ANNUAL REPORT

FOR THE YEAR ENDED
30 JUNE **2000**

Telecom NEW ZEALAND



Online



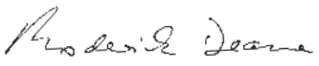
Growth



Value

OUTLOOK	1
REVIEW	2
CHAIRMAN'S LETTER TO SHAREHOLDERS	3
CHIEF EXECUTIVE'S STATEMENT	4, 5
BUILDING PRESENCE IN AUSTRALIA	6, 7
DRIVING GROWTH IN MOBILE COMMUNICATIONS	8, 9
LEADING GROWTH IN DATA	10, 11
HIGHLY COMPETITIVE IN VOICE CALLING	12
MAKING THE INTERNET MORE VALUABLE	13
EXPANDING AND STRENGTHENING NETWORKS	14, 15
DEVELOPING PEOPLE OF TALENT AND COMMITMENT	16
BOARD OF DIRECTORS	17, 18
EXECUTIVE GROUP	19, 20
GOVERNANCE AT TELECOM	21, 22
MANAGEMENT'S DISCUSSION & ANALYSIS	23 – 35
CONSOLIDATED STATEMENT OF FINANCIAL PERFORMANCE	36
CONSOLIDATED STATEMENT OF MOVEMENTS IN CAPITAL FUNDS	37
CONSOLIDATED STATEMENT OF FINANCIAL POSITION	38
CONSOLIDATED STATEMENT OF CASH FLOWS	39
PARENT COMPANY STATEMENT OF FINANCIAL PERFORMANCE	40
PARENT COMPANY STATEMENT OF MOVEMENTS IN CAPITAL FUNDS	40
PARENT COMPANY STATEMENT OF FINANCIAL POSITION	41
PARENT COMPANY STATEMENT OF CASH FLOWS	42
NOTES TO THE FINANCIAL STATEMENTS	43 – 71
AUDITORS' REPORT	72
INTERESTS REGISTER	73
OTHER DISCLOSURES	74, 75
SHAREHOLDER INFORMATION	76, 77

THIS REPORT IS DATED 31 AUGUST 2000, AND IS SIGNED ON BEHALF OF THE BOARD BY:



RODERICK DEANE
CHAIRMAN



THERESA GATTUNG
CHIEF EXECUTIVE OFFICER AND MANAGING DIRECTOR

TELECOM CORPORATION OF NEW ZEALAND LIMITED

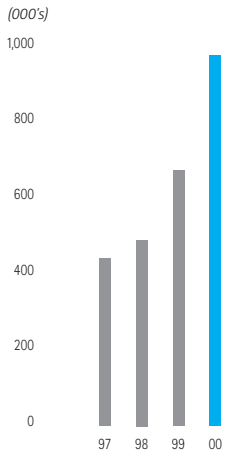
Outlook

The world is going **online**. That means people are making ever more use of communications networks – fixed-line and mobile – to be informed, educated or entertained; to do business; and to access the Internet. Telecom is at the heart of the online world. Our business enables people to have more communication and more information – and to do so in ways which are faster and ever more valuable.

We foresee continued business **growth** as the world moves online. Telecom is helping drive the trends evident today. And our investment in networks and new services will shape communication and information tomorrow. We will focus principally on growth in our part of the online world – New Zealand and Australia.

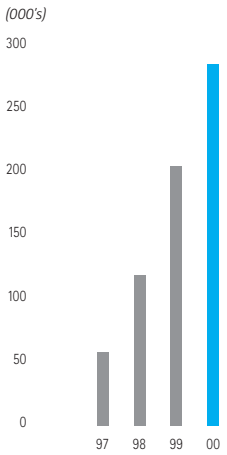
With growth should come **value**. Indeed, we can only expect business growth when customers realise value from using our networks and services. And such business growth will ultimately drive growth in value to Telecom shareholders.

CELLULAR CONNECTIONS*



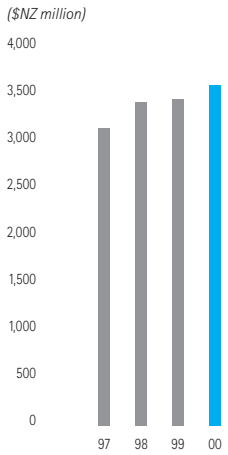
1999–00: 44.8% GROWTH IN CELLULAR CONNECTIONS

XTRA CONNECTIONS*



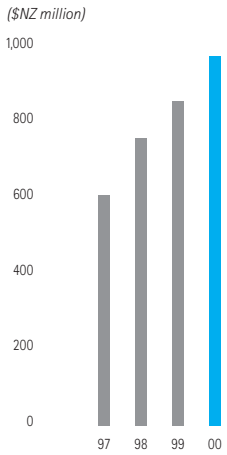
1999–00: 39.3% GROWTH IN XTRA CUSTOMERS

TOTAL REVENUE* (excl. abnormals)



1999–00: 4.2% GROWTH IN TOTAL REVENUES (excl. abnormals)

MOBILE & DATA REVENUES*



1999–00: 13.9% GROWTH IN MOBILE & DATA REVENUES COMBINED

* (excluding AAPT)

Review

In the year ended 30 June 2000, Telecom set a platform for future growth. Some of the achievements:

- AAPT strategic investment
- ADSL broadband roll-out
- Southern Cross Cable development
- Huge growth in data
- CDMA mobile network construction started
- esolutions alliance
- Cellular connections near 1 million
- New corporate business in Australia

Net earnings for the year were NZ$783 million, down 6.1% after consolidating our investment in AAPT. Excluding AAPT, Telecom had total revenues of NZ$3,601 million, up 4.2%, and net earnings of NZ$846 million, up 2.4%.

FINANCIAL PERFORMANCE

	As at and for the year ended 31 March			As at and for the year ended 30 June
	1997	1998	1999	2000*
Operating revenues *($NZ millions)*	3,083	3,398	3,450	4,346
EBITDA[1] (excluding abnormals) *($NZ millions)*	1,776	1,945	1,959	2,037
Net earnings *($NZ millions)*	581	820	822	783
Earnings per share (NZ cents)	30.8	45.9	46.9	44.7
Total assets *($NZ millions)*	4,618	5,165	5,375	7,981
Return on assets[2]	27.3%	29.6%	29.8%	22.8%
Gearing[3]	51.4%	43.6%	42.9%	62.4%
Interest cover[4]	10.9	7.6	6.9	5.1
Debt rating[5]	Aa1/AA	Aa1/AA	Aa2/AA	A1/A+
Cash flow from operating activities *($NZ millions)*	1,419	1,537	1,574	1,545
Capital expenditure *($NZ millions)*	696	587	564	869

1 Earnings before interest, tax, depreciation and amortisation.
2 Normalised earnings before interest and tax divided by average total assets (net of cash and short term investments).
3 Net debt divided by the total of net debt and capital funds.
4 Normalised surplus from continuing operations divided by net interest expense including interest capitalised and capital note coupons.
5 Long-term foreign currency ratings from Moody's Investors Services/Standard and Poor's.
** Includes the consolidation of AAPT from 1 December 1999.*

Chairman's letter to shareholders



RODERICK DEANE
CHAIRMAN

TELECOM IS IN TRANSITION. YOUR COMPANY IS SEIZING NEW OPPORTUNITIES IN THE ONLINE WORLD – AND BROADENING ITS STRATEGIC FOCUS TO ENCOMPASS AUSTRALIA AS WELL AS NEW ZEALAND.

Telephony and network operations, fixed wire, mobile and international, remain our core business. But no matter how excellent we make this business, we must develop beyond old boundaries if we are to sustain superior growth in value for shareholders. Thus Telecom is now becoming a more diversified online and communications company.

The past year has seen major steps in that direction. In November 1999, we increased Telecom's strategic shareholding in AAPT in Australia to approximately 80%. And we have continued to expand and strengthen our networks, introduce new services of value to customers, and form valuable new alliances.

Our results for 1999-00 show progress in many ways although transition does bring new costs in the interim. Telecom's net earnings of $783 million for 1999-00 include funding and goodwill costs associated with our investment in AAPT. That result was down 6.1% from the previous 12 months. Excluding AAPT, Telecom achieved modest earnings growth to $846 million.

TELECOM IS EXPANDING IN NEW MARKETS.

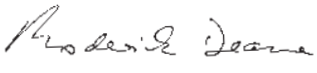
Transition for sustained growth requires major new investment in our business. Telecom will invest in new mobile and broadband technologies, and continue to expand and strengthen its networks. In Australia we intend an even closer relationship with AAPT, based on our offer to buy minority shareholdings in that company. Through this and other initiatives, Telecom is building a strong presence on both sides of the Tasman.

Investing for growth requires strong cash flows and financial flexibility. The Board has decided on a change to our dividend policy which will see more of Telecom's earnings retained and invested in key projects. From 2000-01, we will target a dividend payout around 50% of annual net earnings, dependent on the level of earnings, cash flow and other investment opportunities in any given year. Telecom will continue to pay dividends on a quarterly basis, with imputation to the fullest extent possible.

FINANCIAL FLEXIBILITY TO INVEST FOR BUSINESS GROWTH.

Distributions to shareholders will be lower than in recent years. But the Board is confident that retaining cash and investing for growth will deliver greater value for shareholders in the medium and longer term.

Our transition has several dimensions. But some things will never change. Telecom will retain a strong focus on delivering value to customers. Only on this basis can we sustain an unswerving commitment to growth in value for shareholders.



THERESA GATTUNG, CHIEF EXECUTIVE
AND MANAGING DIRECTOR

Chief Executive's Statement



IN 2000, WE HAVE SET A NEW GOAL FOR TELECOM: TO BE THE BEST PERFORMING ONLINE AND COMMUNICATIONS COMPANY IN AUSTRALASIA. IT'S AN AUDACIOUS GOAL, EXTENDING TELECOM BEYOND ALL THAT IT HAS ACHIEVED IN THE PAST DECADE. WE RECOGNISE IT'S TIME FOR BOLD MOVES THAT REPOSITION THE COMPANY FOR THE NEXT TEN YEARS. OUR NEW GOAL SETS A PATH FOR GROWTH, IN EXISTING AND NEW MARKETS.

It's a goal for a changing world. People are making increased use of a diverse array of communications and information technologies. Internet connection, for instance, is higher in New Zealand than almost any other country.

In our part of the world, people are quick to adopt new services and to see advantages in being connected through fixed-line or mobile networks. New broadband technologies are making this easier and less costly. In more traditional telecommunications markets, competition between service providers is becoming more intense and prices are in decline.

Telecom is, of course, a major driver of these trends. We provide connectivity and we constantly seek to add value once customers are connected. As our goal indicates, Telecom is committed to business growth in both New Zealand and Australia as this region goes online and adopts new communication technologies as rapidly as any other part of the world. This annual report summarises our business strategies in seven key areas.

First, we are building our presence in Australia through AAPT and through working closely with corporate customers. AAPT has modern networks and over 875,000 business, government and residential customers. This is a solid platform for growth in Australia. Bringing the two companies more closely together will strengthen our group and create greater flexibility for other strategic moves in Australasia.

Telecom seeks to develop new business with major corporates, most prominently the Commonwealth Bank of Australia. In August 2000, the Bank signed an A$500 million contract for a Telecom-led consortium to source and manage its complex telecommunications and IT needs. The contract will draw on Telecom's outsourcing expertise, AAPT's network capabilities and the skills and resources of other companies including EDS Australia.

OUR STRATEGY IS TO INVEST WHERE THIS BEST SUPPORTS FUTURE GROWTH.

I LOOK TO THE ONLINE FUTURE CONFIDENT THAT OUR SUCCESS WILL BRING GROWTH IN VALUE FOR CUSTOMERS AND FOR SHAREHOLDERS.

Second, we are driving mobile communications forward. Telecom is rolling out a next-generation CDMA network as the platform for a new wave of digital services from mid 2001 onwards. In Australia, AAPT is building a CDMA network for service to around half the populated area. Demand is growing for mobility of telephony, information services and Internet access. Across the Telecom group, we expect sustained growth in mobile connections, especially digital, and increasing take-up of value-added services.

Third, Telecom is committed to leadership in data. Australasian markets are seeing explosive growth in data flows and applications fuelled by the availability of new computer software and advanced network services. Telecom is meeting the demand by increasing bandwidth through Jetstream and other products, and by creating communications and IT solutions to meet the needs of businesses.

The Internet is central to everyone's view of the future. A fourth Telecom strategy is about making it more valuable to people in our part of the world. Xtra is New Zealand's leading Internet service provider and web portal, while across the Tasman, AAPT is developing a powerful alliance between connect.com.au and America Online.

Voice calling is core to our business. In 1999-00 local service and national and international calling comprised around 60% of total Telecom revenues. Our strategy is to maintain value in the voice business by being highly competitive on service quality and price. We will increasingly look to package calling with other services of value to customers.

Business growth requires Telecom to expand and strengthen its networks. Our strategy is to invest where this best supports future growth and maximises the commercial use of new technologies. In 2000-01, capital expenditure is expected to reach $1 billion with 60% invested in networks for voice and data growth, and our cdmaOne and Southern Cross Cable projects.

Across our region we also need people of talent and commitment. We have strategies for recruiting and developing the human resources vital for taking our business forward in every respect. To be best-performing, Telecom needs individuals and teams who seek best performance in the contribution each makes.

Best performance raises other imperatives including the need to constrain operating costs. In 2000-01 our priorities include reduction in costs not directly related to revenue growth and cost saving through simplification of business processes. Telecom will continue to build alliances with other companies whose assets and skills complement our performance. We recognise that Telecom can best manage the costs and risks implicit in growth by co-operating with like-minded others. esolutions, the alliance with EDS New Zealand and Microsoft, is a great example.

In all we do, customers will be our principal focus. Telecom will base its creation and delivery of services and products on keen understanding of customer requirements. And we will target continuous improvement in their satisfaction. In June 2000, our service channels earned a 49% overall "excellent" rating from customers – up five percentage points from a year earlier and a good base to build on.

Best performance in Australasia is our goal. I look to the online future confident that our success will bring growth in value for customers and for shareholders.



Theresa Gattung
Chief Executive and Managing Director

Building presence in **Australia**

AUSTRALIA IS CENTRAL TO TELECOM'S FUTURE. IN 2000, WE HAVE TAKEN MAJOR STEPS TO BUILD OUR PRESENCE IN THAT MARKET BY LEVERAGING THE EXPERTISE AND EXPERIENCE OF TELECOM IN NEW ZEALAND.

Australia offers huge potential. The number of Internet subscribers, for instance, is estimated to rise to three million this year and perhaps six million by 2006. Mobile customers are increasing rapidly, with user numbers expected to reach nine million this year and nearly 11 million by the end of 2001. Australia has a rising population and a diverse, growth-oriented business sector.

AAPT is a strong platform for growth for Telecom. As Australia's third largest telecommunications carrier, AAPT has more than 875,000 customers and extensive network infrastructure and services. It has a focused programme of 'first mile' access network build out, which includes fibre optic rings in the central business districts of six state capitals, an Australian-wide broadband wireless network, LMDS and a national mobile network using CDMA technology.

AAPT owns and operates Australia's largest secure private Internet Protocol (IP) network, which services the Victorian Government by linking more than 3,500 sites including schools, hospitals and police stations, and some 700,000 daily users. This IP network is also utilised by AAPT for the provision of data services to a number of business and corporate customers and is part of AAPT's extensive offering of fixed-line, data, Internet and mobile services.

AUSTRALIA

- 19 MILLION PEOPLE
- 7.1 MILLION HOUSEHOLDS
- OVER 1 MILLION BUSINESSES
- 9 MILLION CELLULAR CONNECTIONS
- TELECOMMUNICATIONS REVENUES NEARLY DOUBLED IN PAST 5 YEARS

AAPT

AAPT launched Smartchat in 1997 to offer national and international calling to consumers. This was expanded in 1999 to provide a bundled 'full service' consumer offering, including local calls. By the end of June 2000, Smartchat had captured 300,000 customers or more than 5% of the overall residential local call market.

The successful Smartchat launch and AAPT's push into regional Australia has led to the establishment of an additional 300-seat call centre in Victoria.

Telecom and AAPT are committed to keep on deploying their joint infrastructure on an Australasian basis. Together, the two companies have been focusing on providing the best mobile, voice, data and Internet services on both sides of the Tasman. Our IP networks give scope to offer integrated, managed IP network services to Australasia.

Seamless Trans-Tasman solutions will become increasingly important to businesses operating in both countries. AAPT is chasing business in Australia from New Zealand-based corporates, who are doing business across the Tasman and several large corporate accounts have already been won.

AAPT NETWORKS

- CDMA TRIAL IN QUEENSLAND: COMMERCIAL LAUNCH EARLY 2001
- FIBRE RINGS IN SYDNEY, MELBOURNE, BRISBANE, ADELAIDE, PERTH, CANBERRA - 670 KM IN TOTAL
- AAPT ROLLING OUT A BROADBAND WIRELESS LMDS NETWORK NATIONALLY



AAPT has established an Internet joint venture in Australia with America Online (AOL), one of the world's leading interactive service companies. This initiative brings together AAPT's network, marketing and distribution capabilities with AOL's content and software plus its business contacts. The joint venture gives AAPT a tremendous opportunity to develop substantial new markets.

In the business Internet area, AAPT and its subsidiary connect.com.au, one of Australia's largest Internet access and e-commerce providers, have acquired leading e-commerce provider Commerce Solutions. connect.com.au has also entered a major e-procurement licencing agreement with US software provider Ariba and acquired 60% of EC-Pay Pty Ltd, which owns and markets a specialist Internet-based service for the superannuation industry.

Telecom and AAPT have been working to develop new business with major corporates in Australia. To secure the 10-year contract with the Commonwealth Bank Group of Australia, Telecom assembled a strong team, led by TCNZ Australia, which included AAPT, EDS and Com Tech. TCNZ Australia will streamline the Commonwealth Bank Group's existing telecommunications infrastructure into a single Internet Protocol network supporting a full range of integrated data, voice and video services. This will provide a seamless service that will enable links and integration across the Bank's 1,100 branches, around 4,000 agencies, 100,000 Eftpos terminals and nine million customers.

Commonwealth Bank's relationship with the consortium will give it the opportunity to be first to market with new packages and services and to offer online financial services and telecommunications to customers. The Group expects the contract will enable it to give customers services and benefits they could not otherwise access. It sees the agreement's support for online capability as ensuring the Bank is at the forefront of the industry. Commonwealth Bank has taken an initial 5% equity stake in TCNZ Australia, with an option to increase this to 35%. Telecom sees this first big contract with a major Australian corporate as an excellent strategic marriage. The new relationship with the Group will serve as a solid foundation for growth in the Australian corporate market, as it enhances TCNZ Australia's credibility with other major players across the Tasman. It therefore provides TCNZ Australia with a great opportunity to develop business, particularly with the Commonwealth Bank's existing business partners and customers.

FEDERAL GOVERNMENT CONTRACT

- AAPT WILL MANAGE OUTGOING CALLS
- CENTRELINK, DEPARTMENT OF FAMILY & COMMUNITY SERVICES
- A$18 MILLION IN TELECOMMUNICATIONS SPENDING OVER THREE YEARS

CommonwealthBank

MORE THAN ONE MILLION TELECOM CUSTOMERS NOW KEEP IN TOUCH BY USING MOBILE PHONES. AND ALTOGETHER, OVER 40% OF NEW ZEALANDERS ARE CONNECTED TO A MOBILE NETWORK.

Driving growth in mobile communications



CDMAONE NETWORK

- ACCESS SPEEDS UP TO 144 KBPS
- UNIQUE DIGITAL CODE FOR EACH USER
- ALREADY IN USE BY 50 MILLION WORLDWIDE
- NZ'S BROADEST RANGE OF MOBILE DATA SERVICES

In 2000, mobile communication has really come of age. Telecom has extended choice to people in all walks of life through new packages of services and features that add value to using a mobile phone: competition has spurred growth in the market overall.

Pre-paid service plans, available through various retail channels, have been the major contributor to growth in connections. During the 1990s, Telecom price caps on national calling gave people new certainty and a sense of personal control over their use of fixed-line phones. Now, Telecom is providing mobile customers with the same through pre-paid plans and post-paid plans with "free" minute calling components. By paying in advance, people can overcome possible concern about affordability of their individual calls. Telecom has made mobile phones an option readily available between friends and family members, as well as people at work.

Telecom has made it easy to get connected. Over the past year we have more than doubled the number of outlets selling mobile phones and equipment to 1,600 retailers. These include some 65 Telecom Business Directions stores, as well as the outlets of CellPhone City and Ben Rumble.

Mobile is now Telecom's biggest revenue stream after traditional fixed-line calling. We have created a separate business that manages both the provision of the mobile network and services, and looks after the relationships with our customers. The new division ensures we have a single-minded customer focus, while still enabling us to tap into our full range of telecommunications and online services.

One of the driving factors for the future growth of the mobile business has been Telecom's decision to adopt a CDMA (Code Division Multiple Access) cellular network to provide New Zealand with the next generation of mobile technology. CDMA has taken the world by storm with more than 50 million subscribers using the technology worldwide. It offers a robust, high-quality mobile service with greater capacity than GSM or standard analogue and with high-speed data transfer. This data capacity means Telecom's cdmaOne™ (the brand of CDMA being adopted by Telecom) will provide the higher speeds necessary for services such as mobile Internet access through Wireless Application Protocol (WAP), as well as fixed-line voice quality. The new network will retain the coverage of Telecom's current analogue and digital cellular services – around 97% of the populated area of New Zealand.



The jump in data speed achievable through CDMA is particularly important given that, within a few years, mobile phones are expected to become the main means by which people access the Internet. Checking weather, Lotto, stock prices, traffic, placing a bet, banking and buying consumer goods will all be done by mobile. Telecom expects wireless data to account for at least a quarter of total mobile revenues within four years, compared to about 1% now. It's easy to see why. On just one day during the third week of service, a total of 167,000 text messages were sent and received, with an average of nine Telecom text messages per customer.

Telecom has been trialing WAP on digital phones to assess which services are wanted most by New Zealanders. The trial, started in June 2000, has included customer banking services, financial and entertainment information and local and international news updates, as well as a service for personal time organisation and other customised information applications.

To support this convergence of mobile and Internet technologies, Telecom has also launched the *Airinfo* portal, or Internet website, for Telecom mobile customers. *Airinfo* delivers sports, weather and stock market results, among a growing range of other information, direct to Telecom mobile phones, while also providing an email address for customers.

Just a few years ago mobile phones were the domain of business people. Today their popularity extends to people in all areas of life, as a tool for staying in touch and for personal safety. Other new developments in service and pricing, and our ongoing investment in mobile technology, demonstrate why Telecom remains the mobile provider of choice for most New Zealanders. Cellular connections grew nearly 45% in 1999-00, while cellular call minutes grew by a third.

Telecom is committed to staying at the leading edge of mobile services. We are investing $200 million on the CDMA network which will support more advanced mobile third generation (3G) technologies in the future. We intend to continue to invest in and support our analogue and digital mobile networks for at least the next four years. Customers will have the option of changing over to cdmaOne™ from the time of launch in the first half of 2001.



- AUGUST 2000, OVER 1,000,000 CONNECTIONS INCLUDING 310,000 DIGITAL (UP FROM 495,000 INCLUDING 16,000 DIGITAL IN AUGUST 1998).



DATA TRAFFIC IS EXPANDING RAPIDLY AND THAT'S A HUGE GROWTH OPPORTUNITY FOR KEY AREAS OF TELECOM'S BUSINESS.

Businesses and consumers are increasingly going online. There is huge potential for big cost reductions, new operating efficiencies and, indeed, whole new ways of living and doing business.

Telecom is in a strong position to meet rising demand for data services and to help customers capture all the associated benefits. We have made major investments in broadband data networks which can be scaled up as demand grows further. And we have robust vendor relationships with world leaders such as Nokia and Cisco.

GROWTH IN 1999-00

- 114% IN LANLINK CIRCUITS
- 120% IN FRAME RELAY CIRCUITS
- 36% IN ISDN CHANNELS
- 21% IN TOTAL DATA REVENUE

Leading growth in Data

Telecom is committed to market leadership in data. Our strategy is to:

- Ensure people have compelling reasons to use our broadband services
- Target the needs of particular business segments
- Simplify products and prices, and create packages of real value for customers
- Partner with value-adding provider channels
- Accelerate a process of migration from "Old World" data services, such as dedicated data circuits and ISDN, onto new managed services and platforms.

"New World" technologies are at the heart of Telecom's data strategy. Like most telecommunications companies around the world, Telecom used to deliver data services to customers on relatively low speed point-to-point links across legacy platforms. These platforms were limited to delivering specific services and did not have the flexibility provided by new platforms. The advent of IP (Internet Protocol) as the new global standard for data communications is leading to highly flexible, high bandwidth, "anywhere-to-anywhere" packet networks. "New World" technologies such as ADSL (Asymmetric Digital Subscriber Line) provide faster, "always-on" access to a wider range of content, applications and the Internet. Other data services such as Frame Relay, ip.networking (IPVPNs), IPNet and LanLink allow customers to cost-effectively customise their networks to suit their changing requirements.

While customers benefit from the flexibility and affordability these services provide, "New World" data technologies enable Telecom to consolidate platforms. That will bring new efficiencies and lower costs in the delivery of a wide range of data services. With ADSL, Telecom can also develop new revenue streams using the existing copper network.

By delivering multiple data services on the same platform, Telecom is able to migrate customers onto higher value, higher bandwidth services quickly and inexpensively. This means reduced costs and further sales opportunities for Telecom, and the commercial benefits to the customer are equally compelling.





Looking ahead, the ever-increasing demand for IP applications and services will create significant revenue opportunities through the provision of online applications and new online content without the need for major new investment by Telecom.

esolutions is a Telecom alliance with EDS New Zealand and Microsoft New Zealand, launched in February 2000 to offer New Zealand businesses leading edge online solutions. esolutions develops and delivers packages of products and services sourced principally from the parent companies.

Among the first packages is businessXchange which offers businesses a secure e-procurement environment. Its safecom package provides communities of interest with a highly secure physical and virtual safe online communications platform.

eOffice is esolutions' suite of application service provider (ASP) products. It is the easy way to put the applications which customers need into their hands, wherever they are and without the costs of software ownership. eOffice currently gives online access to three products: NettPay, a powerful online payroll system for small to medium businesses, and Office Online, the ASP version of industry standards Microsoft Office 2000 and Microsoft Exchange 5.5.

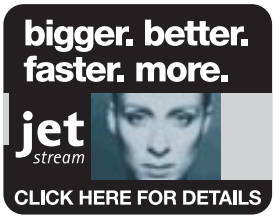
Telecom's investment in the ultra-high bandwidth Southern Cross Cable will ensure New Zealand businesses have high-speed access to the world, opening up markets previously out of reach. For multinational and Trans-Tasman companies operating in New Zealand, Telecom partnerships with international carriers ensure seamless and reliable data connectivity.

Jetstream uses ADSL to achieve phenomenal bandwidth on copper lines in Telecom local networks. Jetstream provides customers an "always on" link to the Internet at speeds about 70 times faster than a dial-up modem and seven times faster than other "high-speed" offerings to New Zealand customers.

Telecom is among the first in the world to commercially deploy ADSL technology. It has been installed in 69 exchanges with potential to connect a total of 770,000 customers by 30 June 2000. We offer significantly greater broadband coverage than any other provider in New Zealand.

A range of other ADSL-based services will be launched in the future and new value-added service opportunities such as streaming video are being investigated. Jetstream will offer customers access to an expanding range of new content and applications, on and off the Internet. For example, Jetstream's online games server is one of the most popular in the world; and teleworkers can connect seamlessly to corporate LANs via Jetstream without relying on public access to the Internet.

In July 2000, Telecom converted to the international standards for ADSL modems, opening the way for multiple modem vendors to enter the market and stimulate growth through lower equipment costs to customers.







GROWTH IN 1999-00

- INTERNATIONAL OUTWARD CALLS UP 24.9%
- NATIONAL CALLS UP 5.6%
- CALLS TO MOBILE PHONES UP 32.9%
- BUSINESS LOCAL CALLS UP 3.9%

HUMAN VOICES WILL ALWAYS BE CENTRAL TO COMMUNICATION. IN THE ONLINE WORLD, PEOPLE STILL HAVE MUCH TO TALK ABOUT AND THE VOICE CALLING BUSINESS REMAINS CORE TO TELECOM.

Calling – local, national and international – is our biggest revenue stream today. And our customer relationships in voice calling provide a solid platform for Telecom's growth in new services based on new communications and information technologies.

Attractive calling offers have reinforced the value of Telecom's services for residential customers. They're taking advantage of capped call prices at off-peak times and call volumes in 1999-00 reached record levels.

Telecom seeks to be highly competitive in voice calling markets by delivering both value to customers and quality of service. Telecom has built an excellent record of service quality over many years and we are focused on doing even better in key areas. To this end, we have linked remuneration for staff directly to measures of customer satisfaction. Improvements in fault repair and account management services during 1999-00 were especially encouraging.

Telecom will look increasingly to package voice calling with services from different networks. In 2000, we have begun working with Sky Television on a market trial among residential customers receiving fixed line telephone and Internet services, combined with mobile communications and digital tv.

Highly competitive in **Voice** calling



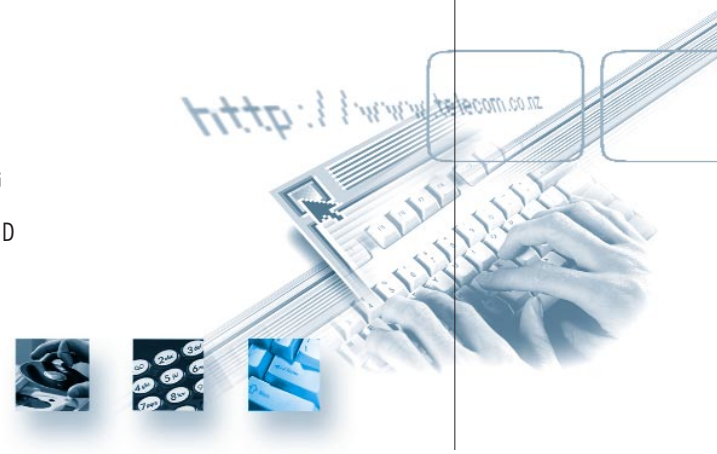
Technology is bringing ever more convenient and cost-effective ways of transmitting voice across fixed and mobile networks. Over the next few years, Telecom is, for instance, planning to move voice services from the PSTN (public switched telephone network) to a new IP (Internet Protocol) network, that is designed to manage fast-growing data flows in conjunction with voice traffic.

As technologies for voice and data traffic are integrated more, Telecom will take the advantages out to customers. We expect to introduce new services to customers with increasing speed and at reduced cost.

The future will bring more seamless use of mobile, fixed-line and Internet technologies to communicate, access information or be entertained. There'll be less need for customers to buy specialised equipment; they will be able to access what they need from Telecom.

We will continue to focus on the benefits of new technology and simpler processes to reduce cost where possible and thereby strengthen our ability to deliver value to customers.

XTRA IS COMMITTED TO BEING NEW ZEALAND'S LEADING INTERNET EXPERIENCE. IT'S CERTAINLY THE MOST VISITED NEW ZEALAND WEBSITE AND OVER THE PAST YEAR, DIAL-UP CUSTOMER NUMBERS GREW 39%.



Making the Internet more valuable

New Zealanders are among the world's most active users of the Internet: more than a third of the adult population is said to use it routinely. Nielsen NetRatings of at-home access to sites consistently show Xtra is the most visited New Zealand site – 265,152 unique visits in June 2000, at an average duration of 13 minutes. Only two other sites in the world are more in use by New Zealanders.

People want the Internet to serve their particular needs and interests at work, home or wherever. The real growth of Xtra is seen in rapid increase in customer sessions each day – the average number grew 70% in the past year to 480,000.

Xtra provides a wide choice in channels of news, information, entertainment and services, as well as great search tools for the web. The Xtra site is constantly being updated. For instance, a Health channel launched in May 2000 provides information from expert sources and provides guidance on hundreds of diseases and conditions.

People want the Internet to be reliable and easy to use. Xtra offers them the quality and robustness of the Telecom network, and other services such as Jetstream for high-speed access on standard telephone lines.

Xtra's success demonstrates that people expect quality Internet service and are willing to pay a fair price for it. With Xtra, they have access to an expertly staffed help desk, 24 hours, seven days a week; Cyber Patrol (for parental control of access to selected websites); and pro-active protection against virus outbreaks. Other features include free personal web pages and global roaming which gives customers convenient access to the Internet wherever they go in the world. Xtra also makes it easier for individuals or businesses to register domain names – 6,244 of them over the past year.

In August 2000, the new Xtra Value Pack was launched to enhance still further the value of the Internet. This plan provides a range of service features and replaces other flat rate plans previously on offer. (Xtra continues to offer access at hourly rates as well.) Its success has been confirmed in 2000 with Xtra being declared Best Internet Service Provider for the year by the Telecommunications Users Association of New Zealand.

XTRA VALUE PACK

- $24.95 PER MONTH
- UNLIMITED ACCESS
- UP TO 5 EMAIL ADDRESSES
- GLOBAL ROAMING
- PRIVACY, VIRUS PROTECTION
- HELP DESK
- 100% SATISFACTION GUARANTEE



TOTAL MINUTES ON XTRA
UP 179% IN 1999-00





Expanding and strengthening Networks

PEOPLE ARE COMMUNICATING WITH EACH OTHER IN WAYS FEW EXPECTED TEN YEARS AGO. TELECOM NETWORKS HAVE MADE POSSIBLE RAPID GROWTH IN DATA AND VOICE CALLING, IN INTERNET USE AND IN MOBILE COMMUNICATIONS. WE CONTINUE TO INVEST IN TECHNOLOGIES THAT OPEN EVEN GREATER POSSIBILITIES FOR THE FUTURE.

Network capacity and diversity are critical to customers and to growth in Telecom's business. In 2000-01 we are investing $70 million to add capacity and robustness to the national network. Explosive growth in Internet use has driven demand for increased capacity across all links in the network (local, regional and national). Our focus is on investing in technologies that are scalable so that Telecom can move quickly to meet future bandwidth requirements.

The programme will see Telecom lay a new fibre optic cable under Cook Strait and strengthen the fibre link from the West Coast to Christchurch. With an initial bandwidth of 10 gigabits per second, scalable up to 1 terabit, the Cook Strait cable will supply the South Island with diversity and capacity to support economic growth over the next 25 years.

Telecom is a 50% owner in the 31,000 kilometre Southern Cross Cable project, which has a capital cost of approximately $US1billion. It's the biggest investment underway by a New Zealand company. When switched on in November 2000, Southern Cross will provide a massive 120 gigabits per second of bandwidth between Australasia and North America – enough to carry nearly 1.5 million simultaneous telephone conversations or transfer two full-length motion pictures every second. Telecom initiated the Southern Cross project in 1996 in response to the dramatic increase in bandwidth requirements stemming from the global explosion in Internet usage. The cable has been designed to support Internet growth and ensure New Zealand has a high-speed link to North America for many years to come.

SOUTHERN CROSS CABLE

- MAJOR BOOST TO AUSTRALASIA/ NORTH AMERICA LINKS
- 31,000 KM OF CABLE
- 120 GIGABITS PER SECOND
- 1.5M CALLS AT A TIME
- TELECOM 50% OWNER

In telecommunications worldwide, traditional ways of transmitting voice over telephone lines are starting to be replaced by Voice over Packet data technology. Over time there will be less reliance on copper wires and telephone exchange switches. To make this transition, Telecom has formed strong associations with global leaders in the supply of telecommunications technology. For example, Cisco of the United States is working with Telecom on how best to meet the future data requirements of New Zealanders.

Telecom's network will increasingly be based on high bandwidth ATM (Asynchronous Transfer Mode) technology. Tomorrow's services will be layered on ATM, providing the capability for Telecom to carry enormous amounts of data traffic, much of this on our IPNet, designed for Internet Service Providers and businesses alike. Jetstream uses ADSL to extend the speed and bandwidth of the ATM network out onto customers' access lines for high-speed Internet access.

With the increasing demand for enhanced mobile communications, Telecom did extensive international research and found CDMA (Code Division Multiple Access) offered the most potential for the future.

CDMA is the most advanced mobile network technology available and offers a robust, fixed-line quality voice service with high-speed mobile data rates of up to 144kbit/s.

Strong supply relationships with international players enable Telecom to introduce new technologies and expand services at competitive prices. We are also encouraging the competitive supply of build and maintenance services in telecommunications. In 2000, Telecom has tendered out 12 area-based contracts with seven service companies in New Zealand and sold the former network service arm, ConnecTel, to the Downer Group.

Telecom's Network International staff are world leaders in trading in telecommunications transactions and have newly-established points of presence in London, Los Angeles and Tokyo. Using these assets, Telecom intends to maintain and grow call traffic and develop new business providing broadband services.



LAYING THE SOUTHERN CROSS CABLE.

cdmaOne

THE NEW COOK STRAIT CABLE – DESIGNED TO SUPPORT GROWTH FOR 25 YEARS.





Developing people of talent and commitment

WANTED: AN ONGOING SUPPLY OF PEOPLE WITH TALENT AND COMMITMENT TO JOIN A HIGH-CALIBRE TEAM WORKING IN AUSTRALASIA'S MOST EXCITING GROWTH SECTOR.



ONLINE FOR PEOPLE

- eRECRUITMENT TO MARKET JOBS
- INTRANET TO COMMUNICATE TRAINING OPPORTUNITIES

Telecom has always attracted good people. Our engineers have long been rated as second to none, and we have continually sought to recruit and develop people who will contribute to our success in a fast-changing world. As our business transforms and grows, so Telecom must transform the mix of talent and experience among its people.

Over the past decade, telecommunications in New Zealand has grown into a complex industry of diverse network operators and service providers, supported by many suppliers. The industry has become an increasingly attractive career choice for people with diverse backgrounds and expertise.

From an historical focus on engineering capability for delivering voice telephony, Telecom has moved to having a range of talent that includes web developers, sales specialists, and IP and data capability strategists. The challenges we face in online and communications markets are reflected in the challenges we face in recruiting and retaining the right people.

Telecom recognises fundamental changes in the nature of work. People increasingly seek self-development in their work and look beyond the more traditional goals of security and status. Many see their working lives as a series of chapters, rather than a single career marked by lineal progression within one organisation or industry. Even the definition of employment is changing and a growing number of people prefer to work in contractual relationships with different companies and agencies.

Telecom has 5,717 full-time employees, including 109 off-shore, and around 2,300 contractors (including outsourced arrangements). Over 3,000 of these are frontline people, working with customers directly. We have outsourced arrangements with EDS for Telecom's information services needs and with SITEL for some of our call centre operations. These arrangements are all part of our drive to have contestable delivery of services and to work with strategic allies for quality service both externally and internally.

Theresa Gattung's Executive Team is committed to a collaborative leadership style, with the optimum balance between teamwork and individual accountability. Thinking and acting as teams is critical in every area of the business. Consistent with this, management structures have become flatter, and programmes have been designed to encourage people to collaborate across business boundaries, form virtual project teams and take collective responsibility for setting and achieving objectives.

Inevitably, Telecom has a level of employee turnover, and recruitment of new people of talent and commitment is vital. For this, we have gone online with an eRecruitment solution to harness the Internet for attracting the people we need into the future.

THE DIRECTORS OF TELECOM CORPORATION OF NEW ZEALAND LIMITED ON 30 JUNE 2000 WERE:



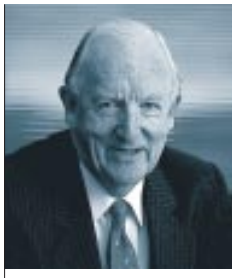
RODERICK DEANE,
CHAIRMAN

Roderick Deane became Chairman in October 1999 after seven years as Chief Executive and Managing Director. He was named Chief Executive of the Decade in 1999 in the Top 200 New Zealand corporate awards. Dr Deane also chairs Fletcher Challenge Limited, Te Papa Tongarewa (The Museum of New Zealand) and the ANZ Banking Group (New Zealand) Limited. He is a Director of the Australia and New Zealand Banking Group Limited (Melbourne), TransAlta Corporation (Canada), Woolworths Limited (Australia) and eVentures New Zealand Limited. He is on the boards of the Centre for Independent Studies in Sydney and the Institute of Policy Studies at Victoria University of Wellington, and is Professor of Economics and Management at Victoria University of Wellington (a part-time position). Jointly, along with his wife Gillian, Dr Deane is Patron of IHC New Zealand Inc and is a member of the IHC Board of Governance. He is Chairman of the City Gallery Wellington Foundation and has an active interest in promoting the arts and music.



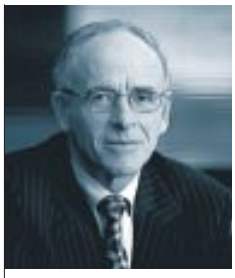
THERESA GATTUNG,
CHIEF EXECUTIVE AND MANAGING DIRECTOR

Theresa Gattung became Chief Executive in October 1999. She had previously been Group General Manager, Services and before that General Manager, Marketing. Before joining Telecom in 1994, Ms Gattung was Chief Manager, Marketing for Bank of New Zealand, and had previously held executive positions with National Mutual and TVNZ. She graduated with a Bachelor of Laws (LLB) from Victoria University in 1987 and a Bachelor of Management Studies (Honours, with majors in Economics and Marketing) from the University of Waikato in 1983. Her entire career has been in "new economy" companies - telecommunications, media, information technology, banking and finance.



PETER SHIRTCLIFFE

Peter Shirtcliffe has been a Director since April 1987 when Telecom was created as a State Owned Enterprise. He was appointed Chairman in September 1990 and retired from this role in September 1999. Mr Shirtcliffe was Managing Director of foodstuffs producer and distributor Goodman Group Limited from 1976-1985 and Chairman of the New Zealand Trade Development Board from 1985-1990. He is currently a member of the Executive Committee of the Australia and New Zealand Business Council, and a trustee of, or consultant to, a number of charitable trusts.



JOHN KING

John King, LLB, has been a Telecom Director since September 1990. He is Senior Partner with law firm Russell McVeagh, a Director of WestpacTrust Investments Ltd, Chairman of the Takeovers Panel, a member of the Board of the Employers and Manufacturers Association (Northern) Inc and of the Spirit of Adventure Trust Board.



PATSY REDDY

Patsy Reddy joined the Board in December 1997. She is an Executive Director of Active Equities Limited and a Non-Executive Director of Sky City Limited, Infinity Group Limited and New Zealand Opera Limited. She is also Trustee of the Sky City Community Trust. From 1987 to 1998 Ms Reddy was a Senior Executive at Brierley Investments Limited, before which she was a partner in law firm Rudd Watts & Stone. She has also been a lecturer in the Law Faculty at Victoria University of Wellington.



MICHAEL TYLER

Michael Tyler is Managing Director and Senior Partner of London-based professional services firm Tyler & Company, which provides advisory and analytical services in the telecommunications, media and electronic commerce fields. He joined the Board in June 1999. Before founding Tyler & Company, Mr Tyler was a Senior Partner and Director at Putnam, Hayes & Bartlett Inc, where he headed the telecommunications consulting business, and before that he led the telecommunications practice as a Partner and Vice-President at Booz, Allen & Hamilton Inc. Mr Tyler started his telecommunications career at British Telecom in 1972 and has worked in the advisory, research, educational and venture investment fields since 1976. Mr Tyler is also a Director of Swedish software, systems integrator and operations support company ConNova AB.



PAUL BAINES

Paul Baines joined the Board in May 1998. He is Chairman of Tower Managed Funds, and a Director of Comalco New Zealand, Fletcher Challenge, Gough, Gough and Hamer, Greenstone Fund, New Zealand Post, Reserve Bank of New Zealand, South Eastern Utilities and Wrightson. Mr Baines has been Chief Executive Officer of CS First Boston New Zealand and before that held a number of senior positions at sharebroking and investment banking firm Jarden & Co. He has degrees in accountancy, economics and public policy.

THE EXECUTIVE GROUP CONSISTS OF SENIOR MANAGERS WHO EACH RUN MAJOR UNITS WITHIN TELECOM AND REPORT DIRECTLY TO THE CHIEF EXECUTIVE.



THERESA GATTUNG | KEVIN STRATFUL | DAVID BEDFORD | MOHAN JESUDASON | MARK RATCLIFFE | GRAHAM MITCHELL

THERESA GATTUNG, CHIEF EXECUTIVE leads the company's Executive Team, overseeing the day-to-day management of Telecom on behalf of the Board of Directors. The team meets regularly to consider strategy, policy, investment and corporate activities, and to monitor business performance. It also advises the Chief Executive on matters such as strategy and policy.

KEVIN STRATFUL'S SALES AND SERVICE GROUP is responsible for meeting the telecommunications needs of our consumer, business and corporate customers. It markets Telecom's services to customers, bills them for services and manages the relationships. Kevin joined Telecom as Group General Manager Sales and Service in January 2000. Prior to joining Telecom, Kevin was Managing Director of Freightways and prior to this, Managing Director of Lion Nathan New Zealand. He has over 25 years' experience in sales and marketing across a range of industries.

DAVID BEDFORD'S NETWORK GROUP plans, develops, operates and manages the maintenance of Telecom's fixed-line, international and broadband networks. David is also responsible for Telecom's corporate information technology and systems function, which includes management of its outsourcing partnership with EDS. He was appointed Group General Manager Network in July 1998 from his role as Group General Manager Enterprises. He was previously General Manager, Human Resources and has worked at Electricity Corporation of New Zealand, Bechtel Corporation, Weddell Group and Downer & Company Limited.

MOHAN JESUDASON'S MOBILE BUSINESS UNIT is responsible for all aspects of our mobile business. Mohan joined Telecom in September 1996 as General Manager Business. He was appointed to his new role as General Manager Mobile in December 1999. Prior to coming to Telecom, Mohan spent 16 years with AXA in Melbourne and New Zealand where he held a variety of senior positions in marketing, distribution and general management.

MARK RATCLIFFE'S DATA & VOICE GROUP is accountable for developing and marketing Telecom's range of data and voice products and services. Mark was appointed in December 1999 from his role as General Manager Product & Service Development. He has worked in a variety of senior roles over his ten-year career at Telecom. Prior to coming to Telecom, Mark worked in senior accounting, IT, project management and consulting roles in England and New Zealand.

GRAHAM MITCHELL is GENERAL MANAGER OF TELECOM INTERNET & MEDIA properties, which encompass the Xtra and Telecom Directories Limited businesses and associated brands. Graham is also a Board Member of AOL Australia which is a Joint Venture between AOL International and AAPT. Graham was appointed to his role in April 1999. He came to Telecom from Brierley Investments Limited where he was New Zealand Investments Manager. Graham has previously held senior management positions with Telecom and Electricity Corporation of New Zealand.



JANE FREEMAN | KARYN DEVONSHIRE | MARKO BOGOIEVSKI | JOHN BELL | BRUCE PARKES | JANE AUSTIN | GLEN PETERSEN

JANE FREEMAN is GENERAL MANAGER OF ESOLUTIONS. esolutions, the alliance with EDS and Microsoft in New Zealand and delivers a full range of e-commerce applications to corporate and business customers. esolutions will play a key part in the realisation of our vision to lead New Zealanders online. Jane started at Telecom in December 1999. She has a strong e-commerce background, having launched BankDirect, the first totally phone and Internet bank in New Zealand. Previously she was Chief Manager Marketing at the ASB and General Manager Residential Markets for Clear Communications. Jane is accountable to an Advisory Board of representatives of all three parent companies of esolutions.

KARYN DEVONSHIRE'S TCNZ CORPORATE, AUSTRALIA GROUP is at the cutting edge of developing Telecom's presence in the Australian corporate market, including the contract with the Commonwealth Bank of Australia. Karyn took up her role as Group General Manager in May 2000. She joined Telecom in December 1997 and was appointed General Manager Corporate Strategy and Information Services in March 1999. Her role expanded to include development of online systems. Previously, Karyn held a variety of information system roles at the New Zealand Dairy Board. She has experience in the insurance, services, manufacturing and international consumer marketing sectors.

MARKO BOGOIEVSKI CHIEF FINANCIAL OFFICER. The Finance Group provides business and financial information, analysis and advice to help Telecom maximise shareholder value. The Finance Group also oversees strategy, investor relations, treasury operations, corporate finance and shared corporate services. Marko has held a number of senior financial, operational and sales roles with Ansett New Zealand, Lion Nathan, Elders Finance Group and Price Waterhouse and more recently helped launch a US start-up company.

JOHN BELL'S BUSINESS DEVELOPMENT GROUP evaluates new business opportunities within the converging telecommunications, information technology and entertainment sectors to see if they have the potential to create long-term shareholder value. John joined Telecom in May 1996 from Fujitsu New Zealand Limited, where he was managing director. He has also worked for IBM New Zealand Limited and Beca Carter Hollings and Ferner (BCHF).

BRUCE PARKES' GOVERNMENT AND INDUSTRY RELATIONS team manages Telecom's relationship with the Government. Bruce came to Telecom in 1993 from Electricity Corporation of New Zealand. He was appointed to his current position in November 1999 having previously been Manager of our Industry Services Unit. Bruce has a strong strategy, marketing and economics background. His other roles in Telecom include managing the Services Strategy Group.

JANE AUSTIN'S CORPORATE COMMUNICATIONS GROUP develops frameworks to sustain and increase the value of Telecom's brand. The group also directly supports the brand through communications with shareholders, staff, media and communities. Jane joined Telecom 11 years ago from British Telecom. Her roles in Telecom have spanned communications, service and sales, and, prior to taking up her current role in December 1999, she managed branding strategy in the Services team. This followed a period heading up Business Service and Indirect Channels.

GLEN PETERSEN'S HUMAN RESOURCES GROUP oversees and develops strategies and policies for managing participation by Telecom employees in creating value. Glen was appointed General Manager, Human Resources in August 2000. He was previously General Manager, Human Resources, Commercial and Consumer at Telstra Corporation. He has extensive senior level experience in human resources over the past 20 years including various roles with Pizza Hut in Australia and North America and then Lion Nathan trans-Tasman. In 1955 Glen joined Arnotts and was Vice President Human Resources for several years prior to joining Telstra in 1999.

THE GENERAL COUNSEL AND COMPANY SECRETARY oversees the provision of legal, secretariat and risk management services to Telecom to ensure that the company uses sound business practices. (Position vacant as this report went to print.)

THE BOARD OF DIRECTORS IS ELECTED BY THE SHAREHOLDERS TO GOVERN THE COMPANY IN SHAREHOLDERS' INTERESTS AND IS THE OVERALL AND FINAL BODY RESPONSIBLE FOR ALL DECISION-MAKING.

The Board has delegated some of its powers to Board committees and other powers to the Chief Executive. The Chief Executive has formally delegated certain authorities to her executives and has established a formal process for those executives to further delegate certain authorities to their managers.

ROLE OF THE BOARD The Board establishes the Telecom Group's objectives and medium-term strategic financial plan, major strategies for achieving these objectives, annual budgets and the overall policy framework within which business is conducted. The Board takes advice from independent sources and from the Chief Executive relating to changes to the business, performance goals, strategies and policy frameworks of the Telecom Group. The Board monitors Management's performance relative to these goals and plans, and reports to shareholders at least once a year at the Annual Meeting.

BOARD OPERATIONS The Board comprises seven Directors, being a non-executive Chairperson, an executive Director, and five non-executive Directors. Directors in office at 30 June 2000, are set out elsewhere in this report. Procedures for the operation of the Board, including the appointment and removal of Directors, are governed by the Company's Constitution.

The full Board formally met fifteen times during the financial year ended 30 June 2000. Two of these meetings spanned two days.

Attendance at Board and Committee Meetings for period 1 July 1999 to 30 June 2000:

	Shirtcliffe	Deane	Gattung	King	Reddy	Baines	Tyler
TCNZ Board	13	15	8*	15	15	15	13
HR/ Committee	2***	5***	5**	6	7		
Audit Committee	1***	1***	1**			2	1

* *Ms Gattung was appointed to the Board in October 1999.*

** *Ms Gattung is not a member of the Audit and HR Compensation Committees but is entitled to attend meetings.*

*** *The Chairman is an ex-officio member of the HR/Compensation and Audit Committees. Mr Shirtcliffe was Chairman until 30 September 1999 and Dr Deane became Chairman on 1 October 2000.*

BOARD COMMITTEES The Board has two formally constituted Committees, the Human Resources/Compensation Committee and the Audit Committee. The Human Resources/Compensation Committee comprises three non-executive Directors and the Audit Committee comprises three non-executive Directors, which in both cases include the Chairman, who is an ex-officio member of both Committees.

The Human Resources/Compensation Committee, chaired by Patsy Reddy, is responsible for overseeing the policy framework for human resources activities within the Telecom Group, including overseeing senior management succession planning, establishing employee incentive schemes, reviewing and approving the compensation arrangements for the Chief Executive and managers who report directly to the Chief Executive, and recommending to the full Board the compensation of Directors. The Audit Committee, chaired by Mr Baines, is responsible for overseeing the financial policies of the Telecom Group, including financial delegations, internal controls, internal and external audit, liaising with the Telecom Group's independent auditors and making recommendations to the Board as to their appointment and remuneration.

GOVERNANCE PRINCIPLES The Board has established Telecom's governance policy to outline what it expects from the people to whom it has delegated financial and decision-making authority. Telecom's governance principles, which are a very broad description of the way in which the Board expects the Company to be managed for shareholders' benefit, are:

1. Future shareholder value will be built from additional growth.
2. Telecom will be market-focused.
3. The organisational structure will support Telecom's strategies.
4. The structure will support individual accountability.
5. Telecom's policy and strategy framework will be decided at corporation level. Business and operational decisions will be made by management and staff within corporate frameworks.
6. Business plans will determine accountability for resources and budgets.
7. Contestability will drive efficiency.

MANAGEMENT OVERSIGHT Telecom Directors and the Chief Executive oversee managers to ensure they make decisions in line with corporate policy and direction. An Executive Team, comprising managers who report directly to the Chief Executive, meets regularly to consider and advise the Chief Executive on matters including strategy, policy, investment, and corporate activities, and to monitor performance by the various business groups against strategies and plans. Membership of the Executive Team is set out elsewhere in this report.

DELEGATION FRAMEWORK The Telecom Group has formal policy frameworks in place relating to its principal operations, delegations of financial authority to managers, and compliance with statutory requirements. The Board's delegation of the conduct of the day-to-day affairs of the Company to the Chief Executive is made within this framework. The practices and processes used by the Board, Chief Executive, Executive Team, and senior managers to implement governance include:

1. Delegated management authority.
2. Individual accountability.
3. Delegated financial authority.

Delegated management authority means that limits are set on decision-making and certain decisions require approvals from senior managers, and executives or the Board. However, approval does not involve re-making decisions. Individual accountability means individuals are responsible for achieving specific agreed outcomes; measuring outcomes wherever possible; planning, budgeting and acquiring the resources they need to achieve their accountabilities; and monitoring the use of resources used in achieving their outcomes. Delegated financial authority means that Telecom managers have authority to approve spending up to specified financial limits, with approval from senior managers, Executive Team or the Board needed for expenditure or budget allocation beyond the limits. These limits are reviewed periodically and are set at levels that ensure a proportion of management decisions are discussed by both the decision-maker and their manager, the Executive Team or Board.

Management's Discussion and Analysis of Financial Condition and Results of Operations 30 June 2000

RESULTS OF OPERATIONS

OVERVIEW OF RESULTS

In November 1999, Telecom increased its shareholding in AAPT from 19.7% to approximately 80% (79.9% as at 30 June 2000). Telecom's result for the year ended 30 June 2000 ("2000") reflects the consolidation of AAPT's earnings from 1 December 1999, the amortisation of associated goodwill from 1 December 1999 and the costs of funding the investment in AAPT for the year.

Reported net earnings of NZ$783 million for 2000 decreased by NZ$51 million, or 6.1%, from NZ$834 million for the year ended 30 June 1999 ("1999").

Net earnings for the year represented earnings per share ("EPS") of NZ44.7 cents. EPS decreased by 6.2% for the year compared with 1999.

Excluding the effect of the investment in AAPT, Telecom's net earnings would have been NZ$846 million for the year, an increase of NZ$20 million, or 2.4%, compared with last year's normalised earnings of NZ$826 million (see "Reconciliation of Earnings before and after AAPT").

Dividends

Telecom will pay a fully imputed fourth quarter dividend of NZ11.5 cents per ordinary share in September 2000, bringing the dividend for the year ended 30 June 2000 to NZ46.0 cents. The full-year dividend of NZ46.0 cents represents a distribution of approximately 98% of net earnings before amortisation costs. The dividend for the year ended 30 June 1999 was also NZ46.0 cents per ordinary share.

Telecom is committed to further growth in the Australian market, building on its shareholding in AAPT and supporting AAPT's network investment programme. Telecom is also pursuing growth in its New Zealand-based business, including the roll-out of its CDMA mobile network and new broadband technologies, and expansion of international capacity through the Southern Cross Cable.

These investments for future growth, including those which might arise in the future but which have yet to be identified, require Telecom to maintain strong cash flows and financial flexibility. A review of Telecom's dividend policy has concluded that in the light of the planned growth in investment, a change in policy is appropriate.

Consequently, Telecom has decided to implement a new dividend policy, which will target a dividend pay-out ratio of around 50% of net earnings. This policy will be dependent on earnings, cash flow, and other investment opportunities that might arise in the future.

As a matter of practice, Telecom will look to pay a dividend at the same rate in each of the first three quarters of the financial year, and set the fourth quarter dividend at a level which accommodates the target ratio for the full year.

Fourth Quarter Dividends

Ordinary shares	NZ 11.5 cents
American Depositary Shares	*US 43.15 cents
Supplementary dividend (to non-resident shareholders)	
Per ordinary share	NZ 2.03 cents
Per American Depositary Share	*US 7.62 cents
BOOKS CLOSING DATES	
NZ, Australian Stock Exchanges#	1 September 2000
New York Stock Exchange	31 August 2000
PAYMENT DATES	
NZ, Australia	15 September 2000
New York	22 September 2000

* *Based on an exchange rate at 30 June 2000 of NZ$1.00 to US$0.4690.*

\# *Australian shares go 'ex' dividend on 28 August 2000.*

EFFECT OF AAPT

AAPT's results have been consolidated with Telecom's results with effect from 1 December 1999. Accordingly, Telecom's consolidated results for the year include AAPT's earnings (adjusted for consolidation items including minority interest and goodwill amortisation) for the seven months to 30 June 2000.

Reconciliation of Earnings before and after AAPT	Year Ended 30 June 1999 NZ$M	2000 NZ$M	Change %
Reported net earnings	**834**	**783**	**(6.1)**
Deduct share of AAPT's earnings#:			
Net earnings before abnormals	–	10	
Abnormals	–	12	
	834	761	
Add back:			
Amortisation of goodwill	–	32	
Funding costs relating to AAPT investment (after tax)	1	53	
Reported net earnings before AAPT	835	846	1.3
Deduct normalisations*	9	–	
Normalised net earnings before AAPT	**826**	**846**	**2.4**

 # After minority interest and consolidation items.

** 1999 earnings have been normalised to exclude net abnormals of NZ$1 million (see "Abnormal Items") and release of surplus tax provision (NZ$8 million).*

Key Indicators	Year ended 30 June 1999	Year ended 30 June 2000
INCLUDING AAPT		
Operating Margin (%)[1]	41.2	32.6
Asset Utilisation (%)[2]	71.5	70.0
Net Interest Cover (times)[3]	7.2	5.1
Return on Average Total Assets (%)[4]	29.4	22.8
Earnings Per Share (normalised)	47.1	44.0
Net Debt/Net Debt plus Capital Funds (%)	48.3	62.4
EXCLUDING AAPT		
Operating Margin (%)[1]	41.2	39.4
Asset Utilisation (%)[2]	74.4	73.8
Net Interest Cover (times)[3]	7.2	7.4
Return on Average Total Assets (%)[4]	30.6	29.1
Earnings Per Share (normalised)	47.1	48.3
Net Debt/Net Debt plus Capital Funds (%)	42.6	43.1

1 Normalised surplus from operations/operating revenue (before abnormals).

2 Operating revenue (before abnormals)/average total assets (net of cash and short-term investments).

3 Normalised surplus from operations/net interest expense (before interest capitalised) inclusive of capital note coupons.

4 Normalised surplus from operations/average total assets (net of cash and short-term investments).

FORWARD-LOOKING STATEMENTS

This Management Discussion and Analysis contains forward-looking statements. The words "believe", "expect", "will", "estimate", "project", "forecast", "should", "anticipate", "intend" and similar expressions may identify forward-looking statements. Such forward-looking statements are based on the beliefs of the Company's management as well as on assumptions made by and information currently available to the Company at the time such statements were made. Actual results could differ materially from those projected in the forward-looking statements as a result of the matters discussed herein and certain economic and business factors, some of which may be beyond the control of the Company. Such factors include, but are not limited to, competition in the New Zealand telecommunications market, the outcome of pending litigation, the effect of current or future Government regulation, technological change in the telecommunications industry, and the state of the New Zealand and Australian economies.

TELECOM (EXCLUDING AAPT)

Telecom's net earnings (excluding AAPT) of NZ$846 million for the year ended 30 June 2000 increased by NZ$20 million, or 2.4%, compared with last year's normalised earnings (excluding AAPT) of NZ$826 million.

On a reported basis, earnings (excluding AAPT) increased by NZ$11 million, or 1.3%, for the year.

Earnings Overview (excluding AAPT)	Year Ended 30 June 1999 NZ$M	2000 NZ$M	Change %
Operating revenues^	3,456	3,601	4.2
Operating expenses^	2,033	2,182	7.3
Net earnings (reported)	835	846	1.3
Normalised earnings	826	846	2.4
EBIT* (before abnormals)	1,423	1,419	(0.3)
EBITDA# (before abnormals)	1,981	1,984	0.2

^ Excludes abnormals.

** Earnings before interest and tax.*

 # Earnings before interest, tax, depreciation and amortisation.

OVERVIEW OF RESULTS (EXCLUDING AAPT)

Telecom's results before the effect of the investment in AAPT are summarised in the table on page 35. These results exclude the costs of funding the investment in AAPT, and the effects of consolidating AAPT (i.e. goodwill amortisation and Telecom's share of AAPT's post-acquisition earnings). The consolidated Statement of Financial Performance on page 36 discloses the fully consolidated result.

Reclassifications

For 2000 Telecom has reclassified wholesale revenue previously included with interconnection revenue into national, international and data revenues. Volumes and prior period revenue have been restated for this reclassification.

Operating Revenues (Before Abnormals)

Variation – Increase	NZ$ millions	%
2000:1999	145	4.2

Total revenue (before abnormals) rose by 4.2% for the year to 30 June 2000 compared with 1999, an improvement on revenue growth in the year to 30 June 1999 of 1.0%.

Local Service

Local service revenues consist of business and residential access, local call charges (predominantly paid by business customers), including Centrex and VPN, and enhanced network services products (Smartphone, messaging and call track).

Variation – Decrease	NZ$ millions	%
2000:1999	(2)	(0.2)

Local service revenues decreased by NZ$2 million, or 0.2%, compared with 1999.

Local Service	1999	2000	Change % 00:99
BUSINESS & RESIDENTIAL ACCESS			
Revenue (NZ$m)	858	849	(1.0)
Access lines residential (000s)	1,339	1,349	0.7
Access lines business (000s)	348	330	(5.2)
Centrex lines (000s)	76	80	5.3
LOCAL CALLS*			
Revenue (NZ$m)	133	133	–
Call minutes (m)	3,221	3,348	3.9
SMARTPHONE, MESSAGING AND CALL TRACK			
Revenue (NZ$m)	68	75	10.3
Call minder mailboxes (000s)	268	271	1.1

* *Includes business local calls, residential calls under NZ20 cents local calling option and Centrex and VPN local calls.*

The decrease in access revenue of NZ$9 million, or 1.0%, was largely due to the first full-year impact of a reduction in line rentals for business customers from January 1999.

Local service revenue and access line growth have been affected by the entry of Saturn Communications (now Telstra Saturn Limited) into the local service market, the migration of local access to ISDN services and increased use of cellular phones.

National

National revenue includes calls to a location outside the caller's local calling area, including Centrex and VPN, calls to cellular networks originating within the fixed line network, National 0800 calls and operator services charges.

Variation – Increase	NZ$ millions	%
2000:1999	4	0.6

National revenue increased by NZ$4 million, or 0.6%, for the year, largely due to increases in fixed line to cellular revenues offset by a reduction in national calls revenue as a result of national toll price reductions.

National	1999	2000	Change % 00:99
NATIONAL CALLS			
Revenue (NZ$m)	356	301	(15.4)
Call minutes (m)	2,089	2,206	5.6
Average price (cents)	17.0	13.6	(20.0)
CALLS TO CELLULAR NETWORKS			
Revenue (NZ$m)	218	276	26.6
Interconnect cost (NZ$m)	44	71	61.4
Gross margin (NZ$m)	174	205	17.8
Call minutes (m)	429	570	32.9
Average price (cents)	50.8	48.4	(4.7)
NATIONAL 0800			
Revenue (NZ$m)	110	119	8.2
Call minutes (m)	553	679	22.8
Average price (cents)	19.9	17.5	(12.1)

National calls revenue decreased by 15.4% largely as a result of an approximately 20.0% decline in the average price per call minute, reflecting various capped specials rate reductions.

The BEST (Businesses Enjoy Savings on Tolls) pricing option was launched in February 1999 and was open for enrolment until 30 April 1999. This plan provided a ceiling to business customers on the cost of their tolls until 31 March or 30 April 2000, depending on when they enrolled. The ceiling was 10% lower than the customer's average monthly spend.

In May 1999, new calling plans for residential customers were introduced. These plans offer different combinations of NZ$3 or NZ$5 capping and/or maximum off-peak and peak calling rates.

Fixed line to cellular revenue increased by 26.6%. The average price per minute for fixed line to cellular calls declined by 4.7%, but this was more than offset by a significant increase in call volumes resulting from the strong growth in cellular penetration.

The growth in fixed line to cellular revenue was partly offset by an increase in the cost of interconnecting with other cellular carriers (see "Cost of Sales"). The fixed line to cellular margin increased by 17.8% compared with last year.

International

International revenue includes outgoing international calls made in New Zealand, collect, credit card and "New Zealand Direct" calls to New Zealand, receipts from overseas telecommunications administrations and companies for calls to New Zealand that use Telecom's facilities and calls from international switched traffic transiting Telecom's facilities (referred to as "transit calls").

Variation – Increase	NZ$ millions	%
2000:1999	13	3.4

International revenue increased by NZ$13 million, or 3.4%, due largely to growth in inward call revenue.

International	1999	2000	Change % 00:99
OUTWARD CALLS			
Revenue (NZ$m)	209	194	(7.2)
Call minutes (m)	473	591	24.9
Average price (cents)	44.2	32.8	(25.8)
INWARD CALLS			
Revenue (NZ$m)	127	157	23.6
Call minutes (m)	341	429	25.8
Average price (cents)	37.2	36.6	(1.6)
TRANSIT CALL MARGIN			
Margin (NZ$m)	48	41	(14.6)
Call minutes (m)	377	549	45.6
Average margin (cents)	12.7	7.5	(40.9)

Growth in outward call minutes reflected the volume stimulation from price specials offered to New Zealand customers and significant price reductions over the past year. The annual average per minute charge for outward calls of NZ32.8 cents was 25.8% lower than in 1999, reflecting price reductions and frequent weekend specials.

In February 2000, the price caps on consumer Talk All Day promotions were reduced from NZ$5 to NZ$4 for Australia and from NZ$10 to NZ$8 for the UK, US, Canada and Ireland.

The increase in inward call revenue for the year resulted largely from increased call minutes. The increase in inward call revenue has largely been offset by an increase in the international outpayment included in cost of sales. This outpayment increased by 14.3% for the year.

The net margin received from Telecom's international business, excluding the transit call margin (outward and inward call revenue less the international outpayment), decreased by 3.8%.

The decrease in the transit call margin (revenue net of outpayments) was largely due to lower average margins per call minute. The increased volumes from the transit business are attributable to the utilisation of a variety of outward routing options and to new transit traffic won by Telecom's points of presence ("POPs") in the US, Japan, Australia and the UK.

International Margin *NZ$ millions*	1999	2000	Change % 00:99
International outwards revenue	209	194	(7.2)
International inwards revenue	127	157	23.6
International outpayment	(154)	(176)	14.3
Net international margin before transits	182	175	(3.8)

Interconnect

Interconnect revenue is derived from charges for delivering to and/or accepting from other service providers local, national, international, cellular and 0800 calls. Installation charges and interconnecting links and service delivery point charges are also included.

Variation – Increase	NZ$ millions	%
2000:1999	15	21.1

Interconnection revenue increased by NZ$15 million, or 21.1%, largely due to increased activity with existing carriers.

For 2000 Telecom has reclassified wholesale revenue previously included with interconnection revenue into national, international and data revenues. Volumes and prior periods' revenue have been restated for the revenue reclassifications.

While interconnect revenue increased by NZ$15 million, interconnect costs, including the cost of interconnecting with other cellular carriers, increased by NZ$48 million, or 85.2% (see "Cost of Sales").

Cellular and Other Mobile Services

Cellular and other mobile services revenue comprises access and airtime charges for calls originating from Telecom's cellular network (including international calls), revenue from paging and mobile radio services, cellular equipment (CPE) and other related services.

Variation – Increase	NZ$ millions	%
2000:1999	44	8.8

Revenue from cellular and other mobile services grew by NZ$44 million, or 8.8%, compared with 1999. Cellular revenue alone grew by NZ$42 million, or 8.9%.

Cellular and Other Mobile Services	1999	2000	Change % 00:99
CELLULAR AND OTHER MOBILE			
Total mobile revenue (NZ$m)	502	546	8.8
Mobile cost of sales (NZ$m)	98	151	54.1
Mobile gross margin (NZ$m)	404	395	(2.2)
CELLULAR			
Cellular revenue (NZ$m)	472	514	8.9
Call minutes (m)	799	1,064	33.2
Connections			
Total at period end (000s)	677	980	44.8
Average during period (000s)	561	838	49.4
Average revenue per customer per month (excl. CPE) – NZ$	70.1	49.5	(29.4)

Telecom had 980,000 cellular connections at 30 June 2000 compared with 677,000 at 30 June 1999, an increase of 44.8%. The continued strong growth in connections is largely due to growth in the prepaid cellular business.

Prepaid service has continued to be popular with consumers, but new pricing plans for postpaid customers, including free minutes and additional services, have also attracted large numbers of customers. The total number of prepaid customers, including third party connections, at 30 June 2000 was 513,000, approximately 52% of total connections.

The total number of cellular connections in New Zealand, including Vodafone New Zealand's ("Vodafone") connections, represents approximately 40% of the New Zealand population. This penetration level, when compared with other countries, suggests scope for continued expansion of this market.

The mobile gross margin (total mobile revenue less cost of sales) decreased by 2.2%, compared with 1999, largely as a result of an increase in cost of sales. Mobile revenue and the mobile margin, set out in the table above, do not include revenue from fixed line to cellular calls terminating on Telecom's cellular network.

Average revenue per cellular customer decreased by approximately 29% compared with 1999, reflecting the higher proportion of prepaid connections. Revenue per prepaid connection is generally lower than revenue per postpaid connection.

Mobile cost of sales increased by 54.1% for the year, reflecting the significant growth in the number of cellular connections over the past year. Special promotions to attract new connections and encourage existing customers to upgrade their mobile phones contributed to the increase in mobile cost of sales.

Data

Data revenue consists principally of revenue from data transmission services, dedicated leased lines and Internet access.

Variation – Increase	NZ$ millions	%
2000:1999	75	21.0

Data revenue increased by NZ$75 million, or 21.0%, for the year. This growth was driven by demand for bandwidth to support business networking and the increased penetration of the Internet.

Data	1999	2000	Change % 00:99
Internet revenue (NZ$m)	43	67	55.8
Xtra registered customers (000s)	206	287	39.3
Xtra dial-up hours (m)	17	47	176.5
Average hours per active customer (per month)	11	20	81.8
ISDN revenue (NZ$m)	56	76	35.7
ISDN channels (000s)	53	72	35.8
New World revenue* (NZ$m)	68	102	50.0
Old World revenue* (NZ$m)	191	187	(2.1)

* *Excludes Internet and ISDN revenue.*

Internet revenue increased by NZ$24 million, or 55.8%, for the year. Telecom's Internet service provider "Xtra" had approximately 287,000 registered customers at 30 June 2000, compared with 206,000 at 30 June 1999, an increase of 39.3%. Of the registered customers, approximately 79% were active during the last month of the year.

ISDN revenue increased by 35.7% for the year. The increase in ISDN revenue partly reflected migration from basic access services. The number of ISDN channels at 30 June 2000 increased by 35.8% from 30 June 1999.

New World revenue (which includes ADSL, LanLink and frame relay) increased by 50% for the year reflecting the migration of customers to higher bandwidth and lower cost platforms. New World revenue comprised approximately 35% of data revenue (excluding Internet and ISDN) in 2000 compared with approximately 26% in 1999.

Directories

Directories revenue is derived largely from local advertising by businesses in both The Telephone Book and YELLOW PAGES® directories and various database services.

Variation – Increase	NZ$ millions	%
2000:1999	15	9.3

Revenue from regional directories increased by approximately 8% for the year as a result of both tariff and volume growth in both The Telephone Book and YELLOW PAGES® products. Revenues from specialised and LOCAL DIRECTORIES™ increased by approximately 24% largely as a result of volume growth and two new LOCAL DIRECTORIES™.

Equipment Revenue

Equipment revenue includes non-cellular equipment sales, installation and CPE rental.

Variation – Decrease	NZ$ millions	%
2000:1999	(25)	(22.9)

Equipment revenue decreased by NZ$25 million, or 22.9%, compared with 1999, largely as a result of a reduction in equipment sales as Telecom continues to reduce its equipment sales business. The impact on earnings of this decrease in revenue was largely offset by a reduction in equipment cost of sales.

Miscellaneous Other Services

Miscellaneous other services revenue is derived principally from software development, telecommunications services provided in the Cook Islands and Samoa and international outside plant projects.

Variation – Increase	NZ$ millions	%
2000:1999	7	12.3

Operating Expenses (Before Abnormals)

Variation – Increase	NZ$ millions	%
2000:1999	149	7.3

Operating expenses increased by NZ$149 million, or 7.3%, for the year. The increase was largely due to higher cost of sales and other operating expenses, partly offset by lower labour costs. If cost of sales were excluded, expenses would have increased by 1.9% for the year. The increase in expenses excluding cost of sales reflects increases in the costs of growth areas such as Xtra, esolutions, the international points of presence and the costs of bidding for contracts in Australia (see "Outsourcing contract with the Commonwealth Bank of Australia").

Labour

Variation – Decrease	NZ$ millions	%
2000:1999	(61)	(13.1)

The decrease in labour costs of NZ$61 million, or 13.1%, for the year largely reflected the outsourcing of information services to EDS effective from 1 September 1999, the sale of ConnecTel effective from 1 June 2000 and the full year impact of the outsourcing of operator services to SITEL during the 1999 financial year. The costs of outsourcing are included in "Other Operating Expenses". These reductions were partly offset by salary increases arising from Telecom's annual salary review process.

Personnel Numbers	June 1999	June 2000	Variation
Operations	5,994	4,463	(1,531)
Other	1,485	1,254	(231)
	7,479	5,717	(1,762)

The decrease in personnel numbers since 30 June 1999 largely reflects the sale of ConnecTel and the outsourcing of information services to EDS.

Depreciation

Variation – Increase	NZ$ millions	%
2000:1999	5	0.9

Depreciation expense increased by NZ$5 million, or 0.9%, in 2000. The year-on-year increase reflects the impact of the increasing fixed asset base resulting from capital expenditure.

Cost of Sales

Cost of sales are costs directly attributable to revenue earned from international outward calls and leased circuits, equipment sales, cellular services, directories and the costs of interconnection.

Variation – Increase	NZ$ millions	%
2000:1999	119	25.9

Cost of sales increased by NZ$119 million, or 25.9%, for the year. This increase was largely due to higher mobile, international, interconnect and directories cost of sales partly offset by lower equipment cost of sales.

Mobile cost of sales increased by NZ$53 million, or 54.1% (see "Cellular and Other Mobile Services").

While the high rate of cellular connection growth is having a negative impact on short-term earnings performance due to the immediate write-off of cellular acquisition costs, the Company believes significant future revenue will accrue from its recent high number of customer acquisitions.

Most Australasian telecommunications companies have adopted the accounting policy of capitalising cellular acquisition costs and subsequently amortising these costs over the life of the underlying contracts. Telecom has considered adopting this policy but has decided against it at this time. Had Telecom adopted this policy effective from 1 July 1999, mobile cost of sales would have been lower by approximately NZ$55 million in 2000.

Interconnect expense increased by NZ$48 million, or 85.2%, reflecting increased volumes including the growth in calls from Telecom's fixed line network to Vodafone's cellular network (see "National").

International cost of sales for outbound calls increased by NZ$22 million, or 14.3%, for the year reflecting growth in outward call volumes (see "International").

Other Operating Expenses

Other operating expenses include occupancy, advertising, computer costs, bad debts, vehicle costs, office expenses, postage and agency, outsourcing costs and certain direct costs, which together represented approximately 80% of other operating expenses before capital recoveries.

Variation – Increase	NZ$ millions	%
2000:1999	86	15.5

The increase in other operating expenses largely reflected an increase in outsourcing costs. This increase reflected the outsourcing of information services to EDS effective from 1 September 1999, the full year impact of the outsourcing of operator services to SITEL during the 1999 financial year and the sale of ConnecTel.

The increase in other operating expenses also reflects increases in other operating costs of growth areas such as Xtra, esolutions, the international points of presence and the costs of bidding for large corporate contracts in Australia.

Abnormal Items

The following abnormal items reduced the 1999 surplus from operations (including abnormals) by NZ$6 million. After tax, the abnormal items increased 1999 earnings by NZ$1 million.

	1999 NZ$M	2000 NZ$M
ABNORMAL REVENUE		
Liquidation of executive share ownership plan	16	–
Cross border finance lease	15	–
	31	–
ABNORMAL EXPENSES		
Restructuring costs	15	–
Onerous contracts provision	22	–
	37	–

See Note 4 to the consolidated financial statements for further comment on these abnormal items.

Net Interest Expense

Variation – Decrease	NZ$ millions	%
2000:1999		
Interest expense	(13)	(8.7)
Investment income	(9)	(20.0)
Net interest expense*	(4)	(3.8)

* *Excludes the cost of funding the investment in AAPT.*

The decrease in net interest expense for the year was partly due to lower short-term interest rates. The surplus from operations before abnormal items covered net interest (after investment income but before interest capitalised) and capital note distribution costs 7.4 times, compared with 7.2 times in 1999.

Taxation

Variation – Decrease	NZ$ millions	%
2000:1999	(7)	(1.7)

The effective tax rate for 2000 was 31.3% compared with 31.9% for 1999 and a statutory rate of 33%.

Capital Expenditure

Capital expenditure (excluding AAPT) amounted to NZ$643 million, an increase of NZ$29 million, or 4.7%, compared with 1999. Cash applied to capital expenditure (excluding AAPT) amounted to NZ$633 million, an increase of NZ$48 million, or 8.2%.

Approximately 60% of 2000 capital expenditure was spent on baseline investment including expenditure for renewal and growth of Telecom's core network (including the international and mobile networks). The remaining capital expenditure was incurred in enhancing network capability to accommodate the increasing demand for data services and in the development of new products and services.

In February 2000, Telecom commissioned communications networking company Lucent Technologies (NZ) Limited to build a mobile phone network based on the code division multiple access ("CDMA") standard. AAPT has also chosen the Lucent Technologies Group as a CDMA supplier. Telecom and AAPT each selected Lucent Technologies as a result of independent evaluations, but Telecom believes that there are operating synergies and benefits with both companies choosing the same vendor.

Excluding AAPT, Telecom currently expects to spend approximately NZ$1 billion on capital expenditure in the 12 months to 30 June 2001. This includes expected CDMA capital expenditure and purchases of capacity from Southern Cross Cables Limited but excludes any potential acquisition of spectrum that may be purchased from the Government in the current spectrum auctions.

LIQUIDITY (CONSOLIDATED)

Telecom believes it has adequate internal and external resources available, including borrowing capacity, to finance its operating requirements, anticipated capital expenditure, dividends and investments.

Cash Flows from Operating Activities

Net cash flows from operating activities were NZ$1,545 million, a decrease of NZ$72 million, compared with 1999. Higher income tax and interest paid contributed to the decrease, while an increase in receipts from customers was largely offset by an increase in payments to suppliers and employees.

Cash Flows from Investing Activities

Net cash flows used in investing activities amounted to NZ$2,616 million, compared with NZ$546 million for 1999. The increase largely reflects the acquisition of shares in AAPT and Independent Newspapers Limited ("INL") and an increase in cash applied to the purchase of fixed assets, partly offset by the proceeds from the sale of ConnecTel and AAPT Sat-Tel.

Cash Flows from Financing Activities

Net cash flows from financing activities were NZ$1,122 million, compared with cash used of NZ$1,064 million in 1999. The increase in 2000 was largely due to net proceeds from short-term and long-term debt to fund the AAPT acquisition.

Telecom has declared a fully imputed dividend for the fourth quarter of NZ11.5 cents per share, a total of NZ$202 million, to be paid in September 2000.

A supplementary dividend of NZ$25 million will be paid to shareholders who are non-resident in New Zealand. Telecom receives an equivalent tax credit from the Inland Revenue Department for this amount.

CAPITAL RESOURCES (CONSOLIDATED)

Cash and Short-term Investments

Telecom had cash and short-term investments of NZ$698 million at 30 June 2000, compared with NZ$143 million at 30 June 1999.

Telecom has available unutilised committed facilities of US$200 million, as well as other substantial uncommitted borrowing capacity. AAPT has available unutilised committed facilities of A$60 million.

Debt

Total interest-bearing long-term and short-term liabilities amounted to NZ$4,323 million at 30 June 2000 compared with NZ$2,067 million at 30 June 1999.

Net debt amounted to NZ$3,591 million at 30 June 2000, compared with NZ$1,898 million at 30 June 1999. The net debt to net debt plus capital funds ratio was 62.4% at 30 June 2000, compared with 48.3% at 30 June 1999. Net debt is deemed to consist of total long and short-term debt, net of cash and short-term investments and a term deposit of NZ$34 million at 30 June 2000 (NZ$26 million at 30 June 1999). Capital funds include shareholders' funds, capital notes (TeleNotes and Restricted Capital Securities) and minority interests.

The estimated fair value of Telecom's long-term debt at 30 June 2000 was NZ$3,146 million compared with its carrying amount of NZ$3,049 million (stated inclusive of the effect of hedging transactions). The estimated fair value of long-term debt at 30 June 1999 was NZ$1,314 million, compared with its carrying amount of NZ$1,250 million (stated inclusive of the effect of hedging transactions). The fair values are based on Telecom's fixed rates of interest on debt in comparison to the prevailing market rates in effect at 30 June 2000 and 30 June 1999 for instruments of a similar maturity.

TeleNotes and Restricted Capital Securities

In 1997 TCNZ Finance Limited ("TCNZ Finance"), Telecom's main financing subsidiary, issued capital notes known as "TeleNotes". TeleNotes on issue at 30 June 2000 amount to NZ$438 million.

TeleNotes are unsecured subordinated securities which pay a fixed coupon rate to the holder between election dates. On an election date, holders may elect to retain some or all of their TeleNotes for a further period on terms specified by TCNZ Finance or require redemption. TCNZ Finance has the option to redeem the TeleNotes, including any unpaid interest, for cash and/or by procuring the issue of Telecom shares (valued at 90% of the then-current market share price) to the holders of the TeleNotes.

In February 1998 Telecom New Zealand Finance Limited ("TNZFL"), another Telecom financing subsidiary, issued US$300 million worth of Restricted Capital Securities ("Capital Securities") to United States-based institutional investors. Such securities are similar to TeleNotes. US$150 million of such securities have a fixed coupon of 6.25% and will be redeemable in 2003. The other US$150 million have a fixed coupon rate of 6.5% and will be redeemable in 2008. Telecom has entered into cross currency interest rate swaps to remove the exposure to exchange rate fluctuations that would otherwise result from the issue of the Capital Securities. On the redemption dates in 2003 and 2008, also referred to as election dates, holders may elect to retain some or all of their Capital Securities for a further period on terms specified by TNZFL or require redemption. TNZFL has the option to redeem the Capital Securities including any unpaid interest for cash and/or by procuring the issue of American Depositary Shares representing ordinary shares of Telecom (valued at 90% of the then-current market value) to the holders of the Capital Securities.

Market Risk

Telecom is exposed to market risk primarily from changes in interest rates and foreign currency exchange rates. Telecom employs risk management strategies including the use of derivatives such as interest rate swaps, interest rate options, foreign currency forwards, foreign currency options and cross currency interest rate swaps to manage these exposures. Any gains or losses on these hedging financial instruments are generally offset by gains or losses on the underlying exposures being hedged. Telecom monitors the use of derivative financial instruments through the use of well defined market and credit risk limits and timely reports to senior management. Telecom does not hold or issue derivative financial instruments for trading purposes.

Telecom is also exposed to market risk arising from changes in equity prices with respect to its investments in shares in listed companies.

Interest Rate Risk Management

The objectives of interest rate risk management are to minimise the cost of net borrowings and to minimise the impact of interest rate movements on Telecom's interest expense/net earnings within policies approved by the Telecom Board of Directors.

As at 30 June 2000, Telecom had hedged approximately NZ$10 million of short-term debt through the use of an interest rate swap compared to NZ$30 million that was hedged in this manner at 30 June 1999. As at 30 June 2000, interest rate options totalling NZ$450 million had been transacted to hedge forecast short-term debt. As at 30 June 1999, interest rate options totalling NZ$300 million had been transacted to hedge forecast short-term debt. Interest rate swaps have also been used to convert Telecom's floating rate obligations on term funding into fixed rate obligations.

The following table provides a sensitivity analysis of the estimated fair values of long-term debt, capital notes and related derivatives, assuming an instantaneous 100 basis point upward and downward parallel shift in the yield curve as at 30 June 2000 and 1999.

NZ$ billions	Fair value	Fair value assuming 100 basis point upward shift	Fair value assuming 100 basis point downward shift
AS AT 30 JUNE 2000			
Long-term debt, capital notes and related derivatives	4.1	3.9	4.4
AS AT 30 JUNE 1999			
Long-term debt, capital notes and related derivatives	2.3	2.2	2.4

Foreign Exchange Risk Management

The objective in managing foreign exchange risk is to protect against the risk that the eventual New Zealand dollar net cash flows resulting from purchases from foreign suppliers and foreign currency borrowings and expenditure will be adversely affected by changes in foreign currency exchange rates.

As at 30 June 2000, Telecom had used cross currency interest rate swaps with a contract value of NZ$2,063 million to hedge long-term debt denominated in US dollars, Euros, Swiss francs and Japanese yen. Such swaps were also used to hedge the issue of NZ$512 million equivalent of US dollar denominated Restricted Capital Securities. As at 30 June 1999, Telecom had used cross currency interest rate swaps with a contract value of NZ$925 million to hedge long-term foreign currency denominated debt and Restricted Capital Securities.

As at 30 June 2000, Telecom had also used foreign exchange forwards and foreign currency options with contract values of NZ$1,138 million to hedge short-term debt (principally denominated in US dollars), firm purchase commitments (mainly denominated in US dollars and Japanese yen), and partially hedge the investment in AAPT Limited. As at 30 June 1999, the contract value of such instruments was NZ$1,500 million.

The following table provides a sensitivity analysis of the estimated fair values of foreign exchange contracts hedging firm purchase commitments and the investment in AAPT in 1999, assuming a 10% increase or decrease in the various exchange rates to which Telecom is exposed.

NZ$ millions	Fair value	Fair value assuming 10% increase	Fair value assuming 10% decrease
AS AT 30 JUNE 2000			
Foreign currency forward exchange contracts, and options	60	4	127
AS AT 30 JUNE 1999			
Investment in AAPT	337	324	352
Foreign currency forward exchange contracts	25	(4)	59

The functional currency for nearly all of Telecom's foreign operations is the local currency. The translation of statement of financial performance and statement of financial position balances of these entities into New Zealand dollars results in translation adjustments, which are recorded in the foreign currency translation reserve. As at 30 June 2000, Telecom's primary translation exposure was to the Australian dollar in respect of the Australian subsidiary that holds the investment in AAPT. This exposure is partially hedged, with gains or losses on the hedging contract also recorded in the foreign currency translation reserve.

Equity Risk

During the year ended 30 June 2000, Telecom acquired minority investments in publicly listed companies. These investments expose Telecom to the risk of movements in the market prices of these listed securities. Telecom does not hedge this risk. The following table provides a sensitivity analysis of the estimated fair value of listed securities, assuming a 10% increase and decrease in the market prices of securities in which Telecom holds investments.

NZ$ millions	Fair value	Fair value assuming 10% increase in share price	Fair value assuming 10% decrease in share price
AS AT 30 JUNE 2000			
Listed securities	158	173	142

ECONOMIC TRENDS

Telecom's operations are significantly affected by the state of the New Zealand economy. Gross Domestic Product ("GDP") grew in real terms by 4.4% for the year ended March 2000, after a contraction of 0.2% in the year ended March 1999.

Growth is forecast to continue over the next two years although with moderation in the rate of growth. The New Zealand Institute of Economic Research reports (June 2000) a consensus among forecasters of 4.0% for GDP growth in the year to March 2001; the consensus for the March 2002 year is 3.0%. These forecasts reflect expected growth in export sales by primary producers and manufacturers, and higher levels of domestic spending by the Government. Services are an expanding component of the economy, with communications consistently among the sectors of fastest growth.

New Zealand's balance of payments deficit deteriorated in the year ended March 2000 (NZ$8.3 billion) but the consensus forecast is for steady improvement by March 2002, due to rising export sales and reduced demand for imports. Inflation is widely expected to remain low, with annual rates held between 2.0-3.0%. The official rate of unemployment is forecast to continue declining from 6.4% in March 2000, to 5.5% in March 2002. The New Zealand population was around 3.8 million in June 2000.

COMPETITIVE ENVIRONMENT

New Zealand has highly competitive markets in telecommunications services, governed by the Telecommunications Act 1987 and the Commerce Act 1986. There have been no statutory entry barriers to telecommunications markets since 1989 and services are provided by substantial network operators in addition to Telecom. These include Vodafone, Telstra Saturn Limited ("Telstra Saturn") and Clear Communications Limited ("Clear"), a wholly owned subsidiary of British Telecom. Telecom continues to be subject to Kiwi Share Obligations ("KSO") under which it must maintain a free local calling option for residential customers in all areas of New Zealand where such services were provided in 1990.

In February 2000, the Government established a Ministerial Inquiry into Telecommunications, with an objective to "ensure that the regulatory environment delivers cost-efficient, timely and innovative telecommunications services on an ongoing, fair and equitable basis to all existing and potential users". This inquiry is due to make policy recommendations in September 2000. A draft report in June 2000 proposed "industry self-management with regulatory underpinning", to be provided by a new industry forum and an Electronic Communications Commissioner. Telecom has made extensive submissions to the inquiry, stating the importance of industry agreement on principles for network interconnection and of continuation of the KSO with modifications that recognise industry developments since 1990. Telecom expects amendments will be made to legislation governing telecommunications as a result of final recommendations from the inquiry.

Under the Telecommunications (Information Disclosure) Regulations 1999, Telecom will be required to disclose the value of residential service subsidies under the KSO and report on the financial results of its local access network business separate from all other operations. These disclosures will initially be for the six months ended 30 June 2000.

Telecom has extensive interconnection arrangements with other network operators and service providers. These agreements cover international services, national and local voice services, data services, cellular services, Internet services and mobile trunked services. Telecom now has interconnection agreements with 11 other carriers. Of these, eight have the ability to offer local services and in each case Telecom has a number portability agreement in place enabling competitors to provide customers with the option of changing between local service providers without the need to change numbers.

During the year under review, Telecom and Vodafone renewed and amended the interconnection arrangements between their networks. In July 2000, Telecom and Telstra Saturn reached a comprehensive new agreement on interconnection, wholesale services, Internet traffic, pole-sharing and settlement of litigation on rebilling. This agreement introduced the principle of "bill and keep", involving no payment for the termination of prescribed local calls where volumes of those calls between networks are reasonably in balance. The renegotiation of interconnection terms with Clear was commenced in May 2000. The current interconnection agreement with Clear expires in December 2000.

In addition to those companies with which Telecom has interconnection, numerous other organisations offer voice-calling services from overseas or by re-selling services from network operators in New Zealand. As at 30 June 2000 approximately 150 Internet Service Providers ("ISPs") operate in New Zealand and 103 of these have asked for access to the Telecom network through 0867 dial-up numbers. Telecom competes in the ISP market through its Xtra operation.

Telecom also faces competition in leased-line services, paging, directory publishing and supply, and installation and maintenance of customer premises equipment ("CPE"). Telecom expects strong competition to continue in New Zealand telecommunications markets.

LITIGATION

Telecom is currently involved in a number of legal proceedings, including lawsuits brought against and by Clear relating to a variety of issues, including the terms on which Telecom provides interconnection, Clear's failure to make payment of certain charges under its interconnection agreement, Telecom's bundling practices and Telecom's 0867 service. CallPlus Limited and two other companies have proceedings against Telecom in relation to Telecom's 0867 service. The Commerce Commission has issued proceedings against Telecom claiming that the introduction of 0867 constituted a use by Telecom of its dominant position for proscribed purposes. AAPT is currently involved in lawsuits brought by and against Telstra Corporation. See Note 21 to the consolidated financial statements for further comment on these proceedings.

The legal proceedings pending against Telecom and AAPT involve claims for substantial damages and other relief. There can be no assurance that such litigation will not have a material adverse effect on Telecom's and AAPT's business, financial condition or results of operations.

OTHER MATTERS

Southern Cross

Southern Cross was established in October 1998 to build, own, operate and maintain a trans-Pacific fibre optic cable network (called the Southern Cross Cable Network) as well as market capacity on the cable. Telecom, Cable & Wireless Optus and MCI WorldCom are the shareholders in Southern Cross. Telecom holds a 50% equity interest.

Testing is currently underway as Southern Cross prepares to bring its 31,000 km trans-Pacific cable into service in November 2000. Southern Cross expects to deliver a network incorporating a full fibre ring linking Australia, New Zealand, Fiji and Hawaii, and a direct link from Hawaii to Oregon and to California (which are terrestrially linked).

Southern Cross cable construction costs are being funded through a US$640 million external credit facility and interim funding provided by the shareholders. Telecom has committed to provide up to US$150 million as part of this interim funding and as at 30 June 2000 Telecom had advanced US$120 million (excluding accrued interest) as part of this interim funding arrangement. Southern Cross plans to refinance the external credit facility, and repay all outstanding interim funding from shareholders on or before 15 November 2000.

Southern Cross will hold its third Data Gathering Meeting ("DGM") in Hawaii in August 2000. The company's two previous DGMs generated total capacity sales of around US$1.1 billion.

Based on current capacity commitments and expected revenue forecasts, it is expected that Southern Cross will repay borrowings in the first few years after completion of construction.

Prior to 31 December 1999, the accumulated equity accounted losses of the Southern Cross group included a provision against Telecom's advance to Southern Cross Cables Holdings Limited, a Southern Cross group company. Now that capacity sales commitments have largely covered the cable construction costs, there is no longer a requirement to maintain the provision against this advance.

Sale of ConnecTel

During April 2000, Telecom announced the sale of ConnecTel, its network, design, build and maintenance subsidiary, to Downer Group Limited. Many telecommunications companies already use outside contractors and it is no longer necessary for Telecom to own a contractor in order to maintain the high quality of its service. Telecom will continue to work closely with ConnecTel, which has won a significant number of Telecom's design, build and maintenance contracts in a competitive tendering process.

The transaction settled on 1 June 2000. The sale had a minor favourable impact on Telecom's earnings.

Investment in EDS New Zealand Limited

Telecom has acquired a 10% shareholding in EDS New Zealand Limited ("EDS"), announced when Telecom outsourced its IT requirements to EDS in September 1999.

The agreement also includes options for Telecom to acquire further shares in EDS between 1 September 2000 and 31 March 2004. If these options are exercised Telecom could take a shareholding of up to 49%. Telecom has appointed two representatives to the board of EDS.

Outsourcing Contract with the Commonwealth Bank of Australia

Telecom, in conjunction with AAPT and EDS Australia, has entered final negotiations with the Commonwealth Bank of Australia ("CBA") to provide outsourced telecommunications to support CBA's online leadership position in a five year, A$500 million deal. Under the outsourcing arrangement Telecom will lead a consortium that provides CBA's telecommunications services including: IP-anywhere network capability; managed network services for data, voice, video, and EFTPOS; remote access and international network services; consulting on all telecommunications requirements; and risk, security and performance management.

Investment in INL

During the year Telecom purchased a 10% stake in INL. Through this small strategic position, Telecom hopes to build a closer relationship over time, in order to provide a further opportunity for accessing potential synergies in the future. This relationship should enhance Telecom's transition from a traditional telecommunications company to an online and esolutions provider.

Corporate Venture Capital Fund

During the year Telecom established TMT Ventures, a corporate venture capital fund with a target of NZ$150 million to be invested in new growth businesses in the technology, media, and telecommunications sectors of New Zealand and Australia.

Telecom proposes to make a cornerstone investment of up to NZ$40 million in TMT Ventures and has appointed a joint venture between United States-based Advent International and Direct Capital (New Zealand's largest venture capitalist), to manage the fund.

esolutions

During 2000, Telecom entered into an alliance with EDS and Microsoft in New Zealand, to develop and market packaged and customised electronic commerce products and services for New Zealand businesses using the brand "esolutions". The esolutions alliance facilitates provision of services by its members as "applications service providers" and "applications infrastructure providers".

Services provided under the auspices of the esolutions alliance are designed to meet the needs of businesses of all sizes and complexities (except small offices/home offices) and at any stage of their development. esolutions alliance members specialise in providing packages that meet the complex requirements of businesses and enable them to function online. These packages include hosted applications based on the "virtual office". esolutions alliance members draw on the complementary assets, expertise and business associations of Telecom, EDS and Microsoft.

AAPT

AAPT Earnings for the seven months to 30 June 2000	7 months to June 2000 A$M
Operating revenues	593
Operating costs	570
EBIT	23
EBITDA	51
Abnormal items (before tax)	23
Net earnings including abnormals	**32**

AAPT's reported net earnings for the seven months to 30 June 2000 were A$32 million. AAPT contributed NZ$10 million of net earnings before abnormals to Telecom's consolidated net earnings for 2000. This contribution was after allowing for minority interests in AAPT's net earnings before abnormals and consolidation adjustments for differences in accounting policies.

Allowing for minority interests and the amounts required to be applied to Telecom's fair value of AAPT's assets at the time of acquisition, AAPT's abnormal items of A$23 million (see "Abnormals") resulted in a NZ$12 million contribution to Telecom's consolidated net earnings for the year.

Abnormals

Over the seven month period AAPT reported abnormal income before tax of A$23 million resulting predominantly from the sale of AAPT's wholly owned subsidiary, AAPT Sat-Tel, partly offset by the impact of changes in accounting policies.

During the seven month period, AAPT changed its accounting policies in areas relating to subscriber acquisition costs and the recognition of future benefits arising from international return traffic, following a review of its accounting policies.

AAPT Capital Expenditure

Capital expenditure for the seven month period of A$180 million included major expenditures for the LMDS and CDMA networks as well as further expansion of AAPT's backbone which includes acquisition of capacity from Optus and deployment of optical fibre through the central business districts of Australia's major capital cities. During the year AAPT has invested in international cable arrangements including the Sea-Me-We3 cable system linking Australia to Europe through Asia and preparatory work in anticipation of the completion of the Southern Cross link to the USA.

Projected Capital Expenditure

Based on current forecasts, AAPT expects to invest in excess of A$500 million in the full year to 30 June 2001 as it continues to pursue further development of its first mile access capabilities via roll-out of its LMDS, CBD Fibre, xDSL and CDMA networks.

Bond Issue and Credit Rating

In March 2000, AAPT Limited was assigned an 'A+' long-term and 'A-1' short-term corporate credit rating by Standard and Poors, with a stable outlook. This followed a request by AAPT for a credit rating in order to assess its debt-funding opportunities. Having received this credit rating, AAPT was able to source investment grade debt at a lower cost. The rating also expands the options available to AAPT to meet current and future capital expenditure requirements.

Following this positive credit rating and as part of its funding programme AAPT announced in early July 2000 that it had established an A$600 million debt funding securities programme comprising Commercial Paper and Medium Term Notes.

AAPT OTHER MATTERS

Business, Corporate and Government Tenders

During the period AAPT's Business, Corporate and Government ("BCG") division won a number of significant tenders.

It has a major involvement in the recently awarded Commonwealth Bank telecommunications contract, led by Telecom. AAPT's role in this contract will be as the carrier of voice, data and video services. In addition to the benefits of increased revenue and the ability to further leverage its network infrastructure, AAPT believes the Commonwealth Bank contract will strengthen its credibility in the corporate market and this in turn will enable AAPT to capture further opportunities in this market in coming periods.

Other major contracts include the A$18 million contract to provide outgoing voice services to Centrelink and the Department of Family and Community Services.

The BCG division is also leveraging and driving benefits from the relationship with Telecom. Both companies are working together and have achieved success in securing Trans Tasman telecommunications business on both sides of the Tasman.

VicOne

AAPT owns and operates the largest secure private IP network in Australia for the Victorian Government called VicOne.

During the year VicOne was expanded to link over 3,500 sites, including schools, hospitals, police stations, courts and all other public sector facilities and currently services over 700,000 daily users.

As part of this expansion, the South West Alliance of Rural Hospitals connected its state-of-the-art Internet-based communications systems to VicOne, enabling the participating hospitals to move all their data, voice and video over the network and saving them an estimated A$400,000 annually.

Residential Market

As at 30 June 2000 AAPT Smartchat, AAPT's residential telephony division, had signed up over 300,000 or 5% of the overall residential local call market since launching its bundled residential telephony product in late 1999 following the Australian Competition and Consumer Commission (ACCC) ruling in July 1999 that Telstra must offer wholesale local call services to its competitors.

As a result of this launch and AAPT's marketing push into regional Australia, AAPT has established an additional call centre with 300 seats in Bendigo, Victoria. This call centre currently has 100 seats and will be fully operational by June 2001. An interim 90-seat facility has been established in Melbourne to accommodate the demand arising from the bundled residential telephony product promotion.

Regional Australia

In October 1999, AAPT Regional & Rural was formed to address the telecommunications needs of regional Australia and provide solutions to this market. As part of this initiative, AAPT recently won a tender as the primary telecommunications carrier to one of Australia's first regional community owned telecommunications companies, the Bendigo Community Telco Group.

Further Developing First Mile Access Capabilities

AAPT remains focused on further developing its first mile access capabilities as this will enable AAPT to deliver more services to its customers over its own network.

AAPT is committed to expanding its first mile access capabilities, through rolling out its LMDS, CBD Fibre, xDSL and CDMA networks. By doing so AAPT anticipates achieving better margins rather than relying on other carriers and also delivering its customers the benefits of faster, higher quality, more innovative, competitively priced products and services.

Local Multipoint Distribution Service ("LMDS")

AAPT is currently rolling out a broadband wireless network around Australia based on LMDS technology.

LMDS is currently being used commercially by customers in Melbourne, including the provision of high-speed Internet access to a number of schools on the VicOne network and the provision of voice, data and high speed Internet to a number of corporate CBD-based customers.

This network complements AAPT's existing investment in voice and data switching capabilities and CBD fibre loops. It enables the company to deliver up to and beyond 100 Mbps per customer site and provide voice services; high-speed data and IP-based services and emerging multi-media applications (for example, video on demand and information content).

During the current year the focus of the LMDS roll-out was on testing, site acquisition, site build and integration with the AAPT core network.

AAPT's deployment of point to multi-point LMDS has been impacted by delays in the delivery of equipment. AAPT is working closely with the joint owners of SpectraPoint, Motorola and Cisco Systems, to address the issues.

In the interim, AAPT is continuing to deploy point to point LMDS equipment using the spectrum purchased in 1998.

CBD and Metropolitan Fibre

AAPT is building a fibre optic network in the six capital city CBD areas which directly connects high-volume customers to AAPT's network via a high-speed link.

AAPT has 668 kilometres of fibre optic cable in the CBD and metropolitan areas of Sydney, Melbourne, Brisbane, Adelaide, Perth and Canberra, and as at 30 June had fibred 217 buildings. This will provide savings from the elimination of high cost Telstra leased circuits connecting Telstra's gateway exchanges to AAPT's switches.

Acquisition of National High Bandwidth Network

In March 2000, AAPT and Cable & Wireless Optus ("Optus") signed an agreement under which AAPT will acquire a high bandwidth network on Optus' national backbone linking Cairns, Brisbane, Sydney, Canberra, Melbourne, Adelaide and Perth. Also as part of this agreement, Optus will provide 50 regional drop off points and AAPT will install equipment to link the drop off points with its regional points of presence.

This acquisition will provide AAPT with significant additional capacity to carry more traffic on its own network, further reducing interconnect costs with other carriers and therefore reducing AAPT's transmission costs.

AAPT is currently working with Optus to implement this agreement and expects to have full use of this network by the first quarter of 2001. In the interim, and as part of this agreement, AAPT has use of Optus' backbone network.

Cellular One and AAPT Mobile

Cellular One and AAPT Mobile are both resellers of Vodafone and Optus GSM products and during the year, despite competition in the mobile market, reported an increase of 29.5% to approximately 215,000 customers.

AAPT expects competition in the GSM mobile market to further intensify in the coming periods due to the advent of new technology, the reworking of existing products and the influx of new competitors. To combat this competition and strengthen its distribution channels with the forthcoming launch of AAPT's CDMA mobile network, Cellular One will open a number of new retail outlets over the coming periods, increasing the number to approximately 250.

Code Division Multiple Access (CDMA) Mobile Network

AAPT owns 800MHz spectrum with an addressable market of over 55% of the Australian population and is rolling out a mobile network based on CDMA technology.

Roll-out of this network began earlier in 2000, following AAPT's decision to contract US communications networking company, Lucent Technologies, to build and support its A$500 million CDMA mobile network. As part of this contract, AAPT has an option to migrate its CDMA network to 3G. Telecom has also contracted Lucent as the supplier for its CDMA mobile network.

Initial roll-out has been slower than planned, due to factors related to base station site acquisition, and as such AAPT expects to launch its network commercially in the first quarter of 2001. Prior to this, a soft commercial launch is planned for South East Queensland in November 2000.

Internet and e-commerce Business

During the period AAPT continued to enhance its Internet and e-commerce business through acquisitions, strategic alliances and partnerships.

To enhance its residential Internet offerings, AAPT entered a 50/50 venture with America Online.

In the business Internet space, connect.com.au, which is one of Australia's largest Internet access and e-commerce providers and a wholly owned subsidiary of AAPT, together with AAPT acquired Australian e-commerce solutions provider, Commerce Solutions; entered an e-procurement licensing agreement with US software provider, Ariba; and acquired 60% of EC-Pay Pty Ltd, which owns and markets a specialist Internet-based service for the superannuation industry.

Key Regulatory Decisions

The two regulatory areas that will impact AAPT this year are the progress of arbitration and further introduction of Number Portability (see below).

Arbitration

AAPT is currently engaged in eight arbitrations under the Access regime. Recent decisions by the ACCC in relation to Telstra PSTN Access undertakings had favourable outcomes for AAPT. AAPT is awaiting indication of the progress on three arbitrations, seeking to reduce the price of fixed to mobile calls.

Number Portability

Local Number Portability ("LNP") has been available to all carriers since November 1999. Customers can now keep their local numbers when taking AAPT's bundled residential telephony service.

Freephone Number Portability will be available from 16 November 2000 and Mobile Number Portability ("MNP") from 25 September 2001. Both are favourable for AAPT as they will increase the attraction of AAPT's services to customers.

RECENT US ACCOUNTING PRONOUNCEMENTS

The future impact of recent US accounting pronouncements issued by the Financial Accounting Standards Board ("FASB") and Securities and Exchange Commission ("SEC") applicable to Telecom's financial statements is discussed below.

FASB Accounting Standard – Derivatives and Hedging Activities

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) 133, "Accounting for Derivative Instruments and Hedging Activities".

This statement requires entities that use derivative instruments to measure these instruments at fair value and recognise them as either assets or liabilities on the balance sheet. It also requires entities to reflect the gains or losses associated with changes in the fair values of these derivatives, either in earnings or as a separate component of capital funds, depending on the nature of the underlying contract or transaction.

In June 1999, the FASB issued SFAS 137, "Accounting for Derivative Financial Instruments and Hedging Activities – Deferral of the Effective Date of SFAS 133". This statement addresses certain implementation issues as well as deferring the effective date of SFAS 133 to financial years beginning on or after 15 June 2000.

In June 2000, the FASB issued SFAS 138, "Accounting for Certain Derivative Instruments and Hedging Activities – an amendment of SFAS 133". This standard further amends the accounting and reporting standards of SFAS 133 for certain derivative instruments and certain hedging activities. SFAS 138 makes no further amendment to the effective date of SFAS 133.

Telecom adopted the provisions of SFAS 133 for US GAAP reporting purposes at 1 July 2000. The types and purposes of derivative financial instruments entered into by Telecom are described in Note 19 to the consolidated financial statements. Due to the qualifying nature of Telecom's derivative financial instruments for hedge accounting under SFAS 133, the application of SFAS 133 is not considered to have a material impact on Telecom's financial statements.

SEC Staff Accounting Bulletin – Revenue Recognition

In December 1999, the SEC issued Staff Accounting Bulletin (SAB) No. 101, "Revenue Recognition in Financial Statements". SAB No. 101 provides additional guidance on revenue recognition, as well as criteria for when revenue is generally realised and earned, and also requires the deferral of incremental direct selling costs.

In March 2000, the SEC issued SAB No. 101A "Amendment: Revenue Recognition in Financial Statements", followed in June 2000 by SAB 101B "Second Amendment: Revenue Recognition in Financial Statements". The effect of these amendments is to defer the effective date of SAB 101. Telecom will now have to adopt SAB 101 in its US GAAP reconciliation for the year ending 30 June 2001.

Telecom management is currently evaluating the impact of the adoption of SAB 101 on the financial statements.

GLOSSARY

ADSL (Asymmetric Digital Subscribers Line) – A technology for delivering a high bit rate link to customers over ordinary copper. Data rates can reach 8 Mbit/s from the exchange to the customer and 640 bit/s in the other direction.

Bandwidth – Transmission capacity. The larger the bandwidth, the greater the capacity of voice, video or data that can be carried.

CDMA (Code Division Multiple Access) – An advanced radio spectrum sharing technique used in new digital mobile networks.

Centrex – The use of conventional PSTN lines and phones so that they appear to be part of a private network. Features include traditional PBX features. Centrex is offered to businesses as an alternative to buying or leasing their own PBXs.

CPE (Customer Premises Equipment) – Any telecommunications equipment that resides in the customer's premises and does not constitute part of the network (e.g. telephones, fax machines, PBXs).

IP (Internet Protocol) – A principal communications protocol used in the Internet.

ISDN (Integrated Services Digital Network) – Switched digital transmission system that can carry a range of digitised voice, data and images. Basic Rate Access offers 128 Kbit/s capacity on two channels and Primary Rate Access offers 2 Mbit/s capacity on 30 channels.

LAN (Local Area Network) – A local area network is one which spans a limited geographical area (usually within one building or site) and interconnects a variety of computers and terminals, usually at very high data rates.

LanLink – A group of Telecom services that link customer LANs together via a Wide Area Network (WAN). Solutions involve a degree of customisation in each case.

LMDS (Local Multipoint Distribution System) – A wireless system for distribution of broadband services that functions in the 26 to 29 GHz band.

PBX (Private Branch Exchange) – Customer premises switch, connected to the PSTN, that operates as a private local exchange, typically providing reduced-digit dialing for internal calls.

PSTN (Public Switched Telephone Network) – A nationwide switched fixed line voice telephone network.

VPN (Virtual Private Network) – A carrier-provided service in which the public switched network provides the equivalent of a privately established customer network.

xDSL – A generic reference to any of the many Digital Subscribers Line technologies, e.g. ADSL.

3G (Third Generation – mobile network) – Digital mobile network based on CDMA standards that is capable of delivering data rates up to 2Mbit/s.

OVERVIEW OF NET EARNINGS (EXCLUDING AAPT)

Telecom Corporation of New Zealand Limited and Subsidiaries

	Year ended 30 June				Variation 00:99	
(in NZ$ millions, except percentages)	1999	%	2000	%	$	%
Operating revenues						
Local service	**1,059**	*30.6*	**1,057**	*29.3*	**(2)**	*(0.2)*
Calling						
National	704	*20.4*	708	*19.7*	4	*0.6*
International	385	*11.1*	398	*11.0*	13	*3.4*
Other	51	*1.5*	50	*1.4*	(1)	*(2.0)*
	1,140	*33.0*	**1,156**	*32.1*	**16**	*1.4*
Interconnection	**71**	*2.1*	**86**	*2.4*	**15**	*21.1*
Cellular and other mobile	**502**	*14.5*	**546**	*15.2*	**44**	*8.8*
Data	**357**	*10.3*	**432**	*12.0*	**75**	*21.0*
Other operating revenues						
Directories	161	*4.7*	176	*4.9*	15	*9.3*
Equipment	109	*3.2*	84	*2.3*	(25)	*(22.9)*
Miscellaneous	57	*1.6*	64	*1.8*	7	*12.3*
	327	*9.5*	**324**	*9.0*	**(3)**	*(0.9)*
Total operating revenues (before abnormals)	**3,456**	*100.0*	**3,601**	*100.0*	**145**	*4.2*
Operating expenses						
Labour	467	*13.5*	406	*11.3*	(61)	*(13.1)*
Depreciation	551	*15.9*	556	*15.4*	5	*0.9*
Cost of sales	459	*13.3*	578	*16.1*	119	*25.9*
Other operating expenses	556	*16.1*	642	*17.8*	86	*15.5*
Total operating expenses (before abnormals)	**2,033**	*58.8*	**2,182**	*60.6*	**149**	*7.3*
Surplus from operations (before abnormals)	**1,423**	*41.2*	**1,419**	*39.4*	**(4)**	*(0.3)*
Net financing costs	(105)	*(3.0)*	(101)	*(2.8)*	4	*3.8*
Surplus from operations before income tax	**1,318**	*38.2*	**1,318**	*36.6*	**–**	*–*
Income tax expense	(420)	*(12.2)*	(413)	*(11.5)*	7	*1.7*
Surplus from operations after income tax	**898**	*26.0*	**905**	*25.1*	**7**	*0.8*
Abnormals	**1**	*–*	**–**	*–*	**(1)**	*(100.0)*
Surplus after income tax	**899**	*26.0*	**905**	*25.1*	**6**	*0.7*
Minority interests in profits of subsidiaries	(2)	*–*	(3)	*(0.1)*	(1)	*(50.0)*
Share of losses of associate company after income tax	(7)	*(0.2)*	(2)	*–*	5	*71.4*
Net Surplus	**890**	*25.8*	**900**	*25.0*	**10**	*1.1*
Capital note distribution costs after income tax	(55)	*(1.6)*	(54)	*(1.5)*	1	*1.8*
Net earnings attributable to shareholders	**835**	*24.2*	**846**	*23.5*	**11**	*1.3*

CONSOLIDATED STATEMENT OF FINANCIAL PERFORMANCE FOR THE YEAR ENDED 30 JUNE 2000

Telecom Corporation of New Zealand Limited and Subsidiaries

(Dollars in millions, except per share amounts)	notes	Year ended 31 March 1998 NZ$	Year ended 31 March 1999 NZ$	Three months ended 30 June 1999 NZ$	Year ended 30 June 2000 NZ$	Year ended 30 June 2000 US$
Operating revenues						
Local service		1,025	1,058	264	1,064	499
Calling	2	1,242	1,161	270	1,488	698
Interconnection		56	65	20	90	42
Cellular and other mobile services		431	484	132	717	336
Data		305	342	96	535	251
Other operating revenues	2	339	324	66	437	205
Abnormal revenues	4	–	16	15	15	7
		3,398	3,450	863	4,346	2,038
Operating expenses						
Labour	3	494	479	112	486	228
Depreciation		564	553	136	583	273
Cost of sales		398	451	118	1,079	506
Other operating expenses	3	565	552	133	772	362
Abnormal expenses	4	37	15	22	–	–
		2,058	2,050	521	2,920	1,369
Surplus from continuing operations		**1,340**	**1,400**	**342**	**1,426**	**669**
Investment income	5	28	49	12	38	17
Interest expense	5	(155)	(159)	(34)	(218)	(102)
Surplus from continuing operations before income tax		**1,213**	**1,290**	**320**	**1,246**	**584**
Income tax expense	6	(397)	(411)	(98)	(395)	(185)
Surplus from continuing operations after income tax		**816**	**879**	**222**	**851**	**399**
Discontinued operations:	7					
Reversal of provision for loss on disposal of Pacific Star Group		30	–	–	–	–
Surplus after income tax		**846**	**879**	**222**	**851**	**399**
Share of losses of associate companies after income tax		–	–	(7)	(6)	(3)
Minority interests in profits of subsidiaries		–	(2)	–	(8)	(4)
Net surplus		**846**	**877**	**215**	**837**	**392**
Capital note distribution costs after income tax		(26)	(55)	(13)	(54)	(25)
Net earnings attributable to shareholders		**820**	**822**	**202**	**783**	**367**
Earnings per share from continuing operations		**$0.443**	**$0.469**	**$0.115**	**$0.447**	**$0.209**
Net earnings per share		**$0.459**	**$0.469**	**$0.115**	**$0.447**	**$0.209**
Weighted average number of ordinary shares outstanding (in millions)		1,786	1,752	1,753	1,753	1,753

Unaudited comparative information for the three months ended 30 June 1998 and the year ended 30 June 1999 is disclosed in Note 29 of these financial statements.

CONSOLIDATED STATEMENT OF MOVEMENTS IN CAPITAL FUNDS FOR THE YEAR ENDED 30 JUNE 2000

Telecom Corporation of New Zealand Limited and Subsidiaries

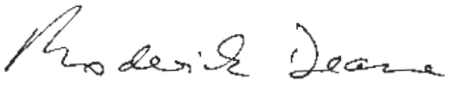
(Dollars in millions)	notes	Year ended 31 March 1998 NZ$	Year ended 31 March 1999 NZ$	Three months ended 30 June 1999 NZ$	Year ended 30 June 2000 NZ$	Year ended 30 June 2000 US$
Capital funds at the beginning of the period		1,642	2,010	2,034	2,035	954
Net earnings attributable to shareholders		820	822	202	783	367
Movement in foreign currency translation reserve	18	1	–	1	48	23
Total recognised revenues and expenses for the period		821	822	203	831	390
Movement in minority interests		4	1	–	82	39
Dividends	18	(859)	(910)	(227)	(906)	(425)
Tax credit on supplementary dividends		103	104	25	100	47
Issue of capital notes	18	946	–	–	–	–
Discount on capital notes amortised		1	1	–	1	–
Redemption of capital notes		(6)	–	–	–	–
Capital contributed	18	2	6	–	19	9
Share repurchase	18	(644)	–	–	–	–
Capital funds at the end of the period		**2,010**	**2,034**	**2,035**	**2,162**	**1,014**
Represented by:						
Contributed capital		903	909	909	928	435
Foreign currency translation reserve		–	–	1	49	23
Minority interests		6	7	7	89	42
Retained earnings		160	176	176	153	72
Capital notes		941	942	942	943	442
		2,010	**2,034**	**2,035**	**2,162**	**1,014**

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 2000

Telecom Corporation of New Zealand Limited and Subsidiaries

(Dollars in millions)	notes	31 March 1999 NZ$	30 June 1999 NZ$	30 June 2000 NZ$	30 June 2000 US$
Assets					
Current assets:					
Cash		21	29	81	38
Short-term investments	8	673	114	617	289
Receivables and prepayments	9	754	691	918	431
Inventories	10	42	48	40	19
Total current assets		1,490	882	1,656	777
Long-term investments	11	47	530	455	213
Intangibles	12	58	56	1,620	760
Fixed assets	13	3,780	3,774	4,250	1,993
Total assets		**5,375**	**5,242**	**7,981**	**3,743**
Liabilities and Capital Funds					
Current liabilities:					
Bank overdraft		9	–	–	–
Accounts payable and accruals	14	801	821	1,242	583
Provisions – current	15	58	64	11	5
Debt due within one year	16	1,130	1,064	1,462	686
Provision for dividend	18	228	227	227	106
Total current liabilities		2,226	2,176	2,942	1,380
Deferred taxation	6	–	25	13	6
Provisions – non-current	15	3	3	3	1
Long-term debt	17	1,112	1,003	2,861	1,342
Total liabilities		3,341	3,207	5,819	2,729
Commitments and contingent liabilities	20,21				
Capital funds:	18				
Shareholders' funds		1,085	1,086	1,130	530
Capital notes		942	942	943	442
Minority interests		7	7	89	42
Total capital funds		2,034	2,035	2,162	1,014
Total liabilities and capital funds		**5,375**	**5,242**	**7,981**	**3,743**

On behalf of the Board



RODERICK DEANE, Chairman



THERESA GATTUNG, Chief Executive and Managing Director

Wellington, 10 August 2000

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 30 JUNE 2000

Telecom Corporation of New Zealand Limited and Subsidiaries

		Year ended 31 March		Three months ended 30 June	Year ended 30 June	
		1998	1999	1999	2000	2000
(Dollars in millions)	note	NZ$	NZ$	NZ$	NZ$	US$
Cash flows from operating activities						
Cash was provided from/(applied to):						
Cash received from customers		3,285	3,423	872	4,192	1,966
Proceeds from cross border lease		–	–	15	–	–
Proceeds from liquidation of Executive Plan, net		–	16	–	–	–
Interest income		20	41	10	19	9
Dividend income		3	4	1	4	2
Payments to suppliers and employees		(1,273)	(1,380)	(399)	(2,093)	(981)
Restructuring, onerous contracts and Year 2000 payments		(60)	(65)	(16)	(58)	(27)
Income tax (paid)/refunded		(289)	(304)	51	(311)	(146)
Interest paid on debt		(149)	(161)	(41)	(208)	(98)
Net cash flows from operating activities	25	1,537	1,574	493	1,545	725
Cash flows from investing activities						
Cash was provided from/(applied to):						
Sale of fixed assets		11	21	1	57	27
(Purchase)/sale of short-term investments, net		(461)	(252)	560	(486)	(228)
Purchase of long-term investments		(8)	–	(104)	(238)	(112)
Proceeds from sale of subsidiary companies		–	16	–	95	45
Acquisition of AAPT Limited, excluding cash acquired		–	–	(385)	(1,189)	(558)
Purchase of fixed assets		(559)	(554)	(142)	(837)	(393)
Capitalised interest paid		(14)	(9)	(3)	(18)	(8)
Redemption of notes receivable		46	–	–	–	–
Net cash flows applied to investing activities		(985)	(778)	(73)	(2,616)	(1,227)
Cash flows from financing activities						
Cash was provided from/(applied to):						
Proceeds from long-term debt		269	12	9	1,850	867
Repayment of long-term debt		(191)	(199)	(49)	(246)	(115)
Proceeds/(repayment) of short-term debt, net		102	378	(135)	466	219
Capital contributed		2	6	–	23	11
Dividends paid		(841)	(914)	(228)	(894)	(420)
Capital note distribution costs paid		(26)	(79)	–	(77)	(36)
Share repurchase		(808)	–	–	–	–
Proceeds from issue of capital notes, net		940	–	–	–	–
Net cash flows from/(applied to) financing activities		(553)	(796)	(403)	1,122	526
Net cash flow		(1)	–	17	51	24
Foreign currency translation adjustment		–	–	–	1	–
Opening cash position (including bank overdrafts)		13	12	12	29	14
Closing cash position (including bank overdrafts)		12	12	29	81	38

STATEMENT OF FINANCIAL PERFORMANCE FOR THE YEAR ENDED 30 JUNE 2000

Telecom Corporation of New Zealand Limited

		Parent Company			
		Year ended 31 March 1999	Three months ended 30 June 1999		Year ended 30 June 2000
(Dollars in millions)	notes	NZ$	NZ$	NZ$	US$
Operating revenues	2	806	202	822	386
Operating expenses		–	–	–	–
Surplus from operations		806	202	822	386
Investment income	5	37	11	104	48
Interest expense	5	(196)	(54)	(254)	(119)
Surplus before income tax		647	159	672	315
Income tax credit	6	52	15	50	24
Net earnings		**699**	**174**	**722**	**339**

STATEMENT OF MOVEMENTS IN CAPITAL FUNDS FOR THE YEAR ENDED 30 JUNE 2000

Telecom Corporation of New Zealand Limited

		Parent Company			
		Year ended 31 March 1999	Three months ended 30 June 1999		Year ended 30 June 2000
(Dollars in millions)	note	NZ$	NZ$	NZ$	US$
Capital funds at the beginning of the period		795	694	666	312
Net earnings		699	174	722	339
		1,494	868	1,388	651
Dividends	18	(910)	(227)	(906)	(425)
Tax credit on supplementary dividends	18	104	25	100	47
Capital contributed	18	6	–	19	9
Capital funds at the end of the period		**694**	**666**	**601**	**282**
Represented by:					
Contributed capital		909	909	928	435
Retained earnings		(215)	(243)	(327)	(153)
		694	**666**	**601**	**282**

STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 2000

Telecom Corporation of New Zealand Limited

		Parent Company			
		31 March 1999	30 June 1999	30 June 2000	30 June 2000
(Dollars in millions)	notes	NZ$	NZ$	NZ$	US$
Assets					
Current assets:					
Prepaid income tax	6	1	65	6	3
Accounts receivable		–	–	2	1
Total current assets		1	65	8	4
Future tax benefit	6	26	–	25	12
Investments	11	3,830	3,381	5,033	2,360
Total assets		**3,857**	**3,446**	**5,066**	**2,376**
Liabilities and Capital Funds					
Current liabilities:					
Accounts payable and accruals	14	31	30	18	9
Provision for dividend	18	228	227	227	106
Due to subsidiary companies	22	2,904	2,523	4,220	1,979
Total current liabilities		3,163	2,780	4,465	2,094
Commitments and contingent liabilities	20,21				
Capital funds:	18				
Shareholders' funds		694	666	601	282
Total liabilities and capital funds		**3,857**	**3,446**	**5,066**	**2,376**

On behalf of the Board

RODERICK DEANE, Chairman

THERESA GATTUNG, Chief Executive and Managing Director
Wellington, 10 August 2000

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 30 JUNE 2000

Telecom Corporation of New Zealand Limited

		Parent Company			
		Year ended 31 March 1999	Three months ended 30 June 1999		Year ended 30 June 2000
(Dollars in millions)	note	NZ$	NZ$	NZ$	US$
Cash flows from operating activities					
Cash was provided from/(applied to):					
Interest income		37	11	104	49
Dividends received from subsidiary companies		825	202	808	379
Interest paid on debt		(196)	(54)	(253)	(119)
Net cash flows from operating activities	25	666	159	659	309
Cash flows from investing activities					
Cash was provided from/(applied to):					
Advances from subsidiary companies, net		232	558	735	345
Redemption/(purchase) of investments, net		11	(490)	(507)	(238)
Net cash flows from investing activities		243	68	228	107
Cash flows from financing activities					
Cash was provided from/(applied to):					
Dividends paid		(914)	(227)	(891)	(418)
Repayment of short-term debt		(1)	–	–	–
Capital contributed		6	–	4	2
Net cash flows applied to financing activities		(909)	(227)	(887)	(416)
Net cash flow		–	–	–	–
Opening cash position		–	–	–	–
Closing cash position		–	–	–	–

NOTE 1 STATEMENT OF ACCOUNTING POLICIES

Reporting Entity and Statutory Base

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

The financial statements presented are those of Telecom Corporation of New Zealand Limited (the "Company" or the "Parent Company") its subsidiaries and associates (the "Telecom Group" or "Telecom").

Nature of Operations

Telecom is a major supplier of telecommunications services in New Zealand and Australia. Telecom provides a full range of telecommunications products and services including local, national, international and value-added telephone services, cellular and other mobile services, data and Internet services, equipment sales and installation services, leased services and directories.

Basis of Preparation

The financial statements have been prepared in accordance with the Financial Reporting Act 1993 which requires compliance with accounting practice generally accepted in New Zealand ("NZ GAAP"). This differs in certain significant respects from accounting practice generally accepted in the United States ("US GAAP"). For a description of the significant differences and related effect on these financial statements, see Note 30.

The financial statements are expressed in New Zealand dollars. The amounts pertaining to the most recent financial period are also expressed in United States ("US") dollars, the latter being presented solely for convenience and translated from New Zealand dollars, as a matter of arithmetical computation only, at a rate on 30 June 2000 of NZ$1.00 to US$0.4690. The US dollar amounts should not be construed as representations that the New Zealand dollars have been, could be, or could in the future be converted into US dollars at this or any other rate. References in these financial statements to "$" and "NZ$" are to New Zealand dollars, references to "US$" are to US dollars and references to "A$" are to Australian dollars.

Measurement Basis

The measurement basis adopted in the preparation of these financial statements is historical cost, modified by the revaluation of certain investments as identified in specific accounting policies below.

Specific Accounting Policies

Basis of Consolidation

Subsidiaries

Subsidiaries are those entities controlled, directly or indirectly, by the Telecom Group.

The consolidated financial statements are prepared from the accounts of the Company and its wholly and majority-owned subsidiaries using the purchase method of consolidation. All significant intercompany accounts and transactions are eliminated on consolidation.

Associates

Associates are entities in which the Telecom Group has significant influence, but not control, over the operating and financial policies.

Associate companies are reflected in the consolidated financial statements using the equity method whereby Telecom's share of the results of associates is included in consolidated net earnings attributable to shareholders.

Where the equity accounted carrying amount of an investment in an entity falls below zero, the equity method of accounting is suspended and the investment recorded at zero. If this occurs, the equity method of accounting is not resumed until such time as the Telecom Group's share of losses and reserve decrements, not recognised during the financial years in which the equity method was suspended, are offset by the current share of profits and reserves.

Goodwill Arising on Acquisition

Goodwill represents the excess of purchase consideration over the fair value of net assets acquired at the time of acquisition of a business or shares in a subsidiary or associate. Goodwill is amortised on a systematic basis over the period benefits are expected to arise, which will be no more than 20 years.

Acquisition or Disposal During the Year

Where an entity becomes or ceases to be a Telecom Group entity during the year, the results of that entity are included in the net earnings of the Telecom Group from the date that control or significant influence commenced or until the date that control or significant influence ceased.

Revenue Recognition

Telecom generally recognises revenues as it provides services or delivers products to customers. Billings for telecommunications services are made on a monthly basis throughout the month. Unbilled revenues from the billing cycle date to the end of each month are recognised as revenue during the month the service is provided. Revenue recognition is deferred in respect of the portion of fixed monthly charges that have been billed in advance.

Accounts Receivable

Accounts receivable are recorded at expected realisable value after providing for bad and doubtful accounts expected to arise in subsequent accounting periods.

Bad debts are written off against the provision for doubtful accounts in the period in which it is determined that the debts are uncollectable.

Inventories

Inventories principally comprise materials for self-constructed network assets, critical maintenance spares, customer premises equipment held for rental or sale and mobile equipment held for sale. Inventories are stated at the lower of cost and net realisable value after due consideration for excess and obsolete items. Cost is determined on a first-in first-out or weighted average cost basis.

Investments

Long-term investments are stated at cost. Long-term investments include the Company's investment in subsidiaries.

Investments in associate companies are stated at the Company's share of the fair value of the net tangible assets at acquisition plus the share of post-acquisition movements in reserves.

Investments not expected to be held to maturity are stated at market value, with the resulting gains or losses taken to earnings.

Where, in the opinion of the Directors, there has been a permanent diminution in the value of investments this is recognised in the current period.

Fixed Assets

Fixed assets are valued as follows:

- The value of fixed assets purchased from the Government was determined on the basis of depreciated replacement cost using estimated remaining lives as at 1 April 1987.
- Subsequent additions are valued at cost. The cost of additions to plant and equipment and other fixed assets constructed by Telecom consists of all appropriate costs of development, construction and installation, comprising material, labour, direct overhead and transport costs.

NOTE 1 **Statement of Accounting Policies** (continued)

- For each fixed asset project, interest costs incurred during the period required to complete and prepare the fixed asset for its intended use are capitalised as part of the total cost.

Software Developed for Internal Use
Telecom capitalises the direct costs associated with the development of network and business software for internal use where project success is regarded as probable. Capitalised costs include external direct costs of materials and services consumed, payroll and direct payroll-related costs for employees (including contractors) directly associated with the project and interest costs incurred while developing the software. Software developed for internal use is depreciated over its useful life to the Telecom Group.

Depreciation
Depreciation is charged on a straight-line basis to write down the cost of the fixed assets to their estimated residual value over their estimated useful lives, which are as follows:

Telecommunications equipment and plant:	
Customer local access	3-50 years
Junctions and trunk transmission systems	10-50 years
Switching equipment	3-15 years
Customer premises equipment	3-5 years
Other network equipment	4-15 years
Buildings	40-50 years
Motor vehicles	4-10 years
Furniture and fittings	5-10 years
Computer equipment	3-5 years

Where the remaining useful lives or recoverable values have diminished due to technological change or market conditions, depreciation is accelerated or the assets are written down.

Land and capital work in progress are not depreciated.

Where a fixed asset is disposed of, the profit or loss recognised in the Statement of Financial Performance is calculated as the difference between the sale price and the carrying value of the fixed asset.

Leased Assets
Telecom is a lessor of customer premises equipment. Such leases are considered operating leases because substantially all the benefits and risks of ownership remain with Telecom. Rental income is taken to revenue on a monthly basis in accordance with the lease term.

Telecom is a lessee of certain plant, equipment, land and buildings under both operating and finance leases. Lease costs relating to operating leases are charged against earnings as incurred. Finance leases, which effectively transfer to Telecom substantially all the risks and benefits of ownership of the leased assets, are capitalised at the present value of the minimum lease payments. The leased assets and corresponding liabilities are disclosed and the leased assets are depreciated over the period Telecom is expected to benefit from their use.

Spectrum Licences
Costs incurred on the acquisition of spectrum licences are amortised from the date the underlying asset is held ready for use on a straight-line basis over the period of their expected benefit, which does not exceed fifteen years.

Debt
Debt is stated at face value less unamortised discounts, premiums and prepaid interest. Discounts, premiums and prepaid interest are amortised to interest expense on a yield to maturity basis over the period of the borrowing. Borrowing costs such as origination, commitment and transaction fees are deferred and amortised over the period of the borrowing.

Compensated Absences
The liability for employees' compensation for future absences, calculated on an actuarial basis, is accrued in respect of employees' services already rendered and where the obligation relates to rights that may eventually vest.

Research and Development Costs
Research and development costs are charged to earnings as incurred, except where, in the case of development costs, future benefits are expected beyond any reasonable doubt to exceed these costs. Where development costs are deferred, they are amortised over future periods on a basis related to the expected future benefits.

Taxation
The taxation expense charged to earnings includes both current and deferred tax and is calculated after allowing for permanent differences.

Deferred taxation calculated on a partial basis using the liability method is accounted for on timing differences between the earnings stated in the financial statements and the assessable income computed for taxation purposes. Deferred taxation is recognised only on those timing differences that are expected to crystallise within the foreseeable future.

Foreign Currency

Transactions
Transactions denominated in a foreign currency are converted at the New Zealand exchange rate at the date of the transaction. Foreign currency receivables and payables at balance date are translated at exchange rates current at balance date. Exchange differences arising on the translation of accounts payable and receivable in foreign currencies are recognised in the Statement of Financial Performance.

Exchange gains and losses and hedging costs arising on contracts entered into as hedges of firm commitments are deferred until the date of such transactions at which time they are included in the determination of net earnings.

Where capital project commitments are hedged against foreign currency rate risk, the exchange difference on the hedging transaction up to the date of purchase and all other costs associated with the hedging transaction are capitalised.

All exchange gains and losses relating to other hedge transactions are brought to account in the Statement of Financial Performance in the same period as the exchange differences on the items covered by the hedge transactions. Costs on such contracts are amortised over the life of the hedge contract.

Translation of Foreign Group Entities
Assets and liabilities of independent overseas subsidiaries are translated at exchange rates existing at balance date. The revenues and expenses of these entities are translated at rates approximating the exchange rates ruling at the dates of the transactions. The exchange gain or loss arising on translation is carried directly to a foreign currency translation reserve.

Derivative Financial Instruments
Telecom uses derivative financial instruments to reduce its exposure to fluctuations in foreign currency exchange rates and interest rates.

Telecom does not currently hold or issue derivative financial instruments for trading purposes. Gains and losses on derivatives are accounted for on the same basis as the underlying physical exposures. Accordingly, hedge gains and losses are included in the Statement of Financial Performance when the gains or losses arising on the related physical exposures are recognised in the Statement of Financial Performance.

NOTE 1 **Statement of Accounting Policies** (continued)

For an instrument to qualify as a hedge, it must be effective at reducing the risk associated with the exposure being hedged and must be designated as a hedge at the inception of the contract.

Derivative financial instruments that do not qualify or no longer qualify as hedges are stated at market values and any resultant gain or loss is recognised in the Statement of Financial Performance.

Interest rate swaps and cross currency interest rate swaps that hedge an underlying physical exposure are accounted for using the accrual method of accounting. Interest receivable and payable under the terms of the interest rate swaps and cross currency interest rate swaps are accrued over the period to which the payments or receipts relate, and are treated as an adjustment to interest expense or capital note distribution costs.

The foreign exchange gains and losses on the principal value of cross currency swaps are reflected in the Statement of Financial Performance using the spot rate which offsets the foreign exchange gains and losses recorded on the underlying hedged transaction.

Premiums paid for interest rate options and the net settlement on maturity of forward rate agreements are amortised over the life of the underlying hedged item.

Forward exchange contracts are accounted for as outlined in the accounting policy for foreign currency transactions.

Cash flows from derivatives are recognised in the Statement of Cash Flows in the same category as that of the hedged item.

Cash and Cash Equivalents

For the purposes of the Statement of Cash Flows, cash and cash equivalents are considered to be cash on hand and in banks, net of bank overdrafts. Cash flows from certain items are disclosed net, due to the short-term maturities and volume of transactions involved.

Earnings Per Share

Earnings per share is computed by dividing net earnings by the weighted average number of ordinary shares outstanding during each period.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Annual Balance Date Change

Effective 1 April 1999, the Company changed its annual balance date from 31 March to 30 June. These financial statements include the transition period result for the three months ended 30 June 1999.

Reclassifications

Certain reclassifications of prior periods' data have been made to conform to current year classifications.

Changes in Accounting Policies

The accounting policies used in the preparation of the financial statements for the year ended 30 June 2000 are consistent with those used in the preparation of the published financial statements for the three month transition period ended 30 June 1999 and the year ended 31 March 1999.

NOTE 2 **CALLING AND OTHER OPERATING REVENUES**

	Telecom Group			
	Year ended 31 March		Three months ended 30 June	Year ended 30 June
	1998	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$
Calling				
National	732	709	171	932
International	450	400	88	506
Other	60	52	11	50
	1,242	**1,161**	**270**	**1,488**
Other operating revenues				
Directories	147	160	19	176
Equipment revenue	144	109	28	84
Miscellaneous other services	48	55	19	177
	339	**324**	**66**	**437**

Parent Company

Operating revenues principally comprise dividends received from subsidiary companies.

NOTE 3 **OPERATING EXPENSES**

Labour

Included in labour costs are pension contributions of $3 million to the Government Superannuation Fund (30 June 1999: $1 million, 31 March 1999: $4 million, 31 March 1998: $5 million) and $5 million on behalf of Australian employees as required by the Superannuation Guarantee (Administration) Act 1992. Telecom has no other obligations to provide pension benefits in respect of present employees. Telecom currently pays administration and management fees, insurance premiums and other expenses incurred with respect to employees' membership of the Telecom Retirement Savings Plan, but only members contribute to that plan.

	Telecom Group			
	Year ended 31 March		Three months ended 30 June	Year ended 30 June
	1998	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$
Other Operating Expenses				
Other operating expenses include:				
Lease and rental costs	35	33	8	42
Research and development costs	6	10	1	5
Foreign exchange (gains)/losses	(4)	1	–	(4)
Goodwill amortised	4	7	2	43
Bad debts written off	33	25	5	40
Increase in provision for doubtful accounts	1	2	–	7
Provision for inventory obsolescence	2	2	–	2
Loss on disposal of fixed assets	4	5	–	7
Auditors' remuneration:				
Audit fees paid to principal auditors	1	1	–	1
Fees paid for other services provided by principal auditors	3	3	1	3
Directors' fees	1	1	–	1

NOTE 4 **ABNORMAL ITEMS**

	Telecom Group			
	Year ended 31 March		Three months ended 30 June	Year ended 30 June
	1998	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$
Abnormal Revenues				
Sale of AAPT Sat-Tel Pty Limited	–	–	–	15
Cross border lease	–	–	15	–
Liquidation of the Executive Share Ownership Plan	–	16	–	–
	–	**16**	**15**	**15**
Abnormal Expenses				
Onerous contract buy-out costs	–	–	22	–
Restructuring costs	–	15	–	–
Discontinuance of HFC roll-out & closure of First Media Limited	37	–	–	–
	37	**15**	**22**	**–**

Abnormal Revenues

Sale of AAPT Sat-Tel Pty Limited

In March 2000, AAPT Limited ("AAPT") completed the sale of its wholly owned subsidiary AAPT Sat-Tel Pty Limited to New Skies Networks Australia Pty Limited. Included in the Consolidated Statement of Financial Performance are post acquisition profits relating to this sale, before minority interests, of $15 million.

Cross Border Lease

During the three months ended 30 June 1999, a gain of $15 million was recognised on the prepayment of Telecom's scheduled payment obligations relating to a cross border finance lease.

Liquidation of the Executive Share Ownership Plan (the "Executive Plan")

The liquidation of the Executive Plan was completed in March 1999. The Trustee of the Executive Plan had disposed of the 1.9 million unallocated shares held on trust and remitted the net proceeds to Telecom as the residuary beneficiary. The net proceeds received were $16 million.

Abnormal Expenses

Onerous Contract Buy-out Costs

During the three months ended 30 June 1999, the costs of buying out the terms of certain onerous contracts were identified and provided for. The contracts were onerous as the unavoidable costs of meeting the contractual obligations exceeded their economic benefits.

NOTE 4 **Abnormal Items** (continued)

Restructuring
During the year ended 31 March 1999, Telecom reached an agreement with specialist call centre operator SITEL Asia Pacific to contract out the provision of operator services. The decision to outsource operator services resulted in approximately 560 redundancies at a cost of $15 million.

Discontinuance of HFC Roll-out & Closure of First Media Limited ("First Media")
During the year ended 31 March 1998, Telecom identified and provided for the estimated costs associated with the termination of the residential hybrid fibre/coax cable roll-out and the closure of First Media, a cable television operator.

NOTE 5 INVESTMENT INCOME/INTEREST EXPENSE

	Telecom Group			
	Year ended 31 March		Three months ended 30 June	Year ended 30 June
	1998	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$
Investment income:				
Interest received	25	45	11	34
Dividends received	3	4	1	4
Total investment income	**28**	**49**	**12**	**38**
Interest expense:				
Fixed loans	113	110	23	108
Finance leases	6	5	1	2
Other interest	50	53	13	126
	169	168	37	236
Less interest capitalised	(14)	(9)	(3)	(18)
Total interest expense	**155**	**159**	**34**	**218**

Parent Company
Investment income and interest expense comprise interest received from and paid to subsidiary companies.

NOTE 6 INCOME TAX

The income tax expense/(credit) is determined as follows:

	Telecom Group				Parent Company		
	Year ended 31 March		Three months ended 30 June	Year ended 30 June	Year ended 31 March	Three months ended 30 June	Year ended 30 June
	1998	1999	1999	2000	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$	NZ$	NZ$	NZ$
Surplus from continuing operations before income tax	1,213	1,290	320	1,246	647	159	672
Tax at current rate of 33%	400	426	106	411	214	52	222
Adjustments to taxation for permanent differences:							
Intercompany dividends	–	–	–	–	(266)	(67)	(267)
Other	(3)	(15)	(8)	(16)	–	–	(5)
Total income tax expense/(credit)	**397**	**411**	**98**	**395**	**(52)**	**(15)**	**(50)**
The income tax expense/(credit) is represented by:							
Current taxation	399	388	99	348	(52)	(15)	(50)
Deferred taxation	(2)	23	(1)	47	–	–	–
	397	411	98	395	(52)	(15)	(50)
Deferred income tax expense/(credit) results from the following:							
Depreciation	15	9	(1)	32	–	–	–
Provisions, accruals and other	(36)	7	(5)	(1)	–	–	–
Year 2000 expenditure	4	3	2	8	–	–	–
Tax losses in overseas subsidiary company	–	–	–	1	–	–	–
Restructuring provisions	15	4	3	7	–	–	–
	(2)	23	(1)	47	–	–	–

NOTE 6 **Income Tax** (continued)

The Statement of Financial Position balances are:

	Telecom Group			Parent Company		
	31 March	30 June		31 March	30 June	
	1999	1999	2000	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$	NZ$	NZ$
Current taxation:						
Balance at the beginning of the year	17	71	(23)	1	1	65
Total taxation (expense)/credit in the current year	(388)	(99)	(348)	52	15	50
Tax benefit of capital note distribution costs	28	7	27	–	–	–
Tax paid/(refunded)	304	(51)	311	–	–	–
Supplementary dividend tax credit						
– previous year fourth quarter interim and special	27	26	–	27	26	–
– first, second and third quarter interims	78	–	75	78	–	75
– transition period interim	–	25	–	–	25	–
Tax loss offset with subsidiary companies	–	–	–	(52)	–	(59)
Supplementary dividend tax credit offset with subsidiary companies	–	–	–	(105)	–	(126)
Transfer from deferred taxation	–	–	(18)	–	–	–
Other	5	(2)	(1)	–	(2)	1
Prepaid income tax/(income tax payable) (see Notes 9 and 14)	71	(23)	23	1	65	6
Deferred taxation:						
Balance at the beginning of the year	23	–	(25)	27	26	–
Provided in the current year	(23)	1	(47)	–	–	–
Supplementary dividend tax credit						
– previous year fourth quarter interim and special	(27)	(26)	–	(27)	(26)	–
– current year fourth quarter interim	26	–	25	26	–	25
Transfer to current taxation	–	–	18	–	–	–
Balance on acquisition of subsidiary company	–	–	14	–	–	–
Other	1	–	2	–	–	–
(Deferred taxation)/future tax benefit	**–**	**(25)**	**(13)**	**26**	**–**	**25**
Deferred taxation balances consist of the following:						
Depreciation	(93)	(92)	(128)	–	–	–
Provisions, accruals and other	34	39	45	–	–	–
Year 2000 expenditure	21	19	11	–	–	–
Restructuring provisions	12	9	2	–	–	–
Tax losses in overseas subsidiary company	–	–	32	–	–	–
Supplementary dividend tax credit	26	–	25	26	–	25
	–	(25)	(13)	26	–	25

At 30 June 2000, a deferred tax asset of $7 million (30 June 1999: $6 million, 31 March 1999: $6 million), in respect of timing differences relating to depreciation on buildings, has not been recognised.

In accordance with the Income Tax Act 1994, Telecom received tax credits from the Inland Revenue Department equivalent to the supplementary dividends paid. Included as a deferred tax asset is $25 million representing a tax credit due on the payment of supplementary dividends that will be paid in conjunction with the fourth quarter dividend.

AAPT has not recognised in its deferred taxation balance the tax effect of accumulated losses amounting to A$7 million (based on the Australian corporation tax rate of 34%). Obtaining the benefits of these tax losses is dependent upon deriving sufficient assessable income, meeting conditions for deductibility and complying with Australian tax legislation.

NOTE 7 DISCONTINUED OPERATIONS

Telecom announced on 22 July 1996 that it was reviewing the operations of those of its Australian subsidiaries which formed the Pacific Star Group ("Pacific Star") at which time a formal plan of disposal or wind-down of the Pacific Star businesses was approved by the Board.

The winding down of Pacific Star operations progressed satisfactorily resulting in a reduction in the provision for loss on disposal of Pacific Star by $30 million at 31 March 1998. The process of winding down the discontinued Pacific Star operations was completed during the year ended 30 June 2000.

NOTE 8 SHORT–TERM INVESTMENTS

	Telecom Group		
	31 March	30 June	
	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$
Short-term deposits	47	55	301
Government securities	15	3	9
Other money market securities	611	56	50
Associate company advance (see Note 22)	–	–	257
	673	**114**	**617**

NOTE 9 RECEIVABLES AND PREPAYMENTS

	Telecom Group		
	31 March	30 June	
	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$
Trade receivables	499	515	742
Less allowance for doubtful accounts	(22)	(23)	(57)
	477	492	685
Unbilled rentals and tolls	163	119	159
Prepaid income tax (see Note 6)	71	–	23
Prepaid expenses and other receivables	43	80	51
	754	**691**	**918**

NOTE 10 INVENTORIES

	Telecom Group		
	31 March	30 June	
	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$
Maintenance materials and consumables	7	5	–
Goods held for resale	11	11	16
Revenue work in progress	14	20	14
Materials for self-constructed assets	21	23	24
	53	59	54
Less provision for inventory obsolescence	(11)	(11)	(14)
	42	**48**	**40**

NOTE 11 **LONG–TERM INVESTMENTS**

	Telecom Group			Parent Company		
	31 March	30 June		31 March	30 June	
	1999	1999	2000	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$	NZ$	NZ$
Term deposits	26	26	34	–	–	–
International telecommunications investments	21	21	21	–	–	–
Associate companies:						
Investments (refer below)	–	(7)	30	–	–	–
Advances	–	104	158	–	–	–
Shares in listed companies	–	386	166	–	–	166
Other long-term investments	–	–	46	–	–	–
Subsidiary companies (see Note 23):						
Shares	–	–	–	2,324	2,814	3,156
Term loans, net	–	–	–	1,506	567	1,711
	47	**530**	**455**	**3,830**	**3,381**	**5,033**

Associate Company Investments

	Telecom Group		
	31 March	30 June	
	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$
Cost of investment in associates	–	–	45
Opening balance of share of associates' equity	–	–	(7)
Share of associates' deficit	–	(7)	(6)
Net exchange difference on translation of associate	–	–	(2)
Equity accounted value of the investment	–	(7)	30

Shares in Listed Companies

During the year ended 30 June 2000, Telecom purchased a 10% stake in Independent Newspapers Limited ("INL") and a 2% stake in eVentures Limited ("eVentures"). At 30 June 2000 the market values of Telecom's investments in INL and eVentures were $155 million and $3 million respectively.

During the three months ended 30 June 1999, Telecom purchased a 19.7% stake in AAPT. At 30 June 1999 the market value of Telecom's investment in AAPT was NZ$337 million. On 27 November 1999 Telecom purchased an additional 61.7% shareholding in AAPT, bringing the total shareholding at that date to 81.4%.

NOTE 12 **INTANGIBLES**

	Telecom Group		
	31 March	30 June	
	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$
Goodwill	58	56	1,469
Spectrum licences	–	–	151
	58	**56**	**1,620**

NOTE 13 **FIXED ASSETS**

	Telecom Group					
	Tele-communications equipment	Capital work in progress	Freehold land	Buildings	Other fixed assets	TOTAL
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$	NZ$	NZ$
Cost	7,554	398	111	525	830	9,418
Less accumulated depreciation	(4,288)	–	–	(243)	(637)	(5,168)
Net book value at 30 June 2000	**3,266**	**398**	**111**	**282**	**193**	**4,250**
Cost	6,798	184	112	517	892	8,503
Less accumulated depreciation	(3,837)	–	–	(225)	(667)	(4,729)
Net book value at 30 June 1999	**2,961**	**184**	**112**	**292**	**225**	**3,774**
Cost	6,693	187	111	516	878	8,385
Less accumulated depreciation	(3,737)	–	–	(222)	(646)	(4,605)
Net book value at 31 March 1999	**2,956**	**187**	**111**	**294**	**232**	**3,780**

Values Ascribed to Land and Buildings

Telecom's properties consist primarily of special-purpose network buildings, which form an integral part of the telecommunications network. The Directors estimate that the fair valuation of land and buildings (excluding properties designated for disposal) is approximately equivalent to their net book value as at 30 June 2000, taking into account their integral value to the network.

Included in land and buildings at 30 June 2000 are properties held for sale at their estimated realisable value of $11 million (30 June 1999: $13 million, 31 March 1999: $12 million).

Operating Leases

Included in telecommunications equipment at 30 June 2000 is equipment (principally customer premises equipment) leased to customers under operating leases with a cost of $303 million (30 June 1999: $284 million, 31 March 1999: $282 million) together with accumulated depreciation of $272 million (30 June 1999: $262 million, 31 March 1999: $260 million).

Included in buildings at 30 June 2000 are buildings on leasehold land with a cost of $11 million (30 June 1999: $9 million, 31 March 1999: $9 million) together with accumulated depreciation of $2 million (30 June 1999: $2 million, 31 March 1999: $2 million).

Finance Leases

Included in telecommunications equipment at 30 June 2000 are assets capitalised under finance leases with a cost of $541 million (30 June 1999: $576 million, 31 March 1999: $287 million) together with accumulated depreciation of $391 million (30 June 1999: $376 million, 31 March 1999: $204 million).

Land Claims

Under the Treaty of Waitangi Act 1975, all interests in land included in the assets purchased from the New Zealand Government may be subject to claims to the Waitangi Tribunal, which has the power to recommend, in appropriate circumstances, with binding effect, that the land be resumed by the Government in order that it be returned to Maori claimants. In the event that the Government resumes land, compensation will be paid to Telecom under the provisions of the Public Works Act 1981. If this is insufficient to cover the loss, certain additional compensation is payable under the provisions of the Sale and Purchase Agreement between the Company and the Government.

Under the State Owned Enterprises Act 1986, the Governor General of New Zealand, if satisfied that any land or interest in land held by Telecom is Wahi Tapu (being land of special spiritual, cultural or historical tribal significance), may declare by Order in Council that the land be resumed by the Government, with compensation payable to Telecom under the provisions of the Public Works Act 1981. Telecom would expect to negotiate with the new Maori owners for continued occupancy rights of any sites resumed by the Government.

NOTE 14 ACCOUNTS PAYABLE AND ACCRUALS

	Telecom Group		
	31 March	30 June	
	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$
Trade accounts payable	502	520	969
Accrued personnel costs	69	60	66
Rentals billed in advance	56	55	64
Accrued interest	60	75	91
Income tax payable (see Note 6)	–	23	–
Other accrued expenses	114	88	52
	801	**821**	**1,242**

Parent Company

Accounts payable and accruals comprise non-resident withholding tax and other sundry payable balances.

NOTE 15 PROVISIONS – ONEROUS CONTRACTS, RESTRUCTURING AND YEAR 2000

	Telecom Group		
	31 March	30 June	
	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$
Current:			
Onerous contracts provision	–	22	8
Restructuring provisions	34	25	3
Year 2000 provision	24	17	–
	58	**64**	**11**
Non-current:			
Restructuring provisions	**3**	**3**	**3**

Onerous Contracts

During the three months ended 30 June 1999, estimated costs of $22 million to buy-out the terms of certain onerous contracts were identified and provided for. During the year ended 30 June 2000 costs of $14 million were charged against this provision.

Restructuring

A strategic restructuring of Telecom was announced towards the end of the 1993 financial year. It was estimated that the cost of implementing this restructuring would be $450 million. This was provided for in the fourth quarter earnings of the year ended 31 March 1993 as an abnormal restructuring cost. During the year ended 30 June 2000, costs of $5 million were charged against this provision. As at 30 June 2000, the balance of this provision was $6 million (30 June 1999: $11 million, 31 March 1999: $12 million), the majority of which relates to expected losses on disposal of surplus freehold properties.

A strategic restructuring, aimed at improving service and reducing operating costs, was finalised in the fourth quarter of the 1997 financial year. In addition, restructuring costs arising out of the Performance 2000 project, aimed at substantially reducing Telecom's operating costs, had been identified as at 31 March 1997. All of these restructuring costs, amounting to $65 million, were provided for in the fourth quarter results of the year ended 31 March 1997. During the year ended 30 June 2000, redundancy and other restructuring costs of $17 million were charged against this provision. As at 30 June 2000, the balance of this provision was nil (30 June 1999: $17 million, 31 March 1999: $18 million).

Redundancy costs of $15 million resulting from the outsourcing of operator services were identified and provided for during the year ended 31 March 1999. The remaining balance of this provision (31 March 1999: $7 million) was paid out during the three months to 30 June 1999.

Year 2000

The operating costs of making the modifications necessary to maintain functionality into the year 2000 and beyond was estimated at $87 million and a provision raised at 31 March 1997. This provision had been fully utilised by 30 June 2000.

NOTE 16 DEBT DUE WITHIN ONE YEAR

	Telecom Group		
	31 March	30 June	
	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$
Long-term debt maturing within one year (see Note 17):			
Bonds and other loans	159	229	130
Finance leases	18	18	58
	177	247	188
Short-term debt:			
Commercial paper	692	545	789
Notes	260	263	485
Other loans	1	9	–
	953	817	1,274
	1,130	**1,064**	**1,462**

The weighted average interest rates at 30 June 2000 (inclusive of the effects of hedging) were 6.20% for commercial paper and 6.73% for notes (30 June 1999: 4.56% and 4.65%, 31 March 1999: 4.45% and 4.33% respectively).

Commercial paper comprises amounts issued under Telecom's US$750 million European Commercial Paper Programme and Telecom's $200 million Asian Commercial Paper Programme. Issues outstanding at 30 June 2000 are denominated in NZ dollars, US dollars, Swiss francs and Euros and are stated inclusive of the effect of hedging transactions.

Notes comprise amounts issued under Telecom's $500 million note facility.

As at 30 June 2000 Telecom had a committed stand-by credit facility of $1,600 million with the major New Zealand trading banks (this facility was cancelled on 31 July 2000), and access to US$200 million of committed short-term funding through a standby facility. Telecom also had committed overdraft facilities of $20 million with New Zealand banks. In addition AAPT had access to an undrawn committed facility with a major Australian trading bank of A$60 million at 30 June 2000. There are no material compensating balance requirements associated with these facilities.

NOTE 17 LONG–TERM DEBT

	Telecom Group		
	31 March	30 June	
	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$
TeleBonds	401	364	387
Eurobonds	655	655	480
Euro Medium Term Notes	–	–	1,650
Swiss franc issue	150	150	150
Finance leases (see Note 20)	90	87	81
Bank facility	–	–	309
Other loans	6	6	6
	1,302	1,262	3,063
Less unamortised discount	(13)	(12)	(14)
	1,289	1,250	3,049
Less long-term debt maturing within one year (see Note 16)	(177)	(247)	(188)
	1,112	**1,003**	**2,861**
Schedule of Maturities*:			
Due 1 to 2 years (7.58%)	253	177	908
Due 2 to 3 years (8.52%)	221	209	269
Due 3 to 4 years (7.71%)	93	223	137
Due 4 to 5 years (7.90%)	239	89	769
Due over 5 years (8.12%)	306	305	778
Total due after one year (7.85%)	1,112	1,003	2,861

(weighted average effective interest rate for Telecom Group – includes the effect of hedging transactions, see Note 19)*

NOTE 17 **Long–term Debt** (continued)

TeleBonds

TCNZ Finance Limited, a subsidiary of the Company, offers bonds ("TeleBonds") to institutional and retail investors. These are issued as income, compounding, or zero coupon bonds and are offered on a continuous basis for a term of from one to fifteen years as stipulated by the investor. The interest or discount rate on offer, as the case may be, is generally adjusted relative to Government debt securities and, upon issue of the TeleBonds, is fixed for the period of the investment.

TeleBonds have interest rates ranging from 5.9% to 10.3% and maturity dates between October 2000 and April 2015.

Eurobonds

Eurobonds are issued by TCNZ Finance Limited and have the following interest rates and maturity dates:

	Telecom Group		
	31 March	30 June	
	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$
7.5% due 19 September 1999	100	100	–
9.5% due 3 April 2000	75	75	–
6.5% due 29 September 2000	69	69	69
6.5% due 11 October 2001	113	113	113
9.25% due 1 July 2002	66	66	66
7.5% due 14 July 2003	82	82	82
6.75% due 11 October 2005	150	150	150
	655	655	480

Eurobond issues with maturities of 11 October 2001 and 2005 are denominated in US dollars. Cross currency and interest rate swaps have been entered into to manage the currency and interest rate risk exposure. The effective NZ dollar interest rates for these issues are 8.53% and 8.44% respectively. All other issues are denominated in NZ dollars.

Euro Medium Term Notes

TCNZ Finance Limited launched a US$1 billion Euro Medium Term Notes ("EMTN") programme in March 2000. Both public debt transactions and private placements can be issued under the programme.

	Telecom Group		
	31 March	30 June	
	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$
5.5% due 19 April 2005	–	–	769
1.85% due 5 June 2007	–	–	412
Various private placements	–	–	469
	–	–	1,650

The EMTN with maturities of 19 April 2005 and 5 June 2007 are denominated in Euro and Yen respectively. The private placements are denominated in Yen and have interest rates ranging from 0.5% to 2.0% with maturity dates ranging from 14 March 2002 to 8 June 2009. Cross currency and interest rate swaps have been entered into to manage the currency and interest rate risk exposures. The effective NZ dollar interest rates for the EMTN range from 8.28% to 8.93%.

Swiss Franc Issue

A Swiss franc bond has been issued by TCNZ Finance Limited with the following interest rate and maturity date:

	Telecom Group		
	31 March	30 June	
	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$
3.25% due 27 May 2003	150	150	150

Cross currency and interest rate swaps have been entered into to manage the currency and interest rate risk exposure. The effective NZ dollar interest rate for this issue is 8.07%.

NOTE 17 **Long-term Debt** (continued)

Finance Lease Obligations

	Telecom Group		
	31 March	30 June	
	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$
Finance lease obligations are denominated in the following currencies:			
NZ dollars	63	60	47
Japanese yen	27	27	34
	90	87	81

Finance lease obligations have interest rates ranging from 1.64% to 9.7%.

Included in long-term investments (see Note 11) are Japanese yen deposits amounting to $34 million (30 June 1999: $26 million, 31 March 1999: $26 million) which effectively hedge a substantial proportion of the finance lease obligations denominated in Japanese yen as noted above. The deposits have the same maturities as the finance lease obligations they are hedging, and interest rates that range from 3.68% to 4.29%.

Bank Facility

AAPT has access to an A$300 million committed bank facility. At 30 June 2000 it had drawn down A$240 million under this facility. Interest rate swaps amounting to A$30 million have been entered into to partially hedge the interest rate exposure on this facility. The effective interest rate of the bank facility (inclusive of hedging) is 6.8%. The maturity date of the bank facility is November 2001.

Other Loans

Other loans have interest rates ranging from 1.0% to 5.72% and maturity dates between January 2002 and December 2006.

NOTE 18 CAPITAL FUNDS

Kiwi Share

A special rights convertible preference share (the "Kiwi Share") was created on 11 September 1990 and is registered in the name of, and may only be held by, the Minister of Finance on behalf of the Crown. The consent of the holder of the Kiwi Share is required for the amendment, removal or alteration of the effect of certain provisions of the Company's Constitution which was adopted upon re-registration on 27 September 1996 under the Companies Act 1993.

The Company's Constitution also contains provisions that require Telecom to observe certain principles relating to the provision of telephone services and their prices, and that require the consent of the holder of the Kiwi Share and the Board of Telecom for a person to become the holder of an interest in 10% or more of the voting shares in Telecom.

The holder of the Kiwi Share is not entitled to vote at any meetings of the Company's shareholders nor participate in the capital or profits of the Company, except for repayment of $1 of capital upon a winding up. The Kiwi Share may be converted to an ordinary share at any time by the holder thereof, at which time all rights and powers attached to the Kiwi Share will cease to have any application.

Contributed Capital

Movements in the Company's issued ordinary shares were as follows:

	Year ended 31 March 1999	Three months ended 30 June 1999	Year ended 30 June 2000
	Number	Number	Number
At the beginning of the period	1,751,976,069	1,752,801,986	1,752,801,986
Issue of new shares upon exercise of options	825,917	–	668,316
Shares issued under the Dividend Reinvestment Plan	–	–	1,943,141
At the end of the period	1,752,801,986	1,752,801,986	1,755,413,443

Each of the ordinary shares confers on the holder the right to vote at any general meeting of the Company except that the Company's Constitution provides for certain restrictions on voting, including where a holder holds more than 10% of the ordinary shares in breach of shareholding limitations.

Share Repurchase

In February 1997, Telecom began a flexible programme of share repurchases subject to the detailed procedures and disclosure requirements of the Companies Act 1993 and the requirements of the New Zealand Stock Exchange. The repurchase programme was completed on 19 December 1997. A total of 138,093,860 shares were repurchased under the programme at a total cost of $1,001 million.

Capital Notes

TCNZ Finance Limited ("the Issuer"), Telecom's main financing subsidiary, has issued long-term fixed interest unsecured subordinated capital notes ("TeleNotes").

An initial issue was completed in May 1997 in the New Zealand market for an aggregate principal amount of face value $275 million. The TeleNotes were issued for an initial term of approximately seven years and with a fixed coupon of 8.5%. A second issue to the institutional market was made in August 1997 for an aggregate principal amount of face value $150 million for an initial term of approximately nine years and with a fixed coupon of 7.5%. At the end of the initial term, investors are offered the option of continuing to hold the TeleNotes at a new yield and for a term set by the Issuer. In the event that the investors do not accept the new terms of the TeleNotes they may elect to have their notes redeemed.

The Issuer can, at its sole discretion, redeem the TeleNotes including any unpaid interest for cash or redeem the TeleNotes including any unpaid interest by subscribing for and procuring the issue of ordinary shares in the Company to the noteholders at a price equivalent to 90% of the average closing price of the Company's shares in the 10 business days preceding the election date.

In February 1998, Telecom New Zealand Finance Limited, a Telecom financing subsidiary, issued to certain qualified institutional buyers in the United States of America, under an Offering Memorandum pursuant to US SEC Rule 144A, an aggregate principal amount of face value US$150 million 6.25% Restricted Capital Securities and US$150 million 6.5% Restricted Capital Securities for an initial term of five and ten years respectively. Telecom has entered into currency swaps to remove the exposure to exchange rate fluctuations that would otherwise result from the issue of US Capital Securities. The effective cost of the US Capital Securities reflects the results of these currency swaps and related New Zealand interest rate swaps. The Restricted Capital Securities rank pari passu with the TeleNotes issued in New Zealand and are similar in all material respects.

The proceeds of the capital notes issues were used to effect the share repurchase programme.

Foreign Currency Translation Reserve

Movements in Telecom's foreign currency translation reserve are reconciled below:

	Telecom Group			
	Year ended 31 March		Three months ended 30 June	Year ended 30 June
	1998	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$
Balance at the beginning of the period	(1)	–	–	1
Net exchange difference on translation of independent overseas subsidiaries	1	–	11	53
Net exchange difference on translation of overseas associate company	–	–	–	2
Hedge of net investment in an independent overseas subsidiary	–	–	(10)	(7)
	1	–	1	48
Balance at the end of the period	–	–	1	49

Telecom Share Options

Telecom (excluding AAPT) operates an executive share option scheme whereby certain key executives are granted a number of options to purchase ordinary shares in the Company. Each option will convert to one ordinary share on exercise (provision is made for adjustment in certain circumstances). A participant may exercise his or her options (subject to employment conditions) any time during a prescribed period commencing at least one year from the date on which the options are conferred. New ordinary shares will be issued in accordance with the Constitution upon the exercise of options. The price payable on exercise will be equivalent to the average daily closing price of Telecom shares reported on the New Zealand Stock Exchange for the 10 business days on which shares are traded immediately preceding the date on which options are granted (subject to adjustment if the shares traded "cum dividend"). The options granted are determined by a committee of the Board of Directors pursuant to the executive share option scheme.

NOTE 18 **Capital Funds** (continued)

Information regarding options granted under the executive share option scheme is as follows:

	Option price* NZ$	Number of options
As at 31 March 1997	5.83	1,467,718
Granted	7.13	1,473,447
Exercised	6.28	(264,992)
Lapsed due to resignation	6.86	(53,685)
As at 31 March 1998	6.49	2,622,488
Granted	8.49	3,022,401
Exercised	6.65	(825,917)
Lapsed due to resignation	8.37	(186,087)
Forfeited	8.54	(999,284)
As at 31 March 1999	7.46	3,633,601
Granted	8.12	3,954,194
Lapsed due to resignation	8.54	(32,239)
As at 30 June 1999	7.80	7,555,556
Granted	8.39	487,894
Exercised	6.16	(668,316)
Lapsed due to resignation	8.15	(641,059)
As at 30 June 2000	7.97	6,734,075

	Options outstanding				Options currently exercisable	
Period Granted	Options outstanding	Price range NZ$	Price * NZ$	Remaining life* (years)	Options exercisable	Price * NZ$
1 April 1995 – 31 March 1996	372,415	5.71	5.71	1.0	372,415	5.71
1 April 1996 – 31 March 1997	135,951	6.01 – 6.98	6.67	2.0	135,951	6.67
1 April 1997 – 31 March 1998	764,040	6.85 – 8.42	7.38	2.9	764,040	7.38
1 April 1998 – 31 March 1999	1,610,000	7.85 – 9.17	8.46	3.6	1,610,000	8.46
1 April 1999 – 30 June 1999	3,363,775	8.12	8.12	4.4	2,179,791	8.12
1 July 1999 – 30 June 2000	487,894	7.87 – 8.80	8.39	5.3	–	–
	6,734,075				5,062,197	

** Weighted average*

AAPT Share Options

AAPT Limited operates an executive and employee share option plan whereby AAPT executives and employees are granted a number of options to purchase AAPT ordinary shares. Each option is convertible to one ordinary AAPT Limited fully paid share. Participants may exercise their options as follows:

- Up to 50% of the options, between two and five years of the grant date;
- Up to a further 25% of the options, between three and five years of the grant date; and
- Up to the remaining 25% of the options, between four and five years of the grant date.

New ordinary shares will be issued in accordance with AAPT's Constitution upon the exercise of the options. The exercise price is determined by the weighted average of the price at which AAPT's shares were traded on the Australian Stock Exchange during the week before the options were granted. The options granted are determined by AAPT's Board pursuant to the executive and employee share option scheme.

Information regarding options granted under the AAPT executive and employee share option plan is as follows:

	Option price* A$	Number of options
As at 27 November 1999	2.15	11,250,000
Granted	5.42	5,524,000
Exercised	2.77	(5,422,475)
Lapsed due to resignation	4.86	(198,400)
As at 30 June 2000	3.62	11,153,125

NOTE 18 **Capital Funds** (continued)

Period Granted	Options outstanding	Price range A$	Price * A$	Remaining life* (years)	Options currently exercisable	Price * A$
	Options outstanding				Options exercisable	
1 July 1997 – 30 June 1998	3,061,500	0.30 – 3.21	0.89	2.2	3,061,500	0.89
1 July 1998 – 30 June 1999	2,342,625	2.68 – 4.59	3.59	3.7	2,342,625	3.59
1 July 1999 – 27 November 1999	360,000	4.75	4.75	4.1	360,000	4.75
28 November 1999 – 30 June 2000	5,389,000	4.83 – 6.45	5.42	4.8	–	–
	11,153,125				5,764,125	

** Weighted average*

Dividends

Dividends declared and provided by the Company are as follows:

	Year ended 31 March		Three months ended 30 June	Year ended 30 June
	1998	1999	1999	2000
(Dollars in millions, except per share amounts)	NZ$	NZ$	NZ$	NZ$
First quarter dividend paid	186	201	–	201
Supplementary dividend	26	26	–	25
Second quarter dividend paid	185	201	–	201
Supplementary dividend	25	26	–	25
Third quarter dividend paid	184	202	–	202
Supplementary dividend	25	26	–	25
Third quarter special dividend provided	61	–	–	–
Supplementary dividend	8	–	–	–
Fourth quarter dividend provided	140	202	–	202
Supplementary dividend	19	26	–	25
Transition period dividend provided	–	–	202	–
Supplementary dividend	–	–	25	–
Total dividends	859	910	227	906
Dividends per share (excluding supplementary dividends)	43.0 cents	46.0 cents	11.5 cents	46.0 cents

Total dividends for the year ended 30 June 2000 represented four quarterly dividends of 11.5 cents per share. In addition, and in accordance with the Income Tax Act 1994, supplementary dividends totalling $75 million were paid with the first three quarterly dividends to shareholders who are not resident in New Zealand, for which Telecom received an equivalent tax credit from the Inland Revenue Department. Supplementary dividends of $25 million have been provided for which will be payable with the fourth quarter dividend.

Shares Issued in Lieu of Dividends

Telecom established a Dividend Reinvestment Plan effective from the third quarter of the year ended 30 June 2000. Under the plan shareholders can elect to receive dividends in cash or additional shares. In respect of the 31 March 2000 quarterly dividend 1,943,141 shares, with a total value of $15 million, were issued in lieu of a cash dividend.

NOTE 19 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Interest Rate and Currency Risk

Telecom employs the use of derivative financial instruments for the purpose of reducing its exposure to fluctuations in interest rates and foreign exchange rates. Telecom effectively monitors the use of derivative financial instruments through the use of well-defined market and credit risk limits and timely reports to senior management.

The majority of Telecom's long-term debt has been, and is currently, subject to fixed interest rates. Telecom uses derivative products such as interest rate swaps, forward rate agreements and interest rate options to reduce the impact of changes in interest rates on its floating rate debt.

The purpose of Telecom's foreign currency hedging activities is to protect it from the risk that the eventual New Zealand dollar net cash flows, resulting from purchases from foreign suppliers and foreign currency borrowings and expenditure, will be adversely affected by changes in exchange rates. As at 30 June 2000, Telecom's net unhedged foreign exchange position relating to the aforementioned activities was not significant.

NOTE 19 **Financial Instruments and Risk Management** (continued)

The notional principal or contract amounts outstanding are as follows:

	Telecom Group			
	31 March 1999	30 June 1999	30 June 2000	Maturities
(Dollars in millions)	NZ$	NZ$	NZ$	
Cross currency interest rate swaps	925	925	2,575	2001-2009
Interest rate swaps	719	719	2,397	2001-2010
Interest rate options	–	300	450	2000-2001
Forward exchange contracts				
(hedging firm purchase commitments and foreign currency investments)	712	895	757	2000-2005
Forward exchange contracts				
(hedging short-term debt)	718	605	340	2000
Forward rate agreements	30	–	–	–
Currency options				
Purchased puts	–	–	21	2000-2001
Sold calls	–	–	20	2000-2001

The notional amounts of the derivative financial instruments, with the exception of forward exchange contracts and cross currency interest rate swaps, do not necessarily represent amounts exchanged by the parties, and therefore, are not a direct measure of the exposure of Telecom through its use of derivative financial instruments. The amounts exchanged are calculated on the basis of the notional principal amounts and the other terms of the instruments, which relate to interest rates and exchange rates.

Parent Company

The Parent Company had no derivative contracts outstanding at 30 June 2000 and 1999, and 31 March 1999.

Concentration of Credit Risk

In the normal course of its business, Telecom incurs credit risk from trade receivables and transactions with financial institutions. Telecom has a credit policy, which is used to manage this exposure to credit risk. As part of this policy, limits on exposures with counterparties have been set and approved by the Board of Directors and are monitored on a regular basis.

Telecom does not require collateral or other security to support financial instruments with credit risk. While Telecom may be subject to credit losses in the event of non-performance by its counterparties, it does not expect such losses to occur.

Financial instruments which potentially subject Telecom to credit risk consist principally of cash, short-term investments, advances to associate companies, trade receivables and various off-balance sheet instruments. Telecom places its cash, short-term investments and off-balance sheet hedging instruments with high credit quality financial institutions and sovereign bodies and limits the amount of credit exposure to any one financial institution. Telecom has no significant concentrations of credit risk in respect of any one financial institution. Concentrations of credit risk with respect to trade receivables are limited due to the large number of customers included in Telecom's customer base.

Fair Values of Financial Instruments

The estimated fair values of Telecom's financial instruments, which differ from the carrying values, are as follows:

	Telecom Group					
	31 March 1999		30 June 1999		30 June 2000	
	Carrying value	Fair value	Carrying value	Fair value	Carrying value	Fair value
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$	NZ$	NZ$
Applicable financial instruments on the balance sheet:						
Long-term investments – term deposits	26	28	26	28	34	35
Long-term investments – advances to associate companies	–	–	104	104	158	151
Long-term investments – shares in listed companies	–	–	386	337	166	158
Long-term debt (see Note 17)	(1,289)	(1,520)	(1,250)	(1,389)	(3,049)	(3,267)
Capital notes	(942)	(1,075)	(942)	(1,029)	(943)	(1,085)
Financial instruments with off-balance sheet risk:						
Interest rate swaps	(6)	(43)	(13)	(24)	(15)	(62)
Cross currency interest rate swaps	6	156	9	146	7	277
Interest rate options	–	–	2	1	1	2
Foreign currency forward exchange contracts (hedging firm purchase commitments and foreign currency investments)	1	29	1	15	1	59
Foreign currency options	–	–	–	–	–	1

Telecom anticipates that long-term debt and capital notes will be held to maturity and, accordingly, settlement at the reported fair value of these financial instruments is unlikely.

NOTE 19 **Financial Instruments and Risk Management** (continued)

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Cash, Short–term Investments, Bank Overdraft, Short–term Debt, Receivables and Prepayments, Accounts Payable and Accruals

The carrying amounts of these balances are approximately equivalent to their fair value and therefore they are excluded from the table shown above.

Long–term Investments

The fair value of term deposits is estimated on the basis of current market interest rates available to Telecom for investments of similar terms and maturities.
The fair value of advances to associate companies is based on current market interest rates for debt of similar maturities.
The fair value of shares in listed companies is based on quoted market prices for these securities.
It was not practicable to estimate fair values of the remaining long-term investments as there are no quoted market prices for these or similar investments.

Long–term Debt

The fair values of TeleBonds, Eurobonds and the Swiss franc issue are estimated on the basis of the quoted market prices of Government debt securities of similar maturities. The fair value of other long-term debt is based on current market interest rates available to Telecom for debt of similar maturities.

Capital Notes

The fair values of Capital Notes are estimated on the basis of the quoted market prices of Government debt securities of similar maturities.

Cross Currency Interest Rate Swaps, Interest Rate Swaps, Forward Exchange Contracts, Foreign Currency Options, Forward Rate Agreements and Interest Rate Options

The fair values are estimated on the basis of the quoted market prices of those instruments.
The carrying value of the cross currency interest rate swaps and interest rate swaps represents the accrued interest on these instruments.

Repricing Analysis

The following table indicates the effective interest rates, the earliest period in which recognised financial instruments reprice and the extent to which these factors have been modified by off-balance sheet financial instruments. This information provides a basis for the evaluation of the interest rate risk to which Telecom is exposed in the future.

	Weighted effective interest rate	Within 1 year	1-2 years	2-3 years	3-4 years	4-5 years	Greater than 5 years	TOTAL
(Dollars in millions)		NZ$	NZ$	NZ$	NZ$	NZ$	NZ$	NZ$
Financial assets:								
Cash balances	5.14%	81	–	–	–	–	–	81
Investments	6.87%	739	38	–	–	–	–	777
Financial liabilities:								
Debt	7.93%	(1,771)	(599)	(269)	(137)	(769)	(778)	(4,323)
Capital notes	8.60%	–	–	(263)	(273)	–	(407)	(943)
Off-balance sheet instruments:								
Interest rate swaps		2,360	(39)	(406)	–	(490)	(1,425)	–
Cross currency interest rate swaps		(2,293)	357	457	–	770	709	–
Interest rate options		350	(350)	–	–	–	–	–
30 June 2000 repricing profile		(534)	(593)	(481)	(410)	(489)	(1,901)	(4,408)
30 June 1999 repricing profile		(518)	(273)	(387)	(486)	(362)	(710)	(2,736)
31 March 1999 repricing profile		(416)	(279)	(199)	(356)	(512)	(690)	(2,452)

NOTE 20 COMMITMENTS

Operating Leases

Minimum rental commitments for all non-cancellable operating leases (excluding amounts provided for in respect of restructuring) are:

	Telecom Group		
	31 March	30 June	
	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$
Payable within 1 year	45	50	56
Payable within 1-2 years	41	45	48
Payable within 2-3 years	35	39	41
Payable within 3-4 years	32	32	28
Payable within 4-5 years	24	23	19
Payable thereafter	116	133	83
	293	322	275

Finance Leases

Lease commitments in respect of capitalised finance leases are:

	Telecom Group		
	31 March	30 June	
	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$
Payable within 1 year	19	19	63
Payable within 1-2 years	63	59	23
Payable within 2-3 years	17	17	–
Payable within 3-4 years	–	–	–
Payable within 4-5 years	–	–	–
Total minimum lease payments	99	95	86
Future finance charges on finance leases	(9)	(8)	(5)
Present value of net future minimum lease payments (see Note 17)	90	87	81

Capital Commitments

At 30 June 2000, capital expenditure amounting to $754 million (30 June 1999: $65 million, 31 March 1999: $55 million) had been committed under contractual arrangements, with substantially all payments due within four years. The capital expenditure commitments principally relate to telecommunications network assets and at 30 June 2000 included Telecom and AAPT's commitments relating to Code Division Multiple Access ("CDMA") network build costs.

In addition Telecom has signed an agreement with other international telecommunications organisations to build and operate a Trans-Pacific submarine optical fibre cable, called the Southern Cross Cable Network ("Southern Cross"), linking Australia and New Zealand with Hawaii, Fiji and the West Coast of the United States. In March 1998, Telecom contractually committed to purchase capacity on Southern Cross of approximately US$140 million. The first payment of approximately US$70 million is due on the first ready-for-service date ("RFS"), now expected to be in November 2000. The second payment of approximately US$57 million is due on the first anniversary of RFS with the balance payable over the following two years. In November 1999, Telecom committed to purchase further capacity at a cost of US$69 million. Payments of US$12 million, US$23 million, US$23 million and US$11 million are due on 31 January 2002, 2003, 2004 and 2005 respectively. In addition AAPT has committed to purchase capacity on Southern Cross at a cost of approximately US$40 million payable over the next three years.

To date Southern Cross has signed capacity purchase commitments with customers totalling US$1.1 billion. Southern Cross cable construction costs are being funded through a US$640 million external credit facility and interim funding provided by the shareholders. Telecom has committed to provide up to US$150 million as part of this interim funding and as at 30 June 2000 had advanced US$120 million (excluding accrued interest) under this arrangement. Southern Cross plans to refinance the external credit facility, and repay all outstanding interim funding from shareholders, on or before RFS. Based on current capacity commitments and expected revenue forecasts, it is expected that Southern Cross will repay its borrowings in the first few years after project completion.

In addition the Telecom Group has committed to provide additional funding of A$90 million to another associate company, over the next 18 months.

NOTE 21 CONTINGENT LIABILITIES

Lawsuits and Other Claims

In proceedings commenced in November 1996, Clear Communications Limited ("Clear") alleges breaches of the Commerce Act in relation to Telecom's bundling practices. Unspecified damages are sought.

In April 1997, Telecom issued proceedings against Clear for withholding certain payments for services supplied under Clear's 1996 interconnection agreement with Telecom. Telecom seeks a declaration that the outstanding amounts are payable and an injunction requiring Clear to pay for services provided under the interconnection agreement. Clear's latest amended defence and counterclaim allege that the provisions of the 1991 and 1996 interconnection agreements requiring payments of the sums invoiced by Telecom are void or unenforceable and that by charging these sums and seeking to enforce the agreements Telecom has an anti-competitive purpose and effect in breach of the Commerce Act.

In May 2000, Clear abandoned most of its causes of action in these two proceedings. A three month liability trial dealing with remaining allegations in both proceedings is due to commence on 26 March 2001. Specified allegations previously the subject of separate proceedings will be referred to arbitration after trial.

In proceedings commenced by Telstra NZ Limited ("Telstra NZ") in May 1999, it was alleged that Telecom's cessation of certain carrier rebilling arrangements with Telstra NZ breached the Commerce Act. Telstra NZ sought injunctive relief together with unspecified damages. Telstra NZ's application for interlocutory injunction was dismissed in July 1999, and the proceedings were settled in July 2000.

In June 1999 a claim was filed against Telecom in the Employment Court by representative and individual plaintiffs. The plaintiffs allege breach of various express and implied terms of their employment contracts. The claim is not fully quantified.

In March 1997 Telstra Corporation commenced proceedings against AAPT in the Commercial Division of the Supreme Court of New South Wales, Australia. These proceedings were later transferred to the Federal Court of Australia in Sydney. Telstra Corporation claims approximately A$127 million plus interest and costs for unpaid charges for telecommunications services and restitution for the benefits received in relation to those telecommunications services. AAPT has cross-claimed asserting claims including breach of contract, negligence, misleading and deceptive conduct, misuse of confidential information, unconscionable conduct and abuse of market power under Part IV of the Australian Trade Practices Act. Trial of these proceedings has commenced and the hearing is due to resume in October 2000.

In April 2000, CallPlus Limited ("CallPlus") and two other companies issued proceedings against Telecom alleging breach of contract and the Commerce Act in relation to Telecom's 0867 service. Clear also commenced proceedings against Telecom in April 2000, alleging breach of contract in relation to the number portability agreement between Telecom and Clear and breach of the Commerce Act in relation to Telecom's 0867 service. CallPlus and Clear each seek injunctive relief and an inquiry into damages.

On 31 July 2000, the Commerce Commission issued proceedings against Telecom claiming that the introduction of 0867 constituted a use by Telecom of its dominant position for proscribed purposes. The Commerce Commission seeks a declaration that this contravened s36 of the Commerce Act, pecuniary penalty, and costs.

Various other lawsuits, claims and investigations have been brought or are pending against Telecom.

The Directors of Telecom cannot reasonably estimate the adverse effect (if any) on Telecom if any of the foregoing claims are ultimately resolved against Telecom's interests, and there can be no assurance that such litigation will not have a material adverse effect on Telecom's business, financial condition or results of operations.

Land Claims

As previously stated in Note 13, interests in land included in fixed assets purchased from the Government may be subject to claims to the Waitangi Tribunal or deemed to be Wahi Tapu and, in either case, may be resumed by the Government. Certain claims have been brought or are pending against the Government under the Treaty of Waitangi Act 1975. Some of these claims may affect land transferred to the Company by the Government and/or by the Company to its subsidiary companies. In the event that land is resumed by the Government, there is provision for compensation to Telecom.

Financial Instruments

There are contingent liabilities in respect of outstanding contracts for the sale and purchase of foreign currencies, cross currency interest rate swaps, interest rate swaps, interest rate options and foreign currency options. No significant losses are anticipated in respect of these matters.

AAPT had issued bank guarantees totalling A$91 million as at 30 June 2000.

Parent Company

The Parent Company has guaranteed, along with guaranteeing subsidiary companies, indebtedness of TCNZ Finance Limited amounting to $3,272 million (30 June 1999: $1,546 million, 31 March 1999: $1,580 million) under a guarantee dated 27 May 1997 and trust deeds dated 25 October 1988, 3 April 1992 and 17 March 2000 and subsequent supplemental trust deeds, together with interest thereon. The Parent Company has issued further guarantees in relation to commercial paper and other treasury activities of TCNZ Finance Limited. The Parent Company has also provided intercompany guarantees to Telecom New Zealand Limited.

NOTE 22 RELATED PARTY TRANSACTIONS

Telecom Group

Transactions with Principal Shareholders

During the share repurchase programme, which was completed in December 1997, 31,979,330 shares were repurchased from each of Ameritech and Bell Atlantic at a cost of $233 million each. At the time of the share repurchase, Ameritech and Bell Atlantic were principal shareholders in Telecom.

Interest of Directors in Certain Transactions

Certain Directors have relevant interests in a number of companies with which Telecom has transactions in the normal course of business.

NOTE 22 **Related Party Transactions** (continued)

Advances to Associate Companies

As at 30 June 2000 Telecom had made a long-term shareholders advance of US$58 million (excluding accrued interest) to Southern Cross Cables Holdings Limited at an interest rate of Libor + 0.75% (30 June 1999: US$55 million) and a short-term advance for interim funding purposes of US$120 million (excluding accrued interest) at an interest rate of Libor + 1.0%. AAPT had made an interest free advance of A$25 million to AOL Australia Online Services Pty Limited at 30 June 2000.

Parent Company

The Parent Company's transactions with subsidiary companies are set out in Notes 2 and 5.

Amounts due to subsidiary companies are for no fixed term and are at a weighted average interest rate of 6.35% at 30 June 2000 (30 June 1999: 4.68%).

Included within investments in subsidiary companies (see Note 11) at 30 June 2000 are net term loans of $1,711 million (30 June 1999: $567 million) advanced to subsidiary companies. These term loans have interest rates ranging between 0% and 9.8% (30 June 1999: 0% and 9.8%).

NOTE 23 SUBSIDIARY AND ASSOCIATE COMPANIES

At 30 June 2000, the significant operating companies of the Telecom Group and their activities were as follows:

	Country of incorporation	Interest held	Principal activity
Subsidiary Companies			
Telecom New Zealand Limited	New Zealand	100%	*Provides local, national and international and value-added telephone services, cellular and other mobile services, data and Internet services.*
Telecom Directories Limited	New Zealand	100%	*Publishes telephone directories.*
Telecom Purchasing Limited	New Zealand	100%	*A group purchasing and procurement company.*
Telecom Cook Islands Limited	Cook Islands	60%	*Provides telecommunications services in the Cook Islands.*
TCNZ (UK) Investments Limited	United Kingdom	100%	*A group finance company.*
TCNZ (United Kingdom) Securities Limited	United Kingdom	100%	*A group finance company.*
TCNZ Finance Limited	New Zealand	100%	*A group finance company.*
Telecom Investments Limited	New Zealand	100%	*A group finance company.*
Telecom New Zealand Finance Limited	New Zealand	100%	*A group finance company.*
TCNZ Financial Services Limited	New Zealand	100%	*A group finance company.*
Telecom Enterprises Limited	New Zealand	100%	*A holding company.*
Telecom Wellington Investments Limited	New Zealand	100%	*A holding company.*
Telecom Pacific Limited	New Zealand	100%	*A holding company.*
TCNZ Australia Investments Pty Limited	Australia	100%	*A holding company.*
Telecom Southern Cross Limited	New Zealand	100%	*A holding company.*
TCNZ (Bermuda) Limited	Bermuda	100%	*A holding company.*
Telecom Southern Cross Finance Limited	Bermuda	100%	*A group finance company.*
Telecom New Zealand Australia Pty Limited	Australia	100%	*Provides international wholesale telecommunications services.*
Telecom New Zealand Japan Kabushiki Kaisha	Japan	100%	*Provides international wholesale telecommunications services.*
Telecom New Zealand UK Limited	United Kingdom	100%	*Provides international wholesale telecommunications services.*
Telecom New Zealand (UK) Licences Limited	United Kingdom	100%	*Holds United Kingdom telecommunications licences.*
Telecom New Zealand USA Limited	United States	100%	*Provides international wholesale telecommunications services.*
AAPT Limited	Australia	79.9%	*Provides value-added telecommunications services.*
Cellular One Communications Limited	Australia	100%*	*Provides mobile telecommunications services.*
connect.com.au Pty Limited	Australia	100%*	*Internet service provider.*
Commerce Solutions Limited	Australia	100%*	*Provides e-commerce solutions.*
AAPT CDMA Pty Limited	Australia	100%*	*Provides CDMA wireless services.*
Associate Companies			
Pacific Carriage Holdings Limited	Bermuda	50%	*A holding company.*
Southern Cross Cables Holdings Limited	Bermuda	50%	*A holding company.*
AOL Australia Online Services Pty Limited	Australia	50%*	*Internet service provider.*

Other than Telecom New Zealand Australia Pty Limited, which has a balance date of 31 March, the financial year-end of all significant operating subsidiaries and associates is 30 June.

** Represents AAPT's shareholding in the company.*

NOTE 24 SEGMENTAL REPORTING

Geographic Segments

As at and for the year ended 30 June 2000

	Telecom Group				
	New Zealand operations	Australian operations	Other operations	Eliminations	Consolidated
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$	NZ$
Operating revenue					
External customers	3,515	741	75	–	4,331
Internal customers	22	15	–	(37)	–
Abnormal revenue	–	15	–	–	15
Total revenue	3,537	771	75	(37)	4,346
Segment net earnings attributable to shareholders	757	31	18	(23)	783
Segment fixed assets	3,724	481	45	–	4,250
Segment total assets	5,076	1,083	648	1,174	7,981

Intersegment sales are priced on an arms length basis.

During the three months to 30 June 1999 and in the years to 31 March 1999 and 1998, more than 90% of the Group's total operating revenues, operating earnings and identifiable assets were generated by operations in New Zealand. The purchase of a majority interest in Australian subsidiary AAPT on 27 November 1999 creates the need for separate geographical disclosures for the year to 30 June 2000.

Industry Segments

Telecom essentially operates within one industry segment as a unitary business, providing an integrated range of telecommunications products and services.

NOTE 25 RECONCILIATION OF NET EARNINGS ATTRIBUTABLE TO SHAREHOLDERS TO NET CASH FLOWS FROM OPERATING ACTIVITIES

	Telecom Group				Parent Company		
	Year ended 31 March		Three months ended 30 June	Year ended 30 June	Year ended 31 March	Three months ended 30 June	Year ended 30 June
	1998	1999	1999	2000	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$	NZ$	NZ$	NZ$
Net earnings attributable to shareholders	820	822	202	783	699	174	722
Adjustments to reconcile net earnings to net cash flows from operating activities:							
Depreciation	564	553	136	583	–	–	–
Bad and doubtful accounts	34	27	5	43	–	–	–
Deferred income tax	(2)	23	(1)	24	–	–	–
Share of losses of associate companies	–	–	7	6	–	–	–
Minority interests in profits of subsidiaries	–	2	–	8	–	–	–
Capital note distribution costs	26	55	13	54	–	–	–
Goodwill amortised	4	7	2	43	–	–	–
Sale of AAPT Sat-Tel Pty Limited	–	–	–	(15)	–	–	–
Discontinued operations	(30)	–	–	–	–	–	–
Other	1	14	(1)	(2)	–	–	–
Changes in assets and liabilities net of effects of non-cash and investing and financing activities:							
(Increase)/decrease in accounts receivable and related items	(108)	23	(15)	(127)	20	–	(2)
Decrease/(increase) in inventories	20	(1)	(9)	6	–	–	–
Increase/(decrease) in current taxation	106	83	153	61	(53)	(15)	(49)
(Decrease)/increase in provisions	(53)	(59)	6	(57)	–	–	–
Increase/(decrease) in accounts payable and related items	155	25	(5)	135	–	–	(12)
Net cash flows from operating activities	**1,537**	**1,574**	**493**	**1,545**	**666**	**159**	**659**

NOTE 26 IMPUTATION CREDIT ACCOUNT

Dividends paid by New Zealand resident companies may include imputation credits representing the taxation already paid by the Company on the profits distributed. New Zealand resident shareholders may claim a tax credit equal to the value of the imputation credit attached to dividends. Overseas shareholders in general are not entitled to claim the benefit of any imputation credit. Overseas shareholders may benefit from supplementary dividends. The movements in the imputation credit accounts are detailed below:

	Telecom Group			Parent Company		
	31 March	30 June		31 March	30 June	
	1999	1999	2000	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$	NZ$	NZ$
Balance (credit) at the beginning of the period	(116)	(126)	(1)	(17)	(3)	(10)
New Zealand income tax (paid)/refunded	(302)	51	(300)	–	–	–
Imputation credits attached to dividends received	(2)	–	(1)	(280)	(81)	(267)
Imputation credits attached to dividends paid	294	74	299	294	74	297
Balance (credit) at the end of the period	(126)	(1)	(3)	(3)	(10)	20
Minority interests	1	1	–	–	–	–
Net balance (credit) at the end of the period	(125)	–	(3)	(3)	(10)	20

NOTE 27 ACQUISITION AND DISPOSAL OF SUBSIDIARIES

The following acquisitions and disposals impacted Telecom's financial statements in the year ended 30 June 2000:

- On 27 November 1999 Telecom purchased an additional 61.7% stake in AAPT, bringing the total shareholding at that date to 81.4%.
- On 10 February 2000 AAPT acquired a 60% stake in EC-Pay Pty Limited.
- On 31 March 2000 AAPT disposed of its entire 100% shareholding in AAPT Sat-Tel Pty Limited.
- On 1 June 2000 Telecom disposed of its entire 100% shareholding in ConnecTel Limited.

The effect of these acquisitions and disposals on the Group's assets and liabilities was:

	Telecom Group
(Dollars in millions)	NZ$
Assets	
Current assets:	
Cash	3
Receivables and prepayments	168
Total current assets	171
Future tax benefit	14
Long-term investments	2
Intangibles	268
Fixed assets	266
Total assets	721
Liabilities	
Current liabilities:	
Bank overdraft	(1)
Accounts payable and accruals	271
Total current liabilities	270
Long-term debt	147
Total liabilities	417
Minority interests	69
Net assets acquired	235
Net consideration:	
Opening investment	(385)
Net cash paid	(1,113)
Goodwill arising on acquisition	1,279
Profit on disposal	(16)
	(235)

NOTE 28 QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

(Dollars in millions, except per share amounts)	Operating revenues NZ$	Net abnormal revenue/ (expense) NZ$	Surplus from continuing operations NZ$	Surplus from continuing operations before income tax NZ$	Net earnings attributable to shareholders NZ$	Net earnings per share NZ$
Quarter ended:						
30 September 1999	887	–	365	337	209	0.119
31 December 1999	993	–	350	311	197	0.112
31 March 2000	1,239	15	380	328	205	0.117
30 June 2000	1,227	–	331	270	172	0.098
Year ended 30 June 2000	4,346	15	1,426	1,246	783	0.447
Transition period ended:						
30 June 1999 – audited	863	(7)	342	320	202	0.115
Quarter ended:						
30 June 1998	826	–	325	300	190	0.109
30 September 1998	869	–	359	328	206	0.118
31 December 1998	859	–	354	325	202	0.115
31 March 1999	896	1	362	337	224	0.128
Year ended 31 March 1999	3,450	1	1,400	1,290	822	0.469

Earnings per share is computed independently for each of the quarters presented. Consequently, the sum of the quarters does not necessarily equal total annual earnings per share.

NOTE 29 COMPARATIVE FINANCIAL INFORMATION (UNAUDITED)

Annual Balance Date Change

Effective 1 April 1999, Telecom changed its annual balance date from 31 March to 30 June. The unaudited consolidated Statement of Financial Performance for the three months ended 30 June 1998 and the year ended 30 June 1999 is presented below for comparative purposes.

(Dollars in millions, except per share amounts)	Three months ended 30 June 1998 NZ$	Year ended 30 June 1999 NZ$
Operating revenues		
Local service	263	1,059
Calling	290	1,140
Interconnection	15	71
Cellular and other mobile services	113	502
Data	81	357
Other operating revenues	64	327
Abnormal revenues	–	31
	826	3,487
Operating expenses		
Labour	124	467
Depreciation	139	551
Cost of sales	109	459
Other operating expenses	129	556
Abnormal expenses	–	37
	501	2,070
Surplus from operations	**325**	**1,417**
Investment income	16	45
Interest expense	(41)	(152)
Surplus from operations before income tax	**300**	**1,310**
Income tax expense	(96)	(412)
Surplus from operations after income tax	**204**	**898**
Share of losses of associate company after income tax	–	(7)
Minority interests in profits of subsidiaries	–	(2)
Net surplus	**204**	**889**
Capital note distribution costs after income tax	(14)	(55)
Net earnings attributable to shareholders	**190**	**834**
Net earnings per share	**$0.109**	**$0.476**
Weighted average number of ordinary shares outstanding (in millions)	1,752	1,752

NOTE 30 SIGNIFICANT DIFFERENCES BETWEEN NEW ZEALAND AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRACTICE

The consolidated financial statements are prepared in accordance with generally accepted accounting practice ("GAAP") applicable in New Zealand ("NZ") which differs in certain significant respects from that applicable in the United States ("US"). These differences and the effect of the adjustments necessary to restate earnings and shareholders' funds are detailed below.

Effect on Net Earnings of Differences Between NZ GAAP and US GAAP

	Telecom Group			
	Year ended 31 March		Three months ended 30 June	Year ended 30 June
	1998	1999	1999	2000
(Dollars in millions, except per share amounts)	NZ$	NZ$	NZ$	NZ$
Net earnings in accordance with NZ GAAP	820	822	202	783
Add discontinued operations	(30)	–	–	–
	790	822	202	783
US GAAP adjustments:				
Depreciation of interest costs capitalised in prior years (a)	(9)	(9)	(2)	(9)
Deferred taxation (b)	28	19	(4)	13
Executive share ownership plan (c)	–	(16)	–	–
Provision for restructuring (d)	(62)	–	–	–
Provision for Year 2000 (e)	(14)	(48)	(7)	(17)
Provision for onerous contracts (f)	–	–	22	(14)
Share of losses of associate company (g)	–	–	–	(23)
Net earnings from continuing operations in accordance with US GAAP	733	768	211	733
Discontinued operations	30	–	–	–
Net earnings in accordance with US GAAP	763	768	211	733
Basic earnings per share from continuing operations in accordance with US GAAP (m)	$0.410	$0.438	$0.120	$0.418
Basic earnings per share from discontinued operations in accordance with US GAAP	$0.017	–	–	–
Basic net earnings per share in accordance with US GAAP	$0.427	$0.438	$0.120	$0.418
Diluted earnings per share from continuing operations in accordance with US GAAP (m)	$0.410	$0.439	$0.120	$0.417

Cumulative Effect on Shareholders' Funds of Differences Between NZ GAAP and US GAAP

	Telecom Group			
	Year ended 31 March		Three months ended 30 June	Year ended 30 June
	1998	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$
Shareholders' funds in accordance with NZ GAAP	1,063	1,085	1,086	1,130
Capitalisation of interest costs, net of accumulated depreciation (a)	50	41	39	30
Deferred taxation (b)	(46)	(27)	(31)	(18)
Provision for dividend (h)	140	202	202	202
Executive share ownership plan (c)	(3)	–	–	–
Provision for Year 2000 (e)	72	24	17	–
Provision for onerous contracts (f)	–	–	22	8
Share of losses of associate company (g)	–	–	–	(23)
Accumulated unrealised holding loss on available-for-sale securities (n)	–	–	–	(8)
Shareholders' funds in accordance with US GAAP	1,276	1,325	1,335	1,321

NOTE 30 **Significant Differences Between New Zealand and United States Generally Accepted Accounting Practice** (continued)

(a) Capitalisation of Interest Costs Relating to the Construction of Property, Plant and Equipment

Prior to 1 April 1989, Telecom did not capitalise interest costs incurred in connection with the financing of expenditures for the construction of telecommunications equipment and other fixed assets. In the year ended 31 March 1990, Telecom changed that policy such that, for each fixed asset project having a cost in excess of $10 million and a construction period of not less than 12 months, interest costs incurred during the period that is required to complete and prepare the fixed asset for its intended use are capitalised as part of the total cost. In the year ended 31 March 1996, Telecom changed that policy further such that, for each fixed asset project having a cost in excess of $100,000 and a construction period of not less than three months, interest costs incurred during the period that is required to complete and prepare the fixed asset for its intended use are capitalised as part of the total cost. The policy was changed again from 1 April 1999 such that interest costs are capitalised for all fixed asset projects.

Under US GAAP, interest costs incurred in connection with the financing of all expenditure for the construction of fixed assets are required to be capitalised during the period required to prepare the fixed asset for its intended use. For the purpose of compliance with US GAAP, the estimated amount of interest that would have been capitalised on construction costs incurred on capital projects not already capitalised in accordance with Telecom's accounting policy has been determined and depreciated over the lives of the related assets. As a result of the change in accounting policy during the year ended 31 March 1996, which brought NZ GAAP accounting treatment in respect of capitalised interest into alignment with US GAAP in all material respects, the ongoing reconciling difference within net earnings will comprise the depreciation charge on interest not capitalised under NZ GAAP prior to 1 April 1995.

(b) Deferred Taxation

Under NZ GAAP, Telecom uses the partial liability method to account for taxation whereby all items expected to reverse in the foreseeable future are recognised, whereas under US GAAP the comprehensive liability method is used.

The components of the US GAAP net deferred tax liability at 30 June 2000, 30 June 1999 and 31 March 1999 amounting to $31 million, $56 million, and $27 million respectively, are as follows:

	Telecom Group					
	Deferred tax asset			Deferred tax liability		
	31 March	30 June		31 March	30 June	
	1999	1999	2000	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$	NZ$	NZ$
Depreciation	19	14	14	(119)	(113)	(145)
Restructuring provisions	12	9	2	–	–	–
Tax losses in overseas subsidiary company	–	–	32	–	–	–
Provisions, accruals and other	105	90	105	(64)	(50)	(57)
Valuation allowance	(6)	(6)	(7)	–	–	–
Supplementary dividend tax credit	26	–	25	–	–	–
	156	107	171	(183)	(163)	(202)

Included in the net deferred tax liability at 30 June 2000 of $31 million is a net current asset of $124 million and a net non-current liability of $155 million. The net deferred tax liability at 30 June 1999 of $56 million included a net current asset of $90 million and a net non-current liability of $146 million. The net deferred tax liability at 31 March 1999 of $27 million included a net current asset of $129 million and a net non-current liability of $156 million.

(c) Executive Share Ownership Plan

The liquidation of Telecom's Executive Plan was completed in March 1999. The Trustee of the Executive Plan had disposed of the 1.9 million unallocated shares and remitted the proceeds to Telecom. Under NZ GAAP the net proceeds from the liquidation of the Executive Plan of $16 million were recorded as abnormal revenue in the Statement of Financial Performance. Under US GAAP the unallocated shares remaining at the time of liquidating the Executive Plan must be considered un-issued. Under US GAAP when a company sells previously un-issued shares in itself, the net proceeds from the sale are accounted for as paid-in capital.

Under NZ GAAP, compensation expense relating to the Executive Plan was recognised systematically over the life of the plan based on the actual cost of the shares of $2 each. Under US GAAP, the Executive Plan would have been treated as a variable stock award plan and, as such, the compensation expense recognised over the life of the plan would be adjusted in each accounting period for changes in the quoted market price of the Company's shares. Additionally, under US GAAP, the shares issued under the plan would not have been recognised as share capital until they vested and would not all have been recognised as outstanding for the purpose of determining the weighted average number of shares for earnings per share calculations.

NOTE 30 **Significant Differences Between New Zealand and United States Generally Accepted Accounting Practice** (continued)

Reconciliation of the cumulative effect of the Executive Plan on shareholders' funds:

	Telecom Group		
	31 March	30 June	
	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$
Opening balance	(3)	–	–
Shares vested, net	18	–	–
US GAAP reversal of NZ GAAP liquidation profit	(16)	–	–
Dividends paid on treasury stock	1	–	–
	–	–	–

(d) Provision for Restructuring

Under US GAAP, provisions for restructuring may only be accrued where a detailed announcement describing the restructuring has been made prior to balance date.

(e) Provision for Year 2000

Under US GAAP, the costs relating to Year 2000 modifications should be expensed as incurred. Consequently, the accrual of such costs is not permitted.

(f) Provision for Onerous Contracts

Under US GAAP, the costs relating to these onerous contracts should be expensed as incurred. Consequently, the accrual of such costs is not permitted.

(g) Share of Losses of Associate Company

Under NZ GAAP where the carrying amount of an equity investment in an associate falls below zero, the equity method of accounting is suspended and the investment is recorded at zero. If this occurs, the equity method of accounting is not resumed until such time as the Group's share of losses and reserve decrements not recognised during the financial years in which the equity method was suspended, are offset by the current share of profits and reserves.

Under US GAAP net losses continue to be accrued until both the equity investment and any advance balance are reduced to zero.

(h) Provision for Dividend

Under NZ GAAP, dividends provided by the Board of Directors after the end of an accounting period, but in respect of that period, are deducted in arriving at retained earnings at the end of that accounting period. Under US GAAP, such dividends are provided in the period in which they are declared by the Board of Directors. The dividend included for the purpose of the US GAAP reconciliation is net of the effect of the supplementary dividend and associated tax credit.

(i) Statement of Cash Flows

Under both NZ GAAP and US GAAP, a Statement of Cash Flows, which discloses cash flows from operating, investing and financing activities, is required to be presented. Under US GAAP, bank overdrafts would be reclassified as a financing activity rather than a component of cash position. In addition, short-term deposits with original maturities of three months or less would generally qualify as a component of cash position. Accordingly, the closing cash position under US GAAP at 30 June 2000, 30 June 1999 and 31 March 1999 would be $342 million, $84 million and $68 million respectively.

(j) Research and Development Expenditure

Under NZ GAAP, research and development costs are charged to expenses as incurred except where, in the case of development costs, future benefits are expected beyond any reasonable doubt to exceed these costs. Where development costs are deferred, they are amortised over future periods on a basis related to future benefits. For the purpose of compliance with US GAAP, all research and development costs must be expensed as incurred. As at 30 June 2000, 30 June 1999 and 31 March 1999 there were no significant amounts of deferred development costs.

(k) Share Repurchase

Under US GAAP, the share repurchase would have been accounted for differently such that the amount of the share repurchase would have been allocated amongst individual components of shareholders' funds.

NOTE 30 **Significant Differences Between New Zealand and United States Generally Accepted Accounting Practice** (continued)

(l) Share Options

SFAS 123 ("Accounting for Stock-Based Compensation") requires that Telecom calculate the value of stock options at the date of grant using an option pricing model. Telecom has elected the "pro forma disclosure only" option permitted under SFAS 123 instead of recording a charge to operations, as shown below:

		Telecom Group			
		Year ended 31 March		Three months ended 30 June	Year ended 30 June
		1998	1999	1999	2000
	(Dollars in millions, except per share amounts)	NZ$	NZ$	NZ$	NZ$
US GAAP:					
Net earnings	As reported	763	768	211	733
	Pro forma	761	766	210	729
Basic earnings per share	As reported	$0.427	$0.438	$0.120	$0.418
	Pro forma	$0.426	$0.437	$0.120	$0.416

The pro forma amounts have been determined using the Black Scholes option pricing model based on the following weighted average assumptions:

	Telecom share options			
	Year ended 31 March		Three months ended 30 June	Year ended 30 June
	1998	1999	1999	2000
Risk-free interest rate	7.2%	6.4%	5.95%	6.8%
Expected dividend yield	5.9%	5.1%	6.3%	5.8%
Expected option life (in years)	6.0	6.0	6.0	6.0
Expected stock price volatility	22.6%	24.0%	24.0%	23.0%
Discount to reflect restrictive terms of the options	0%	25.0%	25.0%	25.0%

	AAPT share options
	Seven months ended 30 June
	2000
Risk-free interest rate	6.5%
Expected dividend yield	0%
Expected option life (in years)	5.0
Expected stock price volatility	41%

(m) Earnings Per Share

SFAS 128 ("Earnings Per Share"), requires companies to present basic earnings per share and diluted earnings per share. The numerators and the denominators used in the computation of basic and diluted earnings per share pursuant to SFAS 128 are reconciled below:

	Telecom Group			
	Year ended 31 March		Three months ended 30 June	Year ended 30 June
(Dollars in millions, except per share amounts)	1998	1999	1999	2000
Basic EPS Computation				
Numerator – net earnings from continuing operations	$733	$768	$211	$733
Denominator – ordinary shares (in millions)	1,786	1,752	1,753	1,753
Basic EPS – continuing operations	$0.410	$0.438	$0.120	$0.418
Diluted EPS Computation				
Numerator:				
Net earnings from continuing operations	$733	$768	$211	$733
Add capital note distribution costs after income tax	$26	$55	$13	$54
	$759	$823	$224	$787
Denominator (in millions):				
Ordinary shares	1,786	1,752	1,753	1,753
Capital notes	65	121	120	135
Options	–	–	1	–
	1,851	1,873	1,874	1,888
Diluted EPS – continuing operations	$0.410	$0.439	$0.120	$0.417

NOTE 30 **Significant Differences Between New Zealand and United States Generally Accepted Accounting Practice** (continued)

(n) Comprehensive Income

	Telecom Group			
	Year ended 31 March		Three months ended 30 June	Year ended 30 June
	1998	1999	1999	2000
(Dollars in millions)	NZ$	NZ$	NZ$	NZ$
Net earnings in accordance with US GAAP	763	768	211	733
Other comprehensive income:				
Foreign currency translation adjustments (see Note 18)	1	–	1	48
Unrealised holding loss on available-for-sale securities	–	–	–	(8)
Other comprehensive income, net of taxation	1	–	1	40
Total comprehensive income	764	768	212	773

Accumulated other comprehensive income, a component of shareholders' funds in accordance with US GAAP, totalled $41 million at 30 June 2000 (30 June 1999: $1 million, 31 March 1999: Nil, 31 March 1998: Nil).

SFAS 115 ("Accounting for Certain Investments in Debt and Equity Securities") requires equity securities to be classified as either 'trading securities' or 'available-for-sale securities'. Telecom's investments in INL and eVentures are not held for the purpose of short-term trading and therefore meet the definition of available-for-sale securities. Available-for-sale securities must be carried at fair value with unrealised gains and losses reported as a component of other comprehensive income.

As at 30 June 1999, Telecom's investment in AAPT also met the definition of an available-for-sale security and an associated holding loss of $49 million was recognised. In the year ended 30 June 2000 Telecom increased its shareholding in AAPT to approximately 80%. As this investment no longer meets the definition of an available-for-sale security, the loss has been reversed in the pro forma disclosure for the three months ended 30 June 1999.

(o) Acquisition of AAPT

APB16 "Business Combinations" requires certain unaudited pro forma disclosures be presented when a subsidiary is acquired. The following pro forma consolidated results of operations are presented as if the acquisition of a controlling interest in AAPT had taken place at the beginning of the current and preceding years. The effects of other acquisitions on the consolidated financial statements are not significant and have been excluded from the pro forma presentation.

	Telecom Group	
	Year ended 30 June	
	1999	2000
(Dollars in millions, except per share amounts)	NZ$	NZ$
Operating revenues	4,384	4,793
Net earnings attributable to shareholders	684	660
Basic earnings per share	$0.390	$0.376
Diluted earnings per share	$0.391	$0.378

The pro forma consolidated results of operations include adjustments to give effect to amortisation of goodwill, interest expense on acquisition debt and certain other adjustments, together with related income tax effects. The unaudited pro forma information is not necessarily indicative of the results of operations that would have occurred had the purchase been made at the beginning of the periods presented or the future results of the combined operations.

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Auditors' Report to the Shareholders of Telecom Corporation of New Zealand Limited

We have audited the financial statements on pages 36 to 71. The financial statements provide information about the past financial performance and cash flows of the Company and the Telecom Group for the year ended 30 June 2000 and their financial position as at that date. This information is stated in accordance with the accounting policies set out on pages 43 to 45.

Directors' responsibilities

The Company's Directors are responsible for the preparation and presentation of the financial statements which give a true and fair view of the financial position of the Company and the Telecom Group as at 30 June 2000 and their financial performance and cash flows for the year ended on that date.

Auditors' responsibilities

We are responsible for expressing an independent opinion on the financial statements presented by the Directors and reporting our opinion to you.

Basis of opinion

An audit includes examining, on a test basis, evidence relevant to the amounts and disclosures in the financial statements. It also includes assessing:

- the significant estimates and judgements made by the Directors in the preparation of the financial statements; and
- whether the accounting policies are appropriate to the circumstances of the Company and the Telecom Group, consistently applied and adequately disclosed.

We conducted our audit in accordance with generally accepted auditing standards in New Zealand. We planned and performed our audit so as to obtain all the information and explanations which we considered necessary to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatements, whether caused by fraud or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Our firm carries out other assignments on behalf of the Company and its subsidiaries in the area of taxation compliance, accounting policy advice and consultancy assignments.

Unqualified opinion

We have obtained all the information and explanations we have required.

In our opinion:

- proper accounting records have been kept by the Company as far as appears from our examination of those records; and
- the financial statements on pages 36 to 71 expressed in New Zealand dollars:
  - comply with generally accepted accounting practice in New Zealand; and
  - give a true and fair view of the financial position of the Company and the Telecom Group as at 30 June 2000 and their financial performance and cash flows for the year ended on that date.

Our audit was completed on 10 August 2000 and our unqualified opinion is expressed as at that date.

PricewaterhouseCoopers

Chartered Accountants

Wellington

Interests Register

The following are particulars of entries made in the Interests Register for the period 1 July 1999 to 30 June 2000:

Disclosures of Interest

Directors disclosed interests, or a cessation of interest, in the following entities pursuant to section 140 of the Companies Act 1993.

Roderick Deane

Entity	Relationship
TransAlta New Zealand Limited	Ceased to be a Director and Chairman
TransAlta Canada Limited	Appointed a Director
Woolworths Limited	Appointed a Director

Theresa Gattung

Entity	Relationship
AAPT Pty Limited	Appointed a Director

Patsy Reddy

Entity	Relationship
Trilogy Corporation Limited	Associated person of a shareholder
New Zealand Opera Limited	Director
Victoria University Foundation	Ceased to be a Trustee
NZSO Foundation	Ceased to be a Trustee
Georgia Pacific New Zealand Company	Director
Caterpillar New Zealand Funding Company	Director
Air New Zealand Limited	Ceased to be a Director
Active Equities Limited	Director and Shareholder
TeamTalk Limited	Associated person of a shareholder

Indemnity and Insurance

Indemnities were given to certain senior staff in relation to potential liabilities and costs such staff may incur for acts or omissions in their capacity as employees of Telecom, Directors of Telecom subsidiaries or Directors of non-Telecom companies in which Telecom holds interests namely Southern Cross, AAPT and EDS.

An indemnity was also given to a partner of Blake Dawson Waldron ("BDW") in the partner's capacity as a Director of TCNZ Australia Pty Limited. This indemnity extended to the other partners of BDW for claims arising out of BDW permitting the partner to act as a Director. Indemnities were also given to two other Directors of TCNZ Australia Pty Limited in their capacity as Directors of TCNZ Australia Pty Limited.

During the year, the Directors' and Officers' liability insurance was renewed to cover risks normally covered by such policies arising out of acts or omissions of Directors and employees in their capacity as such.

Relevant Interests in Shares

Directors disclosed pursuant to section 148 of the Companies Act 1993, the following acquisitions and disposals of relevant interests in Telecom shares:

Roderick Deane

Date of Disposal/Acquisition	Consideration	Number of shares Acquisitions/(Dispositions)
8 December 1999	$859,000	(100,000)
8 December 1999	$553,724	(64,763)
14 December 1999	$953,440	(106,300)

John King

Date of Disposal/Acquisition	Consideration	Number of shares Acquisitions/(Dispositions)
20 July 1999	$328,440	(39,100)
21 July 1999	$252,000	(30,000)
21 July 1999	$84,500	(10,000)
24 August 1999	$83,942	(10,096)
8 October 1999	$74,496	(9,700)

Patsy Reddy

Date of Disposal/Acquisition	Consideration	Number of shares Acquisitions/(Dispositions)
3 September 1999	$17,260	2,000
16 June 2000	$1,380	175

Other Disclosures

Equity Securities Held by Directors

The table below sets out the relevant interests in equity securities of Directors and Associated Persons of Directors at 30 June 2000 for the purposes of Listing Rule 10.5.3 of the New Zealand Stock Exchange Listing Rules:

	Relevant Interest of Director	Relevant Interest of Associated Person
P Shirtcliffe	–	–
R Deane	1,028,958[1]	–
P Baines	10,000	–
J King	227,080	60,000
P Reddy	12,175	–
T Gattung	427,026[2]	–
M Tyler	–	–

(1) Includes options.

(2) Options.

Employee Remuneration

The number of employees (including employees holding office as Directors of subsidiaries) whose remuneration and benefits is within specified bands is as follows:

Remuneration Range NZ$	Number of Employees	Number of employees acting as Directors of subsidiary companies
1,080,001 – 1,090,001	1	1
960,001 – 970,000	1	1
480,001 – 490,000	1	1
430,001 – 440,000	1	
390,001 – 400,000	1	1
380,001 – 390,000	2	1
360,001 – 370,000	4	1
350,001 – 360,000	2	2
330,001 – 340,000	1	
320,001 – 330,000	5	2
310,001 – 320,000	2	1
300,001 – 310,000	2	1
290,001 – 300,000	2	1
280,001 – 290,000	6	
270,001 – 280,000	3	1
260,001 – 270,000	4	2
250,001 – 260,000	2	1
240,001 – 250,000	2	1
230,001 – 240,000	9	1
220,001 – 230,000	6	1
210,001 – 220,000	8	3
200,001 – 210,000	8	1
190,001 – 200,000	7	
180,001 – 190,000	13	
170,001 – 180,000	21	3
160,001 – 170,000	27	2
150,001 – 160,000	31	
140,001 – 150,000	47	
130,001 – 140,000	62	2
120,001 – 130,000	68	1
110,001 – 120,000	124	1
100,000 – 110,000	178	

Employees also receive telephone concessions which can (depending on the nature of the concession) include free telephone line rental, national and international phone calls and online services.

Two employees who act as Directors of subsidiary companies received less than $100,000 during the reporting period.

The above list contains information on employees in Telecom's off-shore subsidiaries including the AAPT group of companies. Amounts are converted into New Zealand dollars where appropriate.

Directors' Remuneration

During the year to 30 June 2000, the total remuneration and value of other benefits received by the Directors of the Company was as follows:

Name	Total remuneration NZ$
Roderick Deane[1]	1,926,293
Peter Shirtcliffe	123,750
Theresa Gattung[2]	805,076
John King	100,000
Patsy Reddy	110,000
Paul Baines	117,813
Michael Tyler	105,417

[1] *Includes salary, options and EVA bonus for part of the year and Directors' fees for part of the year. Dr Deane retired as Chief Executive on 30 September 1999. He commenced as Chairman of the Board on 1 October 1999.*

[2] *Principally salary Ms Gattung does not receive Directors fees.*

Substantial Security Holders

According to notices given under the Securities Amendment Act 1988 the following persons were substantial securities holders in Telecom Corporation of New Zealand Limited as at 18 August 2000 in respect of the number of voting securities set opposite their names:

The Capital Group Companies, Inc	87,650,880
Brandes Investment Partners, LP	133,234,295
Franklin Resources Inc	106,025,108
Bell Atlantic Corporation Bell Atlantic Holdings Limited	437,080,670

The total number of issued voting securities of Telecom Corporation of New Zealand Limited as at that date was 1,755,413,444. This figure includes 1 Kiwi Share.

Stock Exchange Waivers

CBA Outsourcing

In July 2000, following success in a tender process, the Company's subsidiary TCNZ Australia Pty Limited ("TCNZA") was selected by the Commonwealth Bank of Australia ("CBA") to manage and deliver telecommunications services to meet CBA's business requirements throughout Australia. The Company obtained a waiver from the requirement in Listing Rule 9.2.1 for shareholder approval of related party transactions in connection with this outsourcing transaction.

EDS Outsourcing

In July 1999, the Company entered into a major outsourcing transaction with EDS (New Zealand) Limited ("EDS (NZ)") under which EDS (NZ) will manage and operate the Company's company-wide information systems and technology delivery. In connection with the outsourcing, the Company, EDS (NZ) and Microsoft (NZ) Limited entered into an alliance to provide online services to business customers in New Zealand ("the online venture"), and the Company acquired a 10% holding in EDS (NZ) and options to acquire up to a 49% holding ("the equity arrangement"). The Company obtained a waiver from the requirement in Listing Rule 9.2.1 for shareholder approval of related party transactions in connection with the outsourcing transaction, the online venture and the equity arrangement.

TCNZ Finance Limited Quotation of Capital Notes

The Company's subsidiary TCNZ Finance Limited ("TFL") has issued Capital Notes ("TeleNotes") which are quoted on the Stock Exchange. TFL obtained a waiver from Listing Rule 1.9.1 (Listing Rules which apply to issuers if equity securities quoted) on the basis that Listing Rule 1.9.2 (Listing Rules which apply to issuers if no equity securities quoted) would apply in respect of the TeleNotes.

Southern Cross

In 1998 the Company entered into the Southern Cross project ("the project") with Optus and WorldCom to establish the Southern Cross Cable. The Company obtained a waiver from the requirement in Listing Rule 9.2.1 for shareholder approval of material transactions with related parties in respect of any future transactions that might be entered into with Optus and WorldCom which are unrelated to the project. The waiver was granted on the conditions that: (i) the sole reason for the parties being related in terms of the Listing Rules is their involvement in the project, the parties are not related in any other way and the transaction does not otherwise fall within Listing Rule 9.2; and (ii) the transaction must be entered into where there has been no material change in the interests held by the parties in the project and no material change to the rules and relationships of the parties within the joint venture.

Donations

The donation expense for the year was $24,000. In addition, Telecom makes available telecommunications services free of charge or at reduced rates to the community, principally the 111 emergency service, and also provides substantial support to educational and charitable organisations. In the year under review, the operating costs to Telecom of these community programmes were approximately $19 million, including cash payments, revenue foregone and operating costs directly attributable to particular programmes.

Subsidiary Company Directors

The following people held office as Directors of subsidiary companies at the end of the period to 30 June 2000, or retired during the period – indicated with an (R). Alternate Directors are indicated with an (A).

AAPT (NZ) Limited A Rogge, R Nissen, A Sharma, S Picton (R). **AAPT Finance Pty Limited** A Rogge, R Nissen, L Williams, S Picton (R). **AAPT Holdings (Inc)** A Rogge, R Nissen, S Picton (R). **AAPT Investments Pty Limited** A Rogge, R Nissen, L Williams, S Picton (R). **AAPT LMDS Pty Limited** A Rogge, R Nissen, S Picton (R). **AAPT Networks Pty Limited** L Williams, A Rogge, R Strangman, S Picton (R). **AAPT Pty Limited** M Bogoievski, T Gattung, L Williams, CL Casey, E Eidenberg, R McGeoch. **AAPT US Inc** A Rogge, R Nissen, S Picton (R). **AAPT Wireless Holdings Pty Ltd** L Williams, A Rogge, R Nissen, R Dalgleish (R). **AAPT Wireless Pty Limited** L Williams, A Rogge, R Nissen, S Picton (R). **ATT@Phone Pty Limited** D Glavonjic. **Baird Invest. Pty Limited** L Williams, A Rogge, R Nissen, S Picton (R). **Birrell Properties Limited** DJ Bedford, MR Gillespie (R). **Cellphone City Limited** M Jesudason, CF Barclay (R), CG Aitken (R), G Clarke (R), TJ Harrington (R). **Cellular One Communications Limited** L Williams, R Nissen, D Baird (R), S Picton (R), M Baird (R). **Commerce Solutions Limited** L Williams, A Rogge, R Nissen, D Glavonjic, S Picton (R). **Comswest Pty Limited** AH Churchill, JC Bell. **connect.com.au Pty Limited** L Williams, A Rogge, R Nissen, D Glavonjic, S Picton (R), J Stuckey (R). **corpTEL Comm Limited** L Williams, A Rogge, R Nissen, S Picton (R). **corpTEL Mobile Pty Limited** L Williams, A Rogge, R Nissen, S Picton (R). **corpTEL Networks Pty Limited** A Rogge, R Nissen, S Picton (R). **corpTEL Pty Limited** L Williams, A Rogge, R Nissen, S Picton (R). **Digital Video Productions Pty Limited** AH Churchill, DJ Bedford, CE Greville (R), MR Gillespie (R). **Digital Video Services Pty Limited** JC Bell, AH Churchill. **EC–Pay Pty Limited** A Rogge, D Glavonjic, J Begley, A Robertson (A). **First Media Limited** DJ Bedford, MR Gillespie (R). **Interconnect Pty Limited** A Rogge, L Williams, D Glavonjic, S Picton (R), N Stuckey, (R). **New Zealand Telecommunication Systems Support Centre Limited** MO Milner, CJ Scollay, S Inoue, AN Briscoe (R), Y Yoshida (R), C Wakefield (R). **Ozphone Pty Limited** L Williams, A Rogge, R Nissen, S Picton (R). **Pacific Star Communications (NSW) Pty Limited** JC Bell, AH Churchill. **Pacific Star Communications (QLD) Pty Limited** JC Bell, AH Churchill. **Pacific Star Communications Pty Limited** JC Bell, RL Edwards, AH Churchill. **Pacific Star Mobile Pty Limited** K Devonshire, AH Churchill. **Pacific Star Services Pty Limited** JC Bell, AH Churchill. **Pacific Star Technologies Pty Limited** JC Bell, AH Churchill. **Parzolo Pty Limited** A Rogge, R Nissen, S Picton (R). **Queensland Cable Limited** L Williams, A Rogge, R Nissan, A Sharma, S Picton (R). **Seraph Comm Pty Limited** L Williams, A Rogge, R Nissan, D Baird (R), S Picton (R). **Stottholm Holdings Limited** R Nissen, A Rogge, A Sharma. **Sunnet Pty Limited** JC Bell, AH Churchill. **TCNZ (Bermuda) Limited** I Stone, J Collis, JC Bell, D Poole (A), C Adderley (A), K Pearce (A), PJ Duignan (A), MR Gillespie (R). **TCNZ (UK) Investments Limited** PJ Duignan, M Bogoievski, JM White (R), MR Gillespie (R). **TCNZ (UK) Securities Limited** PJ Duignan, R Walker, B Roberts, S Rumball. **TCNZ Australia Investments Pty Limited** M Bogoievski, AH Churchill, LR Edwards, JC Bell (R), JM White (R). **TCNZ Cook Islands Holdings Limited** DJ Bedford, PA Garty, MR Gillespie (R). **TCNZ Cook Islands Limited** DJ Bedford, PA Garty, MR Gillespie (R). **TCNZ Equities Limited** M Bogoievski, LM Cox (A), JM White (R), MR Gillespie (R), LM Cox (R). **TCNZ Finance Limited** TE Gattung, PJ Duignan, M Bogoievski, M Bogoievski (A) JM White (R), MR Gillespie (R), RS Deane (R), LM Cox (R). **TCNZ Financial Services Limited** M Bogoievski, LM Cox (A), JM White (R), MR Gillespie (R), LM Cox (R). **Teleco Insurance (NZ) Limited** M Bogoievski, LM Cox (A), MR Gillespie (R), JM White (R), LM Cox (R). **Telecom 1999 Limited** GA Mitchell, M Bogoievski, LM Cox (A), KG Stephen (R). **Telecom 2000 Limited** M Jesudason. **Telecom Cook Islands Limited** P Garty, C Jarvie, DJ Bedford (R). **Telecom Corporation of New Zealand (Overseas Finance) Limited** B Putterill, M Austen, M Bogoievski, MR Gillespie (R), PJ Duignan (R). **Telecom Credit Limited** M Bogoievski, LM Cox (A), JM White (R), MR Gillespie, (R), LM Cox (R). **Telecom Directories Limited** GR Mitchell, DJ Bedford (R), MR Gillespie (R). **Telecom Enterprises Limited** M Bogoievski, LM Cox (A), MR Gillespie (R), LM Cox (R). **Telecom Europe Holdings Aps** JJM Verhaak, LB Jeppesen, M Bogoievski, JM White (R), PC Olsen (R), STP de Greeff (R). **Telecom Europe Aps** JJM Verhaak, LB Jeppesen, M Bogoievski, JM White (R), PC Olsen (R), STP de Greeff (R). **Telecom Investments Limited** M Bogoievski, LM Cox (A), MR Gillespie (R), LM Cox (R). **Telecom IT Investments Limited** M Bogoievski, LM Cox (A), MR Gillespie (R), LM Cox (R). **Telecom N.Z. Limited** M Bogoievski, LM Cox (A), MR Gillespie (R). **Telecom New Zealand (UK) Licences Limited** AN Briscoe, SJ Rimmer, ACM Blaikie, SJ Rimmer. **Telecom New Zealand Australia Pty Limited** M Bogoievski, JC Bell, L Edwards, AH Churchill, MR Gillespie (R). **Telecom New Zealand Finance Limited** PJ Duignan, M Bogoievski, LM Cox (A), JM White (R), MR Gillespie (R). **Telecom New Zealand International Limited** DJ Bedford. **Telecom New Zealand International Australia Pty Limited** AN Briscoe, A Churchill. **Telecom New Zealand Japan Kabushiki Kaisha** AN Briscoe, CN Angrove, DJ Bedford, A Tierney (R), E Ikekame (R), M Ikeda (R), K Toma (R), E Sakaguchi (R). **Telecom New Zealand Limited** TE Gattung, DJ Bedford, M Bogoievski, LM Cox (A), JM White (R), MR Gillespie (R). **Telecom New Zealand UK Limited** AN Briscoe, SJ Rimmer, ACM Blaikie, SJ Rimmer. **Telecom New Zealand USA Limited** AN Briscoe, IA Neale, LB Miller, DJ Bedford. **Telecom Pacific Investments Limited** DJ Bedford, MR Gillespie (R). **Telecom Pacific Limited** JC Bell, M Bogoievski, LM Cox (A), JM White (R), MR Gillespie (R). **Telecom Pagenet Limited** M Bogoievski, LM Cox (A), MR Gillespie (R), LM Cox (R). **Telecom Purchasing Limited** M Bogoievski, LM Cox (A), JM White (R), MR Gillespie (R), LM Cox (R). **Telecom Samoa Cellular Limited** AN Briscoe, SE Tuioti, SR Petaia, DJ Bedford, CN Angrove. **Telecom Southern Cross Finance Limited** J Collis, I Stone, P Duignan, KA Pearce (A), D Poole (A), C Adderley (A), R Rawlins (R), A Tucker (R), A Simmons (R), JM White (R), KA Pearce (R). **Telecom Southern Cross Limited** M Bogoievski, PJ Duignan (A), MR Gillespie (R), JC Bell (R). **Telecom Telpage Limited** M Bogoievski, LM Cox (A), MR Gillespie (R), LM Cox (R). **Telecom US Leasing Limited** DJ Bedford, M Bogoievski, PJ Duignan (A), JM White (R). **Telecom Wellington Investments Limited** M Bogoievski, LM Cox (A), JM White (R), MR Gillespie (R), LM Cox (R). **The Mobile Phone Company Limited** M Bogoievski, LM Cox (A), MR Gillespie (R), LM Cox (R). **Wanzilla Pty Limited** A Rogge, R Nissan, S Picton (R). **Yellow Pages Limited** M Bogoievski, LM Cox (A), MR Gillespie (R), LM Cox (R).

Twenty Largest Registered Shareholders as at 18 August 2000

Rank	Full Name	Total	Percentage
1	New Zealand Central Securities Depository Limited	1,053,999,353	60.04
2	Bell Atlantic Holdings Limited	437,080,670	24.89
3	NZ Guardian Trust Company Limited – Corporate Trusts Number 5 Account	10,000,000	0.56
4	Perpetual Nominees Limited <PMISF a/c>	9,428,490	0.53
5	NZ Guardian Trust Company Limited	7,541,754	0.42
6	Mercantile Mutual Life Insurance Company Limited	6,471,118	0.36
7	Perpetual Trustees Nominees Limited	6,341,219	0.36
8	Citicorp Nominees Pty Limited	4,856,460	0.27
9	Queensland Investment Corporation	4,712,729	0.26
10	National Nominees Limited	4,338,938	0.24
11	Debenture Nominees Limited	3,769,146	0.21
12	Guardian Assurance Limited <equity fund>	3,458,800	0.19
13	Chase Manhattan Nominees Limited	3,350,456	0.19
14	Merrill Lynch (New Zealand) Limited	2,104,018	0.11
15	Debenture Nominees Limited	1,675,916	0.09
16	Perpetual Nominees Limited <ICIS a/c>	1,672,982	0.09
17	Amcil Limited	1,450,000	0.08
18	MLC Limited	1,407,652	0.08
19	Tower Trust Limited	1,293,462	0.07
20	Athene Nominees Limited	1,225,000	0.06

Analysis of Shareholding as at 18 August 2000

Range	Holder		Holding	
	Count	%	Quantity	%
1 to 499	8,677	15.19	2,604,385	0.15
500 to 999	10,663	18.66	7,421,058	0.42
1,000 to 4,999	29,713	52.00	60,064,555	3.42
5,000 to 9,999	4,934	8.63	31,113,015	1.77
10,000 to 49,999	2,877	5.04	46,295,991	2.64
50,000 and over	276	0.48	1,607,914,439	91.60
Total	57,140	100.00	1,755,413,443	100.00

Constitution

The Company is registered under the Companies Act 1993. New Zealand Stock Exchange rules require listed companies to include in their constitution one of three sets of provisions related to takeovers. The Company's Constitution contains Notice and Pause Provisions restricted to insiders.

Stock Exchange Listing

The ordinary shares of Telecom Corporation of New Zealand Limited ("Telecom shares") are listed on the New Zealand Stock Exchange and Australian Stock Exchange. Telecom shares are listed on the New York Stock Exchange in the form of American Depositary Shares.

Financial Calendar

Annual meeting	12 Oct 00
2000-01 First quarter results announced	14 Nov 00
First quarter dividend paid	Dec 00
2000-01 Half year results announced	Feb 01
Second quarter dividend paid	Mar 01
2000-01 Third quarter results announced	May 01
Third quarter dividend paid	Jun 01
2000-01 Financial Year end	30 Jun 01

Annual Meeting of Shareholders

Telecom's Annual Meeting of Shareholders will be held at the Michael Fowler Centre, Wakefield Street, Wellington, on Thursday, 12 October 2000 at 2.30 pm. A Notice of Annual Meeting and Proxy Form are circulated to shareholders with this Annual Report.

Registered Office

The registered office of Telecom is:

Telecom Networks House
68 Jervois Quay
PO Box 570
Wellington

Dividend Policy

Telecom's dividend policy is to distribute around 50% of net earnings, provided that the Company does not have alternative cash requirements for investment and other purposes.

Telecom's policy is to distribute net earnings through quarterly dividends, thereby reducing the time taken to distribute cash to shareholders. Details of these payments are released in conjunction with quarterly and annual announcements.

Telecom intends to continue paying fully-imputed dividends. Dependent on the level of imputation credits attached to dividends, the Company will pay supplementary dividends to non-resident portfolio shareholders. (The latter are non-resident shareholders who individually hold less than 10% of the shares). Supplementary dividends offset the effect of non-resident withholding tax. Telecom receives from the Inland Revenue Department a tax credit equivalent to supplementary dividends and there is, accordingly, no disadvantage to New Zealand resident shareholders. Some non-resident shareholders whose dividend income is taxable can claim a tax credit for the non-resident withholding tax which has been deducted.

Dividend Reinvestment Plan

As part of its shareholder relations programme, Telecom operates a Dividend Reinvestment Plan which offers shareholders the opportunity to directly increase their investment in Telecom. Shareholders may opt for full or partial participation in the plan. A copy of the Dividend Reinvestment Plan Offer Document and Participation Notice may be obtained on request from Telecom's share registries.

Dividends paid

The following is a summary of all dividends paid by Telecom since listing in July 1991. NZ cents per ordinary share, US cents per American Depositary Share (ADS).

	1st quarter	2nd quarter	3rd quarter	4th quarter
1992 NZ cents		6.50		6.50
US cents		72.62		70.93
1993 NZ cents		7.25		8.25
US cents		74.49		91.34
1994 NZ cents		8.25		14.75
US cents		89.90		141.46
1995 NZ cents		13.50		16.50
US cents		135.82		172.10
1996 NZ cents		17.00	8.50	9.50
US cents		178.05	91.66	103.36
1997 NZ cents	9.50	9.50	9.50	10.50
US cents	104.60	106.10	104.50	57.90
1998 NZ cents	10.50	10.50	10.50	8.00
US cents	62.65	49.19	55.96	32.99
1998 special dividend				
NZ cents			3.50	
US cents			18.05	
1999 NZ cents	11.50	11.50	11.50	11.50
US cents	46.55	47.95	48.95	48.97
1999 Interim June quarter				
NZ cents	11.50			
US cents	48.11			
2000 NZ cents	11.50	11.50	11.50	11.50
US cents	45.18	44.72	43.15	43.15*

** Estimated based on an exchange rate at 30 June of NZ$1 to US$0.4690.*

Shareholder Inquiries

Shareholders with inquiries about transactions, changes of address or dividend payments should contact Telecom's share registries.

New Zealand Registry
Computershare Registry Services Ltd
Level 3, 277 Broadway, Newmarket, Auckland.
(Private Bag 92119, Auckland)
Ph 0-9-522 0022
Fax 0-9-522 0058
NZ Toll Free 0800-737-100

United States Registry
Citibank Shareholder Services
PO Box 2502
Jersey City, NJ 07303-2502
US toll free 1877-248-4237
www.citibank.com/adr

Australian Registry
Computershare Registry Services Ltd
Level 3, 60 Carrington Street
Sydney, NSW 1137,
Australia
(GPO Box 7045, Sydney)
Ph 02 8234 5000
Fax 02 8234 5050
www.cshare.com.au

Contact telephone numbers:

Australia	1800-123-350
Canada	1800-280-0398
Hong Kong	800-962-867
New Zealand	0800-737-500
Singapore	800-641-1013
United Kingdom	0800-960-283
United States	1800-208-2130

Shareholder inquiries about Telecom's operating and financial performance should be emailed to **investor-info@telecom.co.nz** or addressed to:
Manager, Investor Relations
Telecom New Zealand, PO Box 570
Wellington, New Zealand

Visit our website at **www.telecom.co.nz**