Condensed consolidated income statement
For the six months ended 31 December 2011

(Dollars in millions, except per share amounts)	note	Six months ended 31 December 2011 Unaudited NZ$	Six months ended 31 December 2010 Unaudited NZ$	Year ended 30 June 2011 Audited NZ$
Operating revenues and other gains – continuing operations				
Local service		457	486	955
Calling		394	479	928
Interconnection		53	100	195
Mobile		445	405	825
Data		268	291	574
Broadband and internet		238	250	487
IT services		267	274	561
Resale		93	124	235
Other operating revenue	*3*	97	114	199
Other gains	*4*	46	32	45
		2,358	**2,555**	**5,004**
Operating expenses – continuing operations				
Labour		(411)	(421)	(832)
Intercarrier costs		(379)	(490)	(939)
Other operating expenses	*5*	(1,044)	(1,139)	(2,215)
Asset impairments		-	-	(215)
Other expenses	*4*	(5)	(4)	(42)
Earnings before interest, taxation, depreciation and amortisation – continuing operations		**519**	**501**	**761**
Depreciation		(178)	(259)	(468)
Amortisation		(106)	(118)	(240)
Earnings before interest and taxation – continuing operations		**235**	**124**	**53**
Finance income		8	10	15
Finance expense		(67)	(73)	(152)
Share of associates' profits/(losses)		-	1	1
Earnings/(losses) before income tax – continuing operations		**176**	**62**	**(83)**
Income tax (expense)/benefit	*11*	(47)	(28)	4
Earnings/(losses) from continuing operations		129	34	(79)
Earnings from discontinued operations net of tax	*7*	877	131	245
Net earnings for the period		**1,006**	**165**	**166**
Net earnings attributable to equity holders of the Company		1,005	164	164
Net earnings attributable to non-controlling interest		1	1	2
		1,006	**165**	**166**
Basic net earnings per share (in cents)		52	9	9
Diluted net earnings per share (in cents)		52	9	9
Basic and diluted earnings/(losses) per share from continuing operations (in cents)		7	2	(4)
Weighted average number of ordinary shares outstanding (in millions)		1,925	1,923	1,924

See accompanying notes to the financial statements.

Condensed consolidated statement of comprehensive income
For the six months ended 31 December 2011

	Six months ended 31 December		Year ended 30 June
	2011	2010	2011
	Unaudited	Unaudited	Audited
(Dollars in millions)	NZ$	NZ$	NZ$
Net earnings for the period	**1,006**	**165**	**166**
Other comprehensive income[1]:			
Translation of foreign operations	2	2	(8)
Net investment hedges	(3)	(15)	(11)
Reclassified to income statement on winding up of foreign operation	(28)	-	-
Revaluation of long-term investments	(20)	8	(48)
Cash flow hedges	52	(13)	(27)
Other comprehensive income/(loss) for the period	3	(18)	(94)
Total comprehensive income for the period	**1,009**	**147**	**72**
Total comprehensive income attributable to equity holders of the Company	1,008	146	70
Total comprehensive income attributable to non controlling interest	1	1	2
	1,009	**147**	**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 six months ended 31 December

Unaudited (Dollars in millions)	note	Share capital NZ$	Retained earnings NZ$	Hedge reserve NZ$	Deferred compensation 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	1	165
Other comprehensive income/(loss)		-	-	(13)	-	8	(13)	(18)	-	(18)
Transfer to retained earnings on disposal of long-term investments[1]		-	64	-	-	(64)	-	-	-	-
Total comprehensive income for the period		-	228	(13)	-	(56)	(13)	146	1	147
Contributions by and distributions to owners:										
Ordinary dividends		-	(182)	-	-	-	-	(182)	(1)	(183)
Supplementary dividends		-	(9)	-	-	-	-	(9)	-	(9)
Tax credit on supplementary dividends		-	9	-	-	-	-	9	-	9
Dividend reinvestment plan		7	-	-	-	-	-	7	-	7
Issuance of shares under share schemes		6	-	-	(1)	-	-	5	-	5
Total transactions with owners		13	(182)	-	(1)	-	-	(170)	(1)	(171)
Balance at 31 December 2010		**1,528**	**1,342**	**(45)**	**12**	**(289)**	**(33)**	**2,515**	**6**	**2,521**

Unaudited (Dollars in millions)	note	Share capital NZ$	Retained earnings NZ$	Hedge reserve NZ$	Deferred compensation NZ$	Revaluation reserve NZ$	Foreign currency translation reserve NZ$	Total equity holders of the Company NZ$	Non controlling interest NZ$	Total equity NZ$
Balance at 1 July 2011		1,528	1,207	(59)	14	(345)	(39)	2,306	5	2,311
Net earnings for the period		-	1,005	-	-	-	-	1,005	1	1,006
Other comprehensive income		-	-	52	-	(20)	(29)	3	-	3
Total comprehensive income for the period		-	1,005	52	-	(20)	(29)	1,008	1	1,009
Contributions by and distributions to owners:										
Ordinary dividends		-	(183)	-	-	-	-	(183)	-	(183)
Supplementary dividends		-	(25)	-	-	-	-	(25)	-	(25)
Tax credit on supplementary dividends		-	25	-	-	-	-	25	-	25
Issuance of shares under share schemes		16	-	-	(7)	-	-	9	-	9
Distribution of Chorus shares to shareholders	6	(383)	(881)	-	-	-	-	(1,264)	-	(1,264)
Total transactions with owners		(367)	(1,064)	-	(7)	-	-	(1,438)	-	(1,438)
Balance at 31 December 2011		**1,161**	**1,148**	**(7)**	**7**	**(365)**	**(68)**	**1,876**	**6**	**1,882**

See accompanying notes to the financial statements.

[1] Relates to the sale of Telecom's investments in iiNet Limited and Macquarie Telecom Group Limited.

Condensed consolidated statement of changes in equity (continued)

For the year ended 30 June 2011

Audited *(Dollars in millions)*	Share capital NZ$	Retained earnings NZ$	Hedge reserve NZ$	Deferred compensation 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	-		(27)	-	(48)	(19)	(94)	-	(94)
Transfer to retained earnings on disposal of long-term investments[1]	-	64	-	-	(64)	-	-	-	-
Total comprehensive income for the year	-	228	(27)	-	(112)	(19)	70	2	72
Contributions by and distributions to owners:									
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**

See accompanying notes to the financial statements.

[1] Relates to the sale of Telecom's investments in iiNet Limited and Macquarie Telecom Group Limited.

Condensed consolidated statement of financial position
As at 31 December 2011

		31 December		30 June
		2011	2010	2011
		Unaudited	Unaudited	Audited
(Dollars in millions)	*note*	NZ$	NZ$	NZ$
ASSETS				
Current assets:				
Cash		320	332	324
Collateral funds	*9*	-	44	110
Short-term derivative assets		1	3	2
Receivables and prepayments		675	744	701
Taxation recoverable		46	1	-
Inventories		82	91	60
Total current assets		1,124	1,215	1,197
Non-current assets:				
Long-term investments		105	186	125
Long-term receivables		184	41	44
Long-term derivative assets		-	30	40
Intangible assets		803	1,096	1,094
Property, plant and equipment		1,760	4,224	3,892
Total non-current assets		2,852	5,577	5,195
Total assets		**3,976**	**6,792**	**6,392**
LIABILITIES AND EQUITY				
Current liabilities:				
Accounts payable and accruals		839	979	991
Taxation payable		-	-	31
Short-term derivative liabilities		15	326	333
Short-term provisions		12	18	38
Debt due within one year	*13*	420	611	397
Total current liabilities		1,286	1,934	1,790
Non-current liabilities:				
Deferred tax liability		128	285	226
Long-term derivative liabilities		23	287	330
Long-term payables and provisions		39	44	35
Long-term debt	*13*	618	1,721	1,700
Total non-current liabilities		808	2,337	2,291
Total liabilities		2,094	4,271	4,081
Equity:				
Share capital		1,161	1,528	1,528
Reserves		(433)	(355)	(429)
Retained earnings		1,148	1,342	1,207
Total equity attributable to equity holders of the Company		**1,876**	**2,515**	**2,306**
Non-controlling interest		6	6	5
Total equity		1,882	2,521	2,311
Total liabilities and equity		**3,976**	**6,792**	**6,392**

See accompanying notes to the financial statements.

Condensed consolidated statement of cash flows
For the six months ended 31 December 2011

		Six months ended 31 December		Year ended 30 June
		2011	2010	2011
		Unaudited	Unaudited	Audited
(Dollars in millions)	*note*	NZ$	NZ$	NZ$
Cash flows from operating activities				
Cash received from customers		2,394	2,495	5,008
Interest income		8	10	15
Payments to suppliers and employees		(1,730)	(1,840)	(3,421)
Income tax (paid) / refunded		(84)	(74)	(127)
Interest paid		(110)	(97)	(197)
Dividend income		26	39	71
Net cash flow from operating activities	*8*	**504**	**533**	**1,349**
Cash flows from investing activities				
Sale of property, plant and equipment		1	3	3
Sale of business	*4*	5	76	76
Sale of long-term investments	*4*	1	100	107
Purchase of property, plant and equipment and intangibles		(397)	(589)	(1,005)
Capitalised interest paid		(5)	(10)	(16)
Net cash flow from investing activities		**(395)**	**(420)**	**(835)**
Cash flows from financing activities				
(Increase)/decrease in collateral funds		110	(23)	(89)
Debt restructuring costs[1]		(211)	-	-
Proceeds from derivatives[2]		961	1	2
Repayment of derivatives[2]		(1,279)	(11)	(13)
Payments on finance leases		(3)	-	-
Receipts on finance leases		10	-	-
Proceeds from short-term debt[3]		2,012	413	663
Repayment of short-term debt		(570)	(307)	(749)
Repayment of long-term debt[2]		(961)	(9)	(21)
Dividends paid		(183)	(177)	(313)
Net cash flow from financing activities		**(114)**	**(113)**	**(520)**
Net cash flow		(5)	-	(6)
Opening cash position		324	339	339
Foreign exchange movement		1	(7)	(9)
Closing cash position		**320**	**332**	**324**

See accompanying notes to the financial statements.

[1] Excludes an accounting gain of $101 million realised on derivatives novated to Chorus rather than settled in cash.

[2] The proceeds and repayment of derivatives relates to the cash flows arising from closing out hedges on the Group's borrowings as a result of debt repayments.

[3] Includes $1,106 million for the drawdown of funds as part of the demerger (see note 13).

Notes to the Condensed consolidated interim financial statements

NOTE 1 FINANCIAL STATEMENTS

The condensed consolidated interim financial statements of Telecom Corporation of New Zealand Limited (“the Company") together with its subsidiaries and associates ("Telecom"), as at and for the six months ended 31 December 2011, have been prepared in accordance with NZ IAS 34 ‘Interim Financial Reporting’, issued by the New Zealand Institute of Chartered Accountants. These financial statements also comply with International Accounting Standard IAS 34 ‘Interim Financial Reporting’.

As detailed in Telecom’s annual report for the year ended 30 June 2011, Telecom was required to demerge its fixed line access infrastructure business in order for the demerged business to take the cornerstone role in the Government’s ultra-fast broadband (‘UFB’) initiative. Telecom successfully demerged Chorus Limited (‘Chorus’) on 30 November 2011 after 99.8% of votes cast by the Company’s shareholders voted in favour of the demerger proposal. With effect from 1 December 2011, Chorus became a stand-alone, separately listed company.

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 restated 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 with the current period’s presentation.

Except for the adoption of the Standards and Interpretations described below, these condensed consolidated interim financial statements have been prepared using the same accounting policies and methods of computation as, and should be read in conjunction with, the financial statements and related notes included in Telecom’s annual report for the year ended 30 June 2011. The preparation of interim financial statements also requires management to make judgements, estimates and assumptions. Telecom has been consistent in applying the judgements, estimates and assumptions adopted in the annual report for the year ended 30 June 2011.

If new information about the discontinued operations obtained within the current financial year about the facts and circumstances that existed at the date of demerger identifies adjustments to the above amounts, or their presentation, then the disclosures will potentially be revised.

NZ IAS 24 ‘Related party disclosures’ and NZ IFRS 7 ‘Amendments to financial instruments: disclosures’
These revised standards have been adopted prospectively from 1 July 2011, but have had no impact on the condensed consolidated interim financial statements.

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

These condensed consolidated interim financial statements were approved by the board of directors on 23 February 2012 and are unaudited. However, with the exception of the discontinued operation adjustments referred to above, the results for the year ending and as at 30 June 2011 have been extracted from the Group’s audited financial statements. The Group’s audited financial statements are available on Telecom’s website: http://investor.telecom.co.nz.

Notes to the Condensed consolidated interim financial statements (continued)

NOTE 2 SEGMENTAL REPORTING

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

Segmental information for the six months ended 31 December 2011

Unaudited	Wholesale & International	Retail	Gen-i	T&SS	AAPT	Total
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$	NZ$	NZ$
External revenue and other gains	322	940	644	14	348	2,268
Internal revenue[1]	65	22	39	265	22	413
Total revenue and other gains	387	962	683	279	370	2,681
Segment result	79	233	123	1	40	476

[1] T&SS internal revenue includes internal cost allocations and charges to discontinued operations of $28 million.

Segmental information for the six months ended 31 December 2010

Unaudited *Restated*	Wholesale & International	Retail	Gen-i	T&SS	AAPT	Total
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$	NZ$	NZ$
External revenue and other gains	383	951	676	18	437	2,465
Internal revenue[1]	144	61	38	287	40	570
Total revenue and other gains	527	1,012	714	305	477	3,035
Segment result	75	240	105	-	46	466

[1] T&SS internal revenue includes internal cost allocations and charges to discontinued operations of $34 million.

Segmental information for the year ended 30 June 2011

Unaudited *Restated*	Wholesale & International	Retail	Gen-i	T&SS	AAPT	Total
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$	NZ$	NZ$
External revenue and other gains	760	1,893	1,342	31	834	4,860
Internal revenue[1]	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

[1] T&SS internal revenue includes internal cost allocations and charges to discontinued operations of $61 million.

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 expenses, associates' profit / losses and income taxation expense. None of these other items are assessed on a segment basis by Telecom's Chief Executive Officer.

During the year ended 30 June 2011, Telecom established 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.

Notes to the Condensed consolidated interim financial statements (continued)

NOTE 2 SEGMENTAL REPORTING (continued)

Included within the comparative segment results disclosed above for AAPT are the results of its consumer division, which was disposed of in the six months ended 31 December 2010 (refer note 4).

Reconciliation from segment result to earnings before income tax

		Six months ended 31 December		Year ended 30 June
		2011	2010	2011
		Unaudited	Unaudited	Audited
(Dollars in millions)	*note*	NZ$	NZ$	NZ$
Segment result		476	466	969
Net result of Corporate revenue and expenses		12	21	26
Other gains not allocated to segments	*4*	36	18	23
Asset impairments not allocated to segments		-	-	(215)
Other expenses	*4*	(5)	(4)	(42)
Depreciation		(178)	(259)	(468)
Amortisation		(106)	(118)	(240)
Finance income		8	10	15
Finance expense		(67)	(73)	(152)
Share of associates' profits		-	1	1
Earnings/(losses) before income tax – continuing operations		**176**	**62**	**(83)**

NOTE 3 OTHER OPERATING REVENUE (continuing operations)

		Six months ended 31 December		Year ended 30 June
		2011	2010	2011
		Unaudited	Unaudited	Audited
(Dollars in millions)	*note*	NZ$	NZ$	NZ$
Dividend income		26	39	71
Sale of equipment		6	12	18
Miscellaneous other		44	34	59
Revenue from Chorus discontinued operations	*7*	21	29	51
		97	**114**	**199**

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

Revenue from Chorus discontinued operations comprises recoveries of corporate and technology support services. Up to demerger, these were charged internally to the discontinued operations by Telecom's continuing operations.

Notes to the Condensed consolidated interim financial statements (continued)

NOTE 4 OTHER GAINS & OTHER EXPENSES (continuing operations)

	Six months ended 31 December		Year ended 30 June
	2011	2010	2011
	Unaudited	Unaudited	Audited
(Dollars in millions)	NZ$	NZ$	NZ$
Other gains			
Gain on sale	10	18	23
Various resolutions and settlements with supplier	-	14	22
Gain on winding up of foreign operation	28	-	-
Interim settlement on insurances	8	-	-
	46	**32**	**45**
Other expenses			
Natural disaster costs	5	4	42
	5	**4**	**42**

In the six months ended 31 December 2011, other gains of $46 million represented:

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

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) in September 2010; and
- $5 million (A$4 million) gain on the sale of Yahoo!Xtra Limited in April 2011; and
- $22 million relating to a resolution and settlement reached with a supplier.

In the six months ended 31 December 2010, other gains of $32 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) in September 2010; and
- $14 million relating to a resolution and settlement reached with a supplier.

In the six months ended 31 December 2010, Telecom also sold its investments in Macquarie Telecom Group Limited and iiNet Limited for $100 million (A$80 million). This has no impact on the condensed consolidated income statement due to the movements in fair value of these investments (including the difference between sales proceeds and carrying value) being recognised directly in equity in accordance with NZ IFRS 9.

In the six months ended 31 December 2011, other expenses of $5 million ($4 million for the six months ended 31 December 2010) represented costs recognised in relation to the Canterbury earthquakes.

In the year ended 30 June 2011, other expenses of $42 million represented costs recognised in relation to the Canterbury earthquakes, comprised of incremental operational costs incurred, customer credits and asset impairments. Parts of these costs are covered by Telecom's insurance arrangements.

Notes to the Condensed consolidated interim financial statements (continued)

NOTE 5 OTHER OPERATING EXPENSES (continuing operations)

		Six months ended 31 December		Year ended 30 June
		2011	2010	2011
		Unaudited	Unaudited	Audited
(Dollars in millions)	*note*	NZ$	NZ$	NZ$
Network support		47	47	89
Maintenance and other direct costs		12	19	33
Mobile acquisitions, upgrades and dealer commissions		153	126	244
Procurement and IT services		154	164	337
Broadband, internet and other		50	43	78
Computer costs		51	98	159
Advertising, promotions and communications		37	42	68
Accommodation costs		58	50	105
Outsourcing		9	12	22
Travel		6	12	19
Bad debts		6	10	18
Other expenses		44	51	80
Operating expenses to Chorus discontinued operations	7	417	465	963
		1,044	**1,139**	**2,215**

Operating expenses to Chorus discontinued operations comprise costs relating to local services, backhaul, field services and co-location. Up to demerger, these were charged internally from the discontinued operations to Telecom's continuing operations.

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 (NZ$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 (NZ$881 million).

Shares Issued in Lieu of Dividends

In respect of the six months ended 31 December 2011, no shares were issued in lieu of a cash dividend (six months ended 31 December 2010: 3,388,197 shares with a total value of $7 million; year ended 30 June 2011: 3,388,197 shares with a total value of $7 million).

Dividends paid

During the period, Telecom paid a fourth quarter dividend of $145 million, representing 7.5 cents per share, and a special dividend of $38 million, representing 2.0 cents per share. The dividends were fully imputed (at a ratio of 28/72) in line with the corporate income tax rate. In addition, supplementary dividends totalling approximately $20 million and $5 million respectively were paid to shareholders who are not 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 interim financial statements (continued)

NOTE 6 DIVIDENDS AND EQUITY (continued)

Declaration of dividend

On 23 February 2012, the Board of Directors approved the payment of a dividend for the half-year of $173 million, representing 9.0 cents per share. The dividend has been fully imputed (at a ratio of 28/72) in line with the corporate income tax rate. In addition, a supplementary dividend totalling approximately $23 million will be payable to shareholders who are not resident in New Zealand. In accordance with the Income Tax Act 2007, Telecom will receive a tax credit from the Inland Revenue Department equivalent to the amount of supplementary dividends paid.

NOTE 7 DISCONTINUED OPERATIONS

Telecom successfully completed the Demerger for Chorus Limited on 30 November 2011. The condensed consolidated income statement has been re-presented to show the Chorus results 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:

(Dollars in millions, except per share amounts)	*note*	Five months ended 30 November 2011 Unaudited NZ$	Six months ended 31 December 2010 Unaudited NZ$	Year ended 30 June 2011 Audited NZ$
Operating revenues				
Local service		13	13	26
Data		9	8	18
Broadband and internet		44	40	94
Other operating revenue		13	14	31
Internal revenues from Telecom continuing operations	*5*	417	465	963
		496	540	1,132
Operating expenses				
Labour		(17)	(18)	(37)
Other operating expenses		(137)	(112)	(243)
Internal costs with Telecom continuing operations	*3*	(21)	(29)	(51)
Asset impairments		-	-	(42)
Depreciation		(84)	(130)	(265)
Amortisation		(21)	(23)	(54)
Net finance costs		(20)	(26)	(51)
Earnings before income tax		196	202	389
Income tax expense		(55)	(63)	(115)
Net earnings for the period – before demerger related items		141	139	274
Demerger related items:				
Gain on distribution of Chorus shares		775	-	-
Debt restructuring costs		(110)	-	-
Demerger and UFB costs		(47)	(12)	(29)
Net gain on asset arrangements between Chorus and Telecom		88	-	-
Tax benefit on demerger related items		30	4	-
Total demerger related items		736	(8)	(29)
Earnings from discontinued operations		**877**	**131**	**245**
Basic earnings per share (in cents)		45	7	13
Diluted earnings per share (in cents)		45	7	13

Notes to the Condensed consolidated interim financial statements (continued)

NOTE 7 DISCONTINUED OPERATIONS (continued)

The $775 million non-cash gain on demerger of Chorus relates to the difference between the fair value and book value of the new assets demerged to Chorus.

Debt restructuring costs of $110 million includes $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 $47 million includes advisors' fees (including legal, accounting and investment banking fees), independent expert report costs and separation-related costs such as changes to IT systems, program management and preparation for trading between Telecom and Chorus.

Net non-cash gains by Telecom on asset arrangements between Chorus and Telecom of $88 million represented:

- $83 million of net gains on entering into new finance lease arrangements with Chorus on demerger;
- $5 million gains on jointly controlled asset arrangements with Chorus;

The carrying value of assets and liabilities disposed of as discontinued operations are:

(Dollars in millions)	30 November 2011 Unaudited NZ$
Assets	
Receivables and prepayments	4
Short-term derivative assets	1
Current tax receivable	2
Inventories	4
Intangible assets and property, plant and equipment	2,343
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	**489**

The cash flows of the discontinued operations are as follows:

(Dollars in millions)	Five months ended 30 November 2011 Unaudited NZ$	Six months ended 31 December 2010 Unaudited NZ$	Year ended 30 June 2011 Audited NZ$
Cash flows from operating activities[1]	(171)	(136)	(276)
Cash flows from investing activities	(160)	(190)	(429)
Cash flows from financing activities	228	-	-
Net cash flow from discontinued operations	**(103)**	**(326)**	**(705)**

[1] Pre demerger revenue received and expenses paid between the discontinued operations and continuing operations was not settled in cash and is therefore excluded from the cash flows from discontinued operations above.

Notes to the Condensed consolidated interim financial statements (continued)

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

	Six months ended 31 December		Year ended 30 June
	2011	2010	2011
	Unaudited	Unaudited	Audited
(Dollars in millions)	NZ$	NZ$	NZ$
Net profit after tax	1,006	165	166
Adjustments to reconcile net earnings to net cash flows from operating activities:			
Depreciation and amortisation	389	530	1,027
Bad and doubtful accounts	7	10	21
Increase / (decrease) in deferred tax liability	62	(7)	(46)
Net gain on asset arrangements	(88)	-	-
Share of associates' (profits) / losses	-	(1)	(1)
Gain on distribution of Chorus shares	(775)	-	-
Gain on novation of derivatives to Chorus	(101)	-	-
Gain on windup of foreign operations	(28)	-	-
Debt close out costs included in financing cash flows	211	-	-
Asset impairments	-	-	257
Other	(11)	(23)	(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	9	(52)	(27)
Decrease / (increase) in inventories	(27)	(30)	1
Decrease / (increase) in current taxation	(74)	20	30
Increase / (decrease) in accounts payable and related items	(76)	(79)	(71)
Net cash flows from operating activities	**504**	**533**	**1,349**

The cash flows from operating activities for the discontinued operations are included above and summarised in note 7.

NOTE 9 CONTINGENCIES

For further historic detail on the specific matters referred to below, please refer to Telecom's 2011 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 reserved judgment was delivered on 19 April 2011 ordering that Telecom pay a pecuniary penalty of $12 million. Telecom has paid this penalty but has also appealed the penalty judgment and liability to the Court of Appeal. An appeal hearing for liability was held from 26 September to 3 October 2011, with the judgment reserved. The penalty hearing was heard on 21 November 2011, with the judgment reserved.

Notes to the Condensed consolidated interim financial statements (continued)

NOTE 9 CONTINGENCIES (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 Court's finding that Telecom had not breached section 36, and ordered the Commerce Commission to pay Telecom costs of $50,000 in the Supreme Court. The Commerce Commission has paid these Supreme Court costs, and Telecom has settled its outstanding claim for costs in the High Court with the Commerce Commission, and the Commerce Commission has paid these costs.

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 ongoing litigation was allocated between Chorus and Telecom. The allocated party will manage the allocated litigation at their cost, with indemnities in place to ensure that the party to which they are allocated bears the economic risk of that litigation. The matters above were allocated to Chorus. 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.

Other litigation and investigations

As noted in the 2011 Annual Report, a notice of proposed adjustment ('NOPA') to Telecom's 2008 New Zealand tax return had been received from the Inland Revenue Department ('IRD'). Telecom responded, rejecting the IRD's NOPA. In February 2012 the IRD and Telecom agreed to settle the dispute based on confidential terms.

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 are 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, and results of operations or profitability.

Notes to the Condensed consolidated interim financial statements (continued)

NOTE 9 CONTINGENCIES (continued)

Operating commitments

At 31 December 2011, capital expenditure amounting to $47 million (31 December 2010: $160 million) had been committed under contractual arrangements, with substantially all payments due within one year. The capital expenditure commitments principally relate to telecommunications network equipment.

At 31 December 2011, Telecom had other supplier commitments of $48 million, $105 million and $126 million for the years ending 30 June 2012, 2013 and 2014 respectively.

Collateral requirements

Telecom is required to post collateral to support the value of certain derivatives. As at 31 December 2011 no collateral was posted (30 June 2011: US$91 million (NZ$110 million)); 31 December 2010: US$34 million (NZ$44 million)).

NOTE 10 SIGNIFICANT EVENTS AFTER BALANCE DATE

As described in Note 6, Telecom has declared a dividend in respect of the six months ended 31 December 2011.

As described in note 9, Telecom agreed to settle the dispute with the IRD relating to Telecom's 2008 New Zealand tax return.

On 23 February 2012, the Board of Directors approved an on-market share buyback of up to $300 million in the 2012 calendar year. A disclosure document will be sent to shareholders prior to the offer being made.

NOTE 11 TAXATION

The continuing operations tax charge for the six months ended 31 December 2011 of $47 million was $19 million higher than the charge of $28 million in the six months ended 31 December 2010. This is primarily due to a $33 million increase in the current period tax charge as a result of higher continuing taxable earnings, partially offset by an $18 million impact in the comparative period as a result of a reduction in the value of certain tax credits following legislative changes, and a number of other items including the change in tax rate from the prior year rate of 30% to the current year rate of 28%.

Notes to the Condensed consolidated interim financial statements (continued)

NOTE 12 FINANCE LEASE ARRANGEMENTS WITH CHORUS

After the demerger of Chorus, Telecom owns 30 exchanges and Chorus own 632 exchanges. Telecom and Chorus both require space in the majority of these exchanges and have entered into lease arrangements in order to meet their specific business requirements. These long-term arrangements are accounted for as finance leases. There is a legal right of offset of the amounts payable to and receivable from Chorus, meaning Telecom's finance lease payable and receivable position is presented as a net finance lease receivable.

(Dollars in millions)	31 December 2011 Unaudited NZ$
Assets recognised and derecognised as finance lease	
Building assets included in property, plant and equipment	35
Building assets removed from property, plant and equipment	(68)
Net disposal of buildings assets from property, plant and equipment	(33)
Finance lease receivables and payables	
Short-term finance lease receivable	14
Long-term finance lease receivable	143
Short-term finance lease payable	(6)
Long-term finance lease payable	(35)
Net finance lease receivable	**116**
Presented within:	
Current receivables and prepayments	8
Non-current long-term receivables	108
	116

NOTE 13 CURRENT AND LONG-TERM DEBT

	Six months ended 31 December 2011 Unaudited NZ$	Six months ended 31 December 2010 Unaudited NZ$	Year ended 30 June 2011 Audited NZ$
EMTN	80	1,509	1,468
TeleBonds	542	553	542
Short-term debt	419	276	93
Unamortised discount	(3)	(6)	(6)
Total Debt	**1,038**	**2,332**	**2,097**
Debt due within one year	420	611	397
Debt due greater than one year	618	1,721	1,700
Total Debt	**1,038**	**2,332**	**2,097**

Notes to the Condensed consolidated interim financial statements (continued)

NOTE 13 CURRENT AND LONG-TERM DEBT (continued)

Telecom continues to have short-term financing programmes in place; a US$1 billion European Commercial Paper Programme, a NZ$500 million Note Facility of which $184 million of notes and $235 million of European commercial paper have been utilised at 31 December 2011. In addition to the short-term financing programmes, Telecom has committed stand-by facilities of NZ$700 million (30 June 2011: NZ$700 million) which is undrawn at 31 December 2011. The A$1.5 billion Short Term Note and Medium Term Note Programme was disestablished on the wind-up of TCNZ Finance Limited's Australian branch.

During the six months ended 31 December 2011, Telecom repaid the USD250 million, CAD275 million and CHF200 million bonds, including the related derivatives.

Immediately prior to the demerger, Telecom drew NZ$1,106 million under a new syndicated facility. This drawn facility was included in the net assets transferred to Chorus and, from the date of demerger, was no longer part of Telecom's facilities.

As part of the demerger, Telecom bond holders elected to exchange GBP235 million (NZ$625 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 remained 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.

The costs associated with the debt restructuring above have been included in discontinued operations and are summarised in note 7.

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