Condensed consolidated income statement
For the period ended 30 June 2012

		Six months ended 30 June		Year ended 30 June	
		2012	2011	2012	2011
		Unaudited	Unaudited	Audited	Audited
(Dollars in millions, except per share amounts)	*notes*	NZ$	NZ$	NZ$	NZ$
Operating revenues and other gains – continuing operations					
Local service		448	469	905	955
Calling		360	449	754	928
Interconnection		51	95	104	195
Mobile		459	420	904	825
Data		259	283	527	574
Broadband and internet		216	237	454	487
IT services		277	287	544	561
Resale		50	111	143	235
Other operating revenue	*3*	90	85	187	199
Other gains	*4*	8	13	54	45
		2,218	**2,449**	**4,576**	**5,004**
Operating expenses – continuing operations					
Labour		(386)	(411)	(797)	(832)
Intercarrier costs		(519)	(758)	(1,160)	(1,559)
Other operating expenses	*5*	(753)	(767)	(1,535)	(1,595)
Asset impairments		-	(215)	-	(215)
Other expenses	*4*	-	(38)	(5)	(42)
Earnings before interest, taxation, depreciation and amortisation – continuing operations		**560**	**260**	**1,079**	**761**
Depreciation		(185)	(209)	(363)	(468)
Amortisation		(107)	(122)	(213)	(240)
Earnings/(losses) before interest and taxation – continuing operations		**268**	**(71)**	**503**	**53**
Finance income		18	5	26	15
Finance expense		(39)	(79)	(106)	(152)
Share of associates' profits	*13*	-	-	-	1
Earnings/(losses) before income tax – continuing operations		**247**	**(145)**	**423**	**(83)**
Income tax (expense)/credit	*11*	(65)	32	(112)	4
Earnings/(losses) from continuing operations		**182**	**(113)**	**311**	**(79)**
Earnings/(losses) from discontinued operations net of tax	*7*	(31)	114	846	245
Net earnings for the period		**151**	**1**	**1,157**	**166**
Net earnings attributable to equity holders of the Company		150	-	1,155	164
Net earnings attributable to non controlling interest		1	1	2	2
		151	**1**	**1,157**	**166**
Basic net earnings per share (in cents)		8	-	60	9
Diluted net earnings per share (in cents)		8	-	60	9
Basic and diluted earnings/(losses) per share from continuing operations (in cents)		9	(6)	16	(4)
Weighted average number of ordinary shares outstanding (in millions)		1,910	1,925	1,918	1,924

See accompanying notes to the financial statements.

Condensed consolidated statement of comprehensive income
For the period ended 30 June 2012

	Six months ended 30 June		Year ended 30 June	
	2012	2011	2012	2011
	Unaudited	Unaudited	Audited	Audited
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$
Net earnings for the period	**151**	**1**	**1,157**	**166**
Other comprehensive income/(loss)[1]:				
Translation of foreign operations	(15)	(10)	(13)	(8)
Net investment hedges	-	4	(3)	(11)
Reclassified to income statement on disposal of foreign operation	-	-	(28)	-
Revaluation of long-term investments	(48)	(56)	(68)	(48)
Cash flow hedges	1	(14)	53	(27)
Other comprehensive income/(loss) for the period	(62)	(76)	(59)	(94)
Total comprehensive income/(loss) for the period	**89**	**(75)**	**1,098**	**72**
Total comprehensive income/(loss) attributable to equity holders of the Company	88	(76)	1,096	70
Total comprehensive income attributable to non controlling interest	1	1	2	2
	89	**(75)**	**1,098**	**72**

[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 period ended 30 June

(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 2010	1,515	1,296	(32)	13	(233)	(20)	2,539	6	2,545
Net earnings for the period	-	164	-	-	-	-	164	2	166
Other comprehensive income/(loss)	-	-	(27)	-	(48)	(19)	(94)	-	(94)
Transfer to retained earnings on disposal of long-term investments	-	64	-	-	(64)	-	-	-	-
Total comprehensive income for the period net of tax	-	228	(27)	-	(112)	(19)	70	2	72
Contributions by and distributions to owners:									
Ordinary dividends	-	(317)	-	-	-	-	(317)	(3)	(320)
Supplementary dividends	-	(28)	-	-	-	-	(28)	-	(28)
Tax credit on supplementary dividends	-	28	-	-	-	-	28	-	28
Dividend reinvestment plan	7	-	-	-	-	-	7	-	7
Issuance of shares under share schemes	6	-	-	1	-	-	7	-	7
Total transactions with owners	13	(317)	-	1	-	-	(303)	(3)	(306)
Balance at 30 June 2011	**1,528**	**1,207**	**(59)**	**14**	**(345)**	**(39)**	**2,306**	**5**	**2,311**

	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, net of tax	-	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 to shareholders	(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 30 June 2012

		30 June	
		2012	2011
		Audited	Audited
(Dollars in millions)	*note*	NZ$	NZ$
ASSETS			
Current assets:			
Cash		185	324
Collateral funds		-	110
Short-term derivative assets		1	2
Receivables and prepayments		684	701
Taxation recoverable		53	-
Inventories		49	60
Total current assets		972	1,197
Non-current assets:			
Long-term investments		57	125
Long-term receivables and prepayments		222	44
Long-term derivative assets		1	40
Intangible assets		900	1,094
Property, plant and equipment		1,515	3,892
Total non-current assets		2,695	5,195
Total assets		**3,667**	**6,392**
LIABILITIES AND EQUITY			
Current liabilities:			
Accounts payable and accruals		775	991
Taxation payable		6	31
Short-term derivative liabilities		3	333
Short-term provisions		13	38
Debt due within one year	*12*	407	397
Total current liabilities		1,204	1,790
Non-current liabilities:			
Deferred tax liabilities		159	226
Long-term derivative liabilities		23	330
Long-term payables and accruals		30	-
Long-term provisions		20	35
Long-term debt	*12*	605	1,700
Total non-current liabilities		837	2,291
Total liabilities		2,041	4,081
Equity:			
Share capital		990	1,528
Reserves		(495)	(429)
Retained earnings		1,126	1,207
Total equity attributable to equity holders of the Company		1,621	2,306
Non-controlling interest		5	5
Total equity		1,626	2,311
Total liabilities and equity		**3,667**	**6,392**

See accompanying notes to the financial statements.

Condensed consolidated statement of cash flows
For period ended 30 June 2012

		Year ended 30 June	
		2012	2011
		Audited	Audited
(Dollars in millions)	*notes*	NZ$	NZ$
Cash flows from operating activities			
Cash received from customers		4,568	5,008
Interest income		26	15
Dividend income		58	71
Payments to suppliers and employees		(3,402)	(3,421)
Income tax paid		(120)	(127)
Interest expense		(145)	(197)
Net cash flow from operating activities	*8*	**985**	**1,349**
Cash flows from investing activities			
Sale of property, plant and equipment		2	3
Sale of business	*4*	5	76
Sale of and proceeds from long-term investments		1	107
Purchase of property, plant and equipment and intangibles		(663)	(1,005)
Capitalised interest paid		(8)	(16)
Net cash flow from investing activities		**(663)**	**(835)**
Cash flows from financing activities			
Debt restructuring costs		(205)	-
Proceeds from long-term debt		300	-
Repayment of derivatives		(1,299)	(13)
Proceeds from derivatives		961	2
Payments on finance leases		(7)	-
Receipts on finance leases		20	-
Decrease/(increase) in collateral funds		110	(89)
Repayment of long-term debt		(964)	(21)
Proceeds from short-term debt		2,638	663
Repayment of short-term debt		(1,511)	(749)
Dividends paid		(340)	(313)
Share repurchase - buyback		(149)	-
Share repurchase - dividend reinvestment plan		(16)	-
Net cash flow from financing activities		**(462)**	**(520)**
Net cash flow		**(140)**	**(6)**
Opening cash position		324	339
Foreign exchange movement		1	(9)
Closing cash position		**185**	**324**

See accompanying notes to the financial statements.

Notes to the condensed consolidated financial statements

NOTE 1 FINANCIAL STATEMENTS

The condensed consolidated financial statements of Telecom Corporation of New Zealand Limited ('the Company') together with its subsidiaries and associates ('Telecom' or the 'Group'), as at and for the year ended 30 June 2012, have been prepared in accordance with the New Zealand Equivalent to International Accounting Standard No. 34: 'Interim Financial Reporting', issued by the External Reporting Board. These financial statements also comply with International Accounting Standard IAS 34, 'Interim Financial Reporting'.

Telecom successfully demerged Chorus Limited ('Chorus') effective from 1 December 2011 after 99.8% of all votes cast by the Company's shareholders were in favour of the demerger proposal. With effect from 1 December 2011, Chorus became a stand-alone, separately listed company taking on the cornerstone role in the Government's ultra-fast broadband ('UFB') initiative.

Consequently Telecom has separated the Chorus pre-demerger results and presented these results, including comparatives as 'discontinued operations', in accordance with NZ IFRS 5: Non-current Assets Held for Sale and Discontinued Operations ('IFRS 5'). Telecom has also re-presented its comparative segment results to reflect the impact of the demerger. There is no change to the overall Group reported result. Certain other comparative information has also been reclassified to conform to the current period's presentation.

These condensed consolidated 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 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.

The following standard and revised standards have been adopted prospectively from 1 July 2011, but have had no impact on the condensed consolidated financial statements.

- NZ IFRS 7 'Amendments to financial instruments: disclosures'.
- Revised standard NZ IAS 24 'Related party disclosures' ('IAS 24'). The revised standard adds disclosure requirements for commitments (including executory contracts) with related parties.
- FRS 44 'New Zealand additional disclosures'. This standard slightly revises certain disclosures and requirements.

The presentation currency of the 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 financial statements were approved by the board of directors on 23 August 2012 and are unaudited. However, the results for the full year and statement of financial position information as at 30 June have been extracted from the Group's audited financial statements. The Group's audited financial statements will be available on Telecom's website: http://investor.telecom.co.nz.

Notes to the condensed consolidated financial statements (continued)

NOTE 2 SEGMENTAL REPORTING

Telecom's segments comprise Retail, Wholesale & International, Gen-i, AAPT and Technology & Shared Services ('T&SS'). Chorus and certain parts of T&SS and Wholesale & International comprise discontinued operations and have been removed from all segmental information presented below, with the comparative segment results restated accordingly.

Segmental information for the Year ended 30 June 2012

Audited *(Dollars in millions)*	Wholesale & International NZ$	Retail NZ$	Gen-i NZ$	T&SS NZ$	AAPT NZ$	Total NZ$
External revenue and other gains	626	1,883	1,281	43	618	4,451
Internal revenue	119	45	79	417	46	706
Total revenue and other gains	745	1,928	1,360	460	664	5,157
Segment result	154	506	263	-	88	1,011

Segmental information for the year ended 30 June 2011

Audited *(Dollars in millions)*	Wholesale & International NZ$	Retail NZ$	Gen-i NZ$	T&SS NZ$	AAPT NZ$	Total NZ$
External revenue and other gains	760	1,893	1,342	31	834	4,860
Internal revenue	268	122	80	558	66	1,094
Total revenue and other gains	1,028	2,015	1,422	589	900	5,954
Segment result	145	493	237	4	90	969

The segment results disclosed are based on those reported to Telecom's Chief Executive Officer 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 costs, associates' profits/losses and income tax expense. None of these other items are assessed on a segment basis by Telecom's Chief Executive Officer.

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 Chief Executive Officer as a reporting segment.

Included within the comparative segment results disclosed above for AAPT are the results of its consumer division, which was disposed of in the year ended 30 June 2011.

Notes to the condensed consolidated financial statements (continued)

NOTE 2 SEGMENTAL REPORTING (continued)

Reconciliation from segment result to earnings before income tax

		Year ended 30 June	
		2012	2011
		Audited	Audited
(Dollars in millions)	*note*	NZ$	NZ$
Segment result		1,011	969
Net result of Corporate revenue and expenses		37	26
Other gains not allocated to segments[1]	*4*	36	23
Asset impairments not allocated to segments		-	(215)
Other expenses not allocated for segment reporting	*4*	(5)	(42)
Depreciation		(363)	(468)
Amortisation		(213)	(240)
Finance income		26	15
Finance expense		(106)	(152)
Share of associates' profits		-	1
Earnings/(losses) before income tax – continuing operations		**423**	**(83)**

1 Other gains not allocated to segments include $28 million gain on the wind up of a foreign operation and an $8 million gain from insurance proceeds.

NOTE 3 OTHER OPERATING REVENUE (CONTINUING OPERATIONS)

	Six months ended 30 June		Year ended 30 June	
	2012	2011	2012	2011
	Unaudited	Unaudited	Audited	Audited
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$
Dividend income	32	32	58	71
Sale of equipment	4	6	10	18
Miscellaneous other[1]	54	47	119	110
	90	**85**	**187**	**199**

1 Included in Miscellaneous other are revenues derived from sales to discontinued operations of NZ$21 million (30 June 2011: NZ$51 million; 30 June 2010: NZ$46 million).

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

Notes to the condensed consolidated financial statements (continued)

NOTE 4 OTHER GAINS & OTHER EXPENSES

	Six months ended 30 June		Year ended 30 June	
	2012	2011	2012	2011
	Unaudited	Unaudited	Audited	Audited
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$
Other gains				
Gain on sale	-	5	10	23
Various resolutions and settlements with supplier	8	8	8	22
Gain on winding up of foreign operation	-	-	28	-
Interim settlement on insurances	-	-	8	-
	8	**13**	**54**	**45**
Other expenses				
Natural disaster costs	-	38	5	42
	-	**38**	**5**	**42**

In the six months and year ended 30 June 2012, other gains of $8 million represented:

- $8 million relating to various resolutions and settlements reached with a supplier.

In the year ended 30 June 2012 other gains 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 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 six months ended 30 June 2011, other gains of $13 million represented:

- $5 million (A$4 million) gain on the sale of Yahoo!Xtra Limited; and
- $8 million relating to a resolution and settlement reached with a supplier.

In the year ended 30 June 2011, other gains of $45 million represented:

- $18 million (A$15 million) gain on the sale of AAPT's consumer division to iiNet Limited for $76 million (A$60 million);
- $5 million (A$4 million) gain on the sale of Yahoo!Xtra Limited; and
- $22 million relating to a resolution and settlement reached with a supplier.

In the years ended 30 June 2011 and 2012 other expenses represented costs recognised in relation to the Canterbury earthquakes.

Notes to the condensed consolidated financial statements (continued)

NOTE 5 OTHER OPERATING EXPENSES (CONTINUING OPERATIONS)

	Six months ended 30 June		Year ended 30 June	
	2012	2011	2012	2011
	Unaudited	Unaudited	Audited	Audited
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$
Network support	42	42	89	89
Maintenance and other direct costs	4	14	16	33
Mobile acquisitions, upgrades and dealer commissions	183	118	336	244
Procurement and IT services	163	173	317	337
Broadband, internet and other	140	149	279	277
Computer costs	38	60	89	158
Advertising, promotions and communications	28	26	65	68
Accommodation and co-location	64	92	152	178
Outsourcing	11	10	20	22
Travel	8	7	14	19
Bad debts	3	8	9	18
Field services	23	28	51	53
Other expenses	46	40	98	99
	753	**767**	**1,535**	**1,595**

NOTE 6 DIVIDENDS AND EQUITY

Telecom recognised the demerger of Chorus as a return of capital and a distribution of retained earnings. The return of capital ($383 million) was calculated by dividing the market capitalisation of Chorus shares around demerger by the market capitalisation of Chorus and Telecom around demerger and multiplying the result by the balance of Telecom’s share capital account. The part of the distribution that was not a return of capital is treated as a distribution of retained earnings ($881 million).

Shares issued in lieu of dividends

In respect of the year ended 30 June 2012 6,866,385 shares with a total value of $16 million were issued in lieu of a cash dividend (year ended 30 June 2011: 3,388,197 shares with a total value of $7 million).

Notes to the condensed consolidated financial statements (continued)

NOTE 6 DIVIDENDS AND EQUITY (continued)

Dividends paid

The following dividends have been paid in the year ended 30 June 2012:

Approval date *(Dollars in millions)*	Dividends per share cents	Total paid NZ$
16 September 2011	9.5	182
16 September 2011 (supplementary)	1.7	24
5 April 2012	9.0	173
5 April 2012 (supplementary)	1.6	23
		402

The dividends were fully imputed (at a ratio of 28/72) in line with the corporate income tax rate. Supplementary dividends were paid to shareholders who are not tax resident in New Zealand. In accordance with the Income Tax Act 2007, Telecom will receive a tax credit from the Inland Revenue Department equivalent to the amount of supplementary dividends paid.

Declaration of dividend

On 23 August 2012, the Board of Directors approved the payment of a second half dividend of $204 million, representing 11 cents per share. The dividend will be partially imputed at the rate of 3.2083 imputation credits per share (which equates to 75% imputation based on the current corporate tax rate). In addition, supplementary dividends totalling approximately $20 million will be payable to shareholders who are not tax resident in New Zealand. In accordance with the Income Tax Act 2007, Telecom will receive a tax credit from the Inland Revenue Department equivalent to the amount of supplementary dividends paid.

Notes to the condensed consolidated financial statements (continued)

NOTE 7 DISCONTINUED OPERATIONS

Telecom successfully completed the demerger of Chorus with effect from 1 December 2011. The condensed consolidated income statement for the year ended 30 June 2012 and comparatives have been re-presented to show the Chorus results prior to 30 November 2011 as a discontinued operation, separately from Telecom's continuing operations. The discontinued operation results for the periods presented in the income statement are as follows:

	Six months ended 30 June		Year ended 30 June	
	2012	2011	2012	2011
	Unaudited	Unaudited	Audited	Audited
(Dollars in millions, except per share amounts)	NZ$	NZ$	NZ$	NZ$
Operating revenues				
Local service	-	13	13	26
Data	-	10	9	18
Broadband and internet	-	54	44	94
Other operating revenue	-	17	13	31
Internal revenues from Telecom continuing operations	-	498	417	963
	-	**592**	**496**	**1,132**
Operating expenses				
Labour	-	(19)	(17)	(37)
Other operating expenses	-	(131)	(137)	(243)
Internal costs with Telecom continuing operations	-	(22)	(21)	(51)
Asset impairments	-	(42)	-	(42)
Depreciation	-	(135)	(84)	(265)
Amortisation	-	(31)	(21)	(54)
Net finance costs	-	(25)	(20)	(51)
Earnings/(losses) before income tax	**-**	**187**	**196**	**389**
Income tax expense	-	(52)	(55)	(115)
Net earnings/(losses) for the period – before demerger related items	**-**	**135**	**141**	**274**
Demerger related items:				
Gain/(loss) on distribution of Chorus shares	(11)	-	764	-
Debt restructuring costs	-	-	(110)	-
Demerger and UFB costs	(3)	(17)	(50)	(29)
Net gain on asset arrangements between Chorus and Telecom	(20)	-	68	-
Tax (expense)/benefit on demerger related items	3	(4)	33	-
Total demerger related items	(31)	(21)	705	(29)
Earnings/(losses) from discontinued operations	**(31)**	**114**	**846**	**245**
Basic earnings per share (in cents)	(2)	6	44	13
Diluted earnings per share (in cents)	(2)	6	44	13

Notes to the condensed consolidated financial statements (*continued*)

NOTE 7 DISCONTINUED OPERATIONS (continued)

The $764 million gain on distribution of Chorus shares relates to the difference between the fair value and carrying value of the net assets derecognised on distribution of Chorus to shareholders.

Debt restructuring costs of $110 million include $36 million of fees that are an economic cost to Telecom, as well as $74 million of costs that relate to the realisation of economic positions held by Telecom.

Demerger and UFB costs of $50 million (30 June 2011: NZ$29 million) include advisors' fees (including legal, accounting and investment banking fees), independent expert report costs and separation related costs such as changes to IT systems, programme management, employee costs and preparation for trading between Telecom and Chorus.

Net non-cash gains by Telecom on asset arrangements between Chorus and Telecom of $68 million represented:

- $63 million of net gains on entering into new finance lease arrangements with Chorus on demerger; and
- $5 million gains on jointly controlled asset arrangements with Chorus.

The carrying value of assets and liabilities distributed to shareholders on the demerger of Chorus were:

(Dollars in millions)	30 November 2011 NZ$
Assets	
Receivables and prepayments	4
Short-term derivative assets	1
Current tax receivable	2
Inventories	6
Intangible assets and property, plant and equipment	2,352
Liabilities	
Accounts payable and accruals	48
Short-term debt	1
Deferred tax liability	178
Long-term debt	1,582
Long-term derivatives	56
Net assets of discontinued operations at date of disposal	**500**

The cash flows of the discontinued operations are as follows:

	Six months ended 30 June		Year ended 30 June	
	2012	2011	2012	2011
	Unaudit	Unaudit	Audited	Audited
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$
Cash flows from operating activities[1]	(3)	(140)	(174)	(274)
Cash flows from investing activities	-	(235)	(146)	(407)
Cash flows from financing activities	-	-	234	-
Net cash out flow from discontinued operations	**(3)**	**(375)**	**(86)**	**(681)**

1 Pre demerger revenue received and expenses paid between the discontinued operations and continuing operations were not settled in cash and are therefore excluded from the cash flows from discontinued operations above.

Notes to the condensed consolidated financial statements (*continued*)

NOTE 8 RECONCILIATION OF NET EARNINGS TO NET CASH FLOWS FROM OPERATING ACTIVITIES

	Year ended 30 June	
	2012	2011
	Audited	Audited
(Dollars in millions)	NZ$	NZ$
Net earnings for the period	1,157	166
Adjustments to reconcile net earnings to net cash flows from operating activities:		
Depreciation and amortisation	681	1,027
Bad and doubtful accounts	12	21
Increase/(decrease) in deferred income tax liability	88	(46)
Share of associates' (profits)/losses	-	(1)
Asset impairments	-	257
Net gain on asset arrangements	(68)	-
Gain on distribution of Chorus shares	(764)	-
Debt restructuring costs included in financing cash flows	110	-
Gain on windup of foreign operation	(28)	-
Other	(13)	(8)
Changes in assets and liabilities net of effects of non-cash and investing and financing activities:		
Decrease/(increase) in accounts receivable and related items	(5)	(27)
Decrease/(increase) in inventories	6	1
Decrease/(increase) in current taxation	(74)	30
Increase/(decrease) in accounts payable and related items	(117)	(71)
Net cash flows from operating activities	**985**	**1,349**

NOTE 9 CONTINGENCIES & COMMITMENTS

For further historic detail on the specific matters referred to below, please refer to Telecom's 2012 Annual Report, as well as the previously published versions of the condensed consolidated financial statements, all of which are available online at: http://investor.telecom.co.nz

New Zealand Commerce Act Litigation

The proceeding brought by the Commerce Commission under section 36 of the Commerce Act in relation to Telecom's implementation and maintenance of high speed data transmission service pricing remains active. In September 2010, Telecom filed its proposed evidence on data revenue for the penalty hearing in the High Court and the Commerce Commission subsequently advised that it does not object to that evidence. The penalty hearing took place in December 2010 and a reserve judgment was delivered on 19 April 2011 ordering that Telecom pay a pecuniary penalty of $12 million. Telecom paid this penalty and appealed the penalty judgment to the Court of Appeal. The appeal hearing was held between 26 September and 4 October 2011. The Court of Appeal judgment was released in June 2012, dismissing Telecom's appeal. The penalty hearing was heard on 21 November 2011, with the judgment reserved. On 3 August 2012 the Court of Appeal upheld the pecuniary penalty of NZ$12 million.

Notes to the condensed consolidated financial statements (continued)

NOTE 9 CONTINGENCIES & COMMITMENTS (continued)

The proceeding commenced by the Commerce Commission in relation to Telecom's introduction of the 0867 service under section 36 of the Commerce Act was concluded with the delivery of the Supreme Court judgment on 1 September 2010, following a hearing in June 2010. The Supreme Court dismissed the Commerce Commission's appeal from the lower Courts' finding that Telecom had not breached section 36, and ordered the Commerce Commission to pay Telecom costs of $50,000 in the Supreme Court. Telecom has settled its outstanding claim for costs in the High Court with the Commission.

Telecommunications Act Litigation

On 2 August 2011 Telecom and Vodafone announced that they had entered a full and final settlement of the various proceedings that they had initiated in relation to the Commerce Commission's TSO determinations for FY04, FY05, FY06, FY07 and FY08. The terms of the settlement are confidential. The settlement followed the Supreme Court hearing in February 2011 of Telecom's and Vodafone's appeals in respect of the determinations for FY04, FY05 and FY06. The Supreme Court has issued a judgment in respect of the appeals, dismissing each of Telecom and Vodafone's appeals as moot and dismissing the Commerce Commission's appeal in respect of the FY05 and FY06 determinations. Any residual issues are allocated to Chorus under the demerger Asset Allocation Plan and subject to the terms of a Separation Deed between Telecom and Chorus.

In October 2010 the Commerce Commission announced the commencement of an investigation into Telecom's alleged breach of the Operational Separation Undertakings (the obligation not to discriminate) in respect of Chorus' provision of Sub Loop Extension Services ('SLES') and Telecom Wholesale's failure to provide Unbundled Bitstream Access ('UBA') with Sub Loop Unbundling ('SLU') and SLES. A settlement of this matter was entered into in October 2011 between Telecom, the Commerce Commission, Vodafone, Kordia, Orcon, Callplus, Airnet and Compass, pursuant to which the total sum of $31.6 million was paid by Telecom to compensate the various service providers, in agreed amounts. Any residual issues arising out of this matter are allocated to Chorus under the demerger Asset Allocation Plan and subject to the terms of a Separation Deed between Telecom and Chorus.

Certain other ongoing litigation was allocated between Chorus and Telecom. The allocated party will manage the allocated litigation at its cost, with indemnities in place to ensure that the party to which they are allocated bears the economic risk of that litigation. The Separation Deed provides that claims under the indemnities must exceed a certain minimum claim amount and (other than those in relation to litigation) be brought before 30 June 2014. In addition, the amount payable under the indemnities and other claims under the Separation Deed is limited to $300 million.

Effect of outstanding claims

Telecom has other 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.

Operating commitments

At 30 June 2012, capital expenditure amounting to $110 million (30 June 2011: $81 million) had been committed under contractual arrangements. In addition Telecom has an agreement with Optus to on-sell $31 million of capacity. The capital expenditure commitments principally relate to telecommunications network equipment.

As at 30 June 2012, Telecom had other supplier commitments for $238 million and $124 million for the years ending 30 June 2013 and 2014 respectively.

Notes to the condensed consolidated financial statements (continued)

NOTE 10 SIGNIFICANT EVENTS AFTER BALANCE DATE

As described in note 6, Telecom has declared a dividend in respect of the six months ended 30 June 2012.

NOTE 11 TAXATION

The continuing operations tax charge for the year ended 30 June 2012 of $112 million was $116 million higher than the tax credit of $4 million for the year ended 30 June 2011 and was primarily due to:

- a $142 million increase in the current year tax charge as a result of the tax effect of higher earnings before income tax; partially offset by:
- an $8 million credit in the FY12 tax charge in relation to a one-off non-taxable foreign exchange gain;
- an $18 million additional tax expense in the prior year tax charge, due to a reduction in the value of certain tax credits following changes in tax legislation in the year ended 30 June 2011; and
- a number of offsetting other items including Australian tax losses which do not give rise to a tax impact, a higher level of expenses that are not deductible for tax, prior period adjustments and the effect of Southern Cross dividends not subject to tax.

The continuing operations tax charge for the six months ended 30 June 2012 of $65 million was $97 million higher than the benefit of $32 million in the six months ended 30 June 2011. This increase is primarily due to an increase in earnings before tax in the current period, the reduction in value of certain tax credits in the prior periods, and the effect of prior period adjustments in both current and prior periods.

NOTE 12 CURRENT AND LONG-TERM DEBT

	Year ended 30 June	
	2012 Audited NZ$	2011 Audited NZ$
Short-term debt	95	93
EMTN	79	1,468
TeleBonds	539	542
Bank funding	300	-
Unamortised discount	(1)	(6)
Total debt	**1,012**	**2,097**
Debt due within one year	407	397
Debt due greater than one year	605	1,700
Total debt	**1,012**	**2,097**

Notes to the condensed consolidated financial statements (continued)

NOTE 12 CURRENT AND LONG-TERM DEBT (continued)

As part of the demerger, Telecom bondholders elected to exchange GBP235 million (NZ$637 million at hedged rates) of Telecom GBP EMTN bonds to Chorus GBP EMTN bonds, issued by Chorus under the Chorus EMTN Programme. Bondholders representing GBP40 million (NZ$110 million at hedged rates) did not elect to exchange to Chorus bonds and consequently these bonds remain in Telecom. The related cross currency swaps were split and partially novated to Chorus along with the exchanged bonds. Prior to demerger, the interest rate swaps relating to the Telecom GBP bonds were closed out. New interest rate swaps have since been entered into, hedging the GBP bonds that remain in Telecom.

During the year ended 30 June 2012, Telecom repaid the USD$250 million, CAD$275 million and CHF$200 million bonds, including the related derivatives, as well as NZ$3 million of maturing TeleBonds (30 June 2011: NZ$21 million).

During the financial year, Telecom entered into a bank facility agreement with Westpac New Zealand Limited. This facility is unsecured and has two tranches. The first tranche can draw up to $100 million through to 2014 and the second tranche can draw up to $300 million through to 2015. As at 30 June 2012, $300 million was drawn under the facility.

See note 25 of Telecom's Annual Report for further details on the Group's debt facilities at 30 June 2012.

NOTE 13 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
Community Telco Australia Pty Limited	Australia	50%	Community telecommunications provider