Thomson StreetEvents℠

Conference Call Transcript

TEL.NZ - Full Year 2011 Telecom Corporation Of New Zealand Ltd Earnings Conference Call and Webcast

Event Date/Time: Aug 19, 2011 / 10:00AM NZT

CORPORATE PARTICIPANTS

Paul Reynolds
Telecom Corporation of New Zealand Limited - CEO

Nick Olson
Telecom Corporation of New Zealand Limited - CFO

Mark Ratcliffe
Telecom Corporation of New Zealand Limited - CEO Chorus

Alan Gourdie
Telecom Corporation of New Zealand Limited - CEO Telecom Retail

Chris Quin
Telecom Corporation of New Zealand Limited - CEO, Gen-i

David Havercroft
Telecom Corporation of New Zealand Limited - Group Chief Technology Officer

Rod Snodgrass
Telecom Corporation of New Zealand Limited - Chief Product Officer

CONFERENCE CALL PARTICIPANTS

Geoff Zame
Deutsche Bank - Analyst

Kim Vinnell
TVNZ - Media

Andrew Patterson
RadioLIVE - Media

Sameer Chopra
Merrill Lynch - Analyst

Laurent Horrut
JP Morgan - Analyst

Greg Main
First New Zealand Capital - Analyst

Richard Eary
UBS - Analyst

Ian Martin
Royal Bank of Scotland - Analyst

PRESENTATION

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Good morning, ladies and gentlemen, whether you're in the room here in Auckland or on the line in New Zealand or across the world. Welcome to H2 and Full Year 2011 Financial Results.

We'll begin with a review of the progress, and I think the substantial progress that the Company has made in financial year 11; go into some detail on the trends across our key product groups before we go into a review of the performance of each of the business units. Then Nick will take you through the story on the financial results. Then I want to go on to an update on public policy issues - clearly, regulation - and our progress towards demerger.

So let's get started. It's been a challenging - I think it's fair to say - but rewarding year for Telecom. I mean think about the backdrop. As we came into this financial year, we were approaching the end of the enormous operational separation program, a program of 200 pages, many hundreds of milestones that the Company has been managing over the past three years - the biggest IT program in New Zealand's history, as well as a huge program of infrastructure; laying fiber to the node.

Coming to the end of that though, thinking about the start of the next phase of industry restructuring - New Zealand's gone through more industry restructure than any market in the world. The UFB - the fiber world - is approaching very fast as we began this financial year.

Competition (technical difficulty) and market conditions, clearly, extremely challenging in telecom markets across the world. New Zealand, like most Europeans and developed markets, seeing zero revenue growth - the market as a whole - as customers get more for less; product prices coming down, product performance going up. It's a challenge causing a demand for investment and a demand to deliver better value for customers.

Of course (inaudible) story for New Zealand as a whole over 2011 and 2010, and that's the Christchurch earthquakes. Canterbury is a huge region that's our second biggest city, with huge markets for Telecom. The impact of those events, both on the network, our customers and employees, were a big issue for us to deal with over the year. I think we responded very strongly indeed. We've approached this year with an unrelenting focus of taking customers to our heart. As you will see, customer satisfaction has gone up significantly across the year in every market segment.

The performance of our products has improved. They've got faster. They've got more reliable. So we have to overlay that with an initiative to become much more agile and more efficient. Vision 2013 has been a key strategic initiative over the year -- restructuring the business, focusing unrelentingly on customers, removing [failure] costs, getting slimmer where we've seen duplication and waste in our business. We've gone at that with enormous energy. You can see it coming through in the results today.

We've also had to step up, if you like, find the talent, the people across Telecom to address the Government's UFB program. Just the bid process is the mother of all deals, if you like, in New Zealand - the mother of all deals amongst Telecom people and our advisors has been an absolutely huge program. We've gone at it to get the best outcome for customers, for shareholders and for New Zealand. I think we are well underway to achieving that.

Of course, keeping our heads and our feet planted firmly on the ground. We are an enormous part of New Zealand society, and getting it right - taking our place in New Zealand in an effective way. We've organized through something called the Telecom Foundation, where our people are giving their time. We were the first corporate to announce corporate giving, corporate donations through the payroll, and all our charitable efforts have been focused with a theme on New Zealand kids.

The Foundation is the foundation of a big base renewal of Telecom's engagement with the community and with society in New Zealand. We were very delighted to have the Prime Minister join us in launching the Foundation towards the end of the financial year.

The picture on the slide is just one small part of Telecom's people's passion this year of getting right. I had the great pleasure of handing over a cheque for NZD400,000 - just raised by our staff, very quickly, over a few days, to help the people of Christchurch. That was to the Red Cross and Christchurch City earlier this year. One small part of an enormous commitment, I think, that I'm very proud that the organization has shown over 2010-2011.

So what about the result? Well, very significant improvement, financially, year on year. EBITDA - earnings before interest, tax, depreciation - is up 2%, actually up over 4% in the second half of the year, to NZD1.8 billion. NPAT at NZD388 million, up 2% as a consequence.

As we'll talk about, a huge focus on generating free cash and removing waste duplication, being as efficient as we possibly can. The free cash flow generation in the business has been up 53% to NZD887 million. We worked for that. We workshopped, we planned, we decided what's the biggest single number that we would go for as a business, and it's free cash flow. I think I'm incredibly proud of Telecom people and the management team for their efforts in delivering a quite extraordinary (inaudible) over the year.

Revenues, like every developed market and every incumbent around the world, sees revenue decline of between 2% and 6%. For us, in New Zealand, it has been about 3% over the year. We've fought very hard to win and retain high value customers through bundling et cetera as we go on - I'll talk about it as we go on. And keeping that, I think, a very respectable 3% number.

CapEx has (inaudible) transformation (inaudible) is 23% lower - I think part of the improving efficiency message.

The Board and management were really delighted to announce a quarter 4 dividend of NZD0.075 per share, but reflecting a financial performance significantly in excess of our own initial plans and market expectation, a special dividend of NZD0.02 per share in addition. That makes NZD0.20 per share for the year, and comparable with last year.

Customer satisfaction is up - wholesale, retail, corporate, government, across the business. Telecom won 70% of the Government's UFB initiative. In consequence, our progress towards demerger of Chorus is well under way and it should be achieved by the calendar year end subject of course to shareholder and other approvals. So a big year and a very rewarding year for Telecom. Enormous, I've never seen a team so committed to delivering and it coming through.

Look, financially we offered guidance at our Strategy Day last year in May. We at that time suggested adjusted EBITDA between NZD1720 million and NZD1780 million. CapEx we thought between NZD1 billion and NZD1.1 billion and free cashflow of NZD620 million to NZD780 million. Clearly we've knocked all of those out of the park. The story of the year is you know steady improvement and acceleration throughout the year.

It felt very tough at the beginning, it felt achievable by Christmas. It felt we were nudging ahead by March April and we finished the year very, very strongly indeed. Seeing revenue growth in mobile and IT services, you know where we've focused a lot of effort and big improvements in costs, lower marketing costs for example through advertising, mobile costs fell.

Reduced personnel costs restructuring and process improvements helping us there. Much lower discretionary spend. You know we all cut up our credit cards in Telecom. You know we got if you like a cultural shift which is unusual in a corporate I think. To think every dollar treat it like your own dollar and that showed up very much. Some actually maybe counter intuitive stuff. We began to in-source some contracts that we felt we could do more efficiently than our suppliers and get some significant gains from that too.

So the strategy slide if you like a year ago was this one we delivered that turnaround in EBITDA which we have done by reducing costs, simplifying the business, retaining value and through targeted growth in mobile, broadband and ICT. And position our business for the UFB world through open and positive engagement for CFH. Hopefully at that time getting a deal if it was right for our constituents and reshaping our business.

We've delivered on that the turnaround in EBITDA as I've talked about is up. Cost reduction, adjusting the expenses down 6% NZD195 million of costs out of the business NZD40 million more than we targeted which was already an aggressive plan. I think by any standards if you look around (inaudible) was a very solid performance on managing our costs.

But you know how do you do that? It's not just slashing and burning, there isn't just that much low hanging fruit around to get costs out. You have to redesign your business and we've simplified our business. We've simplified it by reducing the number of products that we offer. Getting rid of products that are end of life for customers and focusing on the ones that really matter for the future. We've done it by improving our processes so that we deliver right first time for our customers.

Customers are getting a better product, faster product, products that work more effectively than ever before. Taking the failure costs out of running the business and targeted growth in mobile. We're up in revenue, we're up in ARPU, we're winning the highest value customers that we've aimed to go for with XT as a corporate and high end SME and consumer lines for XT are coming through very strongly.

We want to do more in overall connections but solid improvement. In broadband very strong connection growth. The New Zealand market continues to grow across (inaudible). In ICT we're seeing business New Zealand really focused hard on making their businesses more effective and more efficient. We're seeing businesses become - their balance sheets become stronger.

They're looking for a better deal and a better deal is often IT services provided in the cloud. So our managed services and our cloud services offered through Gen-i are really growing over the year by giving a better deal to our customers. Of course Chorus has won the bulk of the UFB contract. So we've delivered we think on the strategy.

A little bit more of that free cashflow number. CapEx has been reduced by NZD269 million. We're still one of the highest investing incumbents around as we come off the sale of the [offset] obligations. But our CapEx to sales ratio has gone from plus 20 to around [15] I think. You know and we are determined that's that a focus on CapEx efficiency that we can keep driving and will keep driving as we go forward.

How have we done that? Directing investment towards the highest value product, you know cutting out duplication, prioritization of our projects, very hard prioritization of our projects and as I say finishing some of the big transformation investments that we had been making.

EBITDA has been driven through cost reduction, NZD195 million of costs out, processing platform improvements, supplier contracts renegotiated. We're doing more and more of our IT in-house because we can do it better and cheaper than our suppliers. Head count has come down 7% across the business over the year and our discretionary OpEx like travel and general expenses. Don't - if you put it on your own credit card as opposed to a corporate credit card you treat the dollar as your own and that's been working very well for us.

Focus on customers, customer satisfaction, average scores up. I mean you will know in business these are difficult numbers to shift. Up 3% across all business units. Telecom and Gen-i focusing very much on customer value and brand equity and those scores increasing over the year. Why? Mobile image and reputation getting stronger consistently. Broadband real perception of speed increases those investments in fiber to the nodes investments in broadband service. In fact a general improvement both in speeds and data cap really helping customers get the most out of their online experience and helping our customer sat scores.

Gen-i have simplified and really dramatically modernized (inaudible) the new world of managed services in cloud and that product range has been picked up with alacrity. The Right First Time program is if you like the hard yards of customer sat. Our people and managers through the business the executive team are targeted very hard on improving Right First Time. You know in reducing failures if you like, getting broadband installs and broadband repairs done faster, better, with fewer errors in the job.

I mean some of the numbers here are pretty enormous. These are failures coming out of the system that lead to cost reduction that help us offer our customers services at lower prices and still have a reasonable value. Broadband purchase and set up 37% better over the year. Mobile set up 34% better over the year. Data purchase and set up 7% better and fault resolution at 9% better.

By the way the lower two might be smaller numbers but that's because they were already operating at a very high level so the margin, the opportunity for improvement was less in the lower two categories. So we have focused hard right across the peak and will continue to do that.

So let's go into the key product areas. You know I don't know what you think guys about access and calling. You know amongst telcos around the world access lines have been declining. Now some people have described that as an inevitable and inexorable trend. We reported I think last time a modest increase and I've seen one major European telco start to see an increase. I've seen other telcos see a slowdown in the reduction.

We've now seen two successive reporting periods where access lines have actually risen. You can speculate why that is. You know it's part phone new bills is part of it, I suspect a lot of it is as we go, as we anticipate the new world. As we think about our needs at home and in the business people are appreciating that you need the really super fast broadband on a fixed line to complement your mobile broadband. You need both and I'm pretty sure that will continue to be a trend in needing both, a trend for the future.

It's nice to see access lines coming up in two reporting quarters in a row. Fixed to mobile substitution is much lower in New Zealand than some other markets and that's also I think helped by the fact that we have such an enormously wide free local calling area. I mean New Zealanders pay a lot less I think something the marginal price for a call than just about anywhere in the world. Good to have a fixed line. I think it's a great trend as we prepare for de-merger and Chorus prepares its investment plans for fiber, faster fiber, fixed line products are going to have a major place for the future.

Of course within that total there's a shift from retail to wholesale, the market's getting much, much more competitive. We have equal access to our access lines if you like in New Zealand. Probably more than or as much as any but one or two countries in the world. Retail lines continues to shift to wholesale, about 7% per annum, but importantly have remained on the Telecom network. So there is a successful business there in wholesale and in Chorus.

Wholesale access line growth, the wholesale lines have grown faster than retail lines as retail lose lines to UCLL in line with normal trends. Calling, you know NZ calling revenues are starting to - there's a decline there which a lot of people thought might accelerate ahs actually gone the other way. What we're finding is that there's some elasticity out there as fixed to mobile calling prices become more affordable we believe. There is certainly some elasticity and we're holding on to some very god product revenues in that segment of the market.

Shifting to broadband. I think we explained at the Strategy Day and in recent shareholder updates that we're focusing very much on high value. The New Zealand market is not saturate, you know there's still I think about 8% growth in the market. But a lot of that growth is very low usage dial up services migrating to broadband. The crucial thing for us is to retain and grow high value broadband users and the key to doing that is by bundling. You know we are offering very, very attractive bundles of calling and broadband, and in response to customer requests we've recently also introduced a bundle that also includes mobile.

Having been a full range operator you know having the full suite of services all high performing products there's a lot of attraction for customers in buying it all at once, a great bundled package and retail has successfully followed that strategy. Retail market share connections is around 53%. You know the through point of the strategy is working. Our ARPU in a very competitive market where prices are falling our average revenue per user is holding at NZD40. Wholesale market share connections sit at about 31%.

On to Mobile -- objective, grow ARPU and revenue by focusing again on high value customers and increasing data usage, because clearly a lot of upside for better usage on the move and through smartphones, et cetera. For us, the key winner is XT network coverage, its capacity is [steep]. We're seeing very strong anecdotal evidence from customers across New Zealand, referring to XT is a superior network. We know it performs better than our competitors, and it's good to see some significant and independent performance testers recently look to the Wellington and the Auckland market and similarly conclude in XT we have a winner in terms of mobile broadband capabilities, speeds, reach, consistency of coverage (inaudible) in the network, et cetera.

So that's showing up as growth among the high value customer base. We really do dominate in amongst the most choosy customers. Corporate New Zealand continues to sign up to XT and we had a great year last year, but we've had a further great year this year. It's great to see companies like [Fletchers and KiwiRail] move in recent months, and Gen-i connection growth in mobile on the back of that is up 7% and Mobile revenue in NZ and Gen-i up 7%. We've had 1.2 million connections on XT, about 56% of our connection base, but it's 82% of mobile cellular revenue; it's the customers who are really using the networks that are on XT. I think that's critical for the next step.

The Postpaid base is up in the second half and in particular we're seeing about 10,000 increase in the number of retail customers with NZD75 a month ARPU which is the highest value segment in the market. So the strategy going for high value is working. Device revenue, roaming, international roaming and data revenues have all grown strongly, as has mobile broadband, where the (inaudible) for services are up 30% compared to last year despite very aggressive competitor pricing.

Prepaids are a completely different story. We've got a long tail of low and no-use customers on the old CDMA network which will have closed down by next year, and we're seeing those customers coming off the network - 98,000 over the period. We think that tail will continue, but we look at it as having relatively little impact on revenues. The people are just holding devices in a glove box and coming out of the system. The key story in here is definitely Postpaid and the high value customers.

So there will be further base consolidation in our mobile base until shutdown in 2012. I know some commentators have thoughts about this. What is really the right size of the mobile customer base in New Zealand? I think when we get from four networks to three as CDMA shuts down, we're going to have a clearer view of that, how many true active connections there are. We're seeing that consolidation happening right now.

IT Services -- objective, create a platform for success in hosted services and grow share of spend in high value clients. The IT Services market is returning to growth. It was hit hard of course by the recession. As I said earlier, clients are really looking for services here to help their businesses be more efficient and again, our business's, if you like, solutions approach to selling into that market is proving very effective. We've got out early with infrastructure as a service and software as a service, Cloud products, and they are selling well already. In Cloud we're having the salesforce.com and also in ReadyCloud, we partner with a utilised Microsoft exchange.

IT Services revenues are up 7%, mainly driven by managed services and of course procurement. But what I've been passionate about driving here is margin improvement. Debt and revenue is one thing, but you've got to get a decent margin. Right across the Gen-i business, whether it's by segment, by product or by customer, there is a relentless focus on what we need to do to drive a reasonable margin from the business. I'm delighted that that's showing through. Efficiency gains are really beginning to improve the margins which we'll talk a little bit more about that in a second.

So before I go into business units, I'll look at in summary, I think a good strong performance right across the piece. EBITDA up in Chorus 9%, we feel 10 over the year, Gen-i 6.5 over the year. The negatives in Wholesale & International are actually internal. The external we see the EBITDA in Wholesale is up about 12% to 13%. Of course the AAPT number, despite the fact it was sold off a significant part of the EBITDA during the year as part of the consumer sale to iiNet. Underlying right across the piece is progress in each of those units.

Let's go through each of them in turn. Chorus, EBITDA up 9% for the half year, driven by a change in product mix as more of an FTTN fibre to node cabinets are rolled out. Chorus has also been very focused on reducing failure cost efficiency, minimising truck roll, a truck roll when it's needed to solve and detect a customer's problem, not a speculative one. Over the period, 50,000 avoidable truck rolls taken out of the metric, that has a big impact on our bottom line.

Interesting to note, 400,000 New Zealand customers are taking broadband from the FTTN program which, as you know, aims to deliver FTTN light speed to 84% of New Zealand. That program is just finishing now after three years of solid upgrade. UCLL continues to grow and now approximately 93,000 lines. Customer satisfaction metrics, the rest of the industry in New Zealand, satisfaction with Chorus for providing their service, up an all time high in quarter four which is a great place to be as we progress towards demerger of (inaudible). We're also delighted that the rural broadband initiative, which we've also (inaudible) in conjunction with Vodafone, is rollout there, fibre rollout there has already begun.

Wholesale & International, as I said, external EBITDA up 13% versus the same period last year. Access and broadband connections growing strongly, but the guys again have done a great job on cost, reduced truck rolls too, really focusing on our process of getting better diagnostic tools into the hands of our wholesale customers so that they diagnose the fault well before they pass it over for an active intervention in our business. Really, really cuts down on time, gets customers and users a better deal for things to get fixed faster and we don't ping pong between companies in trying to fix a customer's fault. Better diagnostics lead to better customer experience and it's helped also by a big focus and Wholesale helping the industry customers by training them in the use of diagnostic tools.

Customer growth on new products great, HSNS in particular growing well, and like in Chorus. Customer preference metrics at the end of the year up again and at an all time high.

Retail -- retail EBITDA, business in the white heat of competition, is up 20%, 21% for the full year and up 10% in the second half. Mobile revenue growing up is growing; cost reduction to improve call management in our call centres so that we get better - we get it right first time, we really fix the issues, get fewer faults coming through and we can save costs, save repeat calls, get a better deal for customers. (Inaudible) management structures across Wholesale and also some marketing savings. Focus on simplification in Retail by moving low usage products, products that get very little use by customers, for example mobile (inaudible) and content services and the removal of some CDMA services have helped us keep some costs down.

Fixed line bundles driving retention. The new total home broadband plan we're seeing like 70,000 on total home broadband by June. 54% of our customers now pick three or more products and we're driving hard to get that number up even higher. We've focused a lot in past reporting periods, but I think the really noticeable improvement this time is in the small business market. SME churn coming off very, very significantly, again helped by bundling and contracting.

In mobile, the Android strategy becomes the smartphone strategy. We are the smartphone network and that campaign is really delivering some results. (Inaudible) devices, lots of New Zealand and some world exclusives in devices, for example from Motorola and HTC, and we're seeing a very steady rise in smartphone usage. Over 30% of handset sales in any particular period are now smartphones as opposed to the old ordinary phones and of course that gives us the opportunity for more services, more data as well as voice and text.

Gen-i -- EBITDA up 6% versus equivalent period last year, more expensive and better and more effective margin retention in our voice service base which has been an issue for us since the previous period. NZD620 million of contracts closed versus NZD795 million in the same period the previous year. You might say, why is that number lower and it's because of the focus on margin. We've simply focused a good contract, good price, a reasonable price for the customer and for us and if it's not, we won't. So very focused on that and we're very pleased with the quality of the sales where the quality of the sales really coming through.

Mobiles have dropped by quite a bit, connection growth up by 7% and revenue's up 7%. 40% of the Gen-i mobile base are now using smartphones and that wouldn't surprise me, it's across the face in high smartphone usage. Gen-i have really gone through the product portfolio over the last year and there are now approximately 100 products that were taken out of the product portfolio that we no longer sell, but focus on the ones that the customers want in the future and we take the costs out of the business. 75% of managed data service customers are now utilising fibre based products and that's a good basis to go into the UFB world going forward.

AAPT -- big issue on the year, of course and a big opportunity for us was the sale of the consumer division and associated assets to iiNet. That delivered AUD139 million of cash during the year and AAPT had a big cash flow delivery of AUD27 million over the piece.

EBITDA of AUD33 million over the period. You know as we (inaudible) consumer, some of the common costs that supported our consumer business were of course retained and the big push in the business in the second half of this year has been to drive those costs so we eliminate the effect of the calling costs in the business, and that's gone very successfully. We have targeted the business on free cash flow. We hit some aggressive free cash flow figures, meanwhile focusing the business on wholesale and enterprise IT data services at the top end.

AAPT has a terrific fiber-based IT network in Australia and sales coming through strongly in NH2. I think that focus on the future and future products also showing up in AAPT being the first carrier in Australia to achieve NBN network certification.

Then the year - David Yuile, who's not here today but on the line - I was delighted to announce David as the new CEO of AAPT as Paul Broad moved on to a new role in government service in Australia.

That's AAPT and that's the background for the business over the year. I will hand over now to Nick.

Nick Olson - ***Telecom Corporation of New Zealand Limited - CFO***

Thanks Paul. I'm going to kick off with a summary of the key financial metrics. As Paul has said, free cash flow has been our focus in the second half and we have achieved quite outstanding results. Adjusted free cash flow up 53% for the year, driven by significant FX reductions and a focus on taking costs out of the business. A tremendous result.

FY11 adjusted EBITDA of NZD1.8 billion was above our guidance and the key drivers of this performance were negative regulatory impacts which were more than offset by reduced mobile cost of sales and a focus on driving costs out of the business.

FY11 adjusted NPAT of NZD388 million was also just above our guidance range of NZD330 million to NZD370 million, against largely a result of the underlying EBITDA performance.

FY11 CapEx was NZD914 million, reduced by NZD269 million or 23% compared to the prior year, a direct result of granular management of CapEx spend and also favourably influenced by the completion of several transformational programs.

On the basis of this very strong result we have announced the Q4 dividend of NZD0.07.5 per share, plus a special dividend of NZD0.02 per share, bringing the total dividends for FY11 to NZD0.20 per share.

In terms of reported income - the reported income statements - there are several adjusting items which may distort the underlying performance.

The first was a gain of NZD18 million on the sale of AAPT Consumer's position, which was reported in the first half. We also have treated UFB and de-merger costs as an adjusting item, and they have increased from NZD12 million in the first half to NZD29 million for the full year - I'm sorry, that was the UFB cost alone. This increase was signalled at the first half.

One-off natural disaster costs of NZD42 million relating to the Christchurch earthquake have been treated as an adjusting item. These comprised of additional operational costs, customer credits, and the costs to repair damaged assets. We have not yet recognized the benefit of insurance proceeds as the claim is still being assessed.

In addition there were NZD257 million of impairments, which I will talk about on the next slide.

The final adjusting item is NZD88 million of tax, relating to the items noted above.

Asset impairments - during the second half, as noted, we have recognized NZD257 million of non-cash impairments. Following CFH's decision (inaudible) Chorus as cornerstone UFB partner and the passing of the subsequent Telecommunications Act, we determined that it was appropriate to impair some assets (inaudible) as the future in New Zealand moves from a copper to a fiber-centric infrastructure.

The assets that have been impaired are - the fixed network transformation project - this was a regulatory program to replace traditional PSTN voice with a voice service using copper broadband. Secondly a portion of the retail NGP program related to the delivery of new customer relationship management and billing systems - these systems supported the voice service above - and some wholesale systems are now considered stranded.

Now moving on to the adjusted income statement for the full year - revenue declined by 3.2% to NZD5.1 billion. The NZD167 million decline was mainly in access and calling, as competition and regulation impacted the business.

The sale of the AAPT consumer division is also reflected in these numbers.

Expenses for the year decreased by 5.8% to NZD3.3 billion. The decline of NZD204 million was primarily in other operating expenses and reflects cost-out activity and lower mobile costs of sales due to strong XT handset sales in the prior period and better pricing due to foreign exchange rate movements.

Labour costs were down 2.7%, reflecting continued costs and head count reduction.

Depreciation and amortization decreased by NZD5 million as a result of the sale of the AAPT consumer division and reduced depreciation on the CDMA network which is now fully depreciated.

Tax expense was NZD28 million higher than the previous year, mainly due to changes in tax legislation over FY10 and FY11 and we have covered those in detail in previous results.

Adjusted net earnings were 1.6% or NZD6 million higher than last year. This was primarily driven by the increased in EBITDA.

Now looking at the adjusted income statement for the second half - revenue was down 3% compared to the second half of last year and the trends are similar to the full year results, with the largest decline in access and calling. The one exception is mobile revenue, which are up 5% compared to the prior comparative period, mainly driven by increases in data and handset revenue.

Expenses were down 7% or NZD120 million compared to the prior period, mainly driven by lower mobile costs of sales, the sale of the AAPT consumer division and in-sourcing of IT support functions.

Costs have fallen faster than revenue, with EBITDA increasing 4.6% in the second half.

Now looking at the cost-out activity, at the start of the financial year we indicated a cumulative target of NZD404 million cost-out which requires an additional NZD155 million of cost-out on top of the NZD245 million delivered during FY09/FY10.

We've delivered NZD195 million cost-out this year, bringing the cumulative total to NZD444 million over the last three years. This cost-out was mainly delivered in this year by Retail, AAPT and T&SS.

The biggest driver of retail cost-out was discount savings driven by restructuring and process improvements which has allowed us to reduce headcount. T&SS delivered cost savings through enforcing of IT support functions. AAPT delivered cost savings through the successful completion of a billing systems consolidation and restructuring to operationally align to a simpler business structure following the sale of their consumer division.

Headcount has been a significant driver of cost-out and total staff for the Group is now 375 lower than at the same time last year. There has been a small increase since the first half, primarily driven by the in-sourcing of, roughly, 300 IT support staff and if we normalised to that then headcount would be roughly 675, or 7% lower than a year ago.

It is also worth noting that 130 headcount will leave the business in the immediate future, as a result of restructuring already underway, and a further 119 will leave as a result of the sale of Software Solutions.

Capital Expenditure. CapEx is NZD914 million and is down 23% compared to the prior year, and it has been a major driver of the improvements and free cash flow. The key reductions were in transformation projects, the key milestones and undertakings on that business sustaining CapEx was NZD85 million lower than the prior year mainly driven by lower purchases of the Southern Cross (inaudible), the sale of the AAPT consumer division and lower network maintenance and gross spend due to a slowdown in residential and business connections.

Of course, to restate, we should all be aware of the significant management action that drove CapEx forecasts down from NZD1 billion to NZD1.1 billion with an end result of just over NZD900 million in a six month period.

The cash flow statement is based on reported rather than adjusted numbers. As a consequence the reduction in operating cash flow is impacted by UFB and de-merged costs and the Christchurch earthquake.

On this basis, operating cash flow is NZD412 million lower than last year. In addition to the impacts just noted, there was an increase in tax payments, loss of TSO revenues and working capital was returning to normal levels.

Investing cash flows were NZD256 million lower than the NZD1.1 billion invested last year due to NZD180 million of proceeds received from the sale of AAPT consumer division and stakes in iiNet and Macquarie Telecom, and a material reduction in capital expenditure. NZD520 million of cash was applied to financing and we paid dividends of NZD313 million.

Finally, let's take a quick look at the financial profile and capital structure. Net debt for the full year decreased by NZD105 million compared to last year. As to our dividend policy we've declared a Q4 dividend of NZD0.075 per share and a special dividend of NZD0.02 per share following a very strong result, bringing the total to NZD0.20 per share.

The dividend will be fully imputed at a ratio of 28/72 in line with the change in the corporate tax rate. In addition, supplementary dividends of NZD0.013 per share will be payable to shareholders who are not residents in New Zealand.

Again, we have defended the dividend reinvestment plan on market buyback due to ongoing UFB initiatives and proposed de-mergers.

For FY12 and beyond, it is our intention to move to paying dividends on a semi-annual basis. We expect to release further details on FY12 dividend policy in (inaudible).

To close, finally, we maintained our credit rating with S&P at single A, CreditWatch Negative; and with Moody's with A3 outlook negative.

Thank you.

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Okay. So let's finish on public policy and regulation issues before we take questions. That's right.

Look, yeah, I think we've again had a good half in this dimension. The Minister approved variation 5 of our operational separation undertaking, which enabled us to get the RBI, Rural Broadband Initiative, pricing issues sorted out, and that's helped us to fulfil those Rural Broadband Initiative obligations without breaching the undertakings.

We've also in the period reached a settlement with Vodafone regarding TSO claims. You know we're moving to a new era and so there were still some regulated settlements and disputes for the past four or five years as standing with Vodafone. So both parties, in the right spirit in moving to gear, we've gotten together and we've sort of struck a deal and we'll all now move on into the fibre future, as we should.

I did the six years that past settlement, these things take an awfully long time and we think it's just much better to get the best deal and focus on the future rather than the past.

The UBA deregulation and the final UBA price review has been announced. We saw the other UBA price change, a lot of scrutiny, a lot of examination, but the price change was pretty small and also pleased that 27 exchanges have been identified as competitive. So broadband (inaudible) exchanges will be sold on a commercial price basis.

I know over the last few years, I think, mobile termination rates got a lot of press focus. The regulation was anticipated, so I think some of the pricing issues were fairly well anticipated. It's been finalised.

Telecom has announced a number of price changes and price improvements for our customers as a result and Retail, for example, have launched plans for significantly better value for our mobile customers. So we're just getting on with it there.

A bunch of legislative changes, kind of a list here, and I wanted to set it out for you. But amendments of the Telecommunications Act have passed into law and these are important - and maybe (inaudible) but they're really important to enable us to go forward on UFB, on RBI, et cetera.

What are the key changes? The operational separation undertaking, set by the last government, are to be replaced with Deeds of Open Access for the Chorus business and that will replace the country box; the regulated three box model for Telecom, which is Chorus wholesale and our retail businesses for the demerge situation of the Chorus business and our single Telecom business.

Those changes to the pricing of some key legacies of copper services. UBA price freeze and then a shift to - firstly, and then a shift to cost plus pricing and we're going to see the averaging cost, UCLL pricing.

The implements of the Government - the implementation of the Government's TSO reforms and provide for a review in 2013, with a full review of the regulatory framework scheduled for 2016 and then to be completed by 2019.

Now students of those calls would say that that's a good outcome in the sense there was just such enormous regulatory change and uncertainty over the past three or four years and replacing that with a much more steady and stable regime I think helps the industry, helps Telecom, will help customers.

What comes away to get approval of the sharing of assets and systems, subject to regulatory oversight, and that enables separation to take place effectively, cost effectively, efficiently for customers by - and minimising customer impact.

Accounting separation goes away, so one step apparent - that will be good. Removal of ownership restrictions on new Telecom, that is huge. That enables an open market although, of course, restrictions will remain on in the new Chorus.

So we're reshaping our business, as I said at the outset, for that fibre world and the transition to a new operating structure in Telecom is underway. We've created - we've drawn sort of management together from all the business units and created a new Chief Product Officer role. Rod Snodgrass sitting in the front row there is our Chief Product Officer.

The goal is that part of simplification and efficiency with the product group and the TNNS, the shared services group, working in tandem to make sure we've got strong business plans for particular products, that we can reduce products when we don't need them anymore and that we're managing and building products most effectively and efficiently to meet customer needs.

We've already begun to see the gains in this in the year just passed and I think that it's a big opportunity going forward as a result of it. We've also simplified our corporate centre, you know part of the labour reductions you've seen in this time has come through that and going forward we'll have a simple corporate centre, enforcing business units at the front end of selling and marketing have that close customer intimacy. Then in the middle of the organisation if you like, our product and shared services organisation building the capabilities, building the engine of the business to take forward to our customer front end. We're really - it's a more effective way to run Telecom and it's already, as I said, started to show benefits.

We've also over the period progressively moved towards aligning a regulated wholesale business for Chorus, anticipating that two volt regulated model that we hope we'll be doing too.

A lot of work preparing for demerger and UFB implementation. The UFB product descriptions (inaudible) incredibly important for the industry, incredibly important.

What are the products foundations we're going to take this industry forward on? They have been released. We've begun to anticipating that open access world, HSNS has been repriced. The assets, the thousands - the hundreds of thousands of assets that is between Telecom, new Telecom and Chorus, how did we allocate the assets, the assets between these two businesses has been a mammoth piece of work. So the guys have been working on and that plan has been submitted and the public version released for the industry.

A lot of industry consultation to get to - I mean this is not just about Telecom. It's about all of the services all for New Zealand and every player will have a deep interest in what's going on. So the consultation has been underway, Chorus standard offers for UFB products and services, open access deed for a demerged Chorus.

The wholesale services agreement; what's that all about you know? What standards of service, in detail, will the new Chorus offer fibre services to the rest of the industry? A lot of deep discussion and debate, open discussion and debate to get to taking New Zealand to a UFB world, where no other country has gone and to do it smoothly, do it well, do it cost effectively.

We're also reshaping our technology, not just our business structure, but our technology for a fibre world. Look the Government's operational separation undertaking, as I've said a hundred times, was simply a gigantic piece of work. Mostly in IT but also in, for example, fibre and other services laying.

Look, they were mandated in 200 pages of undertaking and the mandate is a set of product offering many which are just not relevant for the UFB worlds that we're now moving into.

Referring back to my comment at the start of this presentation we came into this year still doing those undertakings as we are legally obliged to do, but knowing that most of them were well out of date. It's one of the problems of government intervention in a sector you get told to do things that doesn't match the speed of the market. However, the law is the law.

Moving to UFB and recognizing those things, there's a whole bunch of assets that will not be relevant, are not relevant and that's why Nick was saying there's 257 million of impairments booked in financial year 2011, reflecting IT and other services product development of the old world not relevant for the new world.

The future technology is based on fiber and mobile and, you know, the timetables that I was talking about there for regulatory to view in the future, we've had a fundamental change of industry structure that no other country has gone through.

We hope and believe it will leave the telecommunications as an industry having a more stable structure, where all the players can go on with competing with each other and delivering for customers and with much less of an eye on what the next phase of government's policy might be.

Because that's led to an awful lot, hundreds of millions of dollars of waste. We look forward to a more stable future industry structure and a curtailment of that waste. So everybody wants to know the detail of demerger. When's it going to happen? What's all the stuff? Who's who? What's going where and how does all that (inaudible)?

I can't tell you very much, because those in the market know that I cannot give you any future facing statements other than those that are straightforward (inaudible) that's already been said to the market. You know the (inaudible) which will give a lot of detail and which everybody invariably (inaudible) is coming soon, but legally I can't say much more than is on here.

Clearly early deliverables have focused on providing information to the industry to inform the consultation work that's underway or has already taken place. But we'll secure the contract. We'll issue the UFB product specs. We'll reprice the HSNS. We'll issue the Wholesale Service Agreement. We'll publish the Asset Allocation Plan. We'll submit the Deeds of Open Access for consultation. You know that's just (inaudible). These are enormous pieces of (inaudible) the industry in a different way. And, as I say, I'm very proud of how well we've pulled this together and (inaudible) we are tracking well for demerger by the end of the year.

We look forward, in the next period, to ministerial approval of the Asset Allocation Plan. We will issue in due course the Scheme Booklet (inaudible) Approval of the Deeds of Open Access, and of course the shareholder vote on the proposition, the demerger of the Chorus business, and also to take part in the UFB program, which will be followed by a court approval of a Scheme of Arrangement for demerger and the implementation of the demerger, which, as I say, we anticipate by the end of the year.

The guidance, we normally finish with guidance. As I said recently, guidance is withdrawn. We - the new businesses will give a very clear view of their future when they come into being in the very near future. In the meantime we've taken previous issued guidance off the table.

In summary, strong FY11 results delivering the strategy. I think the strongest result for Telecom for many years. Good progress and momentum in customer-focused delivery across the business and showing up in these results today.

But the great thing about the energy that goes behind that and the results coming through is that we also see (inaudible) lots more opportunities for improvement and we'll be working hard on that.

The restructuring for a fiber world is underway and we're delighted to reflect the performance in this period, in these results, with a NZD0.075 per share dividend and a NZD0.02 per share special dividend. Thank you very much.

We'll end there and we'll go to questions. There's a lot of different (inaudible) in the room. But we're going to start with analysts in the room and then we'll go online.

QUESTION AND ANSWER

Geoff Zame - ***Deutsche Bank - Analyst***

Thank you, Geoff Zame Deutsche Bank. Paul, congratulations anyway on a very disciplined result. It's really been a lot of belt tightening in that second half. The belt tightening seems to have been taken to extremes this week with the abstinence from sex campaign, but all the same I just wanted to touch on the UFB costs.

There's obviously a wide range of cost out there since the separation. I'm really just looking at cash cost, not the non-cash cost. But can you sort of help us think about, you know, where the chunks of value will be, where the cash (inaudible) is going in terms of both the overall cost aspect over the next sort of--

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Geoff, you know (inaudible) I'll show you how these businesses are looking, but I can't give you any forward looking statements (inaudible).

Geoff Zame - ***Deutsche Bank - Analyst***

Okay, that's okay, got to ask the question all the same. Sorry, the next question was probably more for Mark Ratcliffe, but I'm just interested to know whether you've started down the path of pursuing partnerships with those areas you're not engaged on.

Mark Ratcliffe - ***Telecom Corporation of New Zealand Limited - CEO Chorus***

Hi Geoff. Yes, we're talking to all of the parties that were successful over the past (inaudible). Down in Christchurch, the Network in the Hamilton area and (inaudible), those are a mixture of commercial arrangements for potential opportunities to deepen partnerships there. But we'll talk about more about that in the (inaudible).

Geoff Zame - ***Deutsche Bank - Analyst***

Right. Just finally from me, you were talking about the future of mobile as fibre and things. Can you perhaps touch on the future of mobiles, you know what that path looks like for LTE and things and what the plan is there in the next sort of 12 to 24 months?

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Well I think over the next 12 to 24 months you're going to see the mobile industry, the area to continue to be dominated by data, 3G data. You know towards the end of that period clearly was the release of the spectrum and we don't know on what basis the Government will release of spectrum or how any allocation process for what. But you know it's fairly certain that we will go through yet another technology upgrade, initially probably as a partner for 3G technology.

But LTE is coming. Of course we're planning for that. The hard detail is knowing the detail of the Government's plans and how we participate in the allocation process and it will be beyond your view of 24 months before there's any substantial impacts in the New Zealand market.

So hey Geoff, as you know, this is nothing new. The telecom's industry goes through massive technology shifts and changes and results every two or three years dependent on the sector. This is what we do and we're well in touch with it and ready to go. Thank you.

Geoff Zame - ***Deutsche Bank - Analyst***

Thank you.

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Up the back there I think.

Kim Vinnell - ***TVNZ - Media***

Hi Paul, Kim from KDNZ. You talk about squeezing costs; about staff cutting credit cards, that sort of thing, but you can only do that once and then there is only so much fat that you can trim. What comes next? What's after that? Is there going to be more job losses other than what's sort of been indicated?

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Look you can only do cut up credit cards once, but I wouldn't like to - anybody to take the impression that the cost reductions that are here are from being from cutting up credit cards as such, that's a symbolic gesture that costs are really important to our business, to any business if you're going to be effective.

The key drivers have actually been looking at processes; right first time. Folks are extremely hard on how the business units work together and with the rest of the industry to deliver - either to provide or repairs to services really expeditiously for customers, that's enabled us to reduce costs right across the piece. We've also been very hard at our contracts as I was saying. You know we have massive what you call outsourced contracts in the business.

Dave Havercroft, and his team in [T&SS], have looked at those in priority order and we are - as the customers are with us - we are negotiating really hard in those contracts and in some cases through renegotiation or through taking the business back into Telecom, taking tens of millions of dollars of cost base.

There will be more of those to come up. There is more contracts to be renewed in the future. We'll look at more - at processes, due processes, putting them in seamlessly, effectively and in a continuous state. Targeting ourselves to prove our (inaudible) success every year. That's what's going to take costs out of this business, getting it right first time.

All flowing through on better services for customers; more reliable services for our customers, more utility in those services, faster at lower cost, to get them those prices fixed.

Kim Vinnell - ***TVNZ - Media***

Just one more from me. It's slightly off topic, but we haven't had the chance to ask you yet the ad for the game campaign, do you think that's done any sort of brand damage to Telecom?

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

We feel like the best man at a wedding. You know you've just told a slightly risque joke you know, that was hilarious to his mates last night but the brides relatives didn't like it one bit. That's what it said you know, and what can you do in those situations? Say sorry and move on.

But that, in a corporate sense, has given the words for what Telecom does across New Zealand and other markets. Get it in context to fix things that our customer wants is value, they want great devices, they want great services at the corporate level, they want us to be reliable and we are progressing in all of those things. So that's what underpins our brand.

Kim Vinnell - ***TVNZ - Media***

Yes.

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Getting it right in the community--

Kim Vinnell - ***TVNZ - Media***

Right.

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

--which we do.

Kim Vinnell - ***TVNZ - Media***

So you've got to admit that the campaign has sort of hit of a bit of a sour note?

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

It has. You know we (inaudible) and we just said stop that, move on.

Kim Vinnell - ***TVNZ - Media***

Just finally, what was the advice from Kevin Roberts once you started noticing this backlash? Was it--

---

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

I haven't spoken to Kevin Roberts about it all. So let's move on, another question in the room?

Andrew Patterson - ***RadioLIVE - Media***

Mr Reynolds, Andrew Patterson, RadioLIVE. Telecom recently came in at the very bottom in a corporate respect index of New Zealand's top 25 companies. You said in your presentation that you've been successful in engaging with your customers and yet 25th place out of 25 would suggest that you haven't been successful in engaging successfully with the broader public.

After the latest problems with the Rugby World Cup marketing campaign, how do you account for this current situation and doesn't it ultimately reflect on your leadership of Chief Executive of the Company?

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Well the key driver for us is the customers buy our products and services, do they want our products and services, are they buying more of our products and services. What we see in these results is they are. You know customer satisfaction is up, customers are getting more for less and across mobiles, across broadband, across ITT. We're achieving our goals as a business. That's what my responsibility as a Chief Executive is to do.

You know if you take these results in comparison with Telco's, like us, across the world this is a very credible set of results [that] I'm proud as the Chief Executive to recommend to my Board, to our customers and to shareholders. I'll take a question from analysts (inaudible). Is there anymore in the room?

Unidentified Participant

Good morning. I just have really two questions because the - just looking at the asset impairments and the non-cash writedown of NZD297 million. The two questions that I had on that is I'm looking at it over the last two years, Telecom's CapEx to sales ratio been over 20%. You've had a significant amount of that driven by both competitor pressures but also from regulatory pressures.

I just wondered if you had - you spoke of wastage. Can you put a number around the amount that has been spent as a result of operational separation that's now being overturned as a consequence of the USB?

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Nick, do you want to have a go at that?

Unidentified Participant

I would suggest that it's probably more than NZD297 million.

Nick Olson - ***Telecom Corporation of New Zealand Limited - CFO***

Look there's no doubt we've seen some enormous amounts on operational separation over the last three or four years. A lot of the costs is actually not obvious. It actually comes down to the (inaudible) on the organization, operationally separate units, so as a burden being significant. I think the best way to answer that question is to say is what's happened is we've been released from the shackles of a - and you see it in the results. What you see is the last three years we've been defending shareholder value by potentially being as compliant as we possibly could through delivering an undertaking.

What you see in this result is actually 8500 people setting their minds to actually increasing long term shareholder value. Now for me, that difference is night and day and it's also shown - I think we had the low of NZD1.73 last year in the dark days and we're hovering around NZD2.50 today.

So that's a really significant lift in market capitalization. I think actually that represents the value that's possible for a free and fast-moving corporate entity that isn't bound by regulation.

Unidentified Participant

Are we likely to see any writedown on the actual copper asset itself? I mean most of this is related to the product development and the IT systems that were put in place through regulation. But given that we're moving to the fiber environment, are you anticipating them?

Nick Olson - ***Telecom Corporation of New Zealand Limited - CFO***

No there won't be any writedown of this nature. We (inaudible) and it will be set from the depreciation over time. There is an annual review of our assets (inaudible) very regulatory review.

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Okay, any more questions in the room? Let's go to online.

Operator

Thank you and the first question comes from Sameer Chopra of Merrill Lynch. Please go ahead Sameer.

Sameer Chopra - ***Merrill Lynch - Analyst***

Good morning, I had two questions probably both for Nick. The first one, you know the NZD257 million impairment, does this reduce ongoing depreciation in the business? Are these short life assets that you would have been running through as a D&A charge going forward, that you aren't going to anymore?

Nick Olson - ***Telecom Corporation of New Zealand Limited - CFO***

Yes and look I don't have the exact average life of those assets but three to four years would be a reasonable estimate. Yes and it will possibly impact the depreciation.

Sameer Chopra - *Merrill Lynch - Analyst*

Great. The second one is, just looking at the retail business, other Opex has come down quite significantly, down from NZD195 million level down to NZD157 million. I was wondering what's driving that other Opex down.

Nick Olson - *Telecom Corporation of New Zealand Limited - CFO*

I'd like to perhaps actually on that one Sameer, I just don't have that off the top of my head, I'm sorry. We'll get the IR guys to pick that up with you after the call.

Sameer Chopra - *Merrill Lynch - Analyst*

No problem. If I can just one last one just on mobile. In terms of current trends in mobiles, are the ARPUs on the customer that you are signing up better than historical output? I'm just trying to understand what's the run rate looking back on mobiles?

Alan Gourdie - *Telecom Corporation of New Zealand Limited - CEO Telecom Retail*

Alan Gourdie speaking. Yes they are. If you're referring to the migration of customers from CDMA to XT?

Sameer Chopra - *Merrill Lynch - Analyst*

That's right, yes.

Alan Gourdie - *Telecom Corporation of New Zealand Limited - CEO Telecom Retail*

Yes? ARPUs on the XT customers are significantly higher because of the migration onto smartphones and the data use and indeed roaming use on those devices. So the reality is that round about 75% of our existing current CDMA base have an ARPU of NZD20 or less. So what we're seeing as customers migrate on to XT with the Smartphone is higher usage on a user for user basis. But as Paul has pointed out, we're also attracting higher value customers.

Secondly, in that 75% plus bracket, the growth has been about 10% in [Chris's] business in the Gen-i corporate space.

Sameer Chopra - *Merrill Lynch - Analyst*

Great thank you so much and congratulations on the result. Take care.

Operator

The next question comes from Laurent Horrut at JP Morgan. Laurent, please go ahead.

Laurent Horrut - *JP Morgan - Analyst*

Thank you and good morning. Two questions for me. The second half 11 costs were down 7% which shows a really good result. I was just wondering what's the impact of the deconsolidation of AAPT within that and the exchange rate going your way also on that? I'm just looking for a bit more of a like for like kind of normalized [PCP] sort of cost runway.

Second question is if you just could - I know you don't want to put the (inaudible). How do you see the consumer environment in New Zealand and how this filters through your revenue outlook for FY12? I'm not after specific numbers, just generally speaking, how do you see the revenue environment?

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Okay, so the first part's on the exchange rate and the AAPT cost reduction effect?

Nick Olson - ***Telecom Corporation of New Zealand Limited - CFO***

Yeah look I'm sorry Laurent, could you repeat the first question for me?

Laurent Horrut - ***JP Morgan - Analyst***

Yeah just on the cost side on your costs year-on-year, they're down 7% and I suspect that some of that was a bit (technical difficulty) of the deconsolidation of AAPT last year and the exchange rate also going your way over the period. I'm just looking for, if you normalize for these two elements, what would have been the sort of year-on-year cost run rate?

Nick Olson - ***Telecom Corporation of New Zealand Limited - CFO***

We'll take the other one off line. I think that's actually more (inaudible) material.

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Let me - especially I don't think the AAPT sale is in any way a driver of the cost story, Laurent. Within AAPT, the guys again did a fantastic job in the second half in reducing the costs of the AAPT business. So their share of that is coming through here. So that's no way a driver of the result. In terms of the New Zealand economy, you know there's been a lot of commentary on that recently in households and businesses (inaudible) and so forth.

We're seeing really good demands for mobile, broadband, IT products and services, but at sharper prices. So where our mobile usage is going up, particularly broadband is going up significantly, we think the market in New Zealand is going up about 4% and that's actually less than some other markets. So we're fighting for our share of a total market growing about 1%. Corporates are looking for better value and I think Gen-i have been successful in winning a share of that IT service is actually growing at the market as a whole.

That's the way we see it. So it's less than before and that's because customers are getting more for their dollar than ever before. I think focus on the customer is helping us to do well in those tight market conditions.

Laurent Horrut - ***JP Morgan - Analyst***

Paul, just one more if you don't mind. Just on the revenue side, there's a line within Gen-i's revenue that seems to be particularly soft for quite some time now on the data side. What's driving that softness there?

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

The soft side on Gen-i, Chris do you have any comment on that?

Chris Quin - ***Telecom Corporation of New Zealand Limited - CEO, Gen-i***

Hi Sameer, it's Chris Quin speaking.

Laurent Horrut - ***JP Morgan - Analyst***

It's Laurent.

Chris Quin - ***Telecom Corporation of New Zealand Limited - CEO, Gen-i***

Hi Sameer, it's Chris Quin speaking - sorry, Laurent. The managed data line in the Gen-i, it's basically been the price competition and the shift from copper to fiber that's been driving the revenue picture in there.

This year has seen a slowing in the decline and a build back in the value around managed data services in there. So that's what's causing that trend in that line.

Does that answer your question well?

Laurent Horrut - ***JP Morgan - Analyst***

Yeah it does, thank you.

Chris Quin - ***Telecom Corporation of New Zealand Limited - CEO, Gen-i***

Thank you.

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Next question.

Operator

The next question comes from Greg Main, of First New Zealand Capital. Please go ahead Greg.

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Hey Greg.

Greg Main - ***First New Zealand Capital - Analyst***

Thank you, hello. Yeah just a couple of questions from me. Just on that depreciation charge, obviously you had the asset write-off that you've just allowed for. But is there much still coming out of accelerated depreciation related to CDMA and other assets?

Nick Olson - ***Telecom Corporation of New Zealand Limited - CFO***

Well CDMA is all but done. Again Greg, we conduct a review of asset lines between March and June so we actually pick up any accelerated depreciation by the time we get to 30 June this year. So there's nothing beyond what you see in the account.

Greg Main - ***First New Zealand Capital - Analyst***

So could we look at that second half '11 depreciation rate adjusted from maybe the asset writedown of the separation investment as a run rate FY12?

Nick Olson - ***Telecom Corporation of New Zealand Limited - CFO***

I can't give you a forward looking statement but I can give you a generic statement that the depreciation will generally follow CapEx. So you should see those trends follow each other over time.

Greg Main - ***First New Zealand Capital - Analyst***

Okay thank you and then just secondly on the [T&SS] other costs came down in that part of the business and obviously you absorbed the previous outsourcing contract that would have maybe led to some of that cost decline, but was there another driver behind why that other cost came down?

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

David Havercroft will speak to that.

David Havercroft - ***Telecom Corporation of New Zealand Limited - Group Chief Technology Officer***

Yeah hi it's Dave Havercroft from (inaudible). Yeah the other main drivers as Paul talked about earlier on which is mainly other external contracts, whether that's software contracts or service contracts where it's very (inaudible) being focused on the Opex nature of those contracts and we're able to reduce them over time.

Greg Main - ***First New Zealand Capital - Analyst***

Okay, so is some of those related to operational separation in the regulatory requirement or were they--

David Havercroft - ***Telecom Corporation of New Zealand Limited - Group Chief Technology Officer***

No they were more around the core technologies we use for products and services. The reductions for the operational separations have been covered under the writedown.

Greg Main - ***First New Zealand Capital - Analyst***

Okay and then just lastly, is there any other update on Telecom International or is that just sort of, yeah just sitting there now?

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

On International, we're looking for the sales process but we're focused quite hard on generating some value in that business. Rod, do you want to make a bit more comment?

Rod Snodgrass - ***Telecom Corporation of New Zealand Limited - Chief Product Officer***

Sure, all we're really focusing on in [TNZI] at this point is (inaudible) the business and focusing on costs as the market has declined globally. So it's really about our optimizing the cost structure and also how that business supports our retail unit in terms of (inaudible)

Greg Main - ***First New Zealand Capital - Analyst***

Right, by the sound of things, that means you're retaining it still and it's not for sale?

Rod Snodgrass - ***Telecom Corporation of New Zealand Limited - Chief Product Officer***

Yes at this stage we think we're the natural owner.

Greg Main - ***First New Zealand Capital - Analyst***

Okay thank you.

Operator

The next question comes from Richard Eary of UBS. Please go ahead Richard.

Richard Eary - ***UBS - Analyst***

Good morning guys.

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Hello Richard.

Richard Eary - ***UBS - Analyst***

Just a couple of housekeeping questions. The first one is in the presentation, I think, Nick mentioned some FX impacts positively in terms of handset procurement, equipment equipment. I just wonder whether you can attach a dollar value to that number.

But the second one was obviously in the mobile side which was pleasing to see a return to growth in the second half. From memory the second half last year with a lower number due to some rebates due to XT outages. I just wonder if you can give us a like for like number if you stripped out those rebates.

The third question relates to your comments around changes to UBA and UCLA rates through averaging of which you said in the commentary it could negatively impact Chorus. I don't know whether the - not to put a dollar value around it, but to say whether you think that is material or not. And then just the last question relates to costs where you obviously have done very well on - how far through this cost process of taking things out are we, regardless of a - the demerger?

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Let me - let me take the last bit and I think - obviously the demerger of the two new businesses will be what they will be but Richard a strong sense and I think I said this to you before is that a business like ours is looking very hard at process efficiency and effectiveness and really focusing hard on customers and right first time. We don't know where the end of the line is in that. We think there's - if you look at examples around the world certainly two or three years of it and we're nowhere near the end of the line so we are - we go into this year with lots of ideas to go at which we're working on and I expect we will be next year too and the year behind. And I say cost reduction never ends but there's a lot to go at with the right degree of focus and we're doing it.

Nick Olson - ***Telecom Corporation of New Zealand Limited - CFO***

Okay Richard, the first couple of questions, FX in fact probably related up to about half the improvement of cost of sales for mobile. Certainly, look, I haven't actually done the numbers but other works and rebates for customers and a few strengths you saw last year. They weren't hugely material so we don't consider that a swing factor in the overall mobile performance and UBA UCLL--

(multiple speakers)

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Can you repeat the third question Richard?

Richard Eary - ***UBS - Analyst***

Yeah, the third question was, in the commentary in the MD&A you talked about a move to an averaging environment and as a consequence that could have a negative impact on the performance of the new Chorus. I'm just - I'm not interested in dollar values. I just wonder whether you think that that is a material impact or an immaterial impact that we need to take account of.

Nick Olson - ***Telecom Corporation of New Zealand Limited - CFO***

I think that might fall into--

(multiple speakers)

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

We may or may not comment there on later but no forward looks sorry. Next question.

Operator

The next question comes from Ian Martin of the Royal Bank of Scotland. Please go ahead Ian.

Ian Martin - ***Royal Bank of Scotland - Analyst***

Good morning and thanks for doing this. Look, I've just got a question on corporate governance through the separation period and apologies if you've dealt with this at previous sessions that I've missed. But you've got this scheme booklet coming out and that - you're using that to talk or not talk about things that are going on at the moment that have enormous valuation implications, particularly a separation of values between Chorus and new Telecom. So I just wonder, given you're not talking about those valuation things and they're very important, is what the corporate governance process is to make sure that in the separation of assets the separation of responsibilities and so on that it doesn't - because the interest of management now are increasingly looking at on one side the valuation of Chorus and the performance of Chorus on one hand and new Telecom on the other. What's the process to ensure that Telecom New Zealand shareholders as they stand at the moment are best looked after in that separation firstly? Paul, on a related matter, have you indicated what your intentions are for the post separation period?

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Okay, look, corporate governance first. It is Telecom's board's responsibility to get the best results possible and aggregate for shareholders, get the best results possible and aggregate for shareholders. So we've approached UFB negotiations very much with that in mind and we have come to the conclusion that there's a deal there to be done. We will of course present that deal or present the shape of these businesses for shareholders to make up their mind in the scheme booklet and shareholders, that will clearly provide an awful lot of detail and shareholders will then have the opportunity to vote on that. So governance is the Board's responsibility and has a responsibility to provide you with a lot of detail in the scheme booklet and use the vote if you agree with the proposition when we get to the shareholder vote.

Alongside that of course as you would find in any deal of such a nature, we have had - the Board has commissioned an independent expert to review the deal in detail and ultimately we will share independent expert's report with shareholders so that they can take that into account as well as management and the Board's own view. So we've negotiated hard for shareholders. We think - you can see where that's gone so far. We continue to do the fine tuning of that with the same aggregate shareholder value in mind in terms of asset allocation and the precise details with CFH and Government. You will get a look at it in the scheme booklet and an independent expert will also provide their view for you to have a look at. So the governance bit. What was the other half of the question?

Ian Martin - ***Royal Bank of Scotland - Analyst***

Are you going to be---

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

What am I doing?

Ian Martin - ***Royal Bank of Scotland - Analyst***

Yeah.

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

If you're in - unless you're in - if you're in any doubt at all this is quite enormous humongous process. No telco on the planet is dealing with such a set of issues (inaudible), such a set of issues at once. So the leadership challenge of leading Telecom up to and beyond demerger, that's what I'm here for and I absolutely intend to stay here to do that. So yeah, I'm committed to making this work fantastically well up to demerger so that an aggregate of shareholders can take Telecom through to the other side.

Ian Martin - ***Royal Bank of Scotland - Analyst***

Well, I'm very glad to hear that Paul. Thank you.

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Thank you.

Operator

There are no further telephone questions at this time.

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Any more questions online? Any more questions in the room? One in here?

Unidentified Participant

Tony from (inaudible). I was just wondering if you have any sense yourself of what another global recession might mean for a big business like yourself here. The other two questions are about (inaudible).

Paul Reynolds - ***Telecom Corporation of New Zealand Limited - CEO***

Recession can have lots of effects. It can be long, it can be short and the (technical difficulty) can be different. The (inaudible) clearly, mainly around government and government debt and the issue is does it affect profit, who are our customers and does it affect consumer (inaudible) customers. So far we are finding, as I said already, (inaudible) consumers are buying lots of services - telecommunications services are vital in going forward [in the new world]; they're not discretionary spend. So they're looking for great value.

That continuing though depends of course on corporate success and individuals' employment levels in the country. I don't see any sign of deterioration in those aspects at all, but who knows, time will tell.

In terms of profitability, I'm more than happy to do it with you offline when we end the shareholder call.

Any more shareholder questions? Last quick question? If not, thank you very much.

Operator

Ladies and gentlemen, this concludes the Telecom New Zealand Full Year Financial Results Announcement conference call. Thank you for your participation, you may now disconnect.