–	–	2	–	2
Shares repurchased	(114)	–	–	–	–	–	(114)	–	(114)
Total transactions with owners	(91)	(204)	–	(6)	–	–	(301)	–	(301)
Balance at 31 December 2012	**899**	**1,084**	**(4)**	**1**	**(414)**	**(96)**	**1,470**	**6**	**1,476**

See accompanying notes to the financial statements.

Condensed consolidated statement of changes in equity (continued)

For the year ended 30 June 2012

AUDITED (DOLLARS IN MILLIONS)	SHARE CAPITAL NZ$	RETAINED EARNINGS NZ$	HEDGE RESERVE NZ$	SHARE BASED DEFERRED COMPENSATION RESERVE NZ$	REVALUATION RESERVE NZ$	FOREIGN CURRENCY TRANSLATION RESERVE NZ$	TOTAL EQUITY HOLDERS OF THE COMPANY NZ$	NON-CONTROLLING INTEREST NZ$	TOTAL EQUITY NZ$
Balance at 1 July 2011	**1,528**	**1,207**	**(59)**	**14**	**(345)**	**(39)**	**2,306**	**5**	**2,311**
Net earnings for the period	–	1,155	–	–	–	–	1,155	2	1,157
Other comprehensive income/(loss)	–	–	53	–	(68)	(44)	(59)	–	(59)
Total comprehensive income/(loss) for the period	**–**	**1,155**	**53**	**–**	**(68)**	**(44)**	**1,096**	**2**	**1,098**
Contributions by and distributions to owners:									
Ordinary dividends	–	(355)	–	–	–	–	(355)	(2)	(357)
Supplementary dividends	–	(47)	–	–	–	–	(47)	–	(47)
Tax credit on supplementary dividends	–	47	–	–	–	–	47	–	47
Shares repurchased for dividend reinvestment plan	(16)	–	–	–	–	–	(16)	–	(16)
Dividend reinvestment plan	16	–	–	–	–	–	16	–	16
Issuance of shares under share schemes	14	–	–	(7)	–	–	7	–	7
Distribution of Chorus shares	(383)	(881)	–	–	–	–	(1,264)	–	(1,264)
Shares repurchased	(169)	–	–	–	–	–	(169)	–	(169)
Total transactions with owners	(538)	(1,236)	–	(7)	–	–	(1,781)	(2)	(1,783)
Balance at 30 June 2012	**990**	**1,126**	**(6)**	**7**	**(413)**	**(83)**	**1,621**	**5**	**1,626**

See accompanying notes to the financial statements.

Condensed consolidated statement of financial position

As at 31 December 2012

(DOLLARS IN MILLIONS)	NOTE	31 DECEMBER 2012 UNAUDITED NZ$	31 DECEMBER 2011 UNAUDITED NZ$	30 JUNE 2012 AUDITED NZ$
ASSETS				
Current assets:				
Cash		311	320	185
Short-term derivative assets		2	1	1
Receivables and prepayments		714	675	684
Taxation recoverable		26	46	53
Inventories		64	82	49
Total current assets		1,117	1,124	972
Non-current assets:				
Long-term investments		56	105	57
Long-term receivables and prepayments		169	184	222
Long-term derivative assets		–	–	1
Intangible assets		985	911	900
Property, plant and equipment		1,438	1,652	1,515
Total non-current assets		2,648	2,852	2,695
Total assets		**3,765**	**3,976**	**3,667**
LIABILITIES AND EQUITY				
Current liabilities:				
Accounts payable and accruals		823	839	775
Taxation payable		6	-	6
Short-term derivative liabilities		3	15	3
Short-term provisions		19	12	13
Debt due within one year	10	405	420	407
Total current liabilities		1,256	1,286	1,204
Non-current liabilities:				
Deferred tax liability		162	128	159
Long-term derivative liabilities		22	23	23
Long-term payables and accruals		27	5	30
Long-term provisions		20	34	20
Long-term debt	10	802	618	605
Total non-current liabilities		1,033	808	837
Total liabilities		**2,289**	**2,094**	**2,041**
Equity:				
Share capital		899	1,161	990
Reserves		(513)	(433)	(495)
Retained earnings		1,084	1,148	1,126
Total equity attributable to equity holders of the Company		**1,470**	**1,876**	**1,621**
Non-controlling interest		6	6	5
Total equity		**1,476**	**1,882**	**1,626**
Total liabilities and equity		**3,765**	**3,976**	**3,667**

See accompanying notes to the financial statements.

Condensed consolidated statement of cash flows

For the six months ended 31 December 2012

(DOLLARS IN MILLIONS)	NOTE	SIX MONTHS ENDED 31 DECEMBER 2012 UNAUDITED NZ$	SIX MONTHS ENDED 31 DECEMBER 2011 UNAUDITED NZ$	YEAR ENDED 30 JUNE 2012 AUDITED NZ$
Cash flows from operating activities				
Cash received from customers		2,098	2,394	4,568
Interest income		13	8	26
Dividend income		19	26	58
Payments to suppliers and employees		(1,644)	(1,730)	(3,402)
Income tax paid		(32)	(84)	(120)
Interest expense		(30)	(110)	(145)
Net cash flow from operating activities	7	**424**	**504**	**985**
Cash flows from investing activities				
Sale of property, plant and equipment		9	1	2
Insurance proceeds		20	–	–
Insurance proceeds paid to Chorus		(10)	–	–
Sale/(purchase) of business		(5)	5	5
Sale of and proceeds from long-term investments		1	1	1
Purchase of property, plant and equipment and intangibles		(185)	(397)	(663)
Capitalised interest paid		(4)	(5)	(8)
Net cash flow from investing activities		**(174)**	**(395)**	**(663)**
Cash flows from financing activities				
Proceeds from long-term debt		350	–	300
Repayment of long-term debt		(150)	(961)	(964)
Proceeds from short-term debt		356	2,012	2,638
Repayment of short-term debt		(362)	(570)	(1,511)
Dividends paid		(190)	(183)	(340)
Payments on finance leases		(4)	(3)	(7)
Receipts on finance leases		13	10	20
Share repurchase – buyback		(134)	–	(149)
Share repurchase – dividend reinvestment plan		–	–	(16)
Repayment of derivatives		–	(1,279)	(1,299)
Proceeds from derivatives		–	961	961
Debt restructuring costs		–	(211)	(205)
Decrease in collateral funds		–	110	110
Net cash flow from financing activities		**(121)**	**(114)**	**(462)**
Net cash flow		129	(5)	(140)
Opening cash position		185	324	324
Foreign exchange movement		(3)	1	1
Closing cash position		**311**	**320**	**185**

See accompanying notes to the financial statements.

Notes to the condensed consolidated interim financial statements

Note 1 Financial statements

The condensed consolidated interim financial statements of Telecom Corporation of New Zealand Limited (the Company) together with its subsidiaries and associates (Telecom), as at and for the six months ended 31 December 2012, have been prepared in accordance with the New Zealand equivalent to International Accounting Standard No. 34: 'Interim Financial Reporting', and Generally Accepted Accounting Practice in New Zealand (NZ GAAP).

Telecom Corporation of New Zealand Limited is a profit-oriented company registered in New Zealand under the Companies Act 1993 and is an issuer for the purposes of the Financial Reporting Act 1993.

These condensed consolidated interim financial statements have been prepared using the same accounting policies and methods of computation as, and should be read in conjunction with, the financial statements and related notes included in Telecom's annual report for the year ended 30 June 2012. The preparation of interim financial statements also requires management to make judgements, estimates and assumptions. Telecom has been consistent in applying the judgements, estimates and assumptions adopted in the annual report for the year ended 30 June 2012. Critical accounting policies are the same as those set out in the annual report for the year ended 30 June 2012.

Telecom has reclassified its comparative segment results to reflect the discontinuing of the 'Full Cost Apportionment' (FCA) allocation process with effect from 1 July 2012. While certain costs are still allocated internally, the process of substantially allocating all the costs from Technology and Shared Services (T&SS) and certain Corporate costs to customer-facing business units has ceased. These costs instead remain within the T&SS and Corporate results. Telecom has also reclassified the comparative segment results for certain external interconnection revenues and costs previously recognised in Wholesale and then on-charged to other business units. These costs and revenues are now directly recognised in the relevant business unit. There is no change to the overall Group reported result as a result of these changes. Certain other comparative information has also been reclassified to conform with the current period's presentation.

Telecom has adopted amendments to NZ IAS 1 'Presentation of financial statements – presentation of other comprehensive income' for these interim financial statements. These amendments require grouping of items presented in other comprehensive income on the basis of whether they are potentially reclassifiable to profit or loss in subsequent periods.

The presentation currency of these condensed consolidated financial statements is New Zealand dollars which is also the Company's functional currency. References in these financial statements to '$' or 'NZ$' are to New Zealand dollars. All financial information has been rounded to the nearest million, unless otherwise stated.

These condensed consolidated interim financial statements were approved by the board of directors on 21 February 2013 and are unaudited. However, the results for the year ending and as at 30 June 2012, excluding the segmental reclassifications referred to above, have been extracted from the Group's audited financial statements in the annual report for the year ended 30 June 2012. The annual report is available on Telecom's website: http://investor.telecom.co.nz.

Note 2 Segmental reporting

Telecom's segments comprise Wholesale & International, Retail, Gen-i, T&SS and AAPT.

Segmental information for the six months ended 31 December 2012

UNAUDITED (DOLLARS IN MILLIONS)	WHOLESALE & INTERNATIONAL NZ$	RETAIL NZ$	GEN-I NZ$	T&SS NZ$	AAPT NZ$	TOTAL NZ$
External revenue and other gains	280	927	618	28	242	2,095
Internal revenue	32	1	21	–	21	75
Total revenue and other gains	**312**	**928**	**639**	**28**	**263**	**2,170**
Segment result	**113**	**357**	**186**	**(152)**	**36**	**540**

Segmental information for the six months ended 31 December 2011

UNAUDITED (RECLASSIFIED) (DOLLARS IN MILLIONS)	WHOLESALE & INTERNATIONAL NZ$	RETAIL NZ$	GEN-I NZ$	T&SS NZ$	AAPT NZ$	TOTAL NZ$
External revenue and other gains	297	962	647	14	348	2,268
Internal revenue[1]	40	–	25	24	22	111
Total revenue and other gains	**337**	**962**	**672**	**38**	**370**	**2,379**
Segment result	**107**	**346**	**189**	**(155)**	**40**	**527**

1 T&SS internal revenue includes internal cost allocations and charges to discontinued operations of $21 million.

Segmental information for the year ended 30 June 2012

AUDITED (RECLASSIFIED) (DOLLARS IN MILLIONS)	WHOLESALE & INTERNATIONAL NZ$	RETAIL NZ$	GEN-I NZ$	T&SS NZ$	AAPT NZ$	TOTAL NZ$
External revenue and other gains	579	1,925	1,286	43	618	4,451
Internal revenue[1]	72	3	49	24	46	194
Total revenue and other gains	**651**	**1,928**	**1,335**	**67**	**664**	**4,645**
Segment result	**221**	**728**	**389**	**(306)**	**88**	**1,120**

1 T&SS internal revenue includes internal cost allocations and charges to discontinued operations of $21 million.

The segment results disclosed are based on those reported to Telecom's Chief Executive Officer (CEO) and are how Telecom analyses its business results. Segment results are measured based on net earnings before depreciation, amortisation, other gains and expenses not allocated to segments, finance income and expenses, associates' profit / losses and income taxation expense. None of these other items are assessed on a segment basis by Telecom's CEO.

Telecom has a central product group, which designs, develops and manages pricing and business process activities associated with Telecom products across New Zealand customer-facing units. However, for reporting purposes its results are included in the reporting segments set out above and are not separately reported to Telecom's CEO as a reporting segment.

Reconciliation from segment result to earnings before income tax

		SIX MONTHS ENDED 31 DECEMBER		YEAR ENDED 30 JUNE
		2012 UNAUDITED	**2011** UNAUDITED	**2012** AUDITED
(DOLLARS IN MILLIONS)	NOTE	NZ$	NZ$	NZ$
Segment result		540	527	1,120
Net result of Corporate revenue and expenses		(34)	(39)	(72)
Other gains not allocated to segments	4	10	36	36
Other expenses not allocated for segmental reporting	4	–	(5)	(5)
Depreciation		(167)	(178)	(363)
Amortisation		(102)	(106)	(213)
Finance income		15	8	26
Finance expense		(37)	(67)	(106)
Net earnings before income tax – continuing operations		**225**	**176**	**423**

Note 3 Other operating revenue

	SIX MONTHS ENDED 31 DECEMBER		YEAR ENDED 30 JUNE
	2012 UNAUDITED	**2011** UNAUDITED	**2012** AUDITED
(DOLLARS IN MILLIONS)	NZ$	NZ$	NZ$
Dividend income	19	26	58
Sale of equipment	4	6	10
Miscellaneous other	68	65	119
	91	**97**	**187**

Dividend income includes dividends received from Southern Cross Cables Holdings Limited, a related party by way of Telecom's 50% shareholding in the company.

Note 4 Other gains & other expenses

(DOLLARS IN MILLIONS)	SIX MONTHS ENDED 31 DECEMBER 2012 UNAUDITED NZ$	SIX MONTHS ENDED 31 DECEMBER 2011 UNAUDITED NZ$	YEAR ENDED 30 JUNE 2012 AUDITED NZ$
Other gains			
Gain on sale	1	10	10
Settlement on insurances	10	8	8
Various resolutions and settlements with supplier	–	–	8
Gain on winding up of foreign operation	–	28	28
	11	**46**	**54**
Other expenses			
Natural disaster costs	–	5	5
	–	**5**	**5**

Other gains in the six months ended 31 December 2012 of $11 million represented:

- $1 million gain on sale of Telecom's 50% interest in Community Telco Australia; and
- $10 million (net) received from insurers in relation to the February 2011 Canterbury earthquake claim.

Other gains in the six months ended 31 December 2011 of $46 million represented:

- $10 million gain on the sale of Gen-i's Software Solutions business to Infosys and sale of cable capacity;
- $28 million gain on the winding up of the Australian branch of TCNZ Finance Limited; and
- $8 million confirmed as being due from insurers in relation to the February 2011 Canterbury earthquake claim.

Other gains in the year ended 30 June 2012 of $54 million represented:

- $4 million gain on the sale of the Gen-i Software Solutions business to Infosys for $5 million;
- $6 million gain on the sale of cable capacity;
- $8 million gain relating to various resolutions and settlements reached with a supplier;
- $28 million gain on the winding up of the Australian branch of TCNZ Finance Limited; and
- $8 million received from insurers in relation to the February 2011 Canterbury earthquake claim.

In the year ended 30 June 2012 and the six months ended 31 December 2011, other expenses represented costs recognised in relation to the Canterbury earthquakes.

Note 5 Other operating expenses

(DOLLARS IN MILLIONS)	SIX MONTHS ENDED 31 DECEMBER 2012 UNAUDITED NZ$	SIX MONTHS ENDED 31 DECEMBER 2011 UNAUDITED NZ$	YEAR ENDED 30 JUNE 2012 AUDITED NZ$
Direct costs	47	59	105
Mobile acquisitions, upgrades and dealer commissions	175	153	336
Procurement and IT services	154	154	317
Broadband and internet	121	139	279
Computer costs	43	51	89
Advertising promotions and communications	41	37	65
Accommodation and co-location	67	88	152
Outsourcing	11	9	20
Travel	6	6	14
Bad debts	7	6	9
Field service costs	25	28	51
Other expenses	58	52	98
	755	**782**	**1,535**

Note 6 Dividends and equity

Dividends paid

During the period, Telecom paid a dividend relating to the six months ended 30 June 2012 of $204 million representing 11 cents per share. The dividend was partially imputed (at a ratio of 21/72), which equates to 75% imputation based on the corporate income tax rate. In addition a supplementary dividend, of approximately $20 million, was paid to shareholders who are not resident in New Zealand. In accordance with the Income Tax Act 2007, Telecom receives a tax credit from Inland Revenue equivalent to the amount of supplementary dividend paid.

Declaration of dividend

On 21 February 2013, the board of directors approved the payment of a dividend for the six months ended 31 December 2012 of $145 million, representing 8 cents per share. This dividend will be partially imputed (at a ratio of 21/72), which equates to 75% imputation based on the current corporate income tax rate. In addition a supplementary dividend, of approximately $19 million (1.0588 cents per share), will be payable to shareholders who are not resident in New Zealand. In accordance with the Income Tax Act 2007, Telecom will receive a tax credit from Inland Revenue equivalent to the amount of supplementary dividends paid.

Shares repurchased

During the six months ended 31 December 2012, Telecom repurchased 49,899,670 of its own shares at a cost of $114 million. This brings the total shares repurchased as part of the on-market buyback to 118,577,138 at a cost of $283 million. Shares repurchased were cancelled immediately on acquisition.

Shares issued in lieu of dividends

In respect of the six months ended 31 December 2012, 6,493,423 shares with a total value of $15 million were issued in lieu of a cash dividend (six months ended 31 December 2011: no shares with nil value; year ended 30 June 2012: 6,866,385 shares with a total value of $16 million).

Note 7 Reconciliation of net earnings to net cash flow from operating activities

	SIX MONTHS ENDED 31 DECEMBER		YEAR ENDED 30 JUNE
	2012 UNAUDITED	2011 UNAUDITED	2012 AUDITED
(DOLLARS IN MILLIONS)	NZ$	NZ$	NZ$
Net earnings for the period	163	1,006	1,157
Adjustments to reconcile net earnings to net cash flow from operating activities:			
Depreciation and amortisation	269	389	681
Bad and doubtful accounts	8	7	12
Deferred income tax	(6)	62	88
Net gain on asset arrangements	–	(88)	(68)
Gain on distribution of Chorus shares	–	(775)	(764)
Gain on novation of derivatives on demerger	–	(101)	(101)
Debt restructuring costs (included in financing cash flows)	–	211	211
Gain on winding up of foreign operations	–	(28)	(28)
Net insurance proceeds	(10)	–	–
Other	(13)	(11)	(13)
Changes in assets and liabilities net of effects of non-cash and investing and financing activities:			
Decrease/(increase) in accounts receivable and related items	(1)	9	(5)
Decrease/(increase) in inventories	(15)	(27)	6
Decrease/(increase) in current taxation receivable	36	(74)	(74)
Increase/(decrease) in accounts payable and related items	(7)	(76)	(117)
Net cash flow from operating activities	**424**	**504**	**985**

Note 8 Contingencies

Effect of outstanding claims

Telecom has ongoing claims, investigations and inquiries, none of which it currently believes are expected to have significant effect on the financial position or profitability of Telecom. Telecom cannot reasonably estimate the adverse effect (if any) on Telecom if any of the foregoing outstanding claims or inquiries is ultimately resolved against Telecom's interests. There can be no assurance that such litigation or inquiries will not have a significant effect on Telecom's business, financial position, results of operations or profitability.

Commitments

At 31 December 2012, capital expenditure amounting to $101 million (31 December 2011: $47 million) had been committed under contractual arrangements, with substantially all payments due within one year. The capital expenditure commitments principally relate to telecommunications network equipment.

Note 9 Significant events after balance date

As described in Note 6, Telecom has declared a dividend in respect of the six months ended 31 December 2012.

Note 10 Current and long-term debt

	SIX MONTHS ENDED 31 DECEMBER		YEAR ENDED 30 JUNE
	2012 UNAUDITED	2011 UNAUDITED	2012 AUDITED
	NZ$	NZ$	NZ$
Short-term debt	90	419	95
EMTN	79	80	79
TeleBonds	539	542	539
Bank funding	250	–	300
Domestic notes	250	–	–
Unamortised discount	(1)	(3)	(1)
Total debt	**1,207**	**1,038**	**1,012**
Debt due within one year	405	420	407
Debt due greater than one year	802	618	605
Total debt	**1,207**	**1,038**	**1,012**

During the six months ending December 2012, Telecom issued NZ$250 million of notes in New Zealand, maturing in 2019. The notes are unsecured and pay a coupon of 5.25%. See note 25 of Telecom's annual report for the year ended 30 June 2012 for further details on the Group's other debt facilities, the material terms of which are unchanged at 31 December 2012.

Note 11 Investment in associate companies

Telecom's investment in associate companies consists of:

	COUNTRY	OWNERSHIP	PRINCIPAL ACTIVITY
Pacific Carriage Holdings Limited	Bermuda	50%	A holding company
Southern Cross Cables Holdings Limited	Bermuda	50%	A holding company

During the period Telecom sold its shares in Community Telco Australia Pty Limited.

Auditors' review report

KPMG

To the shareholders of Telecom Corporation of New Zealand Limited

We have completed a review of the financial statements on pages 18 to 32 in accordance with the Review Engagement Standard RS-1 issued by the External Reporting Board and RG-1 issued by the New Zealand Institute of Chartered Accountants. The financial statements provide information about the past financial performance of Telecom Corporation of New Zealand Limited and its subsidiaries ("the Group") and its financial position as at 31 December 2012.

Directors' responsibilities

The Directors of Telecom Corporation of New Zealand Limited are responsible for the preparation of financial statements which give a true and fair view of the financial position of the Group as at 31 December 2012 and the results of its operations for the six month period ended on that date.

Reviewers' responsibilities

It is our responsibility to express an independent opinion on the financial statements presented by the Directors and report our opinion to you.

Basis of opinion

A review is limited primarily to enquiries of company personnel and analytical review procedures applied to the financial data and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

We carry out other assignments on behalf of the Group in the areas of other audit and related services and advisory services. The firm and partners and employees of our firm also deal with the Group on normal terms within the ordinary course of trading activities of the business of the Group. These matters have not impaired our independence as auditors of the Group. The firm has no other relationship with, or interest in, the Group.

Review opinion

Based on our review, nothing has come to our attention that causes us to believe that the financial statements on pages 18 to 32 do not give a true and fair view of the financial position of the Group as at 31 December 2012 and the results of its operations for the six month period ended on that date.

Our review was completed on 21 February 2013 and our opinion is expressed as at that date.

KPMG

Auckland

Lead Auditor's Independence Declaration under Section 307c of the Corporations Act 2001 to the directors of Telecom Corporation of New Zealand Limited

I declare that to the best of my knowledge and belief, in relation to the review for the six months ended 31 December 2012 there have been:

(i) No contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the review; and

(ii) No contraventions of any applicable code of professional conduct in relation to the review.

KPMG

KPMG

Malcolm Downes

Malcolm Downes

PARTNER

Auckland

21 February 2013

Forward-looking statements and disclaimer

This Interim Report may include forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995 regarding future events and the future financial performance of Telecom. Such forward-looking statements are based on the beliefs of management as well as on assumptions made by and information currently available at the time such statements were made.

These forward-looking statements may be identified by words such as 'anticipate', 'believe', 'estimate', 'expect', 'intend', 'will', 'plan', 'may', 'could' and similar expressions. Any statements in this announcement that are not historical facts are forward-looking statements. These forward-looking statements are not guarantees or predictions of future performance, and involve known and unknown risks, uncertainties and other factors, many of which are beyond Telecom's control, and which may cause actual results to differ materially from those projected in the forward-looking statements contained in this Interim Report. Factors that could cause actual results or performance to differ materially from those expressed or implied in the forward-looking statements are discussed herein and also include Telecom's anticipated growth strategies, Telecom's future results of operations and financial condition, economic conditions and the regulatory environment in New Zealand and Australia; competition in the markets in which Telecom operates, other factors or trends affecting the telecommunications industry generally and Telecom's financial condition in particular and risks detailed in Telecom's filings with the U.S. Securities and Exchange Commission. Except as required by law or the listing rules of the stock exchanges on which Telecom is listed, Telecom undertakes no obligation to update any forward-looking statements whether as a result of new information, future events or otherwise.

The securities referred to in this announcement have not been, and will not be, registered under the United States Securities Act of 1933 or under the securities laws of any state or other jurisdiction of the United States. This announcement does not constitute an offer of securities in the United States or to any person to whom it would not be lawful outside Australia and New Zealand. Any securities described herein may not be offered or sold in the United States absent registration under the Securities Act or pursuant to an applicable exemption from registration, or to any person to whom it would not be lawful outside Australia and New Zealand.

Non-GAAP financial measures

Telecom results are reported under IFRS. This Interim Report includes non-GAAP financial measures which are not prepared in accordance with IFRS. The non-GAAP financial measures used in this presentation include:

1. EBITDA. Telecom calculates EBITDA by adding back (or deducting) depreciation, amortisation, finance expense/(income), share of associates' (profits)/losses and taxation expense to net earnings/(loss) from continuing operations.
2. Adjusted EBITDA. Adjusted EBITDA excludes significant one-off gains, expenses and impairments.
3. Capital expenditure. Capital expenditure is the additions to property, plant and equipment and intangible assets, excluding goodwill and other non-cash additions that may be required by IFRS such as decommissioning costs.
4. ARPU. Telecom calculates ARPU as revenue for the period (for mobile this is only voice and data) divided by an average number of customers.
5. Free cash flow. Free cash flow is defined as continuing and discontinued EBITDA less capital expenditure.
6. Adjusted free cash flow. Adjusted free cash flow utilises adjusted EBITDA rather than underlying EBITDA defined above.
7. Adjusted free cash flow from continuing operations. Adjusted free cash flow from continuing operations utilises adjusted EBITDA from continuing operations, rather than adjusted EBITDA defined above, and capital expenditure relating to continuing operations.
8. Adjusted net earnings. Adjusted net earnings are net earnings for the year adjusted by the same items to determine adjusted EBITDA, together with any adjustments to depreciation, amortisation and financing costs, whilst also allowing for any tax impact of those items.

Telecom believes that these non-GAAP financial measures provide useful information to readers to assist in the understanding of the financial performance, financial position or returns of Telecom, but that they should not be viewed in isolation, nor considered as a substitute for measures reported in accordance with IFRS. Non-GAAP financial measures as reported by Telecom may not be comparable to similarly titled amounts reported by other companies.

Shareholder inquiries/ contact details

Telecom is a company incorporated with limited liability under the New Zealand Companies Act 1993 and domiciled in New Zealand (Companies Office registration number 328287 and ARBN number 050 611 277).

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Shareholder inquiries
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