

## Contents - Business Description and Financial Statements

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<sup>1</sup> This document includes the disclosure requirements of the US Securities and Exchange Commission (SEC) and will be lodged with the SEC as an Annual Report on Form 20-F. This column lists the item numbers required in Form 20-F and included herein.

The following items are omitted:

- Part I, Item 12: Options to Purchase Securities from Registrant or Subsidiaries; omitted as it is not applicable.
- Part I, Item 13: Interest of Management in Certain Transactions (refer Items 1 and 4).

- Part II, Item 14: Description of Securities to be Registered; omitted as not applicable.
- Part III, Item 15: Defaults upon Senior Securities; omitted as there have been no defaults.
- Part III, Item 16: Changes in Securities and Changes in Security for Registered Securities; omitted as there have been no changes.

<sup>2</sup> All schedules have been omitted since they are not required under the applicable instructions or the substance of the required information is shown in the financial statements. There are no exhibits.

## Exchange Rates

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Telstra Corporation Limited publishes its consolidated financial statements in Australian dollars (A\$ or \$). Unless otherwise specified or the context otherwise requires, all dollar amounts are expressed in A\$. For the convenience of the reader, this report contains translations of certain Australian dollar amounts into US dollars (US\$) at a specified exchange rate (as at 30 June 1998). These translations should not be construed as representations that the A\$ amounts actually represent such US\$ amounts or could be converted into US\$ at the rate indicated. Unless otherwise stated, the translations of A\$ into US\$ have been made at the rate of A\$1.00 = US\$0.6208.

The following table sets forth, for the periods and dates indicated, information concerning the rates of exchange of A\$1.00 into US\$ based on the noon buying rate in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York.

Year Ended 30 June	US\$ per A\$1.00			
	At Period End	Average Rate <sup>(1)</sup>	High	Low
1994	0.7310	0.6926	0.7438	0.6450
1995	0.7108	0.7412	0.7778	0.7108
1996	0.7856	0.7627	0.8026	0.7100
1997	0.7550	0.7814	0.8180	0.7455
1998	0.6208	0.6805	0.7537	0.5867

<sup>(1)</sup> The average of the Noon Buying Rates on the last day of each month during the year.

Fluctuations in the A\$ to US\$ exchange rate will affect the US\$ equivalent of the A\$ price of the Shares and the Instalment Receipts (IRs) on the ASX and, as a result, are likely to affect the market price of Telstra's American Depositary Shares (ADSs) and Interim ADSs in the United States. Such fluctuations would also affect the US\$ amounts received by holders of ADSs and Interim ADSs on conversion by the Depositary or Interim Depositary, as the case may be, of cash dividends paid in A\$ on the Shares and the IRs underlying the ADSs and Interim ADSs, respectively. In addition, such fluctuations will affect the amount of the Final Instalment with respect to the ADSs, due on 17 November 1998, which will be the US\$ equivalent of the Final Instalment based on the then-prevailing exchange rate.

## Item 1: Description of Business

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### Overview

Telstra Corporation Limited (referred to as the Telstra Entity) and its controlled entities collectively referred to as Telstra (or the Telstra Group or the Company), is Australia's principal telecommunications company. Telstra offers a broad range of telecommunications and information services and is permitted to compete in all telecommunications markets throughout Australia. The Company's principal activities include providing telephone exchange lines to homes and businesses, supplying local and long distance telephone calls in Australia and international calls to and from Australia, supplying mobile telecommunications services and providing a comprehensive range of data, Internet and on-line services and, through its affiliates, pay television. The Company is also the principal provider of directory services in Australia.

Telstra is the largest mobile telecommunications company in Australia, with a national digital network covering the area in which 94 per cent of the Australian population resides and international roaming for its digital service in 55 countries. Australia is one of the leading mobile telecommunications markets in the world with approximately 28 per cent of the population owning a mobile telephone as at 30 June 1998. At this time, the Company had an estimated 56 per cent share of the Australian mobile telephone market, with over 3 million MobileNet® customers. Telstra is also a leader in mobile telecommunications technology. For example, it was the first mobile telecommunications company in the world to offer, on a commercial basis, Global System for Mobile Communications (GSM) based Internet access via mobile telephones.

The markets in which the Company operates have undergone significant liberalisation in recent years as Australia has moved towards open competition. Telstra has been subject to competition in the national long distance and international telephone service markets since 1991 and in the mobile telephone service market since 1992. On 1 July 1997, Australia's telecommunications markets were opened to full competition, with no limit on the number of telecommunications Carriers that may enter the market. As this open-market environment has only recently come into existence, there is uncertainty as to how competition will develop and the effect that it will have on the Company. While this changing environment has presented, and will continue to present, significant challenges for Telstra, the Company has implemented strategies to address this evolving regulatory and competitive environment. Telstra believes that today's open market environment provides new opportunities for the Company to respond to competitive pressures. For example, Telstra now has greater freedom to develop product packages and pricing plans tailored to meet the specific needs of particular customer segments.

### Strategy

Telstra's vision is to enhance its position as the leading telecommunications and information services company in Australia and to become a leading provider of such services in the Asia-Pacific region. To realise this vision, increase shareholder value and prepare for competition, the Company

has adopted a four-part growth strategy which has been in place since 1992. This strategy entails:

- ***Optimising returns from traditional telecommunications products and services in Australia***

Telstra is implementing ways to use its assets more efficiently, enhance its extensive distribution capabilities and improve productivity in the delivery of its traditional services. It has also taken action to improve marketing and sales, control costs and enhance customer service. Initiatives include re-organising its business units to serve customer segments more effectively and introducing new products.

- ***Developing and delivering value-added telecommunications, on-line and content services***

To exploit the convergence of telecommunications, computing and media technologies, Telstra is moving further into value-added and content-based services, in some cases through joint ventures. This strategy has been a part of Telstra's move into major Broadband initiatives. This strategy includes: developing the Integrated Services Digital Network (ISDN) as a value-added alternative to basic access; delivering pay television and on-line services; packaging solutions for fixed, mobile and Internet services; and customising virtual private network solutions for large customers. To complement Telstra's expertise, the Company has established joint ventures with The News Corporation Ltd (News Corporation) for pay television, with IBM Australia Ltd (IBM Australia) and Lend Lease Corporation Limited (Lend Lease) for network and information technology services, and is working with other partners and suppliers to provide a range of on-line services in legal information, finance and travel.

- ***Transforming corporate culture and improving productivity***

Telstra is transforming its corporate culture and improving productivity with the objective of lowering its cost base relative to revenue and positioning itself for competition. This involves continuing to change to meet evolving customer requirements, making major changes to work practices and improving management accountability and commercial discipline. The Company is also redeploying and reducing its workforce and outsourcing where appropriate. Telstra has invested substantial resources over the past several years to develop technologically advanced infrastructure and systems. This is expected to result in reduced labour costs, and improve operating flexibility and service reliability.

- ***Extending global scope***

Telstra is focused on increasing its global scope through directly investing in selected markets and serving wholesale and multinational customers. The Company's expertise in providing fixed and mobile telecommunications services creates significant growth opportunities in the Asia-Pacific region. Telstra has established businesses in several countries, including Vietnam, Indonesia and India.

## Item 1: Description of Business

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In an increasingly demanding global market, Telstra is strengthening its ability to provide seamless delivery of products and services to internationally oriented companies. Telstra has recently reviewed its international strategy. As part of this, Telstra is to expand its international Points of Presence (PoPs) in key target markets, with a focus on capturing increased revenues from multi-national corporations (MNCs). The planning and approval for the first PoPs in Japan, Korea, Hong Kong, Europe and the United States is complete and the establishment of businesses is underway. The increased focus on international PoPs has, in part, been precipitated by significant growth in Telstra UK Limited (Telstra UK) and Telstra (New Zealand) Limited, (Telstra New Zealand). To further strengthen its global reach Telstra is a member of a number of international alliances. It is a foundation member of Infonet Inc. and it is also a current member of WorldPartners Company (World Partners). In July 1998, AT&T Corp (AT&T), the largest equity participant in WorldPartners, and British Telecommunications plc (BT) announced the formation of a new alliance and AT&T indicated that WorldPartners, in its current form, will not be continued past December 1999. Continued volatility in international alliance relationships puts this area of activity under regular review. Telstra is continuing to explore arrangements to enhance its ability to support MNCs.

### Competitive and Regulatory Environment

On 1 July 1997, the Australian telecommunications regulatory regime was further liberalised to allow for open competition. While previously there was no limit on the number of providers of telecommunications services, Government policy limited the number of Carriers. The new legislation fosters increased competition in the industry by removing this limit and places greater emphasis upon industry self-regulation and commercial negotiation. As at 30 June 1998, there were 21 licensed Carriers, including Telstra. To date, new competitors have been most active in capital cities. The overall regulatory framework is now overseen principally by the Australian Competition and Consumer Commission (ACCC) and the Australian Communications Authority (ACA).

Telstra will continue to be subject to competition in the provision of mobile telecommunications, national long distance telecommunications, international telephone, video and data services, and faces greater competition in markets such as basic access and local calls where there has previously been relatively limited competition. Telstra expects that there will be many new competitors in its markets and that new and existing competitors will develop telecommunications infrastructure, services and new products based on access to Telstra's own services and facilities.

While the ACCC plays a major regulatory role in this area, the new regulatory environment encourages commercial negotiation between Carriers before disputes are referred to the ACCC. Telstra has reached interconnect agreements with a number of Carriers in relation to a wide range of areas, including Public Switched Telephone Network (PSTN), mobiles, leased transmission, resale and Internet. The regulatory environment is discussed in detail later under Item 1.

### Organisation

In order to have a strong customer focus, Telstra is organised into the following principal strategic business units and corporate centre functions:

#### Strategic Business Units

- **Commercial & Consumer** is responsible for sales and service delivery to more than seven million residential and small business customers as well as management of the Company's operator assisted services and payphones.
- **Business & International** is responsible for sales and services to larger businesses, the Commonwealth, State and Territory governments. In addition, Business & International manages the Company's satellite and radio services, global business services, international operations and international joint ventures.
- **Products & Marketing** is responsible for Company-wide product management for access and local calling services, long distance and intelligent network services, mobile services, customer premises equipment, Internet data services and interconnect services.
- **Network Technology Group & Multimedia** is responsible for the planning, design, construction and operation of the Company's domestic, international, fixed and mobile telecommunications networks and associated systems required to deliver the Company's products, services and customer support. This unit is also responsible for technology strategy, vendor relationships and selection, and research and development within the Company. The unit also manages the Company's pay television interests which are conducted through the FOXTEL joint venture (a 50/50 partnership with News Corporation) as well as managing the Company's joint venture interests in Atlas Travel Technologies Pty Ltd (Atlas), Lawpoint Pty Ltd (Lawpoint), Advantra Pty Ltd (Advantra), IBM Global Services Australia Ltd (IBMGSA) and the Company's 75 per cent owned directory services controlled entity, Pacific Access Pty Ltd (Pacific Access).
- **Carrier Services Group**, formed on 1 January 1998, is responsible for managing Carrier and service provider customers and suppliers in Australia and overseas and aims to be the preferred wholesale supplier of domestic and international telecommunications products and services to this customer segment. This unit is responsible for negotiating arrangements for delivering call and data traffic into and out of Australia.

**Commercial & Consumer, Business & International** and **Carrier Services Group** are responsible for sales and services to the Company's customers. Telstra reinforces its strong customer focus with company wide product management from **Products & Marketing**. This group works actively with the direct sales divisions and with **Network Technology Group & Multimedia** to identify customer segment needs, introduce new products and services, develop pricing and packaging plans, implement distribution strategies, manage product life cycles and reduce product unit costs.

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### Corporate Centre Functions

- **Finance & Administration** provides corporate policy and support functions across Telstra's strategic business units, including finance, audit and risk management, treasury operations, legal counsel, corporate secretarial functions, corporate strategic planning, investor relations and other corporate services.
- **Regulatory & External Affairs** manages regulatory strategy and operations, corporate and public affairs, government relations, consumer affairs, stakeholder and issues management.
- **Employee Relations** manages personnel, industrial relations, health and safety, training and leadership development programmes.

### Marketing and Customer Service

Telstra's marketing and customer service strategy is focused on serving each customer with seamless delivery of products and services. With a broad range of telecommunications expertise, Telstra aims to provide a "one-stop shop" for large and small customers. The Company has built one of the strongest brands in Australia which has been supported by a national advertising and promotion campaign with the theme Making Life Easier™ to enhance customer loyalty and foster retention.

Telstra has an ongoing programme of initiatives to improve customer service, product quality and assurance. Initiatives include the modernisation and digitalisation of its networks, the implementation of its integrated information and billing systems, and the implementation of new work practices. These initiatives are expected to improve the Company's speed to market, cost structure and ability to offer a broad range of customer focused solutions. In addition, the Company's Making Life Easier™ theme is being integrated into the approach of sales and customer support staff. Segment specific campaigns are also being developed including the "People with Initiative" slogan which was launched early in calendar 1998 for the small business market.

The Company's significant customer base gives it the opportunity to market a broad range of products and services throughout Australia. Telstra segments its customer base to serve the differing needs of its customers more effectively. For each segment, the Company seeks to customise its advertising and promotion, customer contact and sales channels and product design and support. Telstra incorporates segment information into its sales systems so that each customer contact can be tailored to the needs of that particular customer. To generate new sales and reach niche customer segments, Telstra intends to rely less on mass media, emphasising instead direct marketing and sales promotions and an increasing use of new media, such as the Internet. Telstra has also established two co-branded Visa card programmes with Australia and New Zealand Banking Group Limited to enhance customer loyalty and retention and promote Telstra's products and services. These programmes are the Telstra Visa card and the Qantas Telstra Visa card. Qantas Airways Limited is a partner in the latter programme.

Approximately 1.35 million cards, in total, have been issued under these programmes.

### Residential Customers and Small Businesses

Telstra segments its approximately 6.9 million residential accounts and approximately 550,000 small business accounts into six segments: young adults, establishers (young homemakers), mature households, home office customers, masters (aged 55 and older) and small businesses. The Company tailors its product and service packages based on the key life stage drivers and associated telecommunications needs of each of the five residential segments. The Company supports these packages with an advertising strategy designed to stimulate usage.

Telstra operates a sales and service network that, in fiscal 1998, received approximately 23.5 million calls and is responsible for sales of products and services, customer service for general and billing enquiries, credit management, order processing, service removals and transfers and referrals for third party products. The Company has enhanced its sales support systems to assist sales representatives in pursuing marketing opportunities during customer enquiries. Telstra also conducts telemarketing campaigns, including promotions targeting particular products, geographic areas and customer segments. The Company's commission-based field sales force markets solution based products and services to small businesses and residential customers.

### Medium and Large Businesses and Governments

Telstra provides medium and large businesses and state and federal governments with a comprehensive range of products, services and customer-driven solutions, from basic services to complex voice and data networks and totally managed solutions. Telstra has segmented its medium and large business and government customer base by size and industry to help identify their key business drivers and telecommunications needs and to develop appropriate product packages.

Telstra's account managers are supported by telesales professionals, engineers, communication consultants and technical design specialists. This team is backed by customer ordering and provisioning, billing and service assurance systems specifically developed to meet the needs of this sector. In addition, Telstra uses a variety of indirect channels such as dealers, Service Providers, equipment suppliers and other alliances and partners to ensure business and government customers' needs are met in the most cost effective manner.

### International Businesses

Telstra offers multinational corporations and small and medium-sized exporters a single source of telecommunications services. The Company has sales and technical professionals located in New Zealand, the United Kingdom, the United States, Hong Kong, China, Vietnam, Singapore, Japan, India and Indonesia. Telstra has switching facilities in the United Kingdom and New Zealand and proposes to extend these to the United States, Hong Kong, Japan, Korea and Europe within the next two years.

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### Mobile Telecommunications Customers

Telstra's mobile telecommunications marketing reinforces the Company's strong MobileNet® brand. The Company uses both internal and external sales channels. The same internal sales networks that target the Company's medium and large business customers also sell MobileNet® services. In addition, Telstra owns and operates 70 shops nationwide which sell a range of consumer telecommunications products, including mobile telecommunication services. External channels consist of third party retail stores, dealers and independent contractors. Telstra's mobile telephone products and services are retailed to businesses and residential customers through more than 1,800 outlets nationwide. Telstra also deals with two independent contractors which operate nationally and handle their own billing and customer care, although the customers remain Telstra's customers. Telstra also sets the prices that are charged. Telstra pays the independent contractors a connection commission and a percentage of revenue.

### Directory Services Advertisers

Telstra, through Pacific Access, distributes Whites Pages™ directories and Yellow Pages® directories to virtually every household and business in Australia. The Company endeavours to stimulate usage of its directory products through general advertising and promotion (emphasising the directories' ease of use and comprehensive listings), thereby enhancing their value as an advertising medium. Pacific Access is developing, on behalf of Telstra, a range of electronic commerce and Internet services which expand the positioning of Yellow Pages® and White Pages™ directories brands into new advertising and content service mediums.

### Pay Television and On-line Services Subscribers

Pay television services are marketed to residential customers in Australia through FOXTEL. FOXTEL packages the

programming content, markets and sells the service and supports the customers. FOXTEL engages in a number of marketing initiatives to maximise the market penetration and reduce churn for pay television services, while Telstra operates the necessary customer database and activation systems for the cable system.

The Company markets its on-line services, particularly Big Pond® Internet services, through retail outlets and the Internet.

### Wholesale Customers

Telstra has established a dedicated group to serve the specific needs of its wholesale customers. Telstra's wholesale customers include Carriage Service Providers (CSPs) (switched and non-switched) and Internet Service Providers (ISPs). The Company's approach to this customer segment, together with the products and services offered, is driven not only by regulation, but also by the commercial importance of this growing segment. Marketing initiatives undertaken by the Company in general have focused on three key areas: Resellers, interconnection to Carriers, and international inpayment from other Carriers including transit/refill traffic. In particular, Telstra encourages CSPs to acquire a full range of the Company's services, complemented by their own products and services, and to repackage these to increase value to customers. Telstra is also taking steps to enhance the suitability of service for its wholesale customers, including the planned introduction of limited automated access to Telstra's systems and revised billing procedures.

### Products and Services

Telstra offers a broad range of telecommunications and information services allowing it to provide virtually all the telecommunications needs of its diverse customer base. The following table shows Telstra's operating revenue by major product and service category for the last three fiscal years and expressed as a percentage of total operating revenue. See Item 9.

	Year Ended 30 June					
	1998		1997		1996	
	A\$m	%	A\$m	%	A\$m	%
Basic access . . . . .	1,770	10	1,740	11	1,727	11
Local calls . . . . .	2,664	15	2,664	17	2,669	18
National long distance calls . . . . .	2,594	15	2,455	15	2,505	16
International telephone services . . . . .	1,380	8	1,342	8	1,338	9
Mobile telecommunications services . . . . .	2,154	13	1,981	12	1,705	11
Data and text services . . . . .	2,097	12	1,883	12	1,574	10
Directory services <sup>(1)</sup> . . . . .	1,013	6	723	5	709	5
Customer premises equipment . . . . .	538	3	576	4	611	4
Intercarrier services . . . . .	582	3	558	3	485	3
Public payphones . . . . .	225	1	248	2	259	2
Other sales and services . . . . .	1,802	11	1,266	8	1,134	8
Sales revenue . . . . .	16,819	97	15,436	97	14,716	97
Other revenue <sup>(2)</sup> . . . . .	483	3	547	3	523	3
Operating revenue . . . . .	17,302	100	15,983	100	15,239	100

(1) 1998 includes the consolidation of Pacific Access into the Telstra Group for the first time.

(2) Other revenue includes interest received/receivable, proceeds from sale of assets/investments, dividends received/receivable and miscellaneous revenue.

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### Basic Access

Telstra provides basic access service to most homes and businesses in Australia. A portion of the Company's basic access service is provided on a rebill basis to Resellers who on-sell such services. Telstra's basic access service consists of the installation, rental and maintenance of connections between a customer's premises and the PSTN for the provision of basic voice, facsimile and Internet services. As such, it excludes enhanced products such as ISDN access and FaxStream® services. Telstra also charges customers for connecting new lines and reconnecting existing lines. A significant amount of cross-subsidisation occurs in favour of rural residential customers because generally the Company charges the same rate to all residential customers.

Residential basic access line growth is driven principally by housing growth and the demand for second basic access lines. Growth in business basic access lines has historically tracked economic growth in Australia. Basic access line growth has been offset, to a certain extent, by the Company's success in encouraging its customers to adopt higher value-added services such as ISDN and FaxStream® services. This migration has been assisted by growth in home offices and increasing customer requirements for integrated voice and data solutions.

Demand for supplementary basic access lines arises from increasing customer convenience requirements, Internet access demand and demand for other services such as dedicated facsimile lines. Although Telstra's ability to promote second lines has in certain cases been constrained by existing capacity, the Company markets second lines in areas where it has capacity available and augments capacity in some areas through the use of technologies such as pair gain systems, line concentrators, fixed radio access and ISDN. Telstra is also investigating technologies such as Asymmetric Digital Subscriber Lines (ADSL) and satellite to enhance capacity to meet retail and wholesale market demand.

### Local Calls

Basic access to Telstra's PSTN provides customers with local calling ability and, as a result, the Company currently provides local call service to virtually all of the residential market and a substantial majority of the businesses in Australia. In addition, Telstra provides local call service to Resellers on a rebill and resale basis, with agreed discounts from its retail price. In general, Telstra charges for local calls on an untimed per call basis.

A benefit of the Company's Networks and Systems Modernisation Programme is the upgrade of the PSTN to allow the Company to offer a wide range of advanced network products and services. Telstra is focused on increasing local call volumes by offering customers services which are designed to increase call stimulation. These include complimentary services such as Call Waiting and Call Forwarding and billable services such as Call Conferencing, Voicemail and Calling Number Display.

### National Long Distance Calls

Telstra is the leading provider of national long distance services in Australia. In addition to providing service to its residential and business customers, the Company also provides national long distance services to Resellers on a rebill basis.

National long distance calls are generally charged based on duration, destination, time of day and day of week. Charges for fixed-to-fixed calls are calculated on a per second basis (after a call connection fee), except in limited instances, and for fixed-to-mobile calls are charged in A\$0.25 multiples. As for local calls, Telstra's complimentary Call Waiting and Call Forwarding services, as well as its billed services, such as Call Conferencing and Voicemail, increase billable minutes.

Telstra offers a variety of short-term special promotions to stimulate volumes and positively influence customers' price value perceptions. National long distance traffic is principally driven by the state of the economy and, particularly in the case of residential customers, by price. As a natural consequence of increased mobile telephone penetration, fixed-to-mobile calls are becoming an increasingly important part of the national long distance market.

Prices have fallen significantly over the last decade, driven by technology improvements and, more recently, competition. Customers have responded with increased calling activity, leading to overall market growth, although competitive pressures continue to affect prices.

### International Telephone Services

Telstra is currently the leading provider of international telephone services in Australia. Telstra offers its customers international telephone service to 230 countries and territories. In addition, the Company offers international outbound telephone service to Resellers on a rebill basis. Similar to national long distance calls, international telephone calls are generally charged based on duration, destination, time of day and day of week. Except in limited circumstances, charges are calculated on a per second basis, after a call connection fee.

Telstra's residential customers generated a substantial majority of the Company's international outgoing traffic in fiscal 1998. As a result, outgoing traffic is principally influenced by economic conditions and is price sensitive. Residential customers tend to treat international calls as a discretionary expense more so than they do national long distance calls. The Company uses a variety of marketing initiatives, including price promotions, to stimulate outgoing calls. As prices have fallen, customers have responded with increased calling activity. During fiscal 1998, the three principal destinations of Telstra's international outgoing calls were the United Kingdom, New Zealand and the United States, representing 19 per cent, 15 per cent and 13 per cent respectively, based on international outgoing minutes for settlement purposes. In the same period, the three principal sources of Telstra's international incoming calls were also the United States, New Zealand and the United Kingdom, representing 23 per cent, 19 per cent and 17 per cent of international incoming minutes, respectively. While competition has led to a significant decline in the Company's



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market share in recent years, it has also stimulated overall market growth and such trends are expected to continue as new competitors enter this market.

An integral part of providing its domestic customers with an international outbound telephone service is Telstra's role in terminating inbound international calls for international Carriers pursuant to bilateral settlement agreements. Consistent with current international convention, Telstra settles its traffic balance payments with other Carriers through bilaterally determined accounting rates. The current international settlements structure has recently come under pressure from initiatives by the United States Federal Communications Commission to lower accounting rates and from increased competition among international Carriers and others. On an aggregate basis, Telstra's payments to international Carriers have exceeded its receipts from such Carriers reflecting the mix of outbound and inbound traffic. As a result, Telstra has advocated lower international accounting rates in order to improve its cost structure.

Telstra also provides international Carriers switched transit services whereby traffic from one country is switched via Telstra's network to another country. In certain circumstances, Telstra acts as an intermediary and charges a transit fee. In other circumstances, Telstra acts as principal and charges fees determined pursuant to international settlement agreements.

### Mobile Telecommunications Services

Telstra is the leading provider of mobile telecommunications services in Australia in terms of number of customers and geographical coverage of its services. The Company has a history of technical innovation in the development of new mobile products and provides its customers with a range of information services. Telstra has demonstrated its ability to operate in the highly competitive Australian mobile telephone market, relying on its innovative marketing plans, diverse distribution capabilities and strong MobileNet® brand.

Telstra's mobile telecommunications services include both analogue and digital cellular services, sales of mobile handsets and a wide range of value-added services. Telstra owns and operates both an analogue Advanced Mobile Phone System (AMPS) mobile telecommunications network and a digital GSM mobile telecommunications network. The digital GSM network currently provides coverage for areas in which 94 per cent of the Australian population resides whilst the analogue AMPS provides coverage for areas in which 93 per cent of the Australian population resides. Telstra is continuing to expand digital coverage into regional centres and along highways linking regional centres, and is also focused on improving the depth of coverage, particularly in-building and underground coverage, in major cities.

### Analogue Service

Telstra operates the only permitted analogue AMPS mobile telecommunications network in Australia. As required by regulation, however, Telstra sells capacity on its analogue network to Optus Communications Pty Limited (Optus), although the revenue from the provision of these services is

recorded as intercarrier services revenue. In addition to mobile voice telephone service, the Company offers analogue customers a number of value-added services including Voicemail, Call Waiting and Call Forwarding. Customers are offered a variety of pricing options which vary depending on committed usage rates. Telstra also generally charges an activation fee. This network is being progressively shutdown as required by legislation. While all metropolitan analogue AMPS sites will close as originally required by 31 December 1999, some non-metropolitan parts of the network may remain open for a maximum further 12 month period. This will be dependent on agreement between Telstra, Optus, Vodafone and the Government.

Telstra will continue to invest considerable resources to migrate its analogue customers to its digital GSM service and, when it is introduced, to the digital service which is to be provided over its new mobiles network. In order to assist this migration, Telstra has developed, and will continue to develop, targeted programmes and offerings for its analogue customers.

### GSM Digital Service

Telstra offers GSM digital mobile telephone service that allows customers in the 900 megahertz (MHz) band to send and receive voice and data calls. The Company offers its GSM digital customers the same value-added services that it offers its analogue customers and also provides mobile facsimile and data services. Other digital mobile services include operator assisted paging, operator through connect, short message services, financial and sports information services and international roaming in 55 countries. Telstra believes that these value-added services enhance customer loyalty and satisfaction and improve usage rates.

Telstra offers GSM digital customers different pricing options which vary depending on committed usage rates. GSM digital customers who opt for a higher monthly access fee generally pay a lower overall usage rate. Telstra also generally charges customers an activation fee.

The number of Telstra's GSM digital mobile customers has increased rapidly since the Company introduced GSM digital services in 1993. Telstra attributes this growth to the increasing recognition of the value of mobile service by both business and private users, the coverage and enhanced features of its GSM digital service and the Company's strong distribution capabilities, particularly in retail stores. The growth in GSM digital customers has recently also been positively affected by the Company's efforts to migrate its analogue customers to its GSM digital service. As the penetration of GSM digital mobile services has increased, the Company initially witnessed declining billed minutes per customer. However, this trend has slowed over recent months due to the introduction of a range of initiatives aimed at increasing usage, particularly the increased use of messaging services.

Telstra recently purchased 1800MHz radio spectrum which it will be utilising to expand capacity on its existing GSM networks. The 1800MHz radio spectrum will not be available for use in the metropolitan areas of Sydney, Melbourne, Brisbane, Adelaide and Perth until after 31 December 1999 unless otherwise agreed



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with the incumbent users of that spectrum. The 1800MHz radio spectrum outside metropolitan areas will not be available for use until after 31 December 2000. Dual band handsets (GSM 900/1800) will be required to enable Carriers or customers to utilise the 1800MHz radio spectrum. These handsets are available and will increase in number as new dual band models replace current single band ones.

### **New Mobiles Network**

Telstra is planning to establish a new mobiles network based on digital technology using recently purchased 800MHz radio spectrum. Telstra is evaluating Code Division Multiple Access (CDMA) and Time Division Multiple Access (TDMA) technologies to meet technical and commercial requirements, including their suitability for rural areas. Telstra intends that the new network will operate alongside and complement Telstra's existing GSM products.

Telstra is currently negotiating with major suppliers of the new technologies to meet its technical and commercial requirements and plans to conduct trials of the new network in early calendar 1999.

### **Data and Text Services**

#### *Private Networking & Data Services*

Telstra provides a range of private networking and data services which allows customers to transmit and receive data. To provide packaged solutions, Telstra markets these services under the Fractal™ brand using a strategy based on emphasising customer relationships and customer driven solutions, rather than the use of particular technologies. The Company develops customer solutions by integrating networks and systems, co-ordinating internal and external support channels, and utilising partners and international alliances. The Company also provides voice services through dedicated leased lines and virtual private network solutions. Telstra is realigning the prices of its private networking and data services to maximise the use of its existing network infrastructure and to minimise customer churn on the basis of price both across the Company's services and to competitors.

#### *Dedicated Network Product*

Telstra provides point-to-point dedicated leased lines, on a managed or unmanaged basis, which business and government customers can use to assemble their own private networks or which Resellers can use to establish their own telecommunications networks in order to offer telecommunications services. Telstra also offers voice-grade dedicated lines although the Company is encouraging these customers to migrate to alternative solutions.

#### *VPN Services*

The Company offers virtual private network solutions which use network intelligence and infrastructure to provide business customers with the functionality of a dedicated private voice network. Virtual private network solutions provide customers with a wide range of access points, tailored billing and reporting,

network features like call barring and short-code dialling, network management and price discounts.

#### *LAN/WAN Services*

Telstra offers a set of local and wide area network solutions. These solutions address a number of market dynamics: the shift from dedicated to switched data services; the demand for higher speed services and packet data transmission; the shift towards Internet protocol environments; and the increased networking of computers. These solutions are built with advanced data switching technologies, including frame relay, Asynchronous Transfer Mode (ATM) and related technologies.

#### *Transaction Services*

Telstra offers several low speed, national, packet switched data services (over a multiprotocol platform, one of which is X.25) designed mainly for transaction services. For example, Telstra provides end-to-end connections for electronic funds transfer applications. The Company also offers dial-up and leased line transaction services across several technologies, including ISDN. The current transaction platform is being replaced which will result in a more flexible service and reduced costs.

#### *International Dedicated Leased Lines*

Telstra provides international leased lines to corporations and providers of telecommunications services to enable them to assemble their own international dedicated private networks. These are offered at a range of speeds. In addition, the Company provides, with the assistance of its international partners, end-to-end global managed network services particularly to its multinational corporate customers.

#### *ISDN Services*

Telstra offers ISDN access services for residential and business customers which require greater bandwidth than that provided by traditional basic access service. ISDN enables customers to make telephone calls, send high-speed data or hold video conferences, separately or simultaneously, over a single service. As part of the Company's Networks and Systems Modernisation Programme, Telstra is integrating ISDN service capability into its PSTN, rather than providing such service via an overlay network, making the service more widely available at lower prices and cost.

#### *Text Services*

Telstra's text services consist principally of facsimile products and services marketed under the FaxStream® brand. The Company also offers enhanced FaxStream® service features such as the ability to hold and store facsimiles, retrieve stored facsimiles, and forward facsimiles to alternative locations. In addition, the Company's FaxStream® Duet service provides customers with multiple numbers on a single access line. The Company charges the same line rental fee for its FaxStream® service as it does for its basic PSTN access service. Additional fees are charged for the use of enhanced features. The facsimile market in Australia has been characterised by an increasing number of small business and residential users, partially offset

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by high volume customers migrating to alternative technologies, such as email.

### Directory Services

Telstra is the principal provider of directory services in Australia, offering printed White Pages™ directories and Yellow Pages® directories, voice directory services, electronic and multimedia services and a portfolio of specialist products and services. The Company provides these services through Pacific Access and continues to develop its directories business through the introduction of new value-added information products and services through multiple media sources. Internationally, the Company has pursued a number of opportunities, including the purchase of a business in Singapore with directory interests in Vietnam, a specialist directories products business in the United States and a previous directory publishing venture in Laos, designed to gain experience in Asian based operations.

Telstra's printed directory portfolio includes six metropolitan, 49 regional and 17 local Yellow Pages® directories and White Pages™ directories, a national business directory, a directory for the hearing impaired and a corporate directory. In addition to printed products, the Yellow Pages® directories portfolio also includes various voice products, including recorded information and facsimile response services, Yellow Pages® Direct on which advertisers can purchase "priority listings", and multimedia services, including publication of the Yellow Pages® directories on the Internet which provides every business in Australia an Internet address, and various Internet advertising options. The Company operates two Internet sites, Yellow Pages® and White Pages™, that are regularly placed in the top 10 Australian sites. In addition, the Company operates the Australasian Alta Vista mirror site, licensed from Compaq Computer Corporation which is also regularly placed in the top 10 Australian sites. Business customers are able to list their business details in the Yellow Pages® directories free of charge, or purchase premium advertising and promotional space. The White Pages™ directories portfolio also includes various multimedia products, including Internet and CD ROM products. Each telephone subscriber receives one free listing by name, address and telephone number in the White Pages™ directories and can purchase special listings or pay for an unlisted number.

In addition to its core products, Telstra offers multimedia services, including its new product of on-line shopping connected to SureLink™ secure transaction processing. Telstra provides customers with value-added services and businesses with customer segmentation capabilities and new advertising media. These services include complementary software that provides multilayered directory information, databases for in-vehicle navigation systems, Internet advertising alternatives and international gateway services enabling offshore directory services. Telstra also offers services which assist commercial customers in business planning through the provision of demographics, mapping services and other marketing information segregated by geographic area.

### Customer Premises Equipment

Telstra participates in the following segments of the market for customer premises equipment: (i) sales, rental, installation and

maintenance of Telstra branded small business telephone systems; (ii) installation and maintenance of PBX telephone systems; (iii) sales of Telstra branded telephones, answering machines, facsimile machines and other telecommunications products; and (iv) the Company's Universal Service Obligation to make available on request, on a rental basis, a customer's first telephone. Telstra purchases from third party suppliers all of the equipment that it sells or rents. Customer premises equipment services have not been profitable for the Company but ongoing cost reduction initiatives have moved the portfolio closer to profitability over the years. The Company has been examining outsourcing and strategic partnership opportunities for parts of its customer premises equipment business and, shortly after fiscal 1998, Telstra sold its Commander® small business systems business into a joint venture company, PlesTel Pty Ltd (PlesTel), owned by Plessey Asia Pacific Pty Ltd (70 per cent) and Telstra (30 per cent).

### Intercarrier Services

Telstra provides a range of services to Carriers. These include the provision of interconnection, transmission services (including leased lines) and wholesale provision of certain of its retail products and services (including basic access, local calls, national long distance and international telephone service and mobile telecommunications services). The interconnection services provided to Carriers include the provision of origination and termination of calls (both to and from fixed and mobile networks), preselection services, switched trunk and transmission services, and access to certain network facilities and established points of interconnection. Telstra provides systems services such as systems maintenance and billing system services to support the provision of Intercarrier services.

Telstra is also required to provide analogue mobile telecommunications services on a resale basis including for limited periods to certain competitors who, along with Telstra, were successful in acquiring radio communications spectrum in the 800MHz bands at recent auctions.

The regulatory regime allows Carriers, CSPs and Content Service Providers to seek regulated access to certain services where the ACCC has considered regulated access would be in the long term interest of end users.

### Public Payphones

Telstra is the principal provider of payphones in Australia. As at 30 June 1998, the Company operated 36,892 public payphones. A further 43,278 coin-only payphones were operated by third parties under equipment sale or lease arrangements with Telstra. The Company's Universal Service Obligation requires it to make public payphone service reasonably accessible throughout Australia, including in certain non-metropolitan and rural areas. Approximately half of the Company's public payphones are in these areas.

Telstra has commenced upgrading its public payphones to accept "smartcards" with embedded computer chips. The upgrade programme also includes the installation of a new centralised system to manage the Company's payphone network and to reduce the risks of misuse, fraud and physical attack downtimes.

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The smartcards have a reload function and are expected to be capable of supporting electronic cash payments through other vending machines.

While the Company has incurred some costs and loss of revenue as a result of vandalism to the new payphone terminals, this has not been inconsistent with past experience in the payphones area.

### Other Sales and Services

The Company's other sales and services principally include intelligent network products and services, operator-assisted services and Internet services. Other sales and services also include the connection of pay television customers, commercial works, ship-to-shore services, mobile data, video and teleconferencing and audio and video services.

### Intelligent Network Services

As part of its strategy to pursue higher margin value-added products and services, Telstra has developed a range of intelligent network products and services, including inbound and call centre services, personal communications services, payment call services and global access cards. Telstra's strategy is to provide customers with seamless access to flexible packages of products and services using network and distributed intelligence.

Inbound call services include Freecall™ 1800, a reverse charge call service used widely by large and small businesses to extend their market reach and attract sales. Telstra also offers Priority® One3 numbers, used by larger businesses and franchise operations for service calls for which inbound callers only pay local call rates irrespective of the source of the call. Priority® One3 services provide intelligent, caller dependent routing to the nearest business location, enabling efficient delivery of customer service. Priority® 1300 services provide features equivalent to Freecall™ 1800 but with local call rates to the inbound caller and lower number charges than Priority® One3 to the lessee. Call centre products include network based solutions aimed at meeting business call centres' needs, and include interactive voice response and on-line customer selection menus. Telstra also offers "190" payment services for voice and facsimile and is developing its managed services business to provide facilities managed services to its business customers.

Telstra also uses network intelligence to support a growing range of virtual access solutions for residential and business customers. These include Telstra's personal communications service, Telepath® One Number. Telepath® One Number permits a customer to be reached on a single telephone number, by redirecting incoming calls to other fixed network or mobile numbers identified in advance by the customer. Telstra also offers a range of products that offer alternative billing options, including prepaid cards (Phoneaway®), automated reverse charging (Homelink®) and calling cards (Telecard™).

### Operator Assisted Services

Telstra's Operator Assisted Services, operating out of 63 call centres in Australia, responded to over 515 million calls in fiscal

1998. Telstra has also introduced an innovative new product called Telstra Call Connect ("12456") which connects customers directly upon request.

### Internet Access Services

Telstra offers a range of Internet access products and packages under its Big Pond® Home and Big Pond® Business brands. The Company also offers Big Pond® Direct service, which provides retail and wholesale customers with dedicated Internet access within Australia at varying transmission rates. In addition, Telstra provides Big Pond® Intranet which enables customers to construct their own intranets.

Telstra has also begun to offer high speed cable Internet service to residential and business customers over the Broadband Network. For corporate customers, Telstra offers direct high speed national and international Internet connections.

Telstra, through its wholly-owned controlled entity, On Australia Pty Ltd (On Australia) provides the Big Pond® Home Internet Service. Since fiscal 1997, On Australia has experienced significant growth levels both in terms of subscriber numbers and revenue. The growth of the Internet represents a significant opportunity for Telstra to deliver existing and future services to an on-line user group. Big Pond® will be providing members only, premium content from ninemsn Pty Ltd, a joint venture between PBL Online Pty Ltd and Microsoft Corporation, to continue the provision of additional valued services.

## Multimedia

### Pay Television

The Company's pay television interests are managed through FOXTEL which offers home video entertainment services including pay television services. FOXTEL currently offers over thirty television channels, including six movie channels, two sports channels, three children's channels, three documentary channels, a 24-hour comedy channel, seven general entertainment channels, news, business and information on six channels, home shopping and re-transmission of the five existing free-to-air national and commercial television networks. FOXTEL has entered into various programme supply arrangements, including with certain minimum subscriber guarantees. These arrangements were revised during fiscal 1998. In some cases the programme supply arrangements impose minimum subscriber commitments and contingent liabilities jointly and severally upon Telstra and News Corporation. As at 30 June 1998, Telstra's share of these contingent liabilities totalled A\$1,064 million.

FOXTEL has experienced relatively high customer churn rates, although Telstra expects these levels to continue to fall as a result of marketing initiatives to retain customers and improved programming as the industry matures. During fiscal 1998 Telstra invested a further A\$92 million and incurred losses of A\$83 million in connection with FOXTEL.

Under arrangements between Telstra, News Corporation and FOXTEL, Telstra is the exclusive long-term supplier of cable distribution services for FOXTEL's pay television services in

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Telstra's cabled areas and receives a share of FOXTEL's pay television revenues. Distribution services used for the delivery of certain pay television services are supplied by Telstra exclusively to FOXTEL, unless otherwise required by law. Telstra can independently, or through partnerships and alliances, provide a broad range of communications, data and information services using Telstra's Broadband Network. FOXTEL is permitted to provide, in addition to most pay television services, a limited range of information and other services, such as certain forms of home shopping, but excluding telephony and on-line services. Telstra and News Corporation have committed generally to confine their involvement in the provision of pay television services in Australia to participation in FOXTEL and News Corporation has made certain long-term programming commitments to FOXTEL.

On 20 June 1997, Telstra, News Corporation and Publishing and Broadcasting Limited (PBL) agreed to work together towards the rationalisation of the pay television industry for the benefit of FOXTEL. Under these arrangements, PBL has the opportunity to equalise its pay television interests with News Corporation. Telstra may, at its option, join in this equalisation.

On 25 July 1997, Telstra, News Corporation and FOXTEL agreed to terms on which the Broadband Network rollout obligations would be satisfied by passing 2.5 million homes by 31 December 1997 and this was achieved by the due date. Under these arrangements, Telstra also agreed to pay News Corporation A\$60 million and agreed to a reduction in the revenue share that it receives from FOXTEL for providing Broadband transmission services for the next seven years. The net present value of the contractual obligation for agreed fixed dollar amount reductions in revenue share at 30 June 1997 was approximately A\$300 million, discounted at 9.7 per cent per annum. In the event that there is insufficient revenue share in a given month to meet the amount of the reduction, Telstra is required to fund the difference to FOXTEL. By the end of fiscal 1998, the balance remaining under the revenue share foregone arrangement was A\$259 million. Payments of A\$37 million were made to News Corporation during fiscal 1998 for the cable rationalisation agreement with the balance of A\$23 million paid in July 1998.

### On-Line Services

Telstra offers customers on-line, content and web hosting services. Telstra's Big Pond® range of Internet services is designed to meet the needs of residential and business customers, with offerings ranging from basic dial up access to sophisticated Intranet solutions for multinational corporate customers. The Company also offers a range of pricing and access plans to home users and small businesses.

eCommerce is expected to create a new paradigm for the way businesses conduct their commercial transactions. A number of analysts have predicted significant growth in sales over the Internet and Telstra expects that the development of secure and effective eCommerce services will underpin this direction. Telstra is cognisant of the opportunities provided by eCommerce and has developed products under the SureLink™ brand, to support the needs of business in the marketplace.

Telstra has developed a number of on-line content services and applications, including Internet versions of the White Pages™ directories and the Yellow Pages® directories. Through its own products, partnerships and alliances, Telstra offers a range of on-line services in legal information, finance and travel. The Broadband Network and alternative technologies offer the capacity for a new generation of services and applications in commerce, travel, education, government and leisure.

Telstra continues to offer a range of conferencing and interactive voice response services designed to meet the needs of businesses and individuals. ConferLink® is a leading edge telephone and video conferencing service. The ConferLink® conferencing services have been enhanced with increased capacity and upgraded service delivery systems.

## Global Alliance and International Investments

### Global Alliance

A component of Telstra's strategy is to provide the seamless delivery of products and services to MNCs. Telstra is pursuing a number of options to achieve this goal. Firstly, Telstra has established sales and service offices across Asia, the United States and Europe to offer a single source of telecommunications services to its multinational customers. Secondly, it has established operations in Europe and New Zealand and it intends to establish further operations in the United States and Asia.

Telstra has been a non equity member of WorldPartners. Equity members included AT&T, KDD America Inc. (KDD), SingTel USA Inc. (SingTel) and Unisource WPC Inc. (Unisource) for some time. On 18 June 1998, following lengthy negotiations, Telstra announced it had purchased a 10 per cent equity interest in WorldPartners, a partnership which provides management and a clearing house function for telecommunications services provided to MNCs on infrastructure owned by the member companies. Telstra paid US\$20 million (A\$33 million) for this interest. Subsequently, in July 1998, AT&T, the largest equity participant in WorldPartners, announced the venture would not be continued beyond calendar 1999 and that it would form a new alliance with BT. Following AT&T's announcement, discussions are being undertaken by Telstra with all organisations involved, including AT&T, BT and the other owners of WorldPartners, to understand better the intentions of each and the likely opportunities for Telstra going forward. These discussions have been constructive to date. Telstra is continuing to explore arrangements to enhance its ability to support MNCs.

### International Investments

Telstra expects to continue to pursue opportunities which enhance long term value and which leverage off the Company's presence in the Asia-Pacific region. These will include establishing facilities based PoPs in Asia, Europe and the United States and investing in mobile communications, directories and telecommunications infrastructure in those regions.

In Vietnam, Telstra has invested approximately US\$171 million under a 10 year partnership with the Vietnamese Government Carrier, VNPT, to expand and upgrade Vietnam's international network. Telstra has a similar contract to upgrade the

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international network of Cambodia, and operates a directories business in Vietnam. The Company is negotiating with VNPT to expand and upgrade the domestic network in West Ho Chi Minh City in Vietnam.

Telstra's Modi Telstra (Private) Limited joint venture operates a digital mobile telephone network in Calcutta and Mobitel (Private) Limited, a 60/40 joint venture between Telstra and Sri Lanka Telecom, operates a mobile telephone network in Sri Lanka. Telstra Vishesh Communications Ltd, a joint venture with India's VSNL, launched India's first meshed satellite based voice and data network. Telstra is also building a network management system in southern India for the Department of Telecommunications.

The extent of Telstra's exposure, through its international investments, to the current Asian economic downturn has been largely limited to two of its investments in Indonesia.

Telstra's largest Indonesian investment is PT Mitra Global Telekomunikasi Indonesia (MGTI) a Build-Operate-Transfer venture to operate existing regional basic services and to install 400,000 extra lines in Central Java by 31 March 1999. Telstra has a 20 per cent shareholding in MGTI. Telstra's funding (both debt and equity) up until 30 June 1998 was A\$58 million. Telstra has written down the investment to A\$Nil with A\$46 million debited to reserves and the remainder against profit and loss. Telstra has a further A\$42 million equity commitment plus a number of contingent liabilities in regard to MGTI. The contingent liabilities relate to equity calls and performance guarantees. Telstra continues to actively monitor its investment in MGTI. See Note 20 to the Financial Statements.

Telstra also has an interest in Indonesia through its 75 per cent shareholding in PT Jastrindo Dinamika (PT Jastrindo), a trunked private mobile radio company holding a national licence, currently operating in Greater Jakarta, Semarang and Surabaya. Telstra's funding in PT Jastrindo has been written down to A\$Nil after providing for losses of A\$12.4 million comprising mainly intercompany loans. Telstra is currently negotiating to sell its interest in PT Jastrindo.

### Network and Information Technology Alliances

In July 1997, Telstra entered into an alliance with IBM Australia and Lend Lease to position Telstra strategically to take advantage of growing opportunities in Australia and the Asia-Pacific region as information technology and telecommunications markets converge. The alliance is expected to reduce Telstra's own long-term information technology costs. As part of the alliance, Telstra acquired a 26 per cent equity interest in IBMGSA which is also owned by IBM Australia (51 per cent) and Lend Lease (23 per cent). As part of its participation in the alliance, Telstra has engaged IBMGSA to conduct its data centre operations and some of its applications maintenance and enhancement activities for a period of ten years. The alliance involved about 2,100 Telstra staff and contractors being engaged by IBMGSA. Telstra has agreed to pay higher rates and penalties if it does not purchase certain volumes of services from IBMGSA over the ten year period. Telstra can terminate this commitment

after four years, subject to potentially significant financial penalties.

Telstra, IBM Australia and Lend Lease have also formed a network services joint venture company, Advantra, of which Telstra owns 50 per cent, IBM Australia 30 per cent and Lend Lease 20 per cent. Advantra supplies network facilities management, network systems integration services and network application services to major business and government customers in Australia and network services to the IBMGSA Network's customers across Australia. Telstra is the preferred supplier of telecommunications services to IBM Australia, IBMGSA and Advantra. Approximately 300 Telstra staff and contractors transferred to Advantra in fiscal 1998.

### Networks and Systems

Telstra operates a number of fixed and mobile telecommunications networks to support its diverse range of products and services. These are all supported by an extensive national and international transmission infrastructure and largely centralised management, including planning, network control centres, operations systems and staffing. Telstra has in recent years invested a substantial amount of capital and resources in its networks and systems. The Company has been deploying its digital mobile telecommunications network and the Broadband Network. The Company is in the final stages of the Networks and Systems Modernisation Programme to upgrade and rationalise certain of its fixed networks and improve many of its systems, including those relating to billing, sales and customer service. This and other ongoing programmes also include initiatives to improve work practices, streamline processes, eliminate duplication of overhead costs and improve record keeping for property, plant and equipment. In addition to its capital expenditure programmes, the Company incurred research and development expenditures of A\$43 million, A\$58 million and A\$86 million in fiscal 1998, 1997 and 1996 respectively. See Note 3 to the Financial Statements. Labour and depreciation incurred on research and development are included under these specific line items in the Profit and Loss Account rather than being shown as part of the total research and development expense. Telstra's research and development covers diverse areas of the business and is aimed at assisting in the development of new competitive products for world markets.

Growth in the demand for data services, including the increasing popularity of the Internet, is expected to drive the next round of investments in networks and systems particularly over the next five years. Telstra currently anticipates that its data traffic, by most measures, will exceed its voice traffic within two to three years. Telstra is evaluating (through a project known as the Data Mode of Operation Study) the feasibility of migrating much of its network traffic to Internet Protocol (IP) and ATM-based technology over the next ten years. The evaluation is also looking at the opportunities for the Company to use these technologies in its internal operations to reduce costs further and improve productivity. The demands from customers to have greater control of their services and access to information about them will require additional investment in systems to complement those already delivered. The Company also expects that it will increasingly become capable of

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supporting services which require high bandwidth using a variety of technologies including either via the Broadband Network or through the use of ADSL technology. In remote areas, this may be achieved through the use of satellite or other wireless technologies.

### Transmission Infrastructure

Telstra's domestic inter-exchange transmission infrastructure consists of both terrestrial and non-terrestrial transmission systems. The domestic terrestrial systems are almost exclusively digital and use approximately 2.64 million kilometres of optical fibre and approximately 2,700 digital radio systems. In August 1995, Telstra activated one of the longest unrepeated digital undersea cables in the world, which connects the Australian mainland and Tasmania. In June 1996, the Company activated what was then the longest synchronous digital hierarchy system in the world, a 5,000 kilometre 2.5 gigabits per second system from Perth to Brisbane. Telstra is currently introducing Wave Division Multiplexing Technology into its network to increase capacity at reduced unit costs.

Telstra's international transmission infrastructure includes both submarine cable and satellite transmission. Telstra owns substantial submarine cable capacity in the Asia-Pacific region and around the world. Cables landing on Australian shores and partly owned and wholly managed within Australia by Telstra are: Tasman 2, PacRimWest, Jasurau, ANZCAN, Tasman 1, A-I-S and APNG. The Company is an initial party to a new large capacity fibre optic cable called SEA-ME-WE3, currently under construction and due to enter service in mid 1999. This cable will link into Asian countries and westward to Europe and eastward to the United States. The Company has also been admitted as an initial party to the China-U.S. cable consortium, which plans to link certain Asian countries to the United States and/or to Europe. This cable is expected to enter service in December 1999. Telstra is an investment shareholder and user of the international consortium satellite operators, INTELSAT and INMARSAT.

### Public Switched Telephone Network

Telstra's PSTN can connect virtually all Australian homes and concentrates traffic from about 8,000 access sites to approximately 200 digital nodal switches across the country. These digital switches and the Company's two international gateway switches are connected by the Company's transmission infrastructure. In addition intelligent network platforms support advanced services, including card-based and toll-free products.

The access sites which connect customers to the local access switches use a variety of technologies, including copper, fibre optic cable and radio. Reflecting Australia's large geographic area but high level of urbanisation, most customers in urban areas are within 2.5 kilometres of an access site, while approximately 50 per cent of customers in provincial towns are within 2.5 kilometres of an access site. In rural areas, approximately 50 per cent of the customers have loop lengths greater than four kilometres, with some copper loops extending as far as 25 kilometres. All Telstra customers have single party services and a high proportion of local loop plant is installed

underground, protecting it from weather and other influences. Telstra recently announced a plan to provide an expanded range of satellite-based services to continue its commitment to the rural and remote areas of Australia. The range of satellite services will include telephony services, access to the Internet, corporate data applications like email, Electronic Funds Transfer Point of Sale (EFTPOS), file transfer, video and telemetry.

During fiscal 1998 Telstra announced a project to significantly reduce the level of faults in the copper Customer Access Network (CAN) through the CAN 2001 project. The aim of this project is to improve the quality and reliability of the CAN. Specific goals to be achieved include reducing the average CAN fault rate, reducing the seasonal variation in fault volumes, reduction of operational expenses by reducing the number of CAN faults and retaining customers and revenue by improving quality and reliability. A consistent improvement in the quality of the CAN Australia-wide will assist in the development and deployment of new products and technologies such as OnRamp® and ADSL.

As part of the Networks and Systems Modernisation Programme, Telstra has significantly upgraded the PSTN by digitalising local exchanges.

The Company is also upgrading and augmenting access for customers in remote areas, typically served by radio-based access through its Remote Australia Telecommunications Enhancement programme. This programme, necessitated by customer growth and growing demand for access to high speed data, facsimile and Internet services, will improve and broaden services to approximately 17,000 customers in rural and remote areas spread across approximately two-thirds of the Australian mainland. Over 6,000 customers have already benefited in some way as a result of this programme with more than 3,000 of these customers achieving improved data speeds.

The PSTN supports voice, facsimile and data products. The rapid growth in the popularity of the Internet is fast changing the mix of these products. Further, Internet users tend to maintain local call connections with ISPs for substantially longer duration than a regular voice local call. These factors have the potential to affect the available capacity of the PSTN. Telstra monitors its traffic flows and manages its network capacity accordingly. In addition, the Company actively promotes the ISDN service to ISPs and is also introducing alternative technologies to provide Internet access without using the PSTN, such as via the Broadband Network and other data networks.

### Integrated Services Digital Network

Telstra's ISDN services are provided in two ways: firstly, via an overlay network and, secondly, via a new composite service integrated with the PSTN. The overlay network has 28 nodes situated in capital and provincial cities of Australia. The composite ISDN service integrated with the PSTN is based on the ETSI (European) standard and is being marketed under the OnRamp® trademark. OnRamp® services are eventually expected to replace the services currently provided via the overlay network. As at 30 June 1998, Telstra had the capacity to

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provide ISDN service to 96.3 per cent of the Company's customers, either immediately or with the deployment of modular units within 90 days of a request for service.

### Intelligent Network Platforms

Telstra operates a number of intelligent network platforms which support a range of advanced services including calling card (Telecard™), prepaid card (Phoneaway®), premium rate (InfoCall®), personal communication services (Telepath®) and inbound services such as Freecall™ 1800 and Priority® One3. The Inbound products are often mission critical to Telstra's major business customers underpinning their call centre and customer service operations. Telstra also operates additional Intelligent Network (IN) platforms to provide a range of enhanced features supporting Telstra's MobileNet® products and a selected range of services in Telstra's United Kingdom and New Zealand subsidiaries.

Telstra's full range of IN products are currently supported on a combination of internally developed and commercially sourced platforms. In order to deliver an enhanced range of integrated customer solutions at reduced operational costs Telstra has recently approved a five year IN upgrade programme to rationalise the number of platforms by the migration of selected products to a commercially sourced IN platform.

### Data Networks

Telstra operates a number of data networks including the Switched Data Network, Transaction Network and the Digital Data Network. The Switched Data Network is a multiservice platform providing the Austpac®, Frame Relay and ATM Products. Austpac® is a public packet switching data service suitable for a wide range of data applications. Frame Relay and ATM provide site to site and multi site Wide Area Network (WAN) connectivity. Frame Relay provides 64 kilobits per second to 2 megabits per second connectivity. ATM provides 2, 34 and 155 megabits per second connectivity. Transend® is a national transaction switching network suitable for EFTPOS and Inventory Applications. The network provides Dedicated and Dial-up access in a secure environment for transaction carriage. The Digital Data Network provides dedicated site to site Digital Data Services at speeds up to 2 megabits per second and has extensive coverage across Australia.

### Broadband Network

In 1994, Telstra commenced the rollout of its Broadband Network. As at 30 June 1998, the Broadband Network had passed 2.5 million homes, excluding businesses, with 750MHz hybrid fibre coaxial cable, primarily underground, with approximately 30 per cent aerial. The optic fibre configuration has two forward and one return path fibres with nodes capable of serving up to 1,200 customers each. The Broadband Network was designed from the outset to provide two-way transmission capabilities for interactive services and high-speed data transfer. Presently, the Broadband Network delivers pay television and, in some areas, high speed Internet access. For the delivery of Broadband on-line services to potential customers not covered by the Broadband Network, the Company may use technologies such as ADSL or satellite and other wireless delivery.

### Mobile Telecommunications Networks

Telstra owns and operates two networks for the provision of mobile telephone services which provide services to a geographic area in which 94 per cent of the Australian population resides. The Company's analogue network uses the AMPS protocol and spectrum in the 800MHz band and has 44 switching centres and 1,365 base stations. While all metropolitan analogue AMPS sites will close as originally required by 31 December 1999, some non-metropolitan parts of the network may remain open for a further twelve month period. This is dependent on agreement between Telstra, Optus, Vodafone and the Government. Telstra's digital network uses the GSM protocol and spectrum in the 900MHz band. As at 30 June 1998, the digital network utilised 27 mobile switching centres, 13 home location registers and 2,146 base stations. The Company is continuing to expand digital coverage into regional centres and along highways linking regional centres, and is also focused on improving the depth of coverage, particularly in-building coverage, in major cities.

The Government has provided for the public auction of radio spectrum and auctioned 800MHz and 1800MHz bands to provide for additional capacity for existing digital networks and the introduction of new competitors. Telstra was successful in obtaining a substantial allocation of spectrum in both the 800MHz and 1800MHz bands. This will allow economical expansion of the GSM network in the 1800MHz band and provide the opportunity for Telstra to deploy a new cellular network and service based on the US digital cellular standards in the 800MHz band.

Telstra is aware that concerns have been expressed about the possible adverse health effects of electromagnetic energy from mobile telecommunications equipment. A claim was filed against Telstra by an individual alleging that such person developed cancer due to electromagnetic energy emitted from one of its base stations but Telstra has now obtained a judgement in its favour in that claim. Typically, the maximum level of energy involved at ground level in the transmission from the Company's mobile telecommunications base stations is approximately 100 times less than the public exposure level permitted by Australian Standard 2772.1.

Currently, the weight of national and international scientific opinion is that there is no substantiated evidence of adverse public health effects from radio signals at typical community levels. However, this evidence has not prevented lawsuits from being initiated by individuals against providers of mobile telecommunications services. From time to time there are studies which suggest avenues for further research. The Government has established a Committee on Electromagnetic Energy Public Health Issues to advise on the issue. The Government has also established a public information and research programme to support further studies, which is funded by a levy on holders of radio-communications licences.



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### Information Processes and Systems

Telstra has a range of information processes and systems to support the delivery of products and services. Telstra aims to increase the benefits of its offerings to customers by introducing new products to the market more quickly, by providing more flexible and detailed billing and by reducing the overall costs to Telstra. To achieve this strategy, the Company is rationalising its existing suite of systems, and the related processes, deploying new systems and processes, implementing new management disciplines and outsourcing certain of its data processing functions.

Telstra has invested in many new systems and processes in recent years, in five principal areas: sales, customer ordering and provisioning, billing, service assurance and workforce management. During fiscal 1997, Telstra completed the national implementation of its new customer ordering and provisioning system called AXIS which improves service activation through improved integration with other core systems. Work has also been undertaken to align the provisioning and billing databases and to validate data entry, resulting in significant reductions in service order rejects and billing anomalies.

Telstra's flexible billing system called Flexcab®, offers customers a wide range of customised billing options and formats together with new functionality which provides faster speed to market for new products and services together with improved support to Telstra's business operations. Flexcab® also provides detailed local call records, enabling the Company to substantially reduce customer complaint levels.

The Company recently deployed new systems capability which allows Telstra's front-line sales and service representatives to access information more quickly to respond to customers. For example, one new system provides customer segment information and sales prompts thus enhancing the quality of service provided to residential and small business customers. Initial indications show that these new systems are significantly improving sales generation and customer service. The Company also recently introduced a workforce management system which aims to align work tasks more efficiently so that customers are provided with better service through more accurate and timely installations and repairs.

Telstra is implementing new commercial disciplines in the management of its processes and systems, including the improved co-ordination of systems and processes across the Company from a centralised group and by using new budgeting and programme management mechanisms, including the use of integrated databases.

Telstra has systems security, data integrity and disaster recovery procedures which it continues to review and upgrade. In particular, Telstra runs its billing systems primarily in one, large data centre for which it has designed a disaster recovery programme. The unlikely event of destruction or substantial impairment of this centre would lead to a delay in the billing of customers and the collection of related receipts while alternative facilities are expanded to resume operations of the billing systems to process back-logged billing data. A contingency plan has been prepared for execution in such a situation.

### Special Projects

#### Jindalee Operational Radar Network

On 13 June 1991, Telstra entered into a contract with the Commonwealth to design, construct, install and maintain the Jindalee Operational Radar Network (JORN) for the Department of Defence. The project calls for the establishment of radar stations in remote spots in Australia which are designed to serve as long range data acquisition devices. As the project proceeded, the Company realised that its initial expectations regarding the timing of project completion and the costs required for completion were unattainable. Accordingly, in mid 1996, Telstra began to examine alternative arrangements for completing the JORN project.

On 14 February 1997, Telstra entered into agreements with Lockheed Martin Corporation Ltd (Lockheed) and Transfield Defence Systems Pty Ltd, now Tenix Defence Systems Pty Ltd (Tenix), to manage the JORN project through to completion. RLM Management Pty Ltd (RLM), a company jointly owned by Tenix and Lockheed, assumed management control of the project from 17 February 1997. Telstra is the prime contractor for the project. The JORN project has proven unprofitable for Telstra and completion is not projected until 2001.

On 2 October 1997, the Company finalised negotiations with RLM to settle arrangements whereby Telstra has a right, on certain events happening, to require RLM to assume full responsibility for completion of the JORN project.

Telstra has made allowance for its ongoing obligation in relation to the JORN project. As at the end of fiscal 1998, this provision remained at A\$605 million (1997 A\$605 million). Accordingly, Telstra believes it has made adequate provisions for JORN. (See Note 13 to the Financial Statements).

Telstra expects that its arrangements with RLM should enable Telstra to complete the project at a level consistent with such provisions. Although there is a residual risk that further costs may be incurred by Telstra in relation to the project, no such costs are presently anticipated.

### Employees

With approximately 57,200 full-time employees as at 30 June 1998, Telstra is one of Australia's largest employers. It has approximately 3,000 work sites in Australia and approximately 800 expatriate and local employees located in parts of Asia, the United States and Europe.

	As at 30 June		
	1998	1997	1996
Full time employees . . . . .	57,234	66,109	76,522
Full time equivalent employees <sup>(1)</sup> . . .	66,760	76,990	88,995

(1) Full-time employees includes full-time staff, fixed term contracted staff and expatriate staff in overseas controlled entities. Full-time equivalent employees includes full-time

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*employees and a full-time equivalent measure of part-time and casual staff, overtime worked, full and part-time contracted staff and a measure of overseas local hires and in fiscal 1997, an additional 405 full-time equivalent employees arising from a change in reporting related to overseas local hires.*

In order to roll out the Broadband Network, provide for the growth of mobile telecommunications services, deliver increased value to customers and implement the Networks and Systems Modernisation Programme, Telstra increased staff numbers in fiscal 1996. However, the strong focus on streamlining the organisation and its work processes to reduce duplication and unnecessary complexity and to take advantage of recent capital investment has resulted in labour efficiencies. Management's goal is to achieve cost and operational efficiencies that will result in a reduction of the Company's full-time staff numbers by approximately 27,500 over a five year period that began in fiscal 1997. During fiscal 1997, a provision of A\$1.1 billion was recorded to cover estimated redundancy and restructuring costs related to its workforce reduction and restructuring. The adequacy of the provision was reviewed in fiscal 1998 in line with the new three year plan approved by the Telstra Board during fiscal 1998 and a further provision has been included in the financial statements for 1998. During fiscal 1998, the Company achieved reductions of approximately 8,900 full-time staff without material industrial disruption, largely through natural attrition, voluntary redundancies, completion of fixed term contracts for construction and technical staff and outsourcing. This brings the total reduction in full-time staff numbers in the last two fiscal years to approximately 20,800. The reductions in 1997 were offset in part by the addition of 1,500 full-time staff relating to the consolidation of Pacific Access as of 20 June 1997. See Item 9 and Note 32 to the Financial Statements.

Telstra is continuing the development of a new corporate culture focused on delivering value to customers, improving commercial discipline, accountability and productivity and increasing workforce flexibility and product innovation. The transformation into a commercially oriented enterprise involves a review of management systems and work practices.

This review is being pursued in a number of ways, including:

- analysis and redevelopment of existing Telstra policies to ensure their compatibility with commercial competitiveness; and
- simplification of Telstra's industrial awards and agreements. Recent changes to Australian Workplace Relations legislation requires simplification of the Company's Awards and also changing them to provide more flexible minimum pay rate arrangements. With freedom to pay above the minimum, this system provides for a variety of reward possibilities for groups and individuals. Simplification of excess workplace regulation in favour of the exercise of discretion by managers means a significant departure from the Company's current employment practices and presents a risk of opposition from the unions which claim to represent over three-quarters of the Company's staff. The Company is continuing discussions with its unions and staff about the transition to the arrangements required by the new legislation. The Australian Industrial Relations Commission

(AIRC) will arbitrate on matters which cannot be agreed between the Company and unions. Already the Company has been able to adopt a commercial performance management system as a result of the AIRC deleting the old public service discipline procedures from Telstra's General Conditions of Employment Award. Several other obsolete provisions have been removed.

Negotiations are continuing between the Company and unions to agree on a replacement for the present single Enterprise Agreement which expired on 4 October 1997 but which continues in effect until a new Agreement is concluded. Significant issues in these negotiations have yet to be resolved and the unions have initiated some industrial action. The Company continues to pursue increased management and labour flexibility from these negotiations.

In 1990, Telstra established its own superannuation scheme. A majority of the Telstra employees participating in the Commonwealth Superannuation Scheme (CSS) elected to transfer to the Telstra Superannuation Scheme (TSS), leading to the transfer of certain amounts from the Commonwealth consolidated revenue. Pursuant to a Ministerial Determination, these amounts are being paid to the TSS by the Commonwealth over an extended period based on actuarial estimates. As at 30 June 1998, the present value of these assets to be transferred was A\$2.1 billion.

In June 1995, Telstra committed to contribute an additional A\$121 million per year through to 2011 to the TSS to ensure that it was not in an unsatisfactory financial position. As at 30 June 1998, Telstra has a liability of A\$785 million using a discount rate of 11.8 per cent, representing the present value of the remaining payments. The Commonwealth has guaranteed these payments in the event that Telstra becomes insolvent during the period.

In addition, Telstra's past payments in relation to the CSS have resulted in Telstra being credited with a surplus in the notional fund of the CSS. The Commonwealth has indicated that repatriation of part of that surplus to the TSS will be permitted where the surplus is greater than 15 per cent of the sum of the employer financed benefits (past and future service) for the Telstra Entity's existing CSS members and outstanding deferred transfer value payments for ex-CSS members who transferred to the TSS.

The actuarial valuation as at 30 June 1997 confirmed that the CSS surplus was greater than 15 per cent and the Telstra Entity is in discussions with the Commonwealth regarding the repatriation of this surplus to the TSS.

An actuarial investigation was conducted by S. Schubert FIAA on the TSS as at 30 June 1997. On the assumption that the CSS surplus, net of 15 per cent contributions tax payable on its transfer into the TSS, is available to increase the assets of the TSS, the actuary has recommended that the Telstra Entity cease defined benefit contributions to the TSS (other than the additional contributions of A\$121 million per annum that the Telstra Entity is committed to contribute to the TSS over the next 13 years, referred to above) for the three year period from 1 July 1998 to 30 June 2001. Based on that advice, the Telstra Entity's Board of Directors (subsequent to fiscal 1998) has agreed

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that the employer contribution rate for the defined benefit component of the TSS will be reduced to nil for the next three years, subject to a satisfactory outcome from the above mentioned discussions and a consequential response from the Minister for Finance and Administration. See Note 21 to the Financial Statements.

### Competition

The Australian telecommunications market has undergone significant liberalisation over the past eight years. A series of changes in regulatory policy beginning in 1989 has increased competition. On 1 July 1997, the regulatory regime was further liberalised to allow for open competition.

Telstra has experienced competition for some time in many of its markets. This competition began with the opening of the customer premises equipment and value added services markets in 1989, followed by the establishment of Reseller competition in 1991, particularly in the national long distance and international telephone service markets. The competitive environment changed significantly in 1992 when Optus assumed the second general Carrier and mobile Carrier licences and began reselling Telstra's analogue mobile telephone service and offering national long distance and international telephone services. In 1993, Optus and Vodafone Pty Limited (Vodafone) (as well as Telstra) each began offering digital mobile telephone services over their own mobile telecommunications networks. Since then, many smaller competitors have emerged.

While the introduction of competition has affected Telstra's market position, it has also stimulated overall market growth and such trends are expected to continue. The Company intends to pursue the opportunities that the new competitive environment provides through the provision of high quality services that deliver value to its broad range of customers. In particular, the new competitive environment provides the Company with increased opportunities to offer customers new value-added products and services and competitive price and product packages. The Company has also redesigned its marketing and distribution channels to improve and augment the Company's service to its customers and to attract new customers.

Starting from the position of being the sole provider of products and services in most Australian telecommunications markets, the Company has inevitably lost market share due to increasing competition. As the open competition environment has only recently come into existence, there is substantial uncertainty as to how competition will continue to develop in the future and the effect that it will have on the Company in each of its markets.

#### Access and Local Calls

Telstra currently faces limited competition in basic access and local calls services. However, the Company expects that competition will increase significantly in these markets as competitors deploy their own infrastructure and continue to resell the Company's services.

Telstra's principal existing facilities based competitors, including Optus and AAP Telecommunications Pty Ltd (AAP),

have established dedicated connections with large business customers, principally in central business districts. Dedicated connections allow these competitors to direct all of a particular business' telecommunications traffic to their own networks, including local, long distance and international calls, data transmission and other telecommunications services. Additional competitors are also entering this market by deploying their own fixed or wireless telecommunications infrastructure. Optus is selectively offering basic access and local calls services over the hybrid fibre coaxial cable network that it has rolled out to residential areas in recent years. Recent initiatives by other cable operators into local telephony have so far failed to materialise and it may be some time before serious competition develops. Notwithstanding the issues facing cable companies, the recent introduction of local number portability may accelerate the development of facilities based competition in these markets.

Telstra offers to providers of telecommunications services (both Resellers and Carriers) complete access and local call services at a discount to its retail pricing. The Company expects the number of such competitors to increase, as providers of long distance and other services seek to gain market share by providing a full service package to their customers. Telstra has signed an interim commercial agreement with Optus in relation to the supply of local services resale. Optus has indicated that it has signed this agreement under protest and is continuing with its legal proceedings against Telstra in relation to these matters. As a result of the ACCC's current local services inquiry, Telstra could also be required by regulation to unbundle access services and to offer local loop access and local call services at lower prices, which may provide additional advantages to Telstra's competitors.

Telstra's strategy to address increased competition in these markets is to package products and services for the convenience of its customers. The Company is also encouraging its customers to migrate to enhanced access services such as ISDN. The Company also seeks to increase growth through the promotion of second lines and to deploy its own advanced dedicated connections to enhance its provision of voice and data services to large businesses. While regulation constrains the Company's pricing, particularly with respect to local calls, Telstra's strategy is to price these services on a more commercial basis.

Competition in the access and local call markets has important flow-on consequences for the Company's other telecommunications markets, particularly national long distance and international telephone services.

#### National Long Distance and International Telephone Services

The competition that Telstra has faced in the national long distance and international telephone services markets for several years has significantly eroded its market share in these markets. Telstra's principal competitor in these markets has been Optus, which operates its own extensive network. Other competitors, such as AAPT, Primus Telecommunications Pty Ltd, WorldxChange Telecommunications Pty Ltd and Global One Communications Pty Ltd, currently own their own switches, lease access and transmission capacity, and resell certain services

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principally from Telstra or Optus. Such competitors now have significantly greater freedom under the new regulatory regime to develop their own infrastructure and to use it to provide additional telecommunications services. Other smaller competitors only resell complete services. In addition, call-back operators compete in the international telephone services market.

Competitors' success in these markets will depend upon several factors, such as customers' sensitivity to pricing, the effectiveness of promotions and other marketing campaigns and the implementation of the new regulatory regime. Call-by-call selection (or "override") dialling and default choice (or "preselection") are available and are required to be provided more broadly in the new environment. A competitor which gains market share in access and local calls will have certain advantages in offering long distance and other services to its customers.

As wholesale originating and terminating access and transmission services are important for the facilities based provision of national long distance and international telephony services, the pricing of these services is likely to shape the development of retail competition. Competition already exists in the wholesale provision of transmission services on major domestic and international routes. The pricing of these services is largely dictated by commercial negotiation and has been falling as new competitors enter the wholesale market. The new regulatory processes introduced on 1 July 1997 also provide a framework to determine terms, conditions and pricing of transmission services, particularly in non-competitive areas.

In response to these competitive pressures, Telstra is focused on delivering a range of tailored products and services in convenient packages and has begun to simplify its billing statements and payment procedures. Telstra's Making Life Easier™ approach underpins these and other initiatives, which are designed to enhance customer loyalty and increase retention. In addition, the Company seeks to stimulate usage through a variety of special promotions and offerings.

### Mobile Telecommunications Services

Mobile telecommunications services is one of the most competitive of the major markets in which Telstra operates. In the analogue service market, the Company competes only with Optus, which resells Telstra's analogue service. In the digital service market, the Company competes with both Optus and Vodafone, each of which operate digital networks, and a range of other competitors which resell either Optus or Vodafone services.

Competition in the mobile telecommunications market has principally been based on handset subsidies, geographic coverage area, service quality, sales channel strength and air time charge differentiation. The Company believes that the strength of the MobileNet® brand name, its ability to market its mobile services to its significant fixed telecommunications customer base and its extensive internal and external distribution channels leave the Company well positioned to continue to compete vigorously.

With the gradual closure of the Company's analogue AMPS mobile telecommunications network both Telstra and Optus are focused on migrating analogue customers to their digital services. In order to assist migration, Telstra has developed targeted programmes and offerings for its analogue customers, such as attractive handset upgrades and enhanced services. Vodafone and other digital service competitors are also targeting these customers. The new regulatory regime assists these other competitors by mandating that the Company provide analogue-to-digital call diversion.

Under the new regulatory regime, the availability of spectrum will determine, in part, the number of mobile telecommunications Carriers. New entrants and existing Carriers acquired 800MHz and 1800MHz spectrum at recent public auctions. The ACA has proposed future spectrum auctions of various frequency bands including spectrum in the 28 and 31 gigahertz (GHz) bands which can be used to provide Broadband Local Multipoint Distribution Services, and spectrum in the 3.4GHz band which can offer an alternative to wireline means for delivering telephony and data services.

Telstra also acquired additional radio communications spectrum in both the 800MHz and the 1800MHz bands at the ACA auctions. The spectrum acquired by other Carriers related to limited areas only. Unlike Telstra, none of these Carriers has adequate spectrum in the 1800MHz band to operate a national network without reliance on other Carriers.

Continued implementation of the revised regulatory regime may also foster competition in this market through such potential developments as the requirement that Carriers provide digital customers with preselection, the introduction of number portability in the digital service market, and the introduction of satellite mobile telephony CSPs.

### Data and Text Services

Competition in data and text services markets is highly developed for certain products, such as high capacity data transmission, and less developed for others. Competitors seek to differentiate their offerings based on price, functionality and ability to offer integrated products and services. While Optus and AAPT are currently the Company's principal competitors the Company expects additional competitors to enter the market, including major international telecommunications providers and global alliances.

This market is characterised by rapidly changing customer needs, particularly driven by increasing demand for higher speed and more flexible data services. The pace of technological change and competitors' abilities to adapt and utilise new technologies will likely be key determinants of success. In addition, the implementation of the new regulatory regime, particularly the compulsory provision of originating and terminating access to competitors, will further shape the nature of competition in this market.

Telstra believes that it is well positioned, with its broad range of products and extensive telecommunication skills, to remain competitive in this dynamic market. The Company emphasises

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the strength of its customer relationships and, in addition to marketing individual products, promotes tailored solutions under the new Fractal™ brand.

### Wholesale Services

Wholesale services include any services sold to providers of telecommunications services who use them to provide their own products and services to end users. The degree of competition in wholesale markets varies by product. To date, Telstra has faced limited competition in the wholesale access and local call markets. The international carriage and call termination market, however, has been highly competitive. In addition, some competitors, including Optus, offer significant discounts on wholesale long-distance services. Optus and other new entrants also rebill and resell Telstra's call termination services to end customers in competition with Telstra. Generally, competitors differentiate their wholesale services based on price, geographical network coverage, capacity and functions used to support retail services. New entrants may include public utilities and foreign wholesale service specialists.

The development of competition in wholesale services will depend in large part on the number of competitors that deploy infrastructure. Under the new regulatory regime, no limits exist on the number of entities that can install and maintain facilities required to provide wholesale services. The incentive for potential new entrants to deploy infrastructure, however, will depend in part on the manner in which existing providers of wholesale services price such services and the regulatory response. Telstra seeks to structure its wholesale product offerings and pricing to ensure compliance with regulatory requirements, while securing full cost recovery and optimising commercial outcomes.

### Pay Television and On-Line Services

The market in which pay television services are offered is highly competitive. FOXTEL and Optus Vision are the principal providers of pay television services over cable in largely overlapping areas. In addition, Austar Entertainment Pty Ltd distributes pay television through wireless and wireline systems in many regional areas and has similar programming to FOXTEL. In some regional areas, limited pay television services are offered by other pay television operators. Pay television providers also compete with free-to-air television operators and are prevented from holding exclusive broadcast rights to certain sports programmes.

FOXTEL is the leading pay television provider in Australia with over 320,000 subscribers as at 30 June 1998. In addition to its cable distribution, FOXTEL is strongly positioned to enter satellite distribution, having acquired digital satellite set-top units (including those located in the homes of former Galaxy Network International Pty Ltd (Galaxy) subscribers) from the Australis Media Limited (Australis) receiver.

Because of the early stage of development of pay television in Australia, the factors upon which operators compete are evolving and relatively high levels of churn exist although these are falling. Competition is based on a number of factors including programming, brand, price, marketing and service

support, and means and geographic scope of service delivery. Telstra believes that FOXTEL is well positioned to compete on the basis of its brand, diverse programme offerings and exclusive delivery arrangements with Telstra. Considerable industry rationalisation has occurred following the termination of certain contracts with Australis, which is the subject of receivership and winding-up orders. However, because programming costs facing pay television providers are still high by world standards, it is likely there will be further industry rationalisation, which could change the competitive position of industry participants. While this rationalisation should further lower programming costs, it may lead to some loss of exclusivity of the programming distributed on Telstra's cable.

The Company's on-line, content and web hosting services are subject to a high level of competition from a number of domestic and international competitors. Many of these competitors are vertically integrated and gain advantages from their position in related markets, such as in content or technology markets. Legitimate vertical integration enables Telstra to establish commercial arrangements to support information and transaction services, and to capture economies of scale and scope. Competitors seek to differentiate themselves based on a variety of factors, including brand recognition and the entertainment, educational and commercial value of the content.

For Internet services, competitors emphasise price, speed and availability of access, and associated information or transaction services. Telstra believes it will remain a strong competitor in the provision of Internet and on-line services based on the Big Pond® product range, the speed and geographic reach of its Internet infrastructure and the growing range of available information and transaction services. Telstra also pursues options to compete through its own product development activity and through alliances and partnerships with a broad range of content developers and providers, established business and financial institutions, educational bodies and merchant organisations.

### Other

In addition to increasing competition in markets described above, the Company competes with a variety of domestic and international companies and alliances in its other markets. For example, the Company expects to experience increasing competition in its Directory Services business as from 1 July 1998 it has been required to provide an integrated public number database for use by all CSPs and has been experiencing increased competition in this business from regional competitors. In its public payphones business, Telstra expects increasing competition due to new market entrants and increased mobile telephone penetration. The Company also faces significant competition from product manufacturers and retail outlets in its customer premises equipment business.

## Regulation

### Background

The 1997 regulatory regime represents the third step in the introduction of open competition to the Australian telecommunications industry.

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The major features of the regime include (i) reliance on general trade practices concepts subject to certain industry specific restraints; (ii) reliance on self-regulation; (iii) no limits on the number of Carriers; (iv) providing CSPs with many of the same access rights and obligations as Carriers; and (v) restricting Carrier land access rights and statutory immunities.

A Carrier is any person holding a Carrier licence. The licence application charge is A\$10,000 with annual licence charges also payable. In general, the owner of certain network infrastructure must not use the infrastructure to supply telecommunications services to the public unless it holds a Carrier licence. A CSP supplies a telecommunications service to the public using network infrastructure owned by a Carrier. A Content Service Provider is a person that uses a telecommunications service to supply to the public a content service, such as a broadcasting service or on-line information or entertainment service. Telstra is a Carrier, Carriage Service Provider and a Content Service Provider.

### Principal Regulators and Self-Regulation

Governmental responsibility for telecommunications industry policy and legislation in Australia rests primarily with the Communications Minister and the Department of Communications and the Arts (DOCA). The Communications Minister can make rules in connection with the implementation and operation of certain aspects of the 1997 regulatory regime and, at his discretion, impose or vary the conditions of a Carrier's licence. In addition, the Communications Minister has power to give binding directions to Telstra, but only in relation to some matters.

The ACCC administers the Trade Practices Act 1974 (Cth) (Trade Practices Act), which is the principal Act relating to the promotion of competition and the protection of consumers. The new telecommunications access regime, the telecommunications specific provisions for controlling anti-competitive conduct and the Telstra retail price caps and price control arrangements are now administered by the ACCC.

The ACA is responsible for regulating the non-competition aspects of the telecommunications industry, such as Carrier licensing, technical regulation, quality of service, numbering, the Universal Service Obligation, spectrum management and industry codes and standards.

### Industry Codes and Standards

The 1997 regulatory regime provides for industry codes governing activities of Carriers or CSPs to be developed by bodies that represent one or more sections of the industry, such as the Australian Communications Industry Forum (ACIF). For example, the ACIF is drafting codes concerning privacy, customers' switching mobile telephone Service Providers, the use of customer information and consumer codes relating to billing, complaint handling and credit management. Although these codes are self-regulatory instruments, the ACA has the power to direct compliance with a registered code and in some circumstances to set mandatory industry standards. Non-compliance with an ACA direction to comply with a registered code or a standard by a Carrier or CSP is subject to a maximum

penalty of A\$250,000 as determined by the Federal Court of Australia.

### Competition Regulation

#### *Competition Rule*

The competition rule provides that a Carrier or CSP must not engage in anti-competitive conduct. The competition rule is breached if a Carrier or a CSP contravenes certain general trade practices rules, in respect of a telecommunications market, or where it has a substantial degree of market power and takes advantage of that power with the effect or likely effect of substantially lessening competition in any telecommunications market.

The ACCC can issue a competition notice stating that a Carrier or a CSP has contravened the competition rule. The competition notice constitutes prima facie evidence in any subsequent Federal Court proceedings of the alleged contravention. Any such conduct in breach of the competition rule which occurs after the competition notice comes into effect exposes the Carrier or a CSP to penalties of up to A\$10 million and A\$1 million per day of contravention, together with potential liability to pay compensatory damages to affected third parties. However, penalties may be imposed and damages awarded only by the Federal Court. In addition, the ACCC may at any time apply to the Federal Court for an injunction to restrain anti-competitive conduct.

As at 13 August 1998 the ACCC had only issued two competition notices, both against Telstra. The first related to conduct in relation to Internet services, however, the ACCC withdrew the notice prior to it coming into effect. The second notice issued on 10 August 1998 refers to Telstra's customer transfer process but does not come into effect until 30 September 1998. Telstra is reviewing the processes and costs of its customer transfer process and is currently in negotiations with the ACCC regarding this issue.

#### *Information Gathering Powers*

The ACCC has a range of powers available to it to seek information from participants in the telecommunications industry, and Telstra specifically. If the ACCC is satisfied that a Carrier or CSP has a substantial degree of power in a telecommunications market, it may direct such Carrier or CSP to provide information about charges for its services and products. In addition, Telstra alone is required to give the ACCC such information about its charges for certain "basic telecommunications services" as the ACCC requires. If the ACCC is satisfied that there would be a net public benefit in publishing charging information, it must do so, subject to a right of appeal. Further broad powers are available to the ACCC to seek information where it considers that a person may be engaging in anti-competitive conduct.

#### *2000 Review*

The Communications Minister has indicated the Government's intention to align the competition rules, competition notice powers and charging information powers for the

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telecommunications industry to the fullest extent practicable with general trade practices law. The legislation states that these industry specific rules and powers must be reviewed before 1 July 2000 to consider whether the provisions should be repealed or amended.

### *Retail Price Restrictions*

The Government imposes retail price controls on various discrete Telstra services and groups of services. Telstra cannot increase prices for the basket of basic access, local, national long distance and international calls, domestic and international leased lines, fixed-to-mobile calls and mobile telecommunications services beyond annual increases in the Consumer Price Index (CPI) over the previous year less a specified percentage (the X amount). If the annual increase in the CPI is less than the X amount, Telstra is required to reduce its prices accordingly. The X amount on the basket for these services is 7.5 per cent until at least 31 December 1998. An X amount of 1 per cent applies to each of the following services for residential customers: connections; line rentals; national long distance calls (including fixed-to-mobile calls); and international calls. These price cap arrangements are being reviewed by the Government with any new arrangements expected to have effect from 1 January 1999. The Communications Minister has also indicated that controls imposed on Telstra as a result of the 1998 review will continue until the end of 2000. The need for controls beyond that date will be determined during 2000.

Telstra cannot increase its prices by an amount more than the CPI without the ACCC's consent for any service in the following categories: mobile telecommunications services; connections and line rental for certain telecommunication services; domestic and international leased lines; and local, national long distance, international, and fixed-to-mobile calls. Further, Telstra must not alter any of the prices for these services in a manner which, in the opinion of the ACCC, is a misuse of market power.

In addition, Telstra must not charge more than A\$0.40 for untimed local calls from payphones and not more than A\$0.25 for any other untimed local calls. A further price control measure, which came into effect on 1 January 1998, effectively requires that both: (i) the average Telstra price for untimed local calls provided to residential/charity customers in non-metropolitan areas in 1998 must not exceed the average price charged by Telstra to residential/charity customers in metropolitan areas in 1997; and (ii) the average Telstra price for untimed local calls provided to business customers in non-metropolitan areas in 1998 must not exceed the average price charged by Telstra to business customers in metropolitan areas in 1997. Further, Telstra also cannot impose or alter a charge for directory assistance services without notifying the Communications Minister, who has the power to disallow such imposition or variation.

### *Untimed Local Calls*

All Carriers and CSPs are required to offer an option for untimed local calls for certain basic telecommunications services provided to residential customers and charitable organisations for all local calls and to businesses for local voice calls, in each case where the call was of a kind that at 20 September 1996 any

Carrier offered on an untimed basis, or is supplied to the customer in fulfilment of a Universal Service Obligation.

### **Access**

#### *Declared Services*

The Trade Practices Act creates an access regime specific to the telecommunications industry. The ACCC can determine that a particular telecommunications service or other service that facilitates the supply of a telecommunications service, is subject to the regulated access regime (Declared Service). Unless exempted by the ACCC, any Carrier or CSP that supplies a Declared Service to itself or another person must provide (i) that service to Carriers, CSPs or Content Service Providers who require it to provide telecommunications services or content services and (ii) relevant interconnect services. These standard access obligations are subject to exceptions relating to available capacity, protected contractual rights and the reliability, creditworthiness and technical ability of the party seeking access. For access to services which are not Declared Services parties must engage in commercial negotiations, subject to general trade practices law.

The ACCC has declared the following as Declared Services:

- (i) originating and terminating access for domestic PSTN, ISDN, GSM and AMPS-based mobile telecommunications networks;
- (ii) transmission capacity on all routes except Melbourne - Sydney on bandwidth of 2, 4, 6, 8, 34/45, 140/155 or higher megabits per second;
- (iii) digital data access service (domestic carriage of data between exchange or other network facilities and customer premises);
- (iv) conditioned local loop service (a bundled service for the supply of unswitched transmission capacity in the local loop);
- (v) the diversion of calls made to disused AMPS numbers to the customers' new GSM-based numbers; and
- (vi) analogue broadcasting access services provided by cable networks and related management subscriber functions.

Further services can be declared by the ACCC either in accordance with an industry recommendation or after conducting a public inquiry and finding that the declaration of a particular service will promote the long term interests of end users. In determining whether the long term interests of end users will be promoted, the ACCC must have regard only to whether declaring the service is likely to promote competition in markets for telecommunications and related services, achieve "any to any" connectivity and encourage the economically efficient use of, and investment in, telecommunications infrastructure.

The ACCC has underway an inquiry into the possible declaration of local services resale and unbundled local loop services.



## Item 1: Description of Business

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Decisions on these issues are expected by late calendar 1998. The ACCC has held an inquiry in relation to the declaration of a GSM intercarrier roaming service, but has decided to take no further action on this issue at this time.

### *Broadband Access*

Under the 1997 regime, owners of Broadband cable networks (Telstra Multimedia and Optus Vision) are regulated as Carriers. Persons who supply carriage services using Broadband cable networks, such as Telstra Multimedia, are regulated as CSPs.

A broadcasting access service for the transmission of pay television has been included in the ACCC's list of Declared Services, with the aim of providing, subject to various preconditions, third party access to Broadband cable networks.

However, a standard access obligation will not attach to a Declared Service where that would deprive any person of a protected contractual right. FOXTEL has certain exclusive contractual rights to access the Broadband Network to supply pay television. Further, under its agreement with FOXTEL, Telstra Multimedia may not provide a broadcasting access service to any person utilising set-top unit functionality unless that service includes certain bundled functionality. These FOXTEL rights are, in Telstra's view, protected contractual rights.

### *Terms and Conditions of Access*

The access provider must take all reasonable steps to ensure that the technical and operational quality of the Declared Service and interconnection supplied to the access seeker is equivalent to that which the access provider provides to itself. Billing information must also be provided. If the access provider supplies a Declared Service using conditional access customer equipment (for example, a set-top unit for a pay television service) it must enable the access seeker to use that equipment.

A Carrier or CSP may propose to the ACCC access undertakings which set forth terms and conditions on which it will offer to supply Declared Services. If an access undertaking adopts terms and conditions set out in a telecommunications access code approved by the ACCC, the undertaking must be accepted by the ACCC. If not, the ACCC may accept an undertaking only if satisfied that its terms and conditions are reasonable, which requires, among other things, consideration of the long term interests of end users and the access provider's legitimate business interests.

The terms and conditions (including price) of standard access obligations are to be resolved by commercial negotiations. If negotiations fail but an access undertaking, which includes the relevant terms and conditions, has been provided by the access provider and has been accepted by the ACCC after public inquiry, the access undertaking will prevail. If there is no such undertaking, the ACCC may arbitrate the terms and conditions on which the standard access obligation will be met. Telstra has filed an access undertaking for ACCC consideration for originating and terminating access for domestic PSTN and GSM and AMPS-based mobile telecommunications networks.

A detailed regime exists for ACCC arbitration of access disputes. Matters which the ACCC must take into account in making an arbitral determination include promoting the long-term interests of end users, the legitimate business interests of the access provider and its investment in facilities and the direct costs of providing access. These matters balance the interests of end users and the access provider and access seeker. ACCC arbitral determinations are subject to appeal on the merits to the Australian Competition Tribunal. If there is a Declared Service for which there is no access undertaking, either party to an access agreement for that service may at any time seek changes to the agreement by ACCC arbitration. However, the ACCC may decline to arbitrate.

### *Access Pricing*

The ACCC has published Access Pricing Principles (Principles) setting out how the ACCC proposes to approach price issues when considering access undertakings and determining access disputes in accordance with the long-term interests of end users. The Principles indicate that regulated cost based pricing is appropriate only for well developed Declared Services that are necessary for competition in particular markets, where competitive forces work poorly to set prices at a level which the ACCC regards as efficient (collectively, Relevant Services) and proposes generally to require access prices for such Relevant Services to be based on the total service long run incremental cost (TSLRIC) of providing the service. TSLRIC is generally regarded as the incremental cost incurred in the long term of producing a service; that is, the cost which would be avoided in the long term if a service were not provided. TSLRIC (as defined by the ACCC) consists of the forward looking operating and maintenance costs incurred in providing a service using the most efficient means commercially available and valuing inputs using current prices, including common costs that are causally related to the service. In defining the TSLRIC standard, the ACCC states it has taken into account the legitimate business interests of the party providing the Relevant Service by including in TSLRIC a normal commercial return on capital.

The legislation provides for the making of a Ministerial pricing determination setting out compulsory principles for establishing access prices which must be followed by the ACCC, however, to date no Ministerial pricing determination has been issued.

Given the lack of precision in the Principles, certainty in access pricing is not likely to be obtained until prices are settled by commercial negotiation, arbitration or the ACCC after public inquiry. In some instances, such prices can be backdated to take effect from 1 July 1997, where the access seeker was a service provider under the Telecommunications Act 1991.

Telstra and Optus have agreed to the pricing for the provision of certain originating and terminating access services and certain other services for fiscal 1998. A new agreement for fiscal 1999 will be negotiated after the ACCC has reviewed Telstra's draft undertaking on pricing.

## Item 1: Description of Business

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### *Carrier-to-Carrier Access Obligations*

In addition to its access obligations under the Trade Practices Act, so that other Carriers may provide competitive facilities or telecommunications services, each Carrier is required to provide access on request to other Carriers to:

- (i) its customer cabling and equipment and network infrastructure (including lines, towers, ducts and land) in place on 30 June 1991 or installed since that date using statutory powers, if such access will promote the long-term interests of end users;
- (ii) certain information relating to the operation of the Carrier's networks; and
- (iii) underground ducts and certain towers and sites with the aim of ensuring that so far as possible facilities are collocated on towers and in underground ducts, unless the ACA finds that collocation is not technically feasible.

Access to these facilities and information is to be on commercially negotiated or arbitrated terms and conditions. In addition, the Communications Minister can determine pricing principles for access to customer cabling and equipment, network infrastructure and information relating to the operation of a network.

The ACCC has developed a draft Facilities Access Code with which Carriers will be required to comply in relation to access to towers and underground facilities. As required by legislation the Code only provides an express right for a Carrier to reserve space for future requirements where it has commenced the process of preparing capacity in or on a facility.

### *Carrier and Service Provider Rights and Obligations*

An owner of certain network infrastructure must not use it to supply a carriage service to the public unless the owner holds a Carrier licence issued by the ACA or a third party Carrier has been nominated and declared by the ACA as accepting Carrier responsibilities for the infrastructure. There is no legislative limit on the number of Carrier licences which may be issued. A licence applies to all carriage services and does not distinguish between fixed, mobile or satellite services. Telstra's Carrier licence is deemed to have taken effect on 1 July 1997 while Telstra Multimedia was granted a Carrier licence which took effect from that day.

Annual licence charges are to be fixed by the ACA to recover certain costs including the operational costs of the ACCC and the ACA in telecommunications regulation. All Carriers must comply with the Telecommunications Act 1997 (Cth) (1997 Act) and the standard access obligations. Any breach of the 1997 Act or a standard access obligation is subject to a penalty determined by the Federal Court of up to A\$10 million. Carrier licences can be cancelled only on very limited grounds such as a failure to pay an annual licence charge or a universal service levy.

The Communications Minister has discretion to impose conditions on any Carrier licence subject to prior consultation with the Carrier. Telstra's Carrier licence currently requires it to:

- (i) provide operator and directory assistance services to end users of certain basic telecommunications services that it provides;
- (ii) annually produce, publish and provide an alphabetical telephone directory;
- (iii) establish and maintain an integrated public number database and the provision of access to the database to all CSPs for certain purposes including supplying directory or operator services or producing a directory. The terms and conditions are to be commercially agreed or arbitrated. In arbitration, Telstra's charge for access to the database is restricted to the direct costs of providing access and a reasonable contribution to a normal return on capital;
- (iv) ensure reductions in connection and annual charges for certain basic telecommunications services of at least specified amounts if a customer does not rent a handset from Telstra for use with that service;
- (v) be in a position by 31 December 1998 to make available to at least 96 per cent of the Australian population a digital data carriage service broadly comparable to that provided by an ISDN data channel with a transmission speed of 64 kilobits per second. The 96 per cent coverage figure is based upon Telstra's own rollout plan;
- (vi) have in place and report against an industry development plan approved by the Minister for Industry, Science and Tourism, and comply with the plan to the extent it relates to research and development;
- (vii) provide local number portability services to Optus on specified terms and conditions until longer term arrangements are set under the provisions of the 1997 Act; and
- (viii) provide resale (for a limited time) of, and/or roaming on, its AMPS service to the operators of proposed new digital mobile networks on terms and conditions, commercially negotiated or arbitrated.

A CSP that provides certain basic telecommunications services must provide or arrange for the provision of itemised billing services, operator services and directory assistance services to end users. Telstra will be required to provide operator and directory assistance services if requested, on terms and conditions commercially negotiated with the CSP or arbitrated. A CSP must also supply information for the integrated public number database.

The ACA may give written directions to a Carrier or CSP or Content Service Provider in connection with exercising any of the ACA's powers. Breach of such a direction is subject to a maximum Federal Court imposed penalty of A\$10 million.

## Item 1: Description of Business

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### Network Operations

#### *Powers and Immunities*

Prior to 1 July 1997, Carriers had extensive rights to install facilities on public and private land without land owner consent and with immunity from State and Territory building, environmental, occupational health and safety laws and local planning regulations. Effective 1 July 1997, these rights have been restricted to: aerial cabling commonly used for Broadband services installed by 30 September 1997 and any other facilities installed by 31 December 1997, that have been determined by the Communications Minister to be low impact facilities; temporary defence facilities; facilities authorised by a facility installation permit issued by the ACA; connecting premises before 1 July 2000 to a network any part of which was in existence at 30 June 1997; and the inspection, maintenance and, in many cases, replacement of existing facilities. Any such activities are subject to an obligation to restore land and pay compensation to land owners and are subject to a Telecommunications Code of Practice providing for notice and objection mechanisms. The Secretary to the Commonwealth Department of the Environment may impose conditions on certain activities. The ACA's power to issue a facility installation permit is subject to stringent conditions.

Subject to Parliamentary disallowance, low impact facilities include many of the facilities routinely used in constructing networks, except aerial cabling and towers and certain other facilities depending upon their location in a residential, commercial industrial or rural area. No facilities in areas of particular environmental or Aboriginal and Torres Strait Islander significance are low impact. All Carrier activities remain subject to laws protecting places of cultural significance to these groups and Torres Strait Islanders (including native title laws).

Facilities other than those described above may only be installed with the agreement of the relevant land owner and in compliance with all relevant State, Territory and local laws or through the facility installation permit powers. These limitations on Carrier powers and immunities may lead to delay or prohibition of the rollout of certain additional Telstra network facilities. The limitations can be expected to have a greater proportional impact on the activities of new Carriers who have no existing network.

If all non-telecommunications overhead cables attached to a pole are placed underground, any Carriers using those poles for any telecommunications cables must, within six months, place those cables permanently underground unless a local authority consents to the cables remaining in place.

A State, Territory or local law must not discriminate against a Carrier or Carriers, unless allowed by the Communications Minister.

#### *Statutory Limitation of Liability*

In most comparable countries, the providers of telecommunications services have statutory caps on their

liability in tort for damages claims. The ACA has power to impose such a cap but to date has not done so.

#### *Number Portability*

Number portability allows customers to switch to another Carrier or CSP while retaining the same telephone number.

The ACA has put in place a numbering plan for Australia. The plan sets out rules about number portability as directed by the ACCC which has mandated portability for local services, 1800 services and I3 services. The ACCC also required the ACA to set an implementation date for each portable service after consulting with the ACCC and considering technical feasibility. The terms and conditions on which CSPs supply number portability are to be set by commercial negotiation or arbitration. The Communications Minister may issue a number portability pricing principles determination which would govern any arbitration.

Carriers are obliged to provide limited number portability for local services. Portability is currently being provided only for single line services and the industry is developing a Code to deal with issues regarding portability for more complex services. The ACA is presently holding an inquiry to review the type of technology required to meet the requirements of full number portability. It is currently intended that full number portability will be implemented by 1 January 2000.

If the kind of local number portability services required by the ACA is different from that currently agreed between Telstra and Optus, Telstra may have to incur substantial additional capital expenditures to effect that implementation and may not be able to recover those costs from other CSPs. The ACCC has also indicated its preliminary view is that, in the near future, mobile number portability is likely to be required. Telstra believes that compliance with any such requirement would be likely to require significant capital expenditure and the resolution of numerous technical issues. Telstra may not be able to recover its costs of providing number portability in full from other CSPs.

Telstra is also subject to an interim licence condition which requires the provision of local number portability services, where requested by Optus, on specified terms and conditions until longer term arrangements are set under the provisions of the 1997 Act. In complying with these interim licence conditions, Telstra expects that it will only recover part of its costs of providing local number portability services to Optus. Accordingly, Telstra will pursue appropriate commercial arrangements by the negotiation and, if necessary, arbitration processes.

The ACCC has issued a draft paper suggesting pricing principles which it would apply in the event it was required to arbitrate in relation to terms and conditions for the provision of local number portability. These draft principles suggested that each party should bear its own costs of supply. Telstra has made several submissions to the ACCC regarding these principles, and expects a further paper from the ACCC.

## Item 1: Description of Business

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Inbound number portability affects Telstra's inbound call services including Freecall™ 1800, Priority®, One3 and Priority®, 1300. For inbound number portability, the implementation date has not been finalised by the ACA. Telstra has been working with the industry to assist the ACA to finalise the technical and organisational methodology to implement inbound portability which would enable the implementation date to be set. Originally expected in 1998, it could be anticipated that, pending resolution of a range of issues, inbound number portability may occur in calendar 1999. The pricing principles described above with respect to local number portability may also apply to inbound services.

### *Preselection and Override Codes*

Preselection allows customers, while connected to a CSP, to specify another CSP to provide certain telecommunications services. Override Codes allow a customer to select a different CSP on a call-by-call basis.

The ACA has set a preselection requirement for CSPs relating to certain basic telecommunications services. Initially, the requirement is to provide the preselection of one CSP for both national long distance and international voice calls and certain operator services. An override function for those voice calls must also be provided. The industry agreed that this must be made available by all CSPs by 24 September 1998. ACA may later require the availability of preselection of different CSPs for different call types. The ACA is investigating the desirability and feasibility of the preselection of fixed to mobile calls. The ACA is likely to issue a decision on this issue in the last quarter of calendar 1998. Preselection of fixed-to-mobile calls could, in certain circumstances, have a significant adverse effect on Telstra's current level of revenues from these services.

### *Analogue AMPS Network Closure and Radio-Communications Spectrum*

The 1997 Act provides for the closure of Telstra's analogue AMPS mobile telecommunications network by 31 December 1999 and has prohibited the installation and operation of any other analogue AMPS mobile telecommunications networks. However, subject to agreement between Telstra, Optus, Vodafone and the Government, Telstra may continue to operate its analogue AMPS network in certain non-metropolitan areas for a maximum further 12 month period. This would enable Telstra to deploy an 800MHz digital cellular network which will meet the Government's policy of providing reasonably equivalent mobile service in those non-metropolitan areas where there is no alternative equivalent mobile service. Industry participants recently bid at an auction to acquire rights to the 800MHz spectrum. The auction concluded in May 1998, with the successful applicants being Telstra, AAPT, Hutchison Telecommunications (Australia) Limited (Hutchison) and OzPhone Pty Ltd (OzPhone). Telstra is required by a licence condition to provide to AAPT, Hutchison and OzPhone, or a Carrier authorised by any of them, resale of its analogue AMPS mobile telecommunications services for a limited period. The licence condition also establishes reciprocal roaming rights between the digital services operated in the 800MHz bands and the AMPS service.

Spectrum in the 1800MHz band was auctioned simultaneously with the 800MHz spectrum. It was acquired primarily by the existing mobile telecommunications Carriers, Telstra, Optus, Vodafone and new entrant, One.Tel Ltd. Catapult Communications Pty Ltd acquired a minor amount.

### *Interception*

As part of the obligation of Carriers to cooperate with law enforcement agencies, they must (unless exempted by the Communications Minister) ensure that telecommunications services passing over their networks can be intercepted by agencies who hold an interception warrant. This requirement can lead to delay in the launch of particular carriage services until the services can be made interceptible. Recent changes to the legislation require the Carriers to bear some of the costs of providing interception capability.

### *Universal Service Obligation*

Telstra is the national universal service provider. As a result, it must take all reasonable steps to ensure that certain basic telecommunications services, payphones and any telecommunications services prescribed by regulation are reasonably accessible to all people in Australia on an equitable basis. The Universal Service Obligation also extends to making services for disabled persons and particular customer equipment, such as specialised telephone handsets, reasonably accessible. In addition, the Communications Minister may determine a system to select Carriers to be a national universal service provider for a particular service or a regional universal service provider for particular areas, such as by competitive tender.

Telstra must take all reasonable steps to comply with a plan to fulfil its Universal Service Obligations, prepared by Telstra and approved by the Communications Minister. The Communications Minister is required to consider whether a digital data carriage service broadly comparable to that provided by an ISDN data channel with a transmission speed of 64 kilobits per second should be prescribed from 31 December 1998. The ACA report on this issue has recommended against this requirement. The Communications Minister may impose price control arrangements on the supply of telecommunications services under the Universal Service Obligation which are not already governed by price control arrangements under the Telstra Corporation Act 1991 (Cth) (Telstra Act). The costs incurred by Telstra in fulfilling its Universal Service Obligation will, in part, be offset by a levy charged to the other Carriers which is calculated by reference to their relative proportion of total industry eligible revenue. The Communications Minister has only recently defined eligible revenue. The Communications Minister may develop principles which would allow Telstra to partly recover only those of its costs which the Communications Minister regards as non excessive.

### *Customer Service Guarantee*

At the direction of the Communications Minister, the ACA has made mandatory standards for CSPs in relation to the supply of Standard Telephone Services to customers. These Customer Service Guarantee (CSG) standards have been in effect since 1

## Item 1: Description of Business

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January 1998. If a CSP contravenes a standard, it is liable to pay damages to affected customers, as an account credit, in an amount specified by the ACA not to exceed A\$25,000 in total.

The current standards relate to connection times, fault repair times and the keeping of appointments in relation to these activities. The CSG penalty payments for missed appointments are monthly telephone line rentals. For delayed connections and repairs, the penalty rates are monthly line rentals for each working day of delay up to five days and A\$40 per working day of delay thereafter. A review of the CSG Standard is being conducted by the ACA at the request of the Communications Minister with a view to tightening performance standards where practicable, for effect on 1 January 1999.

### Broadcasting Regulation

The Government is currently reviewing broadcasting regulation in several areas. These include: provisions affecting the terms and conditions on which pay television operators retransmit free-to-air television services; anti-siphoning rules which regulate the acquisition of rights of television operators to televise certain events; the basis on which digital terrestrial television may be introduced in Australia; and requirements concerning Australian content on pay television, including the feasibility of increasing the current expenditure on Australian drama.

Recent legislation will permit free-to-air television broadcasters (FTAs) to use 7MHz of loaned spectrum to supply digital television. Digital broadcasting, simulcast with analogue for eight years, must commence by 1 January 2001. There must be a review by 1 January 2000 which will determine the regulatory arrangements concerning use of broadcasting spectrum for datacasting by players other than the FTAs, and whether the FTAs will be permitted to provide multi-channel services. Following this review, subject to the vote of both Houses of Parliament, the FTAs will be able to use the spare loaned spectrum for datacasting.

### Future Regulation

On 30 March 1998 the Federal Government introduced the Telstra (Transition to Full Ownership) Bill 1998 (the Bill) to amend the Telstra Act to allow for the sale of the Government's remaining shareholding in the Company. On 11 July 1998 the Bill was defeated in the Senate of the Australian Parliament. The main Opposition Party has stated that if elected it would not support the further privatisation of the Company. On 22 July 1998, the Communications Minister announced that the Bill would be reintroduced to the Parliament to allow for a sale of a further 16 per cent of the Commonwealth's shareholding, but that no further Shares would be sold until an independent inquiry had verified that Telstra's service levels were adequate. In addition to changes to the Telstra Act, the Federal Government has proposed that the passage of any sale legislation will also involve changes to several aspects of the regulatory regime.

In relation to consumer regulation, the Government has proposed that the ACA should be provided with a power to review systemic failures to meet the performance standards on

the basis of the CSG. Where such a systemic failure is found, the ACA would be given a power to direct a CSP to comply with the standards, and penalties of up to A\$10 million could be imposed for breach of such a direction.

In relation to competition regulation, the Government has proposed that several changes should be made to the telecommunications-specific provisions of the Trade Practices Act. First, the ACCC's ability to require a CSP to maintain certain information and records would be clarified, with an additional and very wide ranging power granted to the ACCC to require public disclosure of such information. Telstra believes this could result in sensitive cost information being published to Telstra's commercial detriment. Further, the ACCC would be given expanded powers to participate in access negotiations, and to direct access seekers and access providers. Persons would be able to seek injunctive relief for an alleged breach of the competition rule prior to the ACCC having issued a competition notice. This would likely lead to an increase in litigation against Telstra.

These amendments are subject to further Government and Parliamentary processes so the future progress of the amendments is uncertain.

## Item 2: Description of Property

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A large part of Telstra's network is constructed on land occupied pursuant to statutory powers and immunities. Telstra also owns and occupies land and although Telstra's real property assets are not individually large in area, they include some strategic sites, such as the properties on which its telephone exchanges are located. Telstra owns approximately 5,500 freehold sites and occupies approximately 5,500 sites on a leasehold or other basis. Most of Telstra's sites are related directly to its telecommunications operations and are used for housing network equipment of various types, such as telephone exchanges, transmission stations, microwave radio equipment and mobile radio repeater equipment. Some of Telstra's operational sites are situated on leased land or land to which Telstra has access by statutory right or other formal or informal arrangement. In addition to its operational sites, Telstra owns or leases a range of properties for office accommodation, storage and other miscellaneous purposes.

Telstra's network is constructed with built-in diversity to ensure that customer service is retained to the maximum extent after a major event, and that restoration is rapidly achieved. The computer systems used by Telstra for the processing of data for billing purposes are situated principally in one location. The Company has not established back-up processing facilities for processing this data in the event of the destruction or substantial impairment of its primary processing facilities, which could occur, for example, as a result of fire, flood or other disaster. Were such an event to occur, the Company could experience delays in the processing of customer bills and in the receipt of related payments. However, a Disaster Recovery Plan exists to effectively manage such a situation. Telstra believes that its

## **Item 2: Description of Property**

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properties are in good operating condition and has in place a level of insurance consistent with industry practice.

As at 30 June 1998, Telstra had become a party to some 424 native title claims to parcels of land in Australia in order to ensure that its rights to continue to have existing infrastructure located on that land are recognised should a native title determination be made in favour of the claimants. Telstra believes that any determination of native title will be subject to the continuing presence of Telstra infrastructure validly installed prior to the commencement of the Native Title Act 1993 on 1 January 1994. Telstra has been advised that facilities installed after this date pursuant to statutory powers under the Telecommunications Act 1991 will also receive the protection of the validation provisions in the Native Title Act 1993.

In certain circumstances, the Commonwealth may be required to compensate native title holders where the construction of infrastructure on land prior or subsequent to 1 January 1994 has extinguished or impaired native title. Telstra may be required to indemnify the Commonwealth for any compensation paid to native title holders in respect of any act performed by the Commonwealth relating to telecommunication services prior to 1 July 1975. Telstra may also be directly liable in certain circumstances to pay compensation to native title holders for its activities on native title land.

The quantum, if any, of such liabilities is not known but will depend in each case on the nature and extent of the native title rights and interest determined to exist and the degree to which Telstra's activities have impinged on or restrict the exercise of those rights. As no claims for compensation have been brought involving Telstra (with the result there is no factual position to assess) the extent of Telstra's liability to contribute to compensation cannot be assessed.

The land access powers conferred on Carriers by the 1997 Act are more limited than those conferred by previous legislation. For this reason, Telstra presently has to negotiate with native title holders and claimants to a greater extent than was previously required in order to lawfully access and use land over which native title may exist. These processes may also require co-operation with the relevant State or Territory Governments.

However, the Native Title Act 1997 (Cth) which will commence on 30 September 1998, will make it considerably easier for Telstra to access land subject to native title claims for the purposes of the construction of telecommunications infrastructure for the general public. Again, native title holders will have rights of compensation, which could be recovered against Telstra.

### **Native Title Proceedings**

As at 30 June 1998 Telstra was a party to some 24 proceedings in the Federal Court of Australia in addition to 400 native title claims presently before the National Native Title Tribunal which, if no agreement is reached during the compulsory mediation phase, will proceed to the Federal Court for resolution. In each of these claims the applicants seek a determination by the Federal Court that native title exists in specified areas including areas where Telstra has telecommunications facilities. These are not claims for money.

The main respondent party in each proceeding is the relevant State or Territory. Telstra has elected to become a party to ensure that its existing telecommunications facilities in the areas subject to claim are, in the event native title is determined to exist, noted as interests to which that native title is subject. To do this involves an inquiry as to the basis of Telstra's occupation rights. Only if Telstra is not able to demonstrate the validity of its present occupation rights will there be any adverse outcome for Telstra. In almost all of these claims, Telstra is or will be able to do this. Telstra does not anticipate that the validity of the installation of Telstra's facilities will be contested by the applicants.

## **Item 3: Legal Proceedings**

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The Company is involved in a number of legal proceedings in the course of its business. Except for the proceedings described below, the Company is not a party to any legal or arbitration proceedings which could reasonably be expected to have a significant adverse effect on the Company's business or financial position taken as a whole. From time to time, governmental authorities or third parties may threaten legal proceedings against the Company. Telstra is not aware of any such threatened proceedings which would be reasonably likely to have a significant adverse effect on the Company's business or financial position taken as a whole.

On 10 September 1997 Optus and two of its subsidiaries, Optus Networks Pty Ltd (Optus Networks) and Optus Vision, commenced proceedings in the Federal Court of Australia against Telstra, Telstra Media Pty Ltd (Telstra Media) and Sky Cable Pty Ltd (Sky Cable), a subsidiary of News Corporation. The claims against Telstra Media and Sky Cable have since been discontinued. The claims made against Telstra assert that Telstra has acted in breach of section 46 of the Trade Practices Act (misuse of market power provision) by taking advantage of a substantial degree of power in various markets for prohibited purposes. The asserted misconduct relates to an alleged refusal by Telstra to supply local number portability and local call access and resale services to Optus on reasonable terms and conditions. Optus also asserts that Telstra has breached section 46 of the Trade Practices Act by reason of the arrangements for the supply of Pay TV carriage services from Telstra to FOXTEL and certain arrangements concerning the construction of the Telstra Broadband Network. Optus claims unquantified damages including interest. Telstra believes, on the information currently available, that it has substantial defences to these claims and will continue to defend the action vigorously. If Optus is successful in the litigation, it could have a material adverse effect on Telstra's financial results, operations and competitive position.

Telstra is currently involved in significant litigation with four of its wholesale customers - AAPT, First Netcom Pty Ltd (First Netcom), QAI Australia Ltd/Southern Cross Telco Pty Ltd (QAI) and I-Tel Pty Ltd (I-Tel). These proceedings (other than I-Tel) generally involve claims by Telstra for substantial charges it believes remain unpaid for the provision by Telstra of

### Item 3: Legal Proceedings

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telecommunications services and cross claims by the wholesale customers for substantial amounts. The wholesale customers dispute that the amounts claimed by Telstra or any amounts are owing by them, and typically contend that they are entitled to offset their claims against amounts claimed by Telstra. The wholesale customers typically allege that bills were not received, were inaccurate and/or that Telstra's billing and account management systems were defective in other ways. The wholesale customers' cross claims typically include claims for revenue allegedly foregone by reason of delayed on-billing of third party customers and/or loss of customers and/or revenue from incorrect or delayed billing, and include claims on the basis of alleged breaches by Telstra of the Telecommunications Act 1991, Trade Practices Act, fiduciary duties and/or contract and/or for unconscionable conduct. It is not possible on the information currently available to form a precise view as to the likely outcome of the various proceedings.

The proceedings against AAPT have been set down for trial in the Federal Court of Australia and involve a claim by Telstra for an amount of approximately A\$119 million. AAPT has filed a defence denying that it owes the sums claimed or any sum, and a cross claim against Telstra seeking damages and other relief. In the cross claim, AAPT asserts losses which it estimates to be in the order of A\$300 million. Telstra's proceedings against First Netcom commenced in April 1997, and are currently being conducted in the Federal Court of Australia and involve a claim by Telstra for A\$15 million. First Netcom have filed a defence denying the sums claimed and a cross claim seeking damages and other relief. Although the cross claim does not specify the amount of the damages claimed, First Netcom has asserted that it estimates its losses to be up to approximately A\$37 million. QAI commenced proceedings against Telstra in the Federal Court of Australia on 21 March 1997. QAI has indicated that it seeks an amount of approximately A\$14 million based on a claim including alleged breaches of the Trade Practices Act, breach of contract and fiduciary duties and unconscionable conduct. Telstra has filed a defence and a cross claim against QAI seeking an amount of approximately A\$6.9 million. QAI has filed a defence to the cross claim denying the sum claimed by Telstra. Telstra intends to amend its cross claim to claim an amount of approximately A\$5.5 million.

In August 1995, British Telecom Australasia Pty Limited (BTA) commenced proceedings in the Federal Court of Australia against the State of New South Wales (NSW) and Telstra arising out of BTA terminating a 1992 telecommunications and data network services supply agreement between BTA and NSW. Subsequently, BT made similar claims against Telstra and NSW. BTA and BT have so far asserted claims for direct damages, jointly against Telstra and NSW of approximately A\$315 million in expectation damages and approximately A\$155 million in reliance damages. The allegations include claims that Telstra misused market power, engaged in misleading and deceptive conduct and induced NSW to breach its obligations under the agreement. BTA has also claimed contribution and indemnity from Telstra for any damages awarded to NSW on its cross claim against BTA for substantial damages, including damages of approximately A\$467 million and other damages not quantified in the current pleading. Telstra and NSW have filed cross claims

against each other in relation to the amounts claimed by BTA and BT. It is not expected that a trial will commence before February 1999. Telstra believes that it has substantial defences to and intends to defend vigorously these claims. Telstra's management further believes BTA's claims are unlikely to result in a material adverse effect on future results of operations.

The Company was the subject of proceedings by the ACCC seeking to restrain the completion of the proposed merger between Australis and FOXTEL and claiming that the agreement between Telstra, News Corporation and Australis under which FOXTEL receives certain programming from Australis, including two movie channels and a sports channel, is void on the basis that it was in breach of the Trade Practices Act. Following termination of the proposed merger, the ACCC discontinued the proceedings in November 1997.

On 14 November 1997, Australis Media Holdings Ltd (AMH) and Galaxy, subsidiaries of Australis, commenced proceedings in the Supreme Court of New South Wales claiming damages and other relief from Telstra and News Corporation arising from alleged misleading and deceptive conduct in connection with entering into a programming agreement with AMH and Galaxy in March 1995 and an alleged breach of an obligation to use its best endeavours to ensure that the rollout of a Broadband Network passed 4 million homes by 30 June 1999. Prior to the proceedings, Telstra, News Corporation and FOXTEL had entered into an agreement reducing the number of homes in the rollout of the Broadband Network. The programming agreement between AMH, Galaxy, Telstra and News Corporation required the establishment of a Broadband Network passing 2.5 million homes by the end of December 2000. Telstra completed the rollout of its Broadband Network past 2.5 million homes during calendar year 1997. Telstra denied that it is under any further obligation to AMH and Galaxy to roll out the Broadband Network to 4 million homes. On 21 August 1998, Australis and Galaxy amended their claim in these proceedings to delete the allegation of misleading and deceptive conduct and narrow the contractual claims. Australis and Galaxy quantify the damages claimed in the proceedings, as amended, as US\$3,282,950.

In 1994, claims were made against Telstra by a group of small businesses who refer to themselves as the Casualties of Telecom/Telstra (COTs). As a result of the complaints made by the COTs, in 1994 the Australian Telecommunications Authority (AUSTEL) conducted an investigation into Telstra's handling of the COTs' complaints. AUSTEL made a number of recommendations for improvements to Telstra's systems for handling complaints of service difficulties and recommended that Telstra and the COTs enter into an arbitration process. All claims have now been settled or have been decided by the arbitrator without a material adverse effect on Telstra's financial results or financial position.

In January 1998, Telstra and the Commissioner of Taxation reached agreement on a settlement of a number of disputes relating to the tax consequences of items which date back to when Telstra first became subject to the Income Tax Assessment Act 1936. The settlements did not have a material adverse effect on Telstra's financial results or financial position.



## Item 4: Control of Registrant

The following table sets forth, as at 28 August 1998, the holdings of each person known to Telstra to be the owner of more than ten per cent of Telstra's voting securities and the holdings of Directors and Executive Officers of Telstra, as a group, of Telstra's voting securities.

Title of Class	Identity of Person or Group	Amount owned	% of class
Shares	The Commonwealth	8,582,719,207	66.7%
Shares	Telstra Instalment Receipt Trustee Ltd	4,283,880,993	33.3%
		<u>12,866,600,200</u>	<u>100.0%</u>
Instalment holding via the Telstra Instalment Receipt Trustee Ltd	Directors and Executive Officers as a group	441,910 <sup>(1)</sup>	

(1) Refers to direct and indirect holdings

Telstra Instalment Receipt Trustee Limited has been established to hold Telstra Shares until payment of the final instalment on 17 November 1998. Holders of IRs carry the same voting and dividend rights as fully paid Shares. After payment the holder of the IR will be registered as the holder of the Shares and the IRs will be cancelled. As at 28 August 1998, Telstra is not aware of any IR holders whose IRs represent more than 10 per cent of the issued and outstanding Shares.

### Distribution of Instalment Receipt Holdings as at 28 August 1998

The following table summarises the distribution of registered IR holders.

Size of Holding	IR holders*		IRs	
	Number	%	Number	%
1 - 1,000	933,574	66.0	669,781,056	15.6
1,001 - 2,000	245,182	17.3	411,367,825	9.6
2,001 - 5,000	190,183	13.5	548,858,605	12.8
5,001 - 10,000	34,920	2.5	253,961,043	5.9
10,001 - 100,000	9,131	0.6	178,749,582	4.2
100,001 and over	514	0.1	2,221,162,882	51.9
Total	1,413,504	100.0	4,283,880,993	100.0

\* Number of IR holders holding less than a marketable parcel of 111 IRs was 1,178

### Twenty Largest Instalment Receipt Holders as at 28 August 1998

The following table sets out the top 20 holders of IRs when multiple holdings are grouped together.

IR Holder	Number of IRs	% of Issued IRs
1 Westpac Custodian Nominees Limited	350,056,372	8.1
2 Chase Manhattan Nominees Limited	230,823,273	5.4
3 National Nominees Limited	182,927,668	4.3
4 Telstra ESOP Trustee Pty Limited	135,675,679	3.2
5 Permanent Trustee Australia Limited	106,145,580	2.5
6 AMP Life Limited	92,059,601	2.1
7 Queensland Investment Corporation	67,104,306	1.6
8 BT Custodial Services Pty Limited	67,078,876	1.6
9 ANZ Nominees Limited	65,199,603	1.5
10 Citicorp Nominees Pty Limited	62,014,845	1.4
11 MLC Limited	59,215,493	1.4
12 Commonwealth Custodial Services Limited	55,431,642	1.3
13 SAS Trustee Corporation	43,917,640	1.0
14 Permanent Trustee Company Limited	41,246,976	1.0
15 Perpetual Trustees Victoria Limited	37,322,172	0.9
16 Perpetual Trustee Company Limited	35,419,731	0.8
17 HKBA Nominees Limited	28,940,320	0.7
18 Perpetual Trustees Nominees Limited	26,792,360	0.6
19 NRMA Investments Pty Limited	23,234,600	0.5
20 The National Mutual Life Association of Australasia	21,045,205	0.5
<b>Total</b>	<b>1,731,651,942</b>	<b>40.4</b>

### Substantial Shareholders

As at 28 August 1998, other than the Commonwealth of Australia and the Trustee, there were no substantial shareholders (as defined in the Australian Corporations Law) in the Telstra Entity.

### Relationship with the Commonwealth of Australia

The Commonwealth has a number of distinct relationships with Telstra, including as shareholder, regulator and customer. The Commonwealth is the controlling shareholder in Telstra and has special rights and privileges under the Telstra Act. Telstra's relationship with all of its shareholders including the Commonwealth is, in general, regulated by the Australian Corporations Law, the ASX Listing Rules and Telstra's Articles of Association. Commonwealth departments and agencies are also responsible for the regulation of the telecommunications industry generally and Telstra in particular under the Telstra Act, the Trade Practices Act and the 1997 Act.

## Item 4: Control of Registrant

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### The Commonwealth as Shareholder

The Commonwealth owns 66.7 per cent of the Shares of the Telstra Entity. The Telstra Act precludes any reduction in the Commonwealth's voting rights, paid-up capital or rights to distributions of capital or profit, if any, below a two-thirds interest in Telstra without amending legislation. The effect of this is that Telstra cannot introduce a dividend reinvestment plan or raise new equity capital without Commonwealth participation. There can be no assurance that the Commonwealth would be willing to subscribe for additional Shares in Telstra and Telstra's ability to raise additional equity capital could be constrained as a result.

The Telstra Act requires Telstra to provide the Commonwealth with certain information that the Company would not generally be required to disclose concurrently, if at all, to other shareholders. This information includes: (i) annual provision of the Company's three year corporate plan and any periodic changes to the plan; (ii) interim financial statements, if requested by the Communications Minister; and (iii) reports regarding significant proposed events, including corporate restructurings, acquisitions and divestitures or joint venture and partnership activities. Telstra is also required to keep the Communications Minister and the Minister for Finance and Administration (Minister for Finance) generally informed about the operations of Telstra and to give them such information in relation to the Company's operations as they require. Representatives of Telstra are to continue to be required to appear before and, with limited exceptions, provide information to Parliamentary Committees.

Under the Telstra Act, the Communications Minister has the power to give Telstra, after consultation with the Board of Directors, such written directions in relation to the exercise of the powers of Telstra as appear to the Communications Minister to be necessary in the public interest. No directions have been issued under this power in the past. Telstra's Board of Directors has a duty to ensure that the Company complies with any such direction. The Communications Minister is not permitted to give such directions in relation to the amounts to be charged for work done, or services, goods or information supplied, by Telstra. The Communications Minister, however, has some discretionary powers in relation to charges. The leader of the main Opposition Party has stated that the main Opposition Party strongly supports retention by the Commonwealth of the power of direction over the Company when it is in the national interest, particularly to ensure universal provision of services and the development of Australian industry.

The Telstra Act deems the Commonwealth Auditor-General to have been appointed as the auditor of Telstra for the purposes of the Australian Corporations Law. The Auditor-General cannot be removed without legislative amendment. The Auditor-General has various powers under the Audit Act 1901, including the power to conduct project performance audits on the Company's operations.

The Commonwealth, as holder of 66.7 per cent of the Shares in the Telstra Entity, like any other majority shareholder in an Australian company, has the ability to control the Company. This includes the power to pass any resolution at a shareholders'

meeting requiring a simple majority (including the appointment of Directors) with the exception of matters upon which the Commonwealth is not permitted to vote under the Corporations Law or applicable listing rules. The Commonwealth may be able to achieve the passing of any resolution requiring the approval of the holders of three quarters of the Shares in Telstra present and voting at a meeting (a special resolution), such as amendments to Telstra's Memorandum and Articles of Association, since the Shares in Telstra not owned by the Commonwealth are widely dispersed among Telstra's shareholders.

The Commonwealth has a set of general policies which apply to partially owned government business enterprises, which provide significant commercial freedoms in the conduct of their business, subject to the oversight of appropriate Ministers. These general policies are applied to Telstra as outlined above principally by the Telstra Act and the Company's Articles of Association.

The Government has indicated it will seek to sell the remainder of Telstra in stages if re-elected on 3 October 1998. The first sale will be of 16 per cent, which will leave 51 per cent, and majority control, in Government hands. No further sale, beyond 49 per cent will be possible until the Government has established an independent inquiry which will assess Telstra's service levels to customers in each of metropolitan, rural and remote areas against the prescribed standards. The new consumer protection legislation will specify the performance criteria which the inquiry will use in testing whether Telstra's performance in maintaining service levels has been adequate. Those criteria will build on those which underpin the current arrangements, and will be developed in consultation with all interested sections of the community. Unless and until the independent inquiry certifies that service levels are adequate, there will be no further sell down beyond 49 per cent.

The main Opposition Party has announced that it has no current plans for any further sale of the Commonwealth's shareholding in Telstra.

### The Commonwealth as Regulator

Telstra is currently regulated by the Commonwealth under a number of statutes including the Telstra Act, the Trade Practices Act and the 1997 Act. The Commonwealth's role as regulator is independent and distinct from its role as shareholder. The Government sees the legislation which established the current regime as providing the fundamental legal and institutional reforms required to enhance competition within the Australian telecommunications industry. The framework provided by the legislation is expected to be the basis for regulation of the industry for some time. Like other regulatory regimes, the Government does not expect the current regime to remain static. It will change over time in light of experience and new developments in the industry. The leader of the main Opposition Party has stated that the main Opposition Party does not currently intend to make significant changes to the existing regulatory environment if it became the Government. The Government or any future Government, however, may change its policy as to the regulation of the telecommunications

## Item 4: Control of Registrant

industry, which may adversely affect the competitive position or results of operation of the Company.

Telstra is also subject to a range of Commonwealth legislation, some of which does not apply to its competitors. This legislation covers a wide range of areas including administrative law, environmental law and employment related law. Subject to any exceptions that may be determined by the Commonwealth, the Government decided in June of 1997 to exempt Telstra and its other business enterprises from the application of statutory administrative law, subject to the passage of necessary legislation. To date, no such legislation has been passed so the obligations remain. Similarly, the Government has agreed to exempt Telstra from Government purchasing policies.

### The Commonwealth as Customer

The Commonwealth is a major user of Telstra's services with total recent annual expenditures of between A\$300 million and A\$400 million which Telstra believes comprises approximately 80 per cent of the Commonwealth's spending on telecommunications services. The Commonwealth, as a result of telecommunications liberalisation, is moving toward a whole-of-government approach to the purchase of telecommunications services and will increasingly seek to take advantage of open competition when purchasing telecommunications services. This may result in a reduction of business being awarded to Telstra.

## Item 5: Nature of Trading Market

Since 17 November 1997 the principal listing of the IRs has been the ASX. The IRs are also listed on the New Zealand Stock Exchange (NZSE). Interim ADSs, each representing 20 IRs evidenced by Interim ADRs, have been issued by the Bank of New York as Depositary, and are listed on the New York Stock Exchange (NYSE). IRs and Interim ADSs are also quoted on Stock Exchange Automated Quotation (SEAQ) International. The IRs were included in the Australian Stock Exchange (ASX) All Ordinaries Index and relevant Sub-Indices on 1 January 1998.

In November 1998, upon payment of the final instalment, holders of IRs and Interim ADSs will become entitled to Shares and ADSs. These will be traded and/or quoted on the same exchanges as IRs and Interim ADSs.

The stock market operated by the ASX is the principal stock exchange in Australia. The exchange operates by way of the Stock Exchange Automated Trading System (SEATS), which is a fully computerised system.

Trading on SEATS takes place each business day between the hours of 10:00 am and 4:00 pm, Australian Eastern Standard Time or Australian Eastern Standard Summer Time. At 4:05 pm each day, the ASX subsequently matches any buy and sell orders in the system which are at the same price. The prices of all listed Shares are continuously quoted while the market is open and the system prioritises orders first by price and second by time of

placement in the system. Exchange participants can cross stock between buying and selling orders, at the buy or sell quote provided those quotes are no more than one marketable bid apart and can cross outside this range in amounts of A\$1 million or more. Transactions on the ASX are settled on the fifth business day following the trade date although, in the short term, the ASX intends to change the settlement period to the third business day.

The following table sets out, for the periods indicated, the highest and lowest closing sale prices for IRs as derived from the Daily Official List of the ASX, and the highest and lowest closing sale prices of the Interim ADSs quoted on the New York Stock Exchange.

Period	A\$ per IR		US\$ per Interim ADS	
	High	Low	High	Low
1997				
17 November - 31 December . . . .	3.25	2.53	42 3/16	35 9/16
1998				
1 January - 31 March . . . . .	3.98	3.09	54 3/8	40 1/8
1 April - 30 June . . . . .	4.14	3.58	51 1/4	41 15/16

At 30 June 1998, 4,283,880,993 IRs were outstanding. At that date, approximately 1,419,356 Interim ADSs (equivalent to 28,387,120 IRs) were held by approximately 13 record holders.

## Item 6: Exchange Controls and Other Limitations Affecting Security Holders

### Absence of Exchange Controls

The Reserve Bank of Australia does not currently inhibit the import and export of funds, and no approval is currently required for the movement of funds in and out of Australia. However, payments to or from (or relating to) Iraq, its agencies or nationals, the Government of Libya or any undertaking owned or controlled by Libya or its agencies or the authorities of the Federal Republic of Yugoslavia (Serbia and Montenegro) or their agencies may not be made without the specific approval of the Reserve Bank of Australia.

Accordingly, at the present time, remittances of any dividends, interest or other payment by Telstra to non-Australian holders of its securities are not, subject to the above, restricted by exchange controls or other limitations.

### Restrictions on Foreign Ownership

#### Telstra Act

The Telstra Act provides that an "unacceptable foreign ownership situation" will exist in relation to Telstra if all "foreign persons" and their associates hold, in total, a "particular

## **Item 6: Exchange Controls and Other Limitations Affecting Security Holders**

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type of stake” in Telstra as a whole of more than 11.6667 per cent (the “Aggregate Limit”) or if any foreign person and its associates hold a particular type of stake in Telstra as a whole of more than 1.6667 per cent (the “Individual Limit”). “Foreign person”, “associate”, “group”, “particular type of stake”, “direct control interest” and “interest” in a share are all defined in the Telstra Act and are summarised below under “Definitions”.

Where an acquisition of Shares or interests in Shares in any company results in: (i) an unacceptable foreign ownership situation in relation to Telstra; (ii) an increase in the total of any type of stake held by any group of foreign persons in Telstra where there exists a breach of the Aggregate Limit; or (iii) an increase in any type of stake in Telstra held by any foreign person who is already in breach of the Individual Limit, and the person acquiring the Shares knew or was reckless as to whether the acquisition would have that result, that person is guilty of an offence punishable on conviction by a fine not exceeding A\$40,000.

The Communications Minister or Telstra may apply to the Federal Court for remedial orders where an unacceptable foreign ownership situation exists, including orders requiring the disposal of Shares, restricting the exercise of rights attaching to Shares or prohibiting or deferring receipt of sums due on Shares. In addition, Telstra is required under the Telstra Act to take all reasonable steps to ensure that an unacceptable foreign ownership situation does not exist in relation to Telstra.

The Trust Deed and Telstra’s Articles of Association both contain provisions designed to enable the Trustee, while IRs remain on issue, (the IR period) and Telstra (thereafter) to monitor and enforce the foreign ownership restrictions.

On or after registration of a transfer or transmission application in respect of an IR or Share where the acquirer first becomes an IR or Share holder, the acquirer must generally notify the Trustee (during the IR period) or Telstra (thereafter) whether it is either: (i) a person with an interest in an IR or a Share who is either a foreign person or an associate of a foreign person; or (ii) a person who holds an IR or a Share in which a foreign person or an associate of a foreign person has an interest (in either case, a Foreign Holder).

The information derived from these notifications will be reflected in a Register by means of a Foreign coding.

Where IRs or Shares are traded on the ASX, systems are expected to be established for such notifications to be given by brokers as part of routine provision of ASX settlement information (the ASX systems). Each of the Interim ADR Custodian and ADR Custodian under the Interim ADR and ADR facilities will automatically be treated as a Foreign Holder for the purposes of the Trust Deed and Articles of Association, as were all purchasers of IRs and Shares in the International Offering and New Zealand purchasers in the Australian Offering and all holders of IRs or Shares on the New Zealand IR or Share Register. In the case of other transfers or transmission applications, the onus will be on the acquirer to notify the Trustee or Telstra if it is a Foreign Holder. Neither The Depository Trust Company nor Morgan Guaranty Trust Company of New York, Brussels Office, as Operator of the

Euroclear System, will monitor any transfer or foreign ownership restrictions.

All the IRs or Shares held by Foreign Holders will be treated as Foreign unless the holder: (i) notifies that some of its IRs or Shares are ones in which a foreign person or associate of a foreign person has an interest (Foreign IRs or Foreign Shares) whereas others are not; and (ii) either (a) divides its holding into separate HINs or SRNs under the ASX’s CHES system, one for Foreign IRs or Shares and one for IRs or Shares which are not Foreign, or (b) agrees to provide bi-monthly notices indicating the breakdown of its holding into Foreign and non-Foreign IRs or Shares.

The Trust Deed and Articles of Association also contain provisions permitting the Trustee (during the IR period) or Telstra (thereafter) to send notices to registered holders of IRs or Shares with a view to determining whether they are Foreign Holders or not, and requesting details of any foreign persons or associates of foreign persons having interests in the relevant IRs or Shares (and any other information relating to foreign ownership which may be requested). Such notices must be answered within 30 days.

Where the Trustee or Telstra determines, as a result of information obtained from the notifications and responses to notices referred to above, that an unacceptable foreign ownership situation exists in relation to Telstra, there is power under the Trust Deed or the Articles of Association (as appropriate) for the Trustee (during the IR period) or Telstra (thereafter) to require divestment of IRs or Shares respectively to remedy this situation. In exercising these divestment powers, the Trustee or Telstra is entitled to rely on Foreign codings in the relevant Register and upon the notifications and responses to notices referred to above. Telstra will notify the ASX, NZSE and NYSE of the level of Foreign codings as the level approaches the Aggregate Limit.

The divestment powers are broadly framed, and the Trustee, Telstra and their respective Directors are not liable to IR and Share Holders for the manner of their exercise. Both the Trustee and Telstra have published guidelines as to how they currently propose to exercise such powers, and these are outlined below. The Trustee is obliged to comply with such guidelines under the Trust Deed and may only change them at the relevant Minister’s direction, but Telstra may change its guidelines at any time.

Where the Trustee or Telstra believes that the Individual Limit has been breached, it may require that any IR or Share Holder whose IRs or Shares it believes forms part of the contravening “stake” be divested within 30 days of the date a notice requiring divestment (Disposal Notice) is given.

Where the Trustee or Telstra believes the Aggregate Limit has been breached, the guidelines currently provide that Disposal Notices will be given to all holders whose Foreign IRs or Shares were registered in its name (or which became coded as “Foreign”) on the day that, and on each day thereafter for as long as, the aggregate number of Foreign coded registrations on the relevant Register exceeded the limit.

## **Item 6: Exchange Controls and Other Limitations Affecting Security Holders**

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The recipient of a Disposal Notice will be required to divest the IRs or Shares that are the subject of the Notice before a date (Divestment Date) specified in the Notice. The Divestment Date will be the fifth business day of the month next following the month in which such IRs or Shares were registered in the recipient's name (unless that would be less than 30 days after the date of registration, in which case the Divestment Date will be the fifth business day of the next month). However, in relation to registrations in the 30 days after IRs were first quoted on the ASX, the Divestment Date will be the day six months after such first quotation.

Notwithstanding the foregoing, no divestment will be required on a Divestment Date if Foreign IRs or Shares as shown on the relevant Register on that date do not exceed the Aggregate Limit. Otherwise, if a Disposal Notice is not complied with, the Trust Deed and Articles of Association contain provisions empowering the Trustee or Telstra (as appropriate) to sell the relevant IRs or Shares on behalf of the holder on or after the relevant Divestment Date (and the holder will lose the ability to transfer the IRs or Shares itself after that date). In cases where the Trustee sells IRs, if the Trustee has been notified that a Foreign Holder is not a resident of Australia for Australian taxation purposes, or if no notification has been received but the Foreign Holder has a registered address outside Australia, the Trustee may retain from the proceeds of sale and remit to the Australian Taxation Office the tax due and payable by the IR Holder on any gain arising from the disposal of IRs.

### **Transfers Among Foreign Holders and Interim ADR or ADR Holders**

Special arrangements apply to certain transfers from one Foreign Holder to another.

Disposal Notices will not be given in respect of (i) Foreign IRs or Shares acquired from the International Underwriters on closing of the International Offering or (ii) once the ASX systems have been established, Foreign IRs or Shares acquired under a particular form of ASX "special crossing" for transfers among Foreign Holders. IRs or Shares can only be transferred under such a special crossing if they are not, and are not liable to become, the subject of a Disposal Notice.

All IRs and Shares deposited in the Interim ADR and ADR facilities will be treated as Foreign. Only IRs and Shares which are not, and are not liable to become, subject to Disposal Notices may be deposited in the Interim ADR and ADR facilities. Transfers of Interim ADRs and ADRs cannot lead to a Disposal Notice by reason of breach of the Aggregate Limit.

Holder of Interim ADRs and ADRs are subject to the Individual Limit, and must notify the Interim Depository or the Depository, as applicable, if any of the Interim ADRs or ADRs they hold form part of a "stake" which breaches the Individual Limit. Where the Individual Limit is breached, the Interim Depository or the Depository may be required to divest the relevant IRs or Shares, and the corresponding Interim ADRs or ADRs may be cancelled. The Interim Deposit Agreement and Deposit Agreement contain provisions permitting the Interim Depository and the Depository to obtain, and supply to the

Trustee and Telstra, information relevant in monitoring and enforcing the foreign ownership limits.

IRs or Shares registered on the New Zealand IR or Share Register cannot be the subject of a Disposal Notice (and any IRs or Shares which could be so subject cannot be placed on that Register). NZSE trading will be only in IRs or Shares registered on the New Zealand IR or Share Register.

### **Definitions**

"Foreign person" is defined in the Telstra Act as: (i) a foreign citizen (defined in the Telstra Act as a non-Australian citizen) not ordinarily resident in Australia (a "foreign citizen"); (ii) a company where a foreign citizen or a foreign company (defined in the Telstra Act as an overseas incorporated company) holds a particular type of stake in the company of more than 15 per cent; (iii) a company where a group of two or more persons, each of whom is either a foreign citizen or a foreign company holds, in total, a particular type of stake in the company of more than 40 per cent; (iv) the trustee of a trust estate in which a foreign citizen or a foreign company holds a substantial interest (essentially a 15 per cent beneficial interest, including such foreign citizen's or foreign company's associates' interests); or (v) the trustee of a trust estate in which two or more persons, each of whom is either a foreign citizen or a foreign company, hold an aggregate substantial interest (essentially a 40 per cent beneficial interest including each such foreign citizen's or foreign company's associates' interests).

A "particular type of stake" in any company held by any person is defined as the aggregate of the "direct control interests" of that type in that company held by that person and that person's associates.

An "associate" of a person is defined to include: (i) a wide range of direct and indirect relationships such as relatives, partners, employees and employers of the person; (ii) if the person is an employee of an individual, other employees of the individual; (iii) if the person is a company, an officer of the company and, if the person is an officer of a company, the company and other officers of the company; (iv) the trustee of a discretionary trust where the person or an associate of the person is a beneficiary; (v) a company whose Directors are accustomed, or under an obligation, to act in accordance with the wishes, directions or instructions of the person; (vi) a company where the person is accustomed, or under an obligation, to act in accordance with the company's wishes, directions or instructions; (vii) a company in which the person has a particular type of stake of at least 15 per cent or, if the person is a company, a person who holds a particular type of stake of at least 15 per cent in it; and (viii) an associate of an associate of the person. For purposes of determining foreign ownership of any company, a person's associates also include any other person with whom the person has an arrangement enabling the person to jointly exercise voting power or certain types of power over, or over the appointment of, the board of directors of such company.

"Group", in relation to the foreign ownership limits, includes one person alone or a number of persons, even if they are not in any way associated with each other or acting together.

## **Item 6: Exchange Controls and Other Limitations Affecting Security Holders**

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A “direct control interest” of any person in any company is defined as the equivalent percentage of: (i) the total paid up share capital of the company in which the person holds an interest; (ii) the voting power in the company that the person is in a position to control; (iii) the total rights to distributions of capital or profits of the company to its shareholders on a winding up held by the person; (iv) the total rights to distributions of capital or profits of the company to its shareholders, other than on a winding up, held by the person; and (v) traced interests held via interposed entities.

“Interest in a share” is defined to include: (i) legal or equitable interests in a share; (ii) certain rights under a contract to purchase a share; (iii) options to acquire a share or an interest in a share; (iv) a right to have a share transferred to the person's order; and (v) an entitlement to acquire a share or an interest in a share or to exercise or control the exercise of a right attached to the share. However, certain interests in Shares are disregarded, including: (i) certain interests of lenders under or following enforcement of security arrangements; (ii) interests of a trustee or manager of, or a custodian for, a unit trust or certain Australian complying or exempt superannuation funds if such trustee, manager or custodian reasonably believes that foreign persons hold beneficial interests in less than 40 per cent of the capital and income in the trust or fund; (iii) interests held by an Australian registered life insurance company or a custodian for it, in respect of a statutory fund, if the company reasonably believes that less than 40 per cent of policyholder liabilities of the fund are owed to foreign persons; (iv) interests held by nominees, custodians or depositaries, or brokers acting on clients' instructions in the ordinary course of business, provided in each case the holder has no beneficial interest or discretionary voting authority in respect of the underlying Shares; (v) certain interests held by the International Underwriters and their related corporations; (vi) shareholder interests in companies other than Telstra which are not “foreign persons” under the Foreign Acquisitions and Takeovers Act 1975; (vii) interests held by persons who are not foreign persons and do not have any substantive foreign associates (that is, persons who directly or indirectly control them, with whom they act in concert or in accordance with whose wishes, instructions or directions they are obliged or accustomed to act); (viii) interests held by any person to the extent that, after such interests have been included in the “stake” of that person and any of its substantive foreign associates, such interests would also be included in the stake of a non-substantive associate of the person; and (ix) interests held by any person who is not a foreign person to the extent that, in determining the total of the stakes of a group of foreign persons, such interests would be counted more than once for that purpose. References to “interests” in Shares exclude disregarded interests.

### **Foreign Acquisitions and Takeovers Act**

The Foreign Acquisitions and Takeovers Act of Australia (the Takeovers Act) applies to any acquisition of an interest in the Shares of an Australian company which results in any foreign person and its associates controlling 15 per cent or more, or all foreign persons and their associates in aggregate controlling 40 per cent or more, of Shares or voting power. Any proposed acquisition which would result in these thresholds being

exceeded must be notified to, and are subject to review and approval of, the Treasurer in advance of the acquisition.

### **Foreign Ownership Status**

Telstra estimates that at 30 June 1998, foreign owners of IRs and Interim ADSs held approximately 7.2 per cent of issued and outstanding Shares, including those Shares held by the Commonwealth.

## **Item 7: Taxation**

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### **Australian Taxation**

The Australian Taxation Office has provided prior to the partial privatisation, an indicative opinion confirming the Australian income taxation consequences of investment in IRs, Interim ADSs, Shares and ADSs. This discussion reflects that indicative opinion.

The tax profile of each investor will determine the applicable Australian income taxation implications for that investor. For example, some investors, such as financial institutions, may hold their investments on income account rather than on capital account, in which case the comments below concerning capital gains implications will not be applicable. Certain Tax Non-Residents may, irrespective of whether the assets they dispose of are “taxable Australian assets”, be liable to tax in respect of a profit on a dealing in the asset as ordinary income.

This discussion is based on the law in force at the date of this Report. However, both of the major Federal political parties have announced their intention to seek to amend the system of taxation dealing with corporations if they are elected at the Federal Election on 3 October 1998. The exact scope of these changes is not clear and, in particular, their impact on investors is not presently known.

### **Treatment of Instalment Receipts**

#### *Taxation of Distributions*

The income taxation treatment of distributions to holders of IRs will mirror the income taxation treatment of distributions to holders of Shares.

While the distributions on IRs are strictly speaking trust distributions, they will retain the character of the dividends on the underlying Shares and will be treated in the same way for Australian income tax purposes as dividends on the underlying Shares.

An “imputation system” operates in Australia in respect of company income tax. In the absence of an exemption or concession, Australian resident companies are liable for Australian income tax on their taxable income at the corporate rate (currently 36 per cent). The payment of Australian income tax by Australian companies generates a “franking credit”

## Item 7: Taxation

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which, when the company pays a dividend to shareholders, flows through to resident shareholders.

The Commonwealth Treasurer has announced (but the Australian Parliament is yet to legislate) changes to the income tax law such that income tax paid on income derived when a company is wholly owned by the Commonwealth, such as Telstra was, will generate an “exempting credit” rather than a “franking credit”. Payments of Australian income tax by Telstra attributable to periods after it ceased to be wholly owned by the Commonwealth will generate “franking credits” rather than “exempting credits”. Arrangements have been put in place between the Commonwealth and Telstra in relation to the use of exempting credits. It is expected that for fiscal 1999, Telstra will be able to fully frank declared ordinary dividends. It is unlikely that, under current legislation, Telstra will be able to fully frank declared ordinary dividends out of fiscal 2000 earnings.

A rebate of tax equivalent to the franking credit (known as a franking rebate) is available only to Australian resident shareholders. Exempting credits do not carry tax credits for resident shareholders.

Fully franked dividends (franked with franking credits) paid to non-resident shareholders are not subject to the Australian non-resident dividend withholding tax (DWHT). Dividends which are not fully franked are generally subject to DWHT at the rate of 30 per cent (unless reduced by a double tax treaty). In the case of residents of the United States, provided that the IRs are not effectively connected with a permanent establishment or a fixed base of a Tax Non-Resident in Australia through which the Tax Non-Resident carries on business in Australia or provides independent personal services, the rate is reduced under the double tax treaty to 15 per cent.

Accordingly, dividends paid by Telstra to Tax Non-Residents, to the extent to which they are fully franked will not be subject to DWHT. The unfranked part of any dividends paid by Telstra to Tax Non-Residents will be subject to DWHT. DWHT is deducted by the payer in the source country and so the Tax Non-Resident will receive dividends net of DWHT.

Fully franked dividends paid to Tax Non-Residents and dividends which have been subject to DWHT are not subject to any further Australian income tax.

Under certain rules and proposed rules, there are circumstances where an investor may not be entitled to the benefit of franking credits. The application of these rules depends on the individual's own circumstances including the period for which the IRs or Shares are held and the extent to which the investor is “at risk” in relation to their investment.

### *Taxation of Capital Gains*

Tax Non-Residents will be liable for Australian income tax under the capital gains provisions on the gains (in certain circumstances after an allowance for inflation in Australia) realised on the disposition of certain assets which have a necessary connection with Australia (for the purpose of this discussion, these assets are referred to as “taxable Australian assets”). Taxable Australian assets include a share (or interest in

a share) in a public company where at any time in the preceding five years the non-resident's holding (together with the holding of associates) in the public company is 10 per cent or more, and an interest in an Australian resident trust estate.

An IR is an interest in an Australian resident trust estate, and so is a “taxable Australian asset” for the purposes of the Australian income tax on capital gains. Because the 10 per cent ownership threshold which applies to Shares in public companies does not apply to interests in trust estates, the real gain on sale of an IR by a Tax Non-Resident will be subject to the Australian income tax on capital gains. The Tax Non-Resident rate of income tax currently ranges from 29 per cent to 47 per cent for individuals, and is currently 36 per cent for corporations.

A double tax treaty between Australia and the country of residence of the investor may give relief from liability to pay the Australian income tax on ordinary income. Generally, the “business profits” articles of Australia's double tax treaties provide that a resident of a treaty partner is not subject to Australian income tax on “business profits” derived in Australia, unless derived at or through a permanent establishment in Australia. In the case of residents of the United States, Article 7(1) of the Convention between Australia and the United States for the Avoidance of Double Taxation (the U.S. Treaty) provides that the business profits of a U.S. enterprise are only taxable in the U.S. unless the enterprise carries on business in Australia through a permanent establishment situated in Australia. The term “permanent establishment” is defined in Article 5 of the U.S. Treaty. In the view of the Australian Taxation Office, capital gains realised on the disposal of IRs or Interim ADRs would not be “business profits”. Prospective investors should seek their own independent taxation advice should they wish to rely on a double-tax treaty for relief from liability to pay Australian income tax upon the disposal of an IR.

The assessable capital gain will be the difference between the arms-length consideration in respect of disposal of the IR and the cost base (which is indexed for inflation where the asset is held for more than 12 months). The cost base of an IR will include the consideration on acquisition and incidental costs associated with acquisition and disposal.

Investors who incur a liability for Australian income tax will be required to file an income tax return in Australia.

### **Treatment of Interim American Depositary Receipts**

#### *Taxation of Distributions*

The Australian income taxation treatment of distributions to holders of Interim ADRs will mirror the Australian income taxation treatment of distributions to holders of IRs.

Accordingly, distributions to holders of Interim ADRs will be treated in the same way as distributions to holders of IRs discussed above.

#### *Taxation of Capital Gains*

As discussed above, an IR is an interest in an Australian resident trust estate, and so is a “taxable Australian asset” for the purposes

## Item 7: Taxation

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of the Australian income tax on capital gains. The holder of an Interim ADR (evidencing Interim ADSs which represent IRs) will be subject to income tax in Australia as though the holder of the underlying IRs. As stated above, the 10 per cent ownership threshold which applies to Shares in public companies does not apply to interests in trust estates. Therefore, the disposal by Tax Non-Residents of an Interim ADR will be subject to the Australian income tax on capital gains.

In relation to the potential application of a double-tax treaty between Australia and the country of residence of the investor to give relief from liability to pay Australian income tax upon a disposal of an Interim ADR, refer to the comments above in relation to the disposal of IRs.

The assessable capital gain will be the difference between the arm's length consideration in respect of disposal of the Interim ADR and the cost base (which is indexed for inflation where the asset is held for more than 12 months). The cost base of an Interim ADR will include the consideration on acquisition and incidental costs associated with acquisition (such as fees paid to the Depository) and disposal.

### *Payment of Final Instalment*

The payment of the Final Instalment and transfer of legal title in the Share from the IR Trustee to the investor or to the Depository, (in respect of interim ADRs) does not constitute a disposal of an asset for the purposes of the Australian income tax on capital gains, and does not give rise to any Australian income tax liability. The failure to pay the Final Instalment and subsequent sale by the IR Trustee of the underlying Share may also have Australian income tax implications for investors. Investors should seek their own advice in relation to this issue.

### **Treatment of Shares**

#### *Taxation of Dividends*

An imputation system operates in Australia in respect of company income tax. In the absence of an exemption or concession, Australian resident companies are liable for Australian income tax on their taxable income at the corporate rate (currently 36 per cent). The payment of Australian income tax by Australian companies generates a franking credit which, when the company pays a dividend to shareholders, flows through to resident shareholders.

The Commonwealth Treasurer has announced (but the Australian Parliament is yet to legislate) changes to the income tax law such that income tax paid on income derived when a company is wholly owned by the Commonwealth, such as Telstra was, will generate an "exempting credit" rather than a "franking credit". Payments of Australian income tax by Telstra attributable to periods after it ceased to be wholly owned by the Commonwealth will generate "franking credits" rather than "exempting credits". Arrangements have been put in place between the Commonwealth and Telstra in relation to the use of exempting credits. It is expected that for fiscal 1999 Telstra will be able to fully frank declared ordinary dividends. It is unlikely that, under current legislation, Telstra will be able to fully frank declared ordinary dividends out of fiscal 2000 earnings.

A rebate of tax equivalent to the franking credit (known as a franking rebate) is available only to Australian resident shareholders. Exempting credits do not carry tax credits for resident shareholders.

Fully franked dividends (franked with franking credits) paid to non-resident shareholders are not subject to DWHT. Dividends which are not fully franked are generally subject to DWHT at the rate of 30 per cent (unless reduced by a double tax treaty). In the case of residents of the United States, provided that the Shares are not effectively connected with a permanent establishment or a fixed base of a Tax Non-Resident in Australia through which the Tax Non-Resident carries on business in Australia or provides independent personal services, the rate is reduced under the double tax treaty to 15 per cent.

Accordingly, dividends paid by Telstra to Tax Non-Residents to the extent to which they are fully franked will not be subject to DWHT. The unfranked part of any dividends paid by Telstra to Tax Non-Residents will be subject to DWHT. DWHT is deducted by the payer in the source country and so the Non-Resident will receive dividends on the Shares net of DWHT.

Fully franked dividends paid to Tax Non-Residents and dividends which have been subject to DWHT are not subject to any further Australian income tax.

Under certain rules and proposed rules, there are circumstances where an investor may not be entitled to the benefit of franking credits. The application of these rules depends on the individual's own circumstances including the period for which the IRs or Shares are held and the extent to which the investor is "at risk" in relation to their investment.

#### *Taxation of Capital Gains*

Tax Non-Residents will be liable for income tax under the capital gains provisions on the gains (in certain circumstances after an allowance for inflation in Australia) realised on the disposal of certain assets which have a necessary connection with Australia (for the purpose of this discussion, these assets are referred to as "taxable Australian assets"). Taxable Australian assets include a share (or interest in a share) in a public company where at any time in the preceding five years the non-resident's holding (together with the holding of associates) in the public company is 10 per cent or more.

Tax Non-Residents who, together with their associates, hold less than 10 per cent of the Shares (or an interest in a Share) in Telstra will, on disposal of the Shares, not be subject to any Australian income tax on capital gains. Restrictions on the extent of foreign ownership in Telstra should ensure that Tax Non-Resident investors qualify for this exemption. Where Shares are held on income account, profits on the sale of such Shares are subject to Australian income tax if, under the terms of Australia's double tax treaties, the Tax Non-Residents have a permanent establishment in Australia.

#### **Treatment of American Depositary Receipts**

When investors have paid the Final Instalment and the Depository has taken legal title in the Shares, Tax Non-Resident



## Item 7: Taxation

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holders of ADRs evidencing ADSs will be treated for Australian income tax purposes as the owners of the Shares represented by the ADSs.

### *Taxation of Distributions*

The Depositary will receive dividends on the Shares represented by the ADSs net of DWHT (where payable). Holders of ADRs will not be subject to any further Australian income tax on distributions representing fully franked dividends or dividends which have been subject to DWHT.

### *Taxation of Capital Gains*

A disposal of an ADR by a Tax Non-Resident investor will constitute a disposal by the investor of the Telstra Shares represented by the ADS evidenced by that ADR. Tax Non-Residents who, together with their associates, hold less than 10 per cent of the Shares or interests in Shares in Telstra (including through ADSs) will, on disposal of ADRs, not be subject to any Australian income tax on capital gains. Restrictions on the extent of foreign ownership in Telstra should ensure that Tax Non-Resident investors qualify for this exemption. Where ADRs are held on income account, profits on the sale of ADRs are subject to Australian income tax if, under the terms of Australia's double tax treaties, the Tax Non-Residents have a permanent establishment in Australia.

## Australian Stamp Duty

### **Instalment Receipts**

Transfers of IRs in Australia may attract Australian stamp duty applicable to marketable securities.

In general, stamp duty law in Australia distinguishes between transactions which are on the Australian Stock Exchange ("on market") and those which are not ("off market", which would include transfers on the NYSE, NZSE and SEAQ International). Stamp duty for on market trades of IRs is payable by the brokers involved at 0.15 per cent for the selling broker and 0.15 per cent for the buying broker. This stamp duty is paid to the State or Territory revenue office of the place where the broker takes the order. The brokers are reimbursed by their clients. Stamp duty for off market transfers of IRs is payable by the transferee at the rate of 0.3 per cent, and is payable in the Australian Capital Territory (ACT). Transfers of IRs upon issue or surrender of Interim ADRs and transfers of IRs on the NZSE and SEAQ International will be exempt, and other particular exceptions may apply.

Where a change in ownership of an IR is effected without stamp duty being paid as outlined above, the ACT's laws have a special provision which has the effect of making additional duty payable by transferees on trades or transfers of IRs (both on market and off market) at the rate of 0.3 per cent of the value of the underlying Shares.

### **Interim ADRs**

As a general matter, no Australian stamp duty will be payable in respect of transactions involving the issue, transfer, transmission or surrender of Interim ADRs.

### **Shares**

If a transfer of Shares takes place on market through a broker, stamp duty is payable through the brokers (0.15 per cent by the seller and 0.15 per cent by the purchaser) in the manner described above under the heading "Instalment Receipts". Any off market transfer of Shares (including a transfer to or from the Depositary's custodian on issue or surrender of ADRs) would, in most cases, require the payment by the transferee of ACT stamp duty at 0.3 per cent calculated on the higher of sale price or value of those Shares.

### **ADRs**

Transfers of ADRs after payment of a Final Instalment may be liable to stamp duty in the ACT at 0.3 per cent calculated on the higher of the sale price and the value of the underlying Shares.

## Item 8: Selected Financial Data

The following selected consolidated financial data for the five year period ended 30 June 1998 has been derived from Telstra's audited consolidated financial statements and accompanying notes thereto. The statistical data represents management's best estimates. PricewaterhouseCoopers, independent accountants, have reported on the Financial Statements for fiscal 1995 through to fiscal 1998 (the Financial Statements). The following information should be read in conjunction with the Financial Statements and the other information contained in this Report.

The Financial Statements were prepared in accordance with Australian GAAP, which differs in certain material respects from US GAAP. For a reconciliation of the material differences between Australian GAAP and US GAAP as they relate to Telstra, see Note 32 to the Financial Statements. The Company instituted certain accounting policy changes during fiscal 1997, some of which had a significant effect on the results of operations for fiscal 1998 and 1997.

	Year ended 30 June						
	1998	1998 <sup>(1)</sup>	1997		1996	1995	1994
	(in millions, except per Share and per ADS amounts)						
	A\$	US\$	A\$	A\$	A\$	A\$	A\$
<b>Profit and Loss Statement Data</b>							
<i>Amounts in accordance with Australian GAAP:</i>							
Operating revenue <sup>(2)</sup> . . . . .	17,302	10,741	15,983	15,239	14,081	13,363	
Operating expense (excluding depreciation and amortisation, interest expense, and abnormals) <sup>(2)</sup> . . . . .	9,878	6,132	9,301	9,113	8,398	7,550	
Depreciation and amortisation. . . . .	2,322	1,441	2,353	2,351	2,204	2,123	
Operating profit before interest expense, abnormals and income tax expense . . . . .	5,102	3,168	4,329	3,775	3,479	3,690	
Operating profit before abnormals and income tax expense. . . . .	4,468	2,774	3,805	3,242	2,973	2,942	
Operating profit before income tax expense . . . . .	4,468	2,774	2,073	3,447	2,405	2,528	
Operating profit after income tax expense . . . . .	3,000	1,863	1,609	2,302	1,756	1,705	
Operating profit attributable to shareholders. . . . .	3,004	1,865	1,617	2,305	1,753	1,699	
Earnings per Share <sup>(3)</sup> . . . . .	0.23	0.14	0.13	0.18	0.14	0.14	
Earnings per ADS <sup>(3)</sup> . . . . .	4.67	2.90	2.51	3.58	2.73	2.75	
Dividends provided for or paid <sup>(4)</sup> . . . . .	1,802	1,119	4,146	1,368	944	738	
Dividends per Share <sup>(3)</sup> . . . . .	0.14	0.09	0.32	0.11	0.07	0.06	
Dividends per ADS <sup>(3)</sup> . . . . .	2.80	1.74	6.44	2.13	1.47	1.19	
Dividends per ADS <sup>(5)</sup> . . . . .	US\$1.50	-	US\$5.10	US\$1.45	US\$0.91	US\$1.16	
<i>Amounts in accordance with US GAAP<sup>(6)</sup>:</i>							
Operating revenue . . . . .	16,819	10,441	15,436	14,716	13,613	-	-
Operating profit attributable to shareholders. . . . .	2,674	1,660	1,136	2,714	2,463	-	-
Earnings per Share <sup>(3)</sup> . . . . .	0.21	0.13	0.09	0.21	0.19	-	-
Earnings per Share fully diluted. . . . .	0.21	0.13	0.09	0.21	0.19	-	-
Earnings per ADS <sup>(3)</sup> . . . . .	4.16	2.58	1.77	4.22	3.83	-	-
<b>Balance Sheet Data (at year end)</b>							
<i>Amounts in accordance with Australian GAAP:</i>							
Total assets . . . . .	26,470	16,434	25,858	24,362	24,083	21,139	
Current borrowings . . . . .	2,935	1,822	1,560	793	1,984	723	
Non-current borrowings. . . . .	4,787	2,972	6,421	4,350	3,872	5,010	
Shareholders' equity . . . . .	11,079	6,879	9,938	12,668	11,727	10,755	
<i>Amounts in accordance with US GAAP<sup>(6)</sup>:</i>							
Total assets . . . . .	29,868	18,543	28,965	27,459	26,246	-	-
Current borrowings . . . . .	2,935	1,822	1,560	793	1,984	-	-
Non-current borrowings. . . . .	4,787	2,972	6,421	4,350	3,872	-	-
Shareholders' equity . . . . .	14,676	9,112	13,473	16,633	15,181	-	-

**Item 8: Selected Financial Data**

	Year ended 30 June				
	1998 A\$m	1997 A\$m	1996 A\$m	1995 A\$m	1994 A\$m
<b>Operating revenue includes:</b>					
Sales revenue . . . . .	16,819	15,436	14,716	13,613	12,788
Interest received/receivable . . . . .	49	85	105	107	69
Proceeds from sale of assets/investments . . . . .	266	202	199	153	349
Dividends received/receivable . . . . .	20	38	33	38	23
Share of associated entities net profit after income tax expense . . .	14	-	-	-	-
Miscellaneous revenue . . . . .	134	222	186	170	134
<b>Operating revenue . . . . .</b>	<b>17,302</b>	<b>15,983</b>	<b>15,239</b>	<b>14,081</b>	<b>13,363</b>
<b>Operating expenses (excluding depreciation and amortisation, interest expense and abnormals) includes:</b>					
Book value of assets/investments sold . . . . .	313	218	190	179	393

(1) All amounts have been translated at the Noon Buying Rate on 30 June 1998 of A\$1.00 = US\$0.6208 unless otherwise stated.

(2) For a breakdown of operating revenue by product group and a breakdown of operating expenses by expense category, see Item 9.

(3) Calculated based on 12,866,600,200 Shares and, in the case of ADS calculations, based on a ratio of 20 Shares per ADS. Fully diluted earnings per Share in fiscal 1994 was A\$0.13 after taking into account the lower number of equivalent Shares on issue in that year.

(4) During the year ended 30 June 1998, the Telstra Entity declared and paid dividends of A\$1,422 million (1998 interim dividend plus 1997 final dividend paid during the year ended 30 June 1998), (1997 A\$4,307 million of which A\$3,000 million was paid as a special dividend to the Commonwealth on 30 June 1997.)

(5) Calculation as per (3) in US currency based on the exchange rates at each respective payment date.

(6) US GAAP amounts for fiscal 1994 are not available.

## Statistical Data

	Year ended 30 June		
	1998	1997	1996
<b>Billable Traffic Data (in millions)</b>			
Local calls (number of calls) . . . . .	11,138	10,844	10,650
National long distance minutes <sup>(1)</sup> . . . . .	11,319	10,326	10,080
International outgoing minutes <sup>(2)</sup> . . . . .	705	700	702
International incoming minutes . . . . .	767	755	687
Mobile telephone minutes <sup>(3)</sup> . . . . .	2,720	2,415	2,121
<b>Network and Operations Data (at year end)</b>			
Basic access lines in service (millions) <sup>(4)</sup>			
Residential . . . . .	6.88	6.74	6.56
Business . . . . .	2.70	2.61	2.61
Total . . . . .	9.58	9.35	9.17
FaxStream® services access lines (thousands) <sup>(5)</sup> . . . . .	374.8	300.0	177.4
ISDN access lines (basic access line equivalents) (thousands) <sup>(6)</sup> . . . . .	488.4	360.3	269.5
Digitalisation of PSTN exchanges <sup>(7)</sup>			
Metropolitan . . . . .	95%	86%	77%
Non-metropolitan . . . . .	94%	81%	70%
All areas . . . . .	95%	84%	74%
Mobile telephone customers (thousands)			
Analogue <sup>(8)</sup> . . . . .	1,323	1,688	1,772
Digital . . . . .	1,745	1,089	511
Total . . . . .	3,068	2,777	2,283
Payphones <sup>(9)</sup> . . . . .	36,892	37,362	37,049
Broadband Network—homes passed (thousands) <sup>(10)</sup> . . . . .	2,505	2,088	1,120
<b>Employee Data (at year end)<sup>(11)</sup></b>			
Full-time employees . . . . .	57,234	66,109	76,522
Full-time equivalent employees . . . . .	66,670	76,990	88,995
Basic access lines per full-time equivalent employee . . . . .	144	121	103
Sales revenue per full-time equivalent employee <sup>(12)</sup> . . . . .	A\$252,272	A\$200,494	A\$165,358

(1) Includes national long distance minutes from Telstra's PSTN and independently operated payphones to Australian fixed and mobile telephones. Excludes minutes related to calls from non-PSTN networks, such as ISDN and virtual private networks, and FaxStream® services. Fiscal 1998 and fiscal 1997 also include 298 million minutes and 131 million minutes respectively related to calls made from Telstra's non-PSTN fixed networks (with the exception of calls from FaxStream® services) to Australian mobile telephones.

(2) International outgoing minutes for international settlement purposes also include minutes from mobile telephone services, ISDN and Telstra operated public payphones. For fiscal 1998, 1997 and 1996, total international outgoing minutes for settlement purposes were 833 million, 829 million and 806 million, respectively.

(3) Includes all calls made from mobile telephones including long distance, international and data calls.

(4) Excludes advanced access services, such as ISDN, and FaxStream® services.

(5) Facsimile access product.

(6) Expressed in equivalent number of clear voice channels.

(7) Based on the total primary switch capacity of the PSTN exchanges.

(8) Analogue figures exclude customers who redirect their Telstra analogue mobile service to Telstra's digital service.

(9) Includes public payphones which are owned and operated by Telstra.

## Statistical Data

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(10) *Homes passed excludes businesses. Telstra has interests in joint ventures with News Corporation to market and deliver pay television services. These joint ventures began service in October 1995 and had approximately 320,000 and 205,000 pay television customers as at 30 June 1998 and 1997 respectively.*

(11) *Full-time employees includes full-time staff, fixed term contracted staff and expatriate staff in overseas controlled entities. Full-time equivalent employees includes full-time employees and a full-time equivalent measure of part-time and casual staff, overtime worked, and full and part-time contracted staff and a measure for overseas local hires. From fiscal 1997 a change in reporting overseas local hires added 405 full time equivalent employees.*

(12) *For a breakdown of operating revenue by product group and a breakdown of operating expenses by expense category, see Item 9.*

## Item 9: Management's Discussion and Analysis of Financial Condition and Results of Operations

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### Introduction

The markets in which the Company operates have undergone significant liberalisation in recent years as Australia has moved towards open competition. This liberalisation has affected the Company's results of operations for fiscal 1998, 1997 and 1996, particularly with respect to national long distance calls, international telephone services, mobile telecommunications and wholesale services. While this changing competitive environment has presented and will continue to present significant challenges for Telstra, the Company has instituted strategies to address this evolving regulatory and competitive environment.

The new environment of open competition, which began on 1 July 1997, is expected to be the principal external factor affecting Telstra's operating revenue and results of operations for the next several years. Telstra's operating revenues in future years will be affected by the Company's anticipated loss of significant market share to competitors and by falling prices, particularly in the Company's traditional products and services. However, Telstra expects the overall market to grow as competition increases. Telstra's operating revenue will also be affected by the extent to which the Company is able to develop innovative packages of products and services and pricing plans. Telstra believes that today's open market environment provides new opportunities for the Company to respond to competitive pressures. In particular, Telstra now has greater freedom to develop product packages and pricing plans tailored to meet the needs of particular customer segments, subject to certain

regulatory limitations. The Company believes that its success will depend, in part, on the success of its strategy of promoting the development and adoption of higher value-added products and services while maximising returns in its traditional markets.

Telstra has in recent years committed substantial capital and other resources to upgrade and rationalise its network infrastructure and improve many of its systems in order to support and maintain its range of products and services, allow the timely introduction of new and innovative products and services and reduce its cost structure. The Company is in the final stages of the Networks and Systems Modernisation Programme and has recently announced plans to build another digital mobile network using the 800MHz spectrum.

These initiatives are also producing significant operating efficiencies by controlling maintenance and other costs and simplifying processes, thereby also allowing reductions in the Company's workforce. As a result, the Company's full-time staff is expected to decrease by approximately 27,500 employees between 1 July 1996 and 30 June 2001. During fiscal 1998, the Company reduced full-time staff numbers by approximately 8,900. This brings the total reduction of full-time staff numbers in the last two fiscal years to approximately 20,800 (of which approximately 20 per cent resulted from the outsourcing of activities by the sale of certain businesses and the contracting out of some operations). These reductions were offset in part by the addition of 1,500 full-time staff relating to the consolidation of Pacific Access as of 20 June 1997.

The Company's future results of operations may be affected by a number of factors. There remains uncertainties as to regulatory outcomes and competition continues to strengthen.

In the regulatory area, the following may impact future results:

- the "Consumer Price Index less x" pricing regime review;
- the extent to which the AMPS mobile network is closed by 31 December 1999;
- the ACCC investigations into the declarations of access for telephony, data and transmission;
- the ACCC review into interconnect pricing; and
- the ACA study into the final form of Local Number Portability.

Individually, the decisions reached on these matters could impact the future results of operations and, combined, this impact could be significant.

Furthermore, there is additional pressure on future operations arising from the current economic decline in Asia and the devaluation of the Australian dollar. In order to offset the possible impacts of the abovementioned events, Telstra intends to:

- continue to improve customer service;
- continue to aim for best practice operational and financial performance;
- continue to transform the Company into a truly commercially driven entity; and
- continue to invest in infrastructure and new products and services as Australia moves towards the multimedia age.

## Item 9: Management's Discussion and Analysis of Financial Condition and Results of Operations

### Effect of Changes in Accounting Policies

In order to further align its accounting policies with common practice in the telecommunications industry, Telstra changed certain accounting policies during fiscal 1997 to capitalise software developed for internal use and to capitalise interest and indirect overheads incurred during the self-construction of assets. Prior to these changes, these costs were expensed as incurred rather than capitalised. The reconciliation of amounts determined under Australian GAAP to amounts determined under US GAAP includes adjustments on the basis that these policies had been in effect historically under US GAAP. See Note 32 to the Financial Statements.

In fiscal 1998, Telstra adopted the equity method of accounting for investments in associated entities in its consolidated accounts as detailed in Note 1.9 to the Financial Statements but the impact for both Australian and US GAAP purposes has been immaterial. See Note 32 to the Financial Statements.

### Results of Operations

Telstra accounts for its business as a single segment because substantially all of its assets, revenues and profits are related to the provision of telecommunications services. The following discussion, therefore, analyses revenue for each of Telstra's significant products and services, but does not provide separate segment information for profits or assets. Most of Telstra's operating revenue for fiscal 1998 was derived from basic access, local calls, national long distance calls, international telephone services, mobile telecommunications services, data and text services and directory services.

Telstra's telephony products such as long distance and international calls have historically been more profitable than non-telephony products such as data. However, telephony

products continue to decline as a proportion of profit as competition erodes market share and margins. This trend is expected to continue.

The requirement for Telstra to provide universal service to all Australians has impacted adversely on the Company's profitability. Telstra's obligation to make available, for rental on request, a customer's first telephone, has also impacted adversely on profitability.

In addition, the margins on the Company's mobile telecommunications services have contracted during the last three fiscal years, despite strong mobiles revenue growth, principally due to the cost of migrating customers to the Company's digital mobile telecommunications service. Also, mobiles depreciation expense has grown due to the investment in the Company's digital network.

With an increasingly competitive telecommunications market, the Company expects to experience continued pressure on margins in certain of its principal product categories.

### Operating Revenue

Operating revenue grew at an average rate of 6.6 per cent per year from fiscal 1996 to fiscal 1998, principally reflecting strong growth in mobile telecommunications services (12.4 per cent per year on average), data and text services (15.4 per cent per year on average), and other sales and services (26 per cent per year on average), particularly toll-free services, Internet related products and value added services such as international mobile roaming and conferencing calling. Table 1 shows Telstra's operating revenue by major product and service category for the last three fiscal years and expressed as a percentage of total operating revenue.

Table 1 - Operating Revenue by Major Product and Service Category

	Year Ended 30 June					
	1998		1997		1996	
	A\$m	%	A\$m	%	A\$m	%
Basic access . . . . .	1,770	10	1,740	11	1,727	11
Local calls . . . . .	2,664	15	2,664	17	2,669	18
National long distance calls . . . . .	2,594	15	2,455	15	2,505	16
International telephone services . . . . .	1,380	8	1,342	8	1,338	9
Mobile telecommunications services . . . . .	2,154	13	1,981	12	1,705	11
Data and text services . . . . .	2,097	12	1,883	12	1,574	10
Directory services . . . . .	1,013	6	723	5	709	5
Customer premises equipment . . . . .	538	3	576	4	611	4
Inter-carrier services . . . . .	582	3	558	3	485	3
Public payphones . . . . .	225	1	248	2	259	2
Other sales and services . . . . .	1,802	11	1,266	8	1,134	8
Sales revenue . . . . .	16,819	97	15,436	97	14,716	97
Other revenue <sup>(1)</sup> . . . . .	483	3	547	3	523	3
Operating revenue . . . . .	17,302	100	15,983	100	15,239	100

(1) Other revenue includes interest received/receivable, proceeds from sale of assets/investments, dividends received/receivable and miscellaneous revenue.

## Item 9: Management's Discussion and Analysis of Financial Condition and Results of Operations

The categorisation of operating revenue is based on the classifications reported by the Company to the regulatory authorities but excludes internal charges to the call products for access to the network required for regulatory accounting purposes. These revenue classifications require the Company to treat revenue from the provision of products and services to wholesale customers differently depending on the nature of the product or service supplied. Revenue from interconnect and AMPS resale is categorised as intercarrier services revenue, whereas revenue from other resale is categorised according to the product or service to which it pertains. The ACCC is currently drafting a new set of revenue reporting guidelines. As a result, in future years there may be significant reclassifications of revenue from one category to another.

Revenues for both domestic and international wholesale activities were A\$1.9 billion in fiscal 1998 compared with A\$2.0 billion in 1997. Comparative figures are not available for fiscal 1996.

Telstra is actively promoting alternative value-added products and services to its customers. Acceptance of these new products and services is causing migration in revenue from one category to another. For example, as customers move from basic access to other forms of access such as ISDN or the Company's FaxStream® facsimile access product, revenue will shift from basic access to data and text services.

In addition, since revenue from calls arising from ISDN and FaxStream® services is categorised under data and text services, the revenues from local calls, national long distance calls and international telephone services are also affected.

Revenue from all calls made from Telstra's fixed networks to Australian mobile telephones (fixed-to-mobile calls) is categorised as national long distance calls revenue for regulatory reporting purposes. Revenue from fixed-to-mobile national long distance calls is being positively affected by the increased penetration of mobile telephones in Australia.

**Table 2 - Basic Access Data**

	Year Ended 30 June			Year Ended 30 June	
	1998	1997	1996	1998/1997	1997/1996
	(in millions)			(% change)	
Basic access revenue <sup>(1)</sup>	<b>A\$1,770</b>	A\$1,740	A\$1,727	<b>1.7</b>	0.8
Basic access lines in service (at year end) <sup>(2)</sup>					
Residential	<b>6.88</b>	6.74	6.56	<b>2.0</b>	2.7
Business	<b>2.70</b>	2.61	2.61	<b>3.4</b>	0.0
Total	<b>9.58</b>	9.35	9.17	<b>2.5</b>	2.0

Note: statistical data represents management's best estimates.

(1) Approximately 5 per cent and 7 per cent of basic access revenue in fiscal 1998 and fiscal 1997, respectively was derived from wholesale activities. Comparative figures are not available for fiscal 1996.

In addition to the impacts referred to above, there is a migration of traffic to mobile telephony as a result of strong growth in the mobile customer base. As a result, revenues accounted for as local calls, national long distance calls and international telephone services achieved comparatively lower rates of growth.

Telstra expects to continue to lose market share in certain retail markets as a result of increasing competition. The Company, however, has the opportunity to increase wholesale revenue by providing services to CSPs and other Carriers.

The rates Telstra charges its customers for basic access, local, national long distance and international calls, domestic and international leased lines, fixed-to-mobile calls and mobile telecommunications services are subject to price controls. These controls impose caps based on annual increases in the CPI for the previous year less a certain percentage. In circumstances where the annual increase in the CPI is less than such percentage, Telstra is required to reduce its prices. As the Company reduces its average local call prices in areas where there is competition or likely to be competition, it will be required by regulation to reduce, in the following year, local prices in other areas of Australia. In addition, local call prices in all areas of Australia must not exceed the current A\$0.25 per call price cap, except for calls from pay phones which are capped at A\$0.40 per call.

In recent years, Telstra has been reducing its prices for a number of products and services at rates that exceed the rate required under the price caps. The current price caps, which apply to a large basket of services, are due to expire on 31 December 1998.

(2) Excludes basic access lines for Telstra's internal use.

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### Basic Access

Basic access revenue includes installation and connection charges and monthly rental fees associated with providing basic connections between customer premises and Telstra's PSTN. It excludes charges levied internally to the call products for access to the network. Basic access revenue is generally driven by housing growth, the general state of the economy and the demand for access lines. Basic access revenue is also expected to be affected by loss of market share due to the introduction of open competition, and customer migration to other Telstra access services. Table 2 shows certain information about Telstra's basic access service.

In fiscal 1998, revenue from basic access grew generally in line with the rate of growth of basic access lines in service. In fiscal 1997 and 1996 the rate of revenue growth overall was less than the rate of growth of basic access lines in service principally due to lower prices in the business market reflecting competitive pressures. The growth in basic access lines in service was tempered during the period by migration to other Telstra access services, particularly ISDN and FaxStream® services.

### Local Calls

Local calls revenue reflects the charges associated with local calling and certain billable value-added services. Local calls are charged predominantly on an untimed basis. Local calls revenue is driven by general economic conditions and growth in basic access lines in service and has been positively affected by the Company's efforts to increase call completion by offering customers Voicemail, Call Waiting and Call Forwarding. Revenue from local calls has, as yet, not been materially affected by the introduction of local loop competition, the introduction of local number portability and new local call pricing regulation. Nevertheless, these factors and customer migration to other Telstra access services, are expected to have an adverse effect on local call revenue in future years.

Table 3 shows certain information about Telstra's local calls.

Revenue from local calls remained flat in fiscal 1998 and fiscal 1997 principally due to increased local calls arising from the growth in basic access lines and higher penetration of value added services and the Internet, offset by increased mobile telephone substitution and increased use of discount pricing plans. In fiscal 1996 local calls revenue grew due to the introduction of a programme designed to stimulate volume by offering certain value-added services, such as Call Waiting and Call Forwarding, on a complimentary basis and others such as Call Conferencing and Voicemail on a billed basis.

Table 3 - Local Call Data

	Year Ended 30 June			Year Ended 30 June	
	1998	1997	1996	1998/1997	1997/1996
	(in millions)			(% change)	
Local calls revenue <sup>(1)</sup> . . . . .	A\$2,664	A\$2,664	A\$2,669	-	(0.2)
Number of local calls . . . . .	11,138	10,844	10,650	2.7	1.8

Note: statistical data represents management's best estimates.

(1) Approximately 6 per cent and 10 per cent of local calls revenue in fiscal 1998 and 1997, respectively was derived from wholesale activities. Comparative figures are not available for fiscal 1996.



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Table 4 - National Long Distance Call Data

	Year Ended 30 June			Year Ended 30 June	
	1998	1997	1996	1998/1997	1997/1996
	(in millions)			(% change)	
National long distance calls revenue <sup>(1)</sup> . . . . .	A\$2,594	A\$2,455	A\$2,505	5.7	(2.0)
National long distance minutes . . . . .	11,319	10,326	10,080	9.6	2.4

Note: statistical data represents management's best estimates.

(1) Approximately 5 per cent and 8 per cent of national long distance calls revenue in fiscal 1998 and 1997 respectively, was derived from wholesale activities. Comparative figures are not available for 1996.

### National Long Distance Calls

National long distance calls revenue comprises revenue from fixed-to-fixed national long distance calls, including calls made from independently operated payphones, and fixed-to-mobile calls. National long distance calls are charged to the originating party based on duration, time of day, day of week, destination of the call and whether the call is fixed-to-fixed or fixed-to-mobile. Telstra offers a variety of short-term promotions or specials to stimulate volumes and positively influence customer price-value perceptions. A majority of national long distance revenue is generated by the Company's residential and small business customers. Revenue is largely driven by general economic conditions and customer price-value perceptions and is expected to continue to be affected by competitive activity and market share position.

However, decreasing prices have led to increases in overall market call volume. Increased competitive pressures are expected as regulatory restrictions and technical barriers are reduced, including the expansion of the availability of preselection. Fixed-to-mobile minutes are expected to continue to grow as mobile telephone penetration increases and from increased use of call diversion and call completion initiatives.

Table 4 shows certain information about Telstra's national long distance calls.

National long distance calls revenue increased in fiscal 1998 principally reflecting the effect of increased fixed-to-mobile call revenue with increased penetration of mobile telephony in Australia, together with deployment of call diversion and call completion initiatives. Targeted marketing initiatives have stimulated fixed-to-fixed calls.

National long distance calls revenue decreased in fiscal 1997 and 1996, principally reflecting the continuing effect of preselection losses, migration to other products and services and competitive pricing pressures in fixed-to-fixed calls.

As in fiscal 1997 and fiscal 1996, fixed-to-fixed call revenue continued to decline in fiscal 1998 but at a much reduced rate. This decline was more than offset by the continued growth in fixed-to-mobile call revenue which, as in fiscal 1997 and 1996, again grew, but also at a reduced rate.

During fiscal 1998, Telstra's marketing initiatives drove considerable growth in fixed-to-fixed call minutes. These initiatives included the "A\$3 Offer" providing capped fixed-to-fixed calls during certain periods; the introduction of an afternoon time band and bringing forward the commencement of the economy rate and A\$3 Offer to 7 pm in September 1997 and a further general tariff reduction in April 1998. During fiscal 1996, largely in response to competitive pressures from Resellers, Telstra reduced fixed-to-fixed tariffs twice and introduced a new discount plan to the residential market which, subject to certain conditions being met, delivered discounts of up to 15 per cent principally on national long distance fixed-to-fixed calls. As in fiscal 1997 and fiscal 1996, fixed-to-mobile minutes continued to grow strongly in fiscal 1998.

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Table 5 - International Telephone Services Data

	Year Ended 30 June			Year Ended 30 June	
	1998	1997	1996	1998/1997	1997/1996
	(in millions)			(% change)	
International telephone services revenue <sup>(1)</sup> . . . . .	<b>A\$1,380</b>	A\$1,342	A\$1,338	<b>2.8</b>	0.3
International outgoing minutes <sup>(2)</sup> . . . . .	<b>705</b>	700	702	<b>0.7</b>	(0.3)
International incoming minutes. . . . .	<b>767</b>	755	687	<b>1.6</b>	9.9

Note: statistical data represents management's best estimates.

(1) Approximately 45 per cent and 38 per cent of international telephone services revenue in fiscal 1998 and 1997, respectively was derived from wholesale activities. Comparative figures are not available for fiscal 1996.

(2) International outgoing minutes for international settlement purposes also include minutes from mobile telephone services, ISDN and Telstra operated public payphones. For fiscal 1998, 1997 and 1996, total international outgoing minutes for settlement purposes were 833 million, 829 million and 806 million, respectively.

### International Telephone Services

International telephone services revenue includes revenue generated from international outgoing calls, fees charged by Telstra to overseas telecommunications companies for the carriage and termination of international incoming calls, operator assisted international calls and the transit of international traffic bound for another country. Revenue from international outgoing calls is largely driven by general economic conditions and customer price-value perceptions, and is expected to continue to be affected by competitor activity, through market share position and by decreasing prices. Rates for such calls depend upon the destination, duration, time of day and day of week of the call.

Revenue from fees charged by Telstra to overseas telecommunications companies is largely driven by the volume of international incoming calls, Telstra's share of international outgoing calls, and the charges negotiated for termination and transit of international traffic. Telstra pays for the use of networks of other Carriers for international outgoing calls pursuant to bilateral settlement arrangements which Telstra recognises as an operating expense. Telstra has historically been a net payer under these arrangements and has benefited from the lowering of certain settlement rates in recent years. Telstra records settlement payments to overseas telecommunication companies to complete or route international outgoing traffic as direct cost of sales.

Table 5 shows certain information about Telstra's international telephone services.

Revenue from international telephone services increased marginally in fiscal 1998 and fiscal 1997, following a decline in fiscal 1996. This reflected increased transit traffic revenues across all periods offset by continuing decreases in international outgoing and incoming revenues. Although international outgoing minutes increased slightly during the three year period, revenue was affected by price reductions and discounts especially on calls to high volume countries as competitive pricing pressures continued. Revenue from international incoming calls continued to decline despite increased volumes during the period, reflecting reductions in international settlement rates and contractions in outgoing market share. Revenue from international switched transit traffic increased significantly during the period reflecting an increased level of activity by the Company in switching international traffic through to other destinations.

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Table 6 - Mobile Telecommunications Services Revenue Data

	Year Ended 30 June			Year Ended 30 June	
	1998 (in millions, except customers and minutes in thousands)	1997	1996	1998/1997 (% change)	1997/1996 (% change)
Mobile telecommunications services revenue <sup>(1)</sup> . . . . .	<b>A\$2,154</b>	A\$1,981	A\$1,705	<b>8.7</b>	16.2
Analogue mobile telephone customers . . . . .	<b>1,323</b>	1,688	1,772	<b>(21.6)</b>	(4.7)
Digital mobile telephone customers . . . . .	<b>1,745</b>	1,089	511	<b>60.2</b>	113.1
Total mobile telephone customers . . . . .	<b>3,068</b>	2,777	2,283	<b>10.5</b>	21.6
Mobile telephone minutes <sup>(2)</sup> . . . . .	<b>2,720</b>	2,415	2,121	<b>12.6</b>	13.9

Note: statistical data represents management's best estimates.

(1) Excludes the provision of analogue services to Optus, which is categorised as intercarrier services revenue.

(2) Outbound minutes based on calling party pays billing.

### Mobile Telecommunications Services

Mobile telecommunications services revenue includes revenue from initial connection charges, monthly access fees and usage charges, sales of mobile handsets and charges for a number of value-added and paging services. Mobile calls are charged to the calling party, on a timed basis in 30-second intervals. Mobile telecommunications services revenue is driven principally by overall market growth, Telstra's share of market growth, price and minutes of use.

While per minute charges remained relatively stable during the three year period, prices are expected to trend downward in future years particularly as more competitors enter this market.

Although the mobile telecommunications market has grown substantially over the past few years, the rate of growth slowed during fiscal 1998. This trend is expected to continue as the percentage of the population with mobile telephone services increases and penetration extends to more low-volume users.

Table 6 shows certain information about Telstra's mobile telecommunications services.

Revenue from mobile telecommunications services increased during the three year period, principally due to the strong growth in the number of mobile telephone customers. The number of digital customers increased during the period reflecting Telstra's efforts to migrate its analogue customers to its digital service and overall growth in the market. During the three year period average revenue per customer declined reflecting penetration into the low-volume user market.

Telstra's GSM service experienced a disconnection or churn rate of approximately 22 per cent during the three year period. Churn rates are influenced by numerous events, including the level of credit and short-term disconnections. Subsequent to fiscal 1998, Telstra announced its intention to introduce a new mobile network with national coverage based on digital technology to replace the analogue network and using much of the existing infrastructure. This initiative will ensure that Telstra can continue to provide the necessary capacity for projected growth in the mobile market in the future in the most cost effective manner, whilst enabling coverage equivalent to the analogue network to be continued and increasing the likelihood of Telstra retaining its analogue customers as they migrate to an alternative digital service. The new network will utilise the 800MHz spectrum being vacated by the analogue service which Telstra "re-acquired" as part of spectrum auctions held by the Government in fiscal 1998.

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Table 7 - Data and Text Services Data

	Year Ended 30 June			Year Ended 30 June	
	1998 (in millions, except access lines in thousands)	1997	1996	1998/1997 (% change)	1997/1996
Data and text services revenue <sup>(1)</sup> . . . . .	<b>A\$2,097</b>	A\$1,883	A\$1,574	<b>11.4</b>	19.6
FaxStream® services access lines . . . . .	<b>374.8</b>	300.0	177.4	<b>24.9</b>	69.1
ISDN access lines (basic access line equivalents). . . . .	<b>488.4</b>	360.3	269.5	<b>35.6</b>	33.7

Note: statistical data represents management's best estimates.

(1) Approximately 11 per cent and 14 per cent of data and text services revenue in fiscal 1998 and 1997, respectively, was derived from wholesale activities. Comparative figures are not available for fiscal 1996.

### Data and Text Services

Data and text services revenue consists principally of revenue from data transmission services, dedicated leased lines, ISDN access and call revenue, and facsimile products such as FaxStream® services. Data and text services revenue is driven by the growth in demand for bandwidth to support business networking and the increased penetration of the Internet. However, revenue growth has been partly offset by competition and falling prices. Data and text services revenue was also stimulated by migration from basic access and associated calling products to other access services, in particular ISDN and FaxStream® services.

Table 7 shows certain information about Telstra's data and text services.

Data and text services revenue increased during the period, principally due to increased revenue from ISDN, frame relay, and facsimile products. Growth in data and text services is due in part to the increased use of Internet, Intranet and local area network applications, such as e-mail, and increased customer demand for flexible, high capacity data transmission. Growth in ISDN and facsimile products reflects increased migration from basic access services. As volumes have increased, however, competitive pressures and the greater use of new technologies, such as frame relay, have resulted in price declines, particularly in dedicated leased lines.

### Directory Services

Directory services revenue consists of advertising fees for special listings and revenue from value-added directory products and services, such as electronic and on-line services. Directory services revenue is received both directly by the Telstra Entity and through Pacific Access. Prior to 20 June 1997, Pacific Access was a 50 per cent owned associate, thus it was not consolidated. Effective 1 July 1997, the Company integrated the management of all directory services into Pacific Access in order to achieve cost reductions and improve operational efficiencies. During fiscal 1998, the Company increased its ownership of Pacific Access to 75 per cent. In the 1998 fiscal year, Pacific Access' performance has been consolidated into the Company's results.

In prior years, Telstra's accounts for the Directories business, reflected royalties derived from Pacific Access, results of operations from the National Directory Services division and, in other revenue, dividends derived from the Company's former 50 per cent shareholding in Pacific Access. With consolidation, the total Directories business performance is incorporated into the accounts, which is reflected in the significant increase in revenue from fiscal 1997 to fiscal 1998.

Table 8 (on page 50) shows certain information about Telstra's directory services revenue.

In fiscal 1998, directory services revenue grew by 40.1 per cent including the effect of the consolidation of Pacific Access for the first time and 4.1 per cent excluding this effect. The real revenue growth was achieved in an environment of increased competition from alternatives in print, voice and electronic media, local newspapers, magazines, radio, television and direct marketing. Revenue from directory services may be adversely affected by a downturn in the level of business activity, particularly in the small business sector. New advertising initiatives such as Internet sites, Internet banners and electronic commerce were launched during the year in order to provide future growth in view of changing technologies. The White Pages™ product was re-launched during the year, positioning it as a 'contact' medium and expanding its relevance in the marketplace.

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**Table 8 - Directory Services Data**

	Year Ended 30 June			Year Ended 30 June	
	1998	1997	1996	1998/1997	1997/1996
	(in millions)			(% change)	
Directory services revenue . . . . .	<b>A\$1,013</b>	A\$723	A\$709	<b>40.1</b>	2.0

### Customer Premises Equipment

The largest component of customer premises equipment revenue is the rental of telephones in accordance with the Company's Universal Service Obligation. Customer premises equipment revenue also includes rental and sales of small business systems, maintenance fees for PBX systems, and rental and sales of telephones and other miscellaneous telecommunications equipment. Table 9 shows certain information about Telstra's customer premises equipment revenue.

Customer premises equipment revenue decreased during the three year period principally due to lower volumes and pricing pressure from increased competition. Partially offsetting these declines, however, were increased sales of advanced equipment products reflecting growth in ISDN and other advanced access services.

In fiscal 1998, around one third of customer premises equipment business revenue was derived from the business that was sold to PlesTel subsequent to the end of fiscal 1998.

**Table 9 - Customer Premises Equipment Data**

	Year Ended 30 June			Year Ended 30 June	
	1998	1997	1996	1998/1997	1997/1996
	(in millions)			(% change)	
Customer premises equipment revenue . . . . .	<b>A\$538</b>	A\$576	A\$611	<b>(6.6)</b>	(5.7)

### Intercarrier Services

Intercarrier services revenue consists of revenue from the provision of telecommunications services to Carriers or CSPs. Revenue from resale activity is currently categorised according to the product or service to which it pertains. Prior to 1 July 1997, intercarrier services revenue consisted primarily of revenue from originating and terminating access services, the provision of leased lines and wholesale analogue mobile telephone services. As a result of the changes to the regulatory environment that occurred on 1 July 1997, additional Carrier licences have been granted and more licences are expected to be granted in the future, including to companies that had previously been CSPs. As the ACCC is developing a new set of revenue reporting guidelines, in future years, there may be significant reclassifications of revenue from one category to another.

Table 10 shows certain information about Telstra's intercarrier services revenue.

Intercarrier services revenue increased during the three year period principally due to increased termination of traffic for both Optus and Vodafone due to growth in the mobile telecommunications market and growth in other Carriers' share of the national long distance market.

In fiscal 1997, Optus ceased actively promoting analogue mobile telephone services and in fiscal 1998 the movement of its customers from analogue resale onto Optus' own GSM network accelerated, resulting in a decrease in revenue from the wholesale provision of analogue services.

**Table 10 - Intercarrier Services Data**

	Year Ended 30 June			Year Ended 30 June	
	1998	1997	1996	1998/1997	1997/1996
	(in millions)			(% change)	
Intercarrier services revenue . . . . .	<b>A\$582</b>	A\$558	A\$485	<b>4.3</b>	15.1

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### Public Payphones

Public payphones revenue principally consists of charges for coin-paid calls made from Telstra operated payphones and revenue from use of pre-paid phone cards. It also includes revenue from payphones sold or leased to independent operators. In compliance with Telstra's Universal Service Obligation, approximately half of Telstra's payphones are located in non-metropolitan areas where usage levels are lower than in urban areas. During fiscal 1998, revenue from public payphones decreased slightly, reflecting a mature market and increased substitution by mobile telephony and calling card products. Telstra expects that increased competition from new market entrants and increased mobile telephone penetration will place increased pressure on public payphones revenue in the future. The Company is endeavouring to stimulate and diversify this market by the use of new smartcard technology, so that it may be used as an alternative payment mechanism for payphones and for other vending applications.

### Other Sales and Services

The principal components of revenue recorded by Telstra in other sales and services are revenue from intelligent network services (including local calling rate services Priority® One3 and Priority® 1300 and toll free services), revenue from various controlled entities, Internet access products and services, domestic operator-assisted calls, ship-to-shore services and recorded message and other enhanced call products. The increase in revenue of 26 per cent per annum over the three year period was driven principally by increased revenue from Internet access products and services, intelligent network services and revenues from controlled entities such as Telstra UK and Telstra New Zealand whose revenues were A\$177 million and A\$44 million respectively.

### Other Revenue

Table 11 shows certain information about Telstra's other revenue.

**Table 11 - Other Revenue by Category**

	Year Ended 30 June		
	1998 A\$m	1997 A\$m	1996 A\$m
Interest received/receivable. . . . .	49	85	105
Proceeds from sale of assets/ investments/patents, trademarks and licences. . . . .	266	202	199
Dividends received/receivable . . . . .	20	38	33
Share of associated entities net profit after income tax expense . . . . .	14	-	-
Miscellaneous revenue . . . . .	134	222	186
<b>Total other revenue . . . . .</b>	<b>483</b>	<b>547</b>	<b>523</b>

### Operating Expenses (Before Interest Expense and Abnormals)

Telstra categorises its operating expenses (before interest expense and abnormals) into labour expense, direct cost of sales, depreciation and amortisation and other operating expenses. Table 12 (on page 52) shows a breakdown of Telstra's operating expenses (before interest expense and abnormals) by type and expressed as a percentage of operating revenue.

Overall, Telstra's operating expenses (before interest expense and abnormals) increased by an average rate of 3.2 per cent over the three year period, but fell as a percentage of revenue. Labour expense declined and decreased as a percentage of revenue reflecting reductions in staff numbers during the same period. Direct cost of sales increased principally due to higher payments to other domestic and international Carriers for terminating calls and the growth in the mobile telecommunications market and migration of customers from the analogue network to digital networks which resulted in increased mobile handset purchases and subsidies, dealer bonuses and commissions. Depreciation and amortisation was relatively flat during the period reflecting the effect of recent high levels of capital investments, offset by the extension of service lives of certain capital assets resulting from the Company's annual review of asset lives.

Other operating expenses which are influenced by a number of factors including the size of the workforce, the extent of outsourcing activities, performance of strategic investments, business growth, competitor activity, market trends and economic conditions, remained relatively flat as a percentage of revenues over the period.

In fiscal 1998, labour expense and other operating expenses have been favourably impacted and depreciation and amortisation has been adversely impacted by changes to accounting policies implemented in fiscal 1997, the effects of which were recognised as abnormals in that year.

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Table 12 - Operating Expense Data

	Year Ended 30 June					
	1998		1997		1996	
	A\$m	%	A\$m	%	A\$m	%
Labour expense . . . . .	3,665	21.2	3,973	24.9	3,997	26.2
Direct cost of sales . . . . .	2,582	14.9	2,033	12.7	1,748	11.5
Depreciation and amortisation. . . . .	2,322	13.4	2,353	14.7	2,351	15.4
Other operating expenses . . . . .	3,631	21.0	3,295	20.6	3,368	22.1
Operating expenses (before interest expense and abnormals) . . . . .	12,200	70.5	11,654	72.9	11,464	75.2

### Labour Expense

Labour expense has historically been the Company's largest expense category. Labour expense declined over the three year period and decreased as a percentage of revenue by 5 per cent. This reflected the Company's ongoing programmes to improve work practices, streamline processes, enhance network and systems infrastructure and outsource certain functions, resulting in reductions in the labour force. Labour expense also declined in fiscal 1998 as a result of the changes in accounting policies adopted in fiscal 1997 to capitalise certain labour costs associated with assets under self-construction and software developed for internal use. In fiscal 1997, the reduction in labour expense associated with these changes in accounting policies was recorded as an abnormal item. During fiscal 1998, the Company reduced full time staff numbers by approximately 8,900 which brings total reductions since 1 July 1996 to approximately 20,800 (of which approximately 20 per cent resulted from the outsourcing of activities by the sale of certain businesses and the contracting out of some operations). The reductions in fiscal 1997, however, were offset in part by the addition of 1,500 full-time staff relating to the consolidation of Pacific Access as of 20 June 1997 resulting in a net reported reduction of 19,300. The number of full-time staff at 30 June 1998 was approximately 57,200. The Company's labour force increased in fiscal 1996, principally to support the Company's capital expenditure programmes. However, labour costs associated with these programmes were largely capitalised.

As the Company continues to implement productivity improvements, labour expense is expected to decline in both absolute terms and as a percentage of sales. However, a portion of this decline will be offset by increases in other operating expenses relating to outsourcing of work previously performed within Telstra.

Labour costs were affected by pay increases totalling 5.5 per cent in each of fiscal 1997 and 1996, pursuant to the Company's enterprise agreement with its unions. The Company is negotiating a new enterprise agreement with unions and staff to succeed the agreement which expired on 4 October 1997. As no agreement was reached in fiscal 1998, the provisions of the prior agreement have remained in place and no pay increases were given to staff covered by the agreement in fiscal 1998. In negotiating the new agreement, Telstra aims to increase management and labour flexibility. The new enterprise agreement is expected to result in pay increases, which would offset to some extent the effect of workforce reductions.

During fiscal 1998, Telstra approved a three year plan to fiscal 2001. This three year plan included an additional reduction of approximately 2,000 employees by way of redundancy. As Telstra has identified with sufficient certainty the levels of employees to be made redundant, the initiatives by which the reductions will occur and the expected liability, an additional provision of A\$115 million was raised in fiscal 1998. Telstra also reviewed the initiatives being used to reduce staff in fiscal 1998 and this resulted in an additional 796 employees being made redundant at an additional cost of A\$88 million. This amount was charged to labour expense in fiscal 1998. See Note 32 to the Financial Statements for the disclosures required by EITF 94-3.

The Telstra Group sponsors or participates in a number of superannuation schemes which provide benefits for its employees and their dependants on cessation of employment. Employer contributions paid to the schemes and expensed for fiscal 1998, 1997 and 1996 were A\$294 million, A\$340 million and A\$320 million, respectively. An actuarial valuation has been conducted on the TSS and the CSS as at 30 June 1997.

Telstra is not presently required to contribute to the CSS, however, past contributions to the CSS has resulted in the Telstra Entity being credited with a surplus in the notional fund of the CSS. The Commonwealth has indicated that repatriation of part of that surplus to the TSS will be permitted where the surplus is greater than 15 per cent of the sum of the employer financed benefits (past and future service) for the Telstra Entity's existing CSS members and outstanding deferred transfer value payments for ex-CSS members who transferred to the TSS. The actuarial valuation as at 30 June 1997 confirmed that the CSS surplus was greater than 15 per cent and the Telstra Entity is in discussions with the Commonwealth regarding the repatriation of this surplus to the TSS.

On the assumption that the CSS surplus, net of 15 per cent contributions tax payable on its transfer into the TSS, is available to increase the assets of the TSS, the actuary has recommended that the Telstra Entity cease defined benefit contributions to the TSS (other than the additional contributions of A\$121 million per annum that the Telstra Entity is committed to contribute to the TSS over the next 13 years) for the three year period 1 July 1998 to 30 June 2001. Based on that advice, the Telstra Entity Board of Directors (subsequent to year end) has agreed that the employer contribution rate for the defined benefit component of the TSS will be reduced to nil for the next three years, subject to a satisfactory outcome from the above mentioned discussions and a consequential response from the Minister for Finance.



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### *Direct Cost of Sales*

The largest component of direct cost of sales is payments to other Carriers to terminate international outgoing traffic and transit traffic.

Other significant components of direct costs of sales are costs of mobile handsets, dealer bonuses, commissions paid to indirect distribution channels, costs of customer premises equipment sold, directory publishing costs and payments to domestic Carriers to terminate calls.

Direct cost of sales increased during the period principally due to an increase in payments to international Carriers to terminate outgoing calls following increased activity by the Company in the international transit traffic market, increased payments to domestic carriers and growth in the mobile telecommunications market. As a percentage of operating revenue, direct cost of sales increased to 14.9 per cent in fiscal 1998 from 11.5 per cent in fiscal 1996.

### *Depreciation and Amortisation*

Depreciation and amortisation expense has been and will remain a major component of Telstra's cost structure, reflecting the Company's significant level of capital investment over time. Depreciation and amortisation expense remained relatively flat during the period reflecting increases in capital investment in recent periods relating to the Networks and Systems Modernisation Programme, the digital mobile telecommunications network and the Broadband Network which were substantially offset by the extension of the service lives of certain capital assets. Changes in accounting policies adopted in fiscal 1997 to capitalise certain overhead and interest costs associated with assets under self-construction and software developed for internal use contributed to increased depreciation and amortisation expense in fiscal 1998 and is expected to continue to do so in future years. In fiscal 1997, the increase in depreciation and amortisation expense associated with these changes in accounting policies was recorded as an abnormal item.

### *Other Operating Expenses*

Other operating expenses include such costs as accommodation costs (rent, municipal rates, land tax and power), network maintenance material, travelling costs and fares, promotion and advertising, fleet running costs, information technology costs, bad and doubtful debts, service contracts and agreements (outsourced activities, such as information technology, cleaning services and clearing of coin boxes for public telephones), the carrying value of assets disposed of, cost of directory services paper sold and losses from partnerships. Other operating expenses increased in fiscal 1998 principally due to increased outsourcing costs, increased costs to ensure the Company's network and systems are Year 2000 compliant, increased book value of assets sold, promotion and advertising activity and to a lesser degree, additional bad and doubtful debts offset by the effect of changes in accounting policies adopted in fiscal 1997 to capitalise certain overhead costs associated with assets under self-construction and software developed for internal use.

A significant portion of the increase in bad and doubtful debt expense during the period related to certain of the Company's wholesale customers. The Company is involved in significant legal proceedings with four of these wholesale customers for substantial charges Telstra believes remain unpaid for the provision by Telstra of telecommunications services. These four customers have made counter claims against Telstra for substantial amounts. The four customers dispute that the amounts claimed by Telstra or any amounts are owing by them, and contend that they are entitled to offset their claims against amounts claimed by Telstra. The wholesale customers allege that bills were not received, were inaccurate and/or that the Company's billing and account management systems were defective in other ways. The Company believes that it has made appropriate provision for bad and doubtful debts, including with respect to these and other wholesale customers. However, such provisions may or may not prove to be adequate.

Overall other operating expenses are expected to be relatively flat as a percentage of revenue in the near term. This trend is principally due to increased outsourcing costs and costs to ensure that the Company's networks and systems are Year 2000 compliant. In fiscal 1997, the decrease in other operating expenses associated with the changes in accounting policies was recorded as an abnormal item.

### *Interest Expense*

During the three year period, Telstra's interest expense (borrowing costs) increased to A\$634 million in 1998 from A\$533 million in fiscal 1996. This increase in interest expense was influenced by the level of the Company's debt, declining interest rates and the Company's commitment to fund annually an actuarial shortfall in the TSS and changes in accounting policies adopted in fiscal 1997 to capitalise certain interest costs associated with assets under self-construction and software developed for internal use. The commitment to fund the TSS shortfall increased interest expense in fiscal 1998, 1997 and 1996 by A\$96 million, A\$98 million, and A\$101 million, respectively. On 30 June 1997, the Company fully drew down credit facilities consisting of a A\$1 billion 364 day credit facility and a A\$2 billion five year credit facility in order to replenish working capital following the payment of a A\$3 billion special dividend to the Commonwealth. The A\$1 billion facility was fully repaid during fiscal 1998 and the A\$2 billion facility was refinanced in 1998 with a more efficient combination of short and long term facilities. In fiscal 1997, the decrease in interest expense associated with the changes in accounting policies referred to above was recorded as an abnormal item.

### *Abnormals*

Abnormal items require separate disclosure in Australia where they are abnormal by reason of their size and effect on the operating profit or loss after income tax.

In fiscal 1998, no abnormals were recognised by the Company.

In fiscal 1997, the Company recognised an abnormal charge of A\$1.1 billion for redundancy and associated costs related to its workforce reduction and restructuring programme. During fiscal 1997 and 1998 approximately 5,515 and 7,715 employees



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respectively were made redundant (through either voluntary or involuntary means) and a total of A\$339 million and A\$526 million respectively were charged against the redundancy and restructuring provision.

In order to align further its accounting policies with common practice in the telecommunications industry, Telstra changed certain accounting policies during fiscal 1997 to capitalise software developed for internal use and to capitalise interest and indirect overheads incurred during the self-construction of assets. Prior to these changes, these costs were expensed as incurred rather than capitalised. The effect of these changes in accounting policies in fiscal 1997 was an abnormal benefit to profit before income tax of A\$606 million.

In fiscal 1997, the Company recognised an abnormal charge of A\$394 million reflecting management's best estimate of its cost to satisfy future obligations related to the JORN project. On 2 October 1997, the Company finalised negotiations with RLM to settle arrangements whereby Telstra will have a right, on certain events happening, to require RLM to assume full responsibility for the completion of the JORN project.

The Broadband Network assets were written down in fiscal 1997 by A\$587 million, of which A\$245 million was charged to the asset revaluation reserve and the balance of A\$342 million was included as an abnormal charge against operating profit before income tax expense. The writedown was based on the present value at 30 June 1997 of the estimated future net cash flows before income tax expense over the remaining service life of the assets from pay television and other benefits derived from the Broadband Network (including telephony customer retention and the ability to provide value-added services) and excluded significant recent pit and pipe capital expenditures which are considered to be shared assets predominantly used for narrowband services. The writedown was caused principally by a reduction in the number of homes to be passed and a reassessment of other potential usages for the Broadband Network. Even after this writedown, however, Telstra does not expect the operation of the Broadband Network to be profitable for at least several years.

In addition, in fiscal 1997, the Company recorded an abnormal charge of A\$476 million as a result of an agreement to reduce the rollout of the Broadband Network to 2.5 million homes passed from the previously contracted 4.0 million homes passed. The charge was based on estimated contract settlements of A\$390 million as a result of the rollout reduction and a writedown of excess inventory of A\$86 million. The provision for Broadband Network contract settlements of A\$390 million included an amount of A\$300 million which represented the net present value of a contractual obligation for agreed fixed dollar amount reductions in revenue share to be received by Telstra from FOXTEL over the next seven years using a discount rate of 9.7 per cent per annum. In the event that there is insufficient revenue share in a given year to meet the amount of the reduction, Telstra will fund the difference to FOXTEL.

In fiscal 1996, Telstra recognised a A\$205 million abnormal depreciation benefit related to a change in methodology for determining the service lives of particular telecommunications assets, principally consisting of copper cables and switching

equipment. The methodology was introduced for situations where replacement is determined by technological substitution rather than usage or another basis.

### Income Tax Expense

In fiscal 1997, income tax expense was affected by a tax benefit of A\$285 million related to depreciation on devalued assets, of which A\$216 million related to prior years and was recognised as abnormal.

Income tax expense in fiscal 1998, fiscal 1997 and fiscal 1996 was also reduced by A\$113 million, A\$66 million and A\$87 million respectively, arising from the over provision of income tax in prior years.

### Australian GAAP Compared With US GAAP

Under US GAAP, operating profit attributable to shareholders was A\$2,674 million, A\$1,136 million and A\$2,714 million compared with Australian GAAP amounts of A\$3,004 million, A\$1,617 million and A\$2,305 million in fiscal 1998, 1997 and 1996, respectively. Under US GAAP, shareholders' equity was A\$14,676 million, A\$13,473 million and A\$16,633 million in fiscal 1998, 1997 and 1996, respectively, compared with Australian GAAP shareholders' equity of A\$11,079 million, A\$9,938 million and A\$12,668 million in fiscal 1998, 1997 and 1996 respectively.

Differences primarily result from the different treatment of fixed asset revaluations, timing of the adoption of accounting policies for capitalisation of interest, software and indirect overhead costs, superannuation liability recognition, employee compensation expense, timing of recognition of tax rate changes and dividend liabilities. See Note 32 to the Financial Statements.

### Liquidity and Capital Resources

#### Liquidity

Table 13 shows Telstra's cash flows for the three most recent fiscal years.

*Table 13 - Cash Flow Data*

	Year Ended 30 June		
	1998	1997	1996
	A\$m	A\$m	A\$m
Net cash provided by operating activities . . . . .	5,635	5,254	4,478
Net cash used in investing activities . . . . .	(3,609)	(4,171)	(3,870)
Net cash used in financing activities . . . . .	(1,808)	(1,572)	(1,659)
Net increase/(decrease) in cash. . . . .	218	(489)	(1,051)

#### Net Cash Provided by Operating Activities

Telstra's primary source of liquidity is cash generated from operations.

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Net cash provided by operating activities is after interest paid, of which A\$83 million and A\$106 million was capitalised in fiscal 1998 and fiscal 1997 respectively as a result of the accounting policy changes adopted in fiscal 1997. During the three year period from fiscal 1996 to fiscal 1998 net cash provided by operating activities grew on average by 12.2 per cent principally due to improved cash flow from sales to customers and a decrease in corporate income tax paid, offset in part by increased payments to suppliers and interest payments.

### Net Cash Used in Investing Activities

Net cash used in investing activities represents amounts paid for capital equipment, trademark licences and investments, offset by receipts from the sale of capital equipment and investments. Over the last three fiscal years, Telstra has committed a substantial amount of capital and other resources to upgrade and rationalise its network infrastructure and improve many of its systems. The Company is in the final stages of the Networks and Systems Modernisation Programme and the rollout of its digital GSM mobile telecommunications network and has completed the rollout of its Broadband Network.

Table 14 shows Telstra's net cash used in investing activities over the last three fiscal years.

**Table 14 - Net Cash Used in Investing Activities**

	Year Ended 30 June		
	1998 A\$m	1997 A\$m	1996 A\$m
Switching . . . . .	739	768	659
Transmission. . . . .	563	579	486
Customer access. . . . .	672	848	920
Mobile telecommunications networks. . . . .	332	330	342
Broadband Network. . . . .	97	459	282
International telecommunications infrastructure. . . . .	136	119	197
Other. . . . .	1,202	1,145	1,018
Capital expenditures <sup>(1)</sup> . . . . .	3,741	4,248	3,904
Investments. . . . .	149	150	167
Capital expenditures and investments <sup>(1)</sup> . . . . .	3,890	4,398	4,071
Sale of capital equipment, investments and other. . . . .	(281)	(227)	(201)
Net cash used in investing activities. . . . .	3,609	4,171	3,870

<sup>(1)</sup> Fiscal 1998 and fiscal 1997, exclude A\$83 million and A\$106 million respectively of capitalised interest which is reflected in net cash provided by operating activities.

In fiscal 1998, capital expenditures decreased by A\$507 million compared with 1997, reflecting the substantial completion of various large capital expenditure projects, including the Networks and Systems Modernisation Programme and the rollout of the Broadband Network. In fiscal 1997, capital expenditures increased by A\$344 million over fiscal 1996 reflecting the additional capitalisation of approximately A\$530

million related to the effect of changes in accounting policies made in fiscal 1997, partially offset by a reduction in the Company's capital programme.

Investments in fiscal 1998 included A\$92 million contributed to FOXTEL, A\$33 million invested in WorldPartners and A\$24 million in the Satellite Consortia, INTELSAT and INMARSAT (refer Note 1.9(c) to the Financial Statements). Sale of capital equipment, investments and other in fiscal 1996 included proceeds from the sale of Telstra's interest in Seven Network Limited for A\$112 million.

In fiscal 1997, investments principally comprised A\$129 million contributed to FOXTEL.

Investments in fiscal 1996 principally comprised A\$113 million contributed to FOXTEL and US\$40 million invested in the Company's Indonesian joint venture, PT Mitra Global Telekomunikasi Indonesia.

In fiscal 1998 proceeds on sale of capital equipment, investments and other totalled A\$281 million and included the disposal of assets to IBMGSA. Sale of capital equipment, investments and other, increased in fiscal 1997 compared with fiscal 1996 due to the sale and leaseback of A\$42 million of capital equipment.

Telstra reviews its capital expenditure and investment requirements on a regular basis. The Company expects to incur future capital expenditures in areas including: (i) development of infrastructure and new products and services to meet the evolving needs of customers; (ii) the Data Mode of Operation Programme; (iii) continuation of the digital GSM mobile telecommunications network and a new mobile network based on digital technologies; (iv) anticipated investment in international cables to cater for the expansion of overseas telecommunications traffic; (v) further investment in pay television and on-line services content and development; (vi) investment in offshore ventures; and (vii) provision of enhanced telecommunications services to remote customers through the Company's Remote Area Telecommunications Enhancement Programme. The Company may periodically make investments in, or acquire, complementary businesses.

The Company expects that its cash flow from operating activities will be sufficient to meet anticipated capital expenditures and investments in each of fiscal 1999, 2000 and 2001. To the extent that unforeseen capital expenditures and investments arise or the Company's estimates of its capital requirements prove to be understated and cause capital requirements to exceed net cash provided by operating activities, the Company may need to fund such capital expenditures and investments with debt or other financing.

### Net Cash Used in Financing Activities

In fiscal 1998, the increase in cash used for financing activities of A\$236 million was principally driven by the net repayment of debt in fiscal 1998 of A\$386 million compared with net borrowings in fiscal 1997 of A\$2,735 million offset by a reduction in dividends paid of A\$2,885 million.

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In fiscal 1997, the decrease in cash used in financing activities of A\$87 million reflected primarily a net increase in borrowings of A\$3.2 billion, offset by increased dividend payments of A\$3.1 billion. The increase in dividends was due mainly to the payment of a special dividend of A\$3 billion to the Commonwealth in relation to the recapitalisation of the Company.

The increase in cash used for financing activities in fiscal 1996 to A\$1,319 million was mainly due to the net repayment of debt in fiscal 1996 of A\$442 million compared with net borrowings in fiscal 1995 of A\$453 million, and an increase in dividends paid of A\$424 million. As part of the repayments of debt made during fiscal 1996, the Company retired the remaining A\$558 million of Government debt then outstanding. The increase in dividends was due mainly to an increase in profits, additional dividends of A\$100 million and an increase in the payout ratio from 50 per cent to 55 per cent.

### Capital Resources

At 30 June 1998, total debt was A\$7.7 billion with net debt of A\$6.5 billion after deducting cash of A\$953 million, other interest bearing financial assets of A\$105 million and loans to employees of A\$206 million. Approximately 48 per cent of total debt consisted of domestic borrowings with the balance being sourced from a variety of offshore markets. Current debt (maturing in less than 12 months) comprised approximately 38 per cent of total debt which had an average maturity of approximately five years.

Telstra has access to A\$650 million and US\$100 million of committed standby bank lines. These facilities comprise bilateral arrangements with seven banks which terminate at various times throughout the year. Telstra has three commercial paper programmes with a total borrowing capacity of A\$1 billion and US\$2 billion. In each case, commercial paper is issued through a dealer panel on a best endeavours basis. The commercial paper facilities are not committed and do not provide guaranteed access to funds. Telstra requires all foreign currency borrowings to be fully hedged at inception. Telstra does not use derivatives for speculative purposes.

As at the end of fiscal 1998, 1997 and 1996, Telstra had negative working capital of A\$4,036 million, A\$2,155 million and A\$730 million respectively. On 30 June 1997, the Company paid a special dividend of A\$3.0 billion to the Commonwealth. Also on 30 June 1997, to finance the replenishment of working capital, the Company drew down credit facilities consisting of: (i) a A\$1.0 billion 364 day credit facility, which contributed to the increase in the Company's negative working capital in fiscal 1997; and (ii) a A\$2.0 billion five year credit facility. In addition, the expected reduction in the Company's workforce has contributed to the increase in negative working capital due to the increased payables associated with the programme.

As at 30 June 1998 the negative working capital was attributable primarily to the short term borrowings of A\$1 billion undertaken to refinance a portion of the syndicated bank loan credit facility drawn down in June 1998.

Telstra typically carries current liabilities in excess of current assets, as is common with most international telecommunications companies. The Company believes that its negative working capital position does not create a liquidity risk because the timing of its discretionary capital expenditures can be adjusted should cash inflows from its diverse customer base diminish at any point in time. Also, the Company's standby bank lines and commercial paper programmes provide additional sources of liquidity should the need arise.

### Other Matters

#### Recently issued US Accounting Standards

In June 1997, the US Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No.130 (SFAS 130), Reporting Comprehensive Income, which is effective for financial statements issued for fiscal years beginning after 15 December 1997. SFAS 130 requires that changes in certain items, including foreign currency translation adjustments, be reported in a statement of comprehensive income that is displayed in equal prominence with the other financial statements. SFAS 130 does not specify the format of the statement of comprehensive income, but it does require that an amount representing total comprehensive income be reported in that statement for all periods for which net income is presented. The Telstra Group does not believe that adoption of SFAS 130 will have a material effect on the Telstra Group's financial statements.

Also in June 1997, the FASB issued Statement of Financial Accounting Standards No.131 (SFAS 131), Disclosures about Segments of an Enterprise and Related Information, which is effective for financial statements issued for fiscal years beginning after 15 December 1997. SFAS 131 establishes standards for the way public companies report information about segments of their business in annual financial statements. SFAS 131 also requires entity-wide disclosures about the products and services an entity provides, its major customers and the countries in which it holds material amounts of assets and reports material amounts of revenue. The standard requires public companies to restate comparative information for earlier years in the initial year of application and to report selected segment information in their interim reports issued to shareholders. SFAS 131 need not be applied to interim financial statements in the initial year of its application. The Telstra Group has not determined the potential effect of this standard on the Telstra Group's financial statements.

In February 1998, the FASB issued Statement of Financial Accounting Standards No.132 (SFAS 132) Employers' Disclosures about Pension and other Post Retirement Benefit Disclosures which is effective for fiscal years beginning after 15 December 1997. SFAS 132 revises employers' disclosures about pensions and other post-retirement plans. In the initial year of application comparatives for the prior year are required to be restated. The Telstra Group has not yet determined the potential effect of this standard on the Telstra Group's financial statements.

In June 1998, the FASB issued Statement of Financial Accounting Standards No.133 (SFAS 133) Accounting for Derivative Instruments and Hedging Activities, which is effective for

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financial statements issued for fiscal years beginning after 15 June 1999. SFAS 133 establishes accounting and reporting standards for derivative financial instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities. SFAS 133 broadens the definition of a derivative instrument and significantly modifies the accounting treatment for certain types of derivatives. In the initial year of application comparative information for earlier years is to be restated. The Telstra Group has not yet determined the potential effect of this standard on the Telstra Group's financial statements.

### Year 2000

In common with users of computers around the world, Telstra is investigating whether and to what extent, the date change from 1999 to 2000 may affect its networks and systems.

Telstra has established a programme designed to ensure that the impact of the transition to the Year 2000 on the Company and its customers is minimised by seeking to ensure that the Company's key networks and systems are Year 2000 compliant before 31 December 1999. In reviewing its systems, Telstra is placing priority on those systems which could cause significant financial and legal impacts on the Company's business if they were to fail. The Company has also incorporated Year 2000 considerations into its system development and maintenance plans. Telstra's operations, however, may also be affected by the ability of third parties dealing with Telstra to manage the effect of the Year 2000 date change.

### *Telstra's State of Readiness*

Telstra's Year 2000 Programme addresses the year 2000 status of, among other things, telephony and data networks, customer premises equipment, information technology, electronic data information transactions and building support infrastructure (such as building management systems, air conditioning controls and electrical power systems).

The objective of Telstra's Year 2000 Programme is to enable the Company to manage its business operations with minimal risk and financial impact before, during and after the transition from the year 1999 to the year 2000.

Telstra's Year 2000 Programme aims to have Year 2000 compliant versions of:

- critical telecommunications network components tested and deployed in its network by 31 December 1998; and
- critical information technology (IT) applications tested and deployed by 31 December 1998.

Non critical network components and non critical IT applications are being addressed and are intended to be completed through calendar 1999. The overall plan is currently satisfying the above schedule.

Telstra has a major dependency upon its suppliers and is focused on obtaining Year 2000 compliant assurances from suppliers which are critical to its business, or which supply products that are business critical. Telstra is well under way in obtaining

compliance information from its suppliers of IT and network products, including customer premises, equipment, Electronic Data Interchange (EDI) and also general products and services.

Telstra is working closely with its suppliers to:

- ensure acceptance of Telstra's Year 2000 compliance definition;
- establish and maintain the currency of the supplier's current Year 2000 compliance position for its products and/or services and the suppliers' schedule for becoming compliant, where relevant; and
- achieve the timely delivery by the suppliers of Year 2000 compliant products and services.

### *Estimated Cost*

Telstra estimates that its Year 2000 Programme will cost up to A\$500 million, with the majority of funds expected to be sourced from Telstra's normal cash flows from operations. This cost estimate is in addition to Telstra's budget for other information technology projects and will be expensed as incurred. Telstra's expenditure on Year 2000 in fiscal 1998 was lower than initially anticipated. There were a number of factors which contributed to this including:

- lower than expected volume of remediation work required on some larger IT applications (eg. Flexcab® billing system); and
- deferral of some Year 2000 compliant product deliveries and costs to later in calendar 1998 by some network vendors.

Telstra believes the recorded expenditure to 30 June 1998 of A\$60 million is in line with the Company's plan to ensure the key networks and systems are Year 2000 compliant before 31 December 1999. Telstra is also incurring costs in the normal course of business in relation to the upgrade and maintenance of its network and systems that would include Year 2000 compliance costs which cannot be readily distinguished from the normal upgrade and maintenance costs.

### *The Risks of Telstra's Year 2000 Issues*

Whilst Telstra is making efforts to mitigate its risks, there can be no assurance that Telstra's Year 2000 Programme will, in whole or in part, be successful or that the date change from 1999 to 2000 will not materially affect Telstra's operations and financial results.

Telstra has potential exposure to the Year 2000 problem arising out of a number of issues, including the following:

- loss of revenue if Telstra is unable to bill customers or trading partners or if they have difficulty paying because of Year 2000 problems in their own businesses;
- customers or trading partners may attempt to take action against Telstra if Telstra is unable to maintain continuity of service to them;
- regulators may impose fines or take other action against Telstra if Telstra fails to maintain continuity of service and breaches customer service guarantees; and

## Item 9: Management's Discussion and Analysis of Financial Condition and Results of Operations

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- Telstra's ability to maintain continuity of service may be affected if other domestic or international Carriers or CSPs have Year 2000 problems in their networks.

### *Telstra's Contingency Plans*

Telstra has established contingency plans as part of its standard disaster recovery planning. Contingency plans to deal with the Year 2000 problem will form one aspect of those plans. The development of specific contingency plans for the Year 2000 problem has commenced and will involve work with major vendors and major customers. The Telstra Year 2000 Programme has also established a business focused risk management framework to provide Telstra with a dynamic view of residual business risk across the company.

The risk management process has four elements, as follows:

- risk assessment process to identify and prioritise risks based on business impact, likelihood and current control and to determine actions to improve control effectiveness;
- risk monitoring and reporting on follow-up actions and focusing of management attention on major areas of residual risk;
- internal review process to test risk assessments and effectiveness of follow-up actions in mitigating business risks; and
- independent health assessment of the Year 2000 Programme by external consultants to test approach, status and residual risk. One such assessment has already been completed and a second assessment has been scheduled for October 1998.

## Item 9A: Quantitative and Qualitative Disclosures About Market Risk

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### **Financial Risk Management - Sensitivity and Value at Risk Analysis**

Telstra is exposed to market risk from changes in interest rates and foreign currency exchange rates as part of its normal business operations. Derivative financial instruments are only used to hedge market risks relating to an underlying physical position in accordance with Board approved policies.

Telstra is exposed to changes in interest rates through its debt requirements with maturities generally ranging to ten years. Telstra uses interest rate swaps, cross currency swaps and futures to achieve a targeted interest rate profile and debt portfolio duration that is in line with its debt management policy. A portion of Telstra's borrowings are denominated in foreign currencies. The foreign currency exchange risk on such borrowings is removed by applying cross currency swaps at drawdown.

Interest rate risk is calculated on Telstra's net debt portfolio. This portfolio is defined as Telstra's financial liabilities less short term financial assets whose value is sensitive to interest rates, including both physical and associated derivative instruments.

Telstra is exposed to foreign currency exchange risk on firm or anticipated transactions relating to revenues and expenditures from international traffic settled in foreign currencies, purchase commitments in foreign currencies and investments denominated in foreign currencies. Forward foreign currency derivatives are used to hedge such exchange rate risk.

Foreign exchange risk is calculated on Telstra's net foreign exchange exposure portfolio. This portfolio is defined as Telstra's underlying foreign exchange exposures combined with its associated foreign exchange derivatives used to hedge the risk.

Telstra measures its exposure to movements in market risks on a fair value basis. The potential costs identified below represent adverse movements in the fair value of Telstra's relevant portfolio.

### **Sensitivity Analysis**

A sensitivity analysis on Telstra's net debt and foreign exchange exposure portfolios has been undertaken based on an instantaneous, adverse proportional movement of 10 per cent in interest rates and exchange rates. This does not necessarily represent a true measure of market volatility since it does not take into account the probability of such an occurrence or the diversification characteristics inherent in the portfolios.

A sensitivity analysis which assumes a 10 per cent instantaneous downward shift in interest rates across all yield curves at 30 June 1998 results in a potential cost on Telstra's net debt portfolio of A\$177 million.

A sensitivity analysis which assumes a 10 per cent instantaneous adverse movement in the Australian dollar against each foreign currency to which Telstra is exposed at 30 June 1998 results in a potential cost on Telstra's net foreign exchange exposure portfolio of A\$35 million.

### **Value at Risk**

In addition to sensitivity analysis, Telstra has performed "Value at Risk" (VaR) analysis. The VaR numbers represent the maximum potential cost on each portfolio that is expected over a given period of time (known as the holding period) expressed in terms of a specific degree of certainty (known as the confidence interval). The potential cost is derived by applying historical volatility measures to the quantity of market risk identified. Unlike sensitivity analysis, VaR analysis can adjust for the relevant diversification characteristics inherent in Telstra's net debt and net foreign exchange exposure portfolios.

## Item 9A: Quantitative and Qualitative Disclosures About Market Risk

The VaR numbers have been determined using a Monte Carlo simulation model based on the JP Morgan RiskMetrics methodology and JP Morgan/Reuters RiskMetrics data sets. The data sets from JP Morgan comprise:

- interest rate and foreign exchange rate volatilities; and
- correlations between interest rates and foreign exchange rates.

The simulation model determines the distribution of the fair value of Telstra's debt portfolio and foreign exchange portfolio at future rates by performing a full portfolio valuation using Telstra's actual transaction portfolio after simulating interest and foreign exchange movements. In deriving the VaR numbers, sufficient simulations (50,000) have been undertaken to ensure the production of stable, robust results.

The VaR figures show the change in market value of the portfolios over a monthly period as a result of movements in market interest rates and foreign exchange rates.

The VaR methodology adopted determines the maximum potential cost with a 99 per cent confidence level (ie. the value for which there is a 1 per cent chance of being exceeded). This maximum potential cost is based on a one month holding period. The one month holding period maximum potential cost can be approximately converted to:

- an equivalent one day potential cost figure by multiplying by a factor of 0.22
- an equivalent twelve month potential cost figure by multiplying by a factor of 3.5

This conversion assumes that the portfolios continue with the same basic profiles such as maturity and mix of debt.

Application of a one month holding period is considered appropriate given that Telstra's hedging activities are of a non-trading nature. This is in contrast to the activities of many financial institutions who would consider a one day period appropriate for this analysis.

The VaR analysis of interest rate risk on Telstra's net debt portfolio at 30 June 1998 has identified that a potential cost over one month of A\$212 million has a 1 per cent chance of being exceeded.

The VaR analysis of foreign exchange risk on Telstra's net foreign exchange exposure portfolio at 30 June 1998 has identified that a potential cost over one month of A\$26 million has a 1 per cent chance of being exceeded.

A VaR analysis can be undertaken across Telstra's net debt and net foreign exchange exposure portfolios simultaneously to introduce the diversification benefit that exists between these two portfolios. The result of this analysis is that a potential cost which has a 1 per cent chance of being exceeded over a one month period is A\$207 million. This compares to the potential cost of greater than A\$238 million where the results of the two portfolios are separately undertaken and then added together.

## Item 10: Directors and Officers of Registrant

### Directors and Executive Officers

As at 26 August 1998, the Directors of Telstra Corporation Limited were as follows:

#### Directors

Name	Age	Position	Year of Initial Appointment	Year Last Re-Elected <sup>(1)</sup>
David M. Hoare	65	Chairman	1991	1997
John T. Ralph	65	Deputy Chairman	1996	1997
W. Frank Blount	60	Chief Executive Officer, Director	1992	-
N. Ross Adler	53	Director	1996	1996
Anthony J. Clark	59	Director	1996	1997
Michael H. Codd	58	Director	1992	1996
Malcolm G. Irving	68	Director	1997	1997
Elizabeth A. Nosworthy	52	Director	1991	1996
Christopher I. Roberts	53	Director	1991	1996
John W. Stocker	53	Director	1996	1997
Stephen W. Vizard	42	Director	1996	1996

*(1) Other than the Chief Executive Officer, one third of Directors are subject to re-election by rotation each year.*

On 8 September 1998, two additional non-Executive Directors, Donald McGauchie and Cecilia A. Moar, were appointed to the Telstra Board.

The Chairman, Mr. David Hoare and the Chief Executive Officer, Mr. Frank Blount have made known their intentions to retire. In late calendar 1997 the Chairman indicated he would continue in his position until a convenient date at or after the 1998 Annual General Meeting. Since that time, Mr. Hoare has reviewed his position and confirmed he is willing to continue in his role as Chairman until the end of calendar 1999.

Mr. Blount has also advised that he will continue as Telstra's Chief Executive Officer until the end of calendar 1998 or such other date as is mutually convenient for him and the Telstra Board.

## Item 10: Directors and Officers of Registrant

The search for a new Chief Executive Officer is currently underway with a sub-committee of the Board consisting of the Chairman, the Deputy Chairman and the current Chief Executive Officer together with external advisers examining potential candidates from both within Telstra and externally. However, at the time of this report, there has been no announcement or final decision made on the new Chief Executive Officer.

### The Executive Officers who were not Directors are:

Name and Position	(1)	(2)
Doug Campbell Group Managing Director, Carrier Services	1998	1989
Robert Cartwright Group Managing Director, Employee Relations	1995	1995
Gerry Moriarty Group Managing Director, Network Technology Group & Multimedia	1998	1993
Paul Rizzo Group Managing Director, Finance & Administration	1993	1993
Peter Shore Group Managing Director, Commercial & Consumer	1997	1981
Ziggy Switkowski Group Managing Director, Business & International	1997	1997
Graeme Ward Group Director, Regulatory & External Affairs	1995	1972
Lindsay Yelland Group Managing Director, Products & Marketing	1996	1992

(1) Year appointed to position

(2) Year appointed to Telstra

The following is a brief biography of each of the Directors and Executive Officers of Telstra Corporation Limited:

### Directors

#### David M. HOARE - BEc, FCPA

##### Chairman

Director and Chairman since December 1991.

Chairman, Pioneer International Ltd; Director, Bankers Trust Australia Limited, Comalco Ltd and Birkmyre Pty Ltd; Non Executive Chairman of the Board of Partners, Mallesons Stephen Jaques; Fellow of the Senate, University of Sydney; Chairman Designate, Australian Graduate School of Management.

**John T. RALPH** - AO, FCPA, FTSE, FAICD, FAIM, FAusIMM, Hon LLD (Melb & Qld)

##### Deputy Chairman

Director and Deputy Chairman since October 1996.

Chairman, Foster's Brewing Group Ltd and Pacific Dunlop Limited; Deputy Chairman, Commonwealth Bank of Australia; Director, BHP Limited, Pioneer International Ltd and The Constitutional Centenary Foundation; President, Australia-Japan Business Co-operation Committee; Member of Board of Melbourne Business School; National Chairman, The Queen's Trust for Young Australians; Chairman of the Australian Foundation for Science.

**W. Frank BLOUNT** - BSc (Elec Eng), MBA, MS Management

##### Chief Executive Officer

Chief Executive Officer since January 1992.

Prior to joining the Telstra Entity, Mr. Blount held Presidential positions with the US telecommunications company, AT&T, in sales and marketing, training and education and network operations.

Mr. Blount has held positions including Chairman, National Technical Institute for the Deaf; Chairman, Rochester Institute of Technology; Chairman, Advisory Board, Georgia Institute of Technology and CEO of the New American Schools Development Corporation. He is a Director of Caterpillar Incorporated, First Union National Bank and Entergy Corporation.

**N. Ross ADLER** - BCom, MBA

Director since October 1996.

Chief Executive Officer and Managing Director, Santos Ltd; Director, Santos Group Companies, Commonwealth Bank of Australia, QCT Resources Ltd and Australian Institute of Petroleum Ltd; Member, Business Council of Australia and Corporations & Securities Panel; Chairman of the Board of the Art Gallery of South Australia; Council Member, The University of Adelaide.

**Anthony J. CLARK** - AM, FCA, FCPA, FAICD

Director since October 1996.

Chartered Accountant; Partner of KPMG, formerly Managing Partner KPMG NSW for six years; Chairman Maritime Industry Finance Company Limited; Deputy Chairman of Australian Tourist Commission.

**Michael H. CODD** - AC, BEc (Hons)

Director since February 1992.

Chancellor, Wollongong University; Director, Qantas Airways Limited, MLC Ltd, MLC Lifetime Ltd and Toogoolawa Consulting Pty Ltd; Director and Deputy Chair Australian Nuclear Science and Technology Organisation (ANSTO) and Menzies Foundation; Member: Advisory Board, IBM Australia Ltd; Advisory Board, Spencer Stuart; Advisory Board, Blake Dawson Waldron; and Board of Advisers Constitutional Centenary Foundation; Senior Adviser Asia-Australia Institute.

**Malcolm G. IRVING** - AM, BCom, Hon DLit

Director since July 1997.

Chairman, Caltex Australia Limited, FAI Life Limited and Australian Industry Development Corporation. He is also a Director of a number of other companies.

## Item 10: Directors and Officers of Registrant

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### **Elizabeth A. NOSWORTHY** - BA, LLB, LLM

Director since December 1991.

Chairman, Port of Brisbane Corporation; Deputy Chairman, Queensland Treasury Corporation; Director, David Jones Limited, Australian National Industries Limited, Brisbane Airport Corporation Limited, GPT Management Ltd and The Foundation for Development Cooperation Ltd; Councillor, National Competition Council and Member, Australian Greenhouse Office Experts Group on Emissions Trading.

### **Christopher I. ROBERTS** - BCom

Director since December 1991.

Chief Executive Officer and Managing Director, Arnotts Limited; Director, Arnotts Group Companies, Transparency International Australia and Juvenile Diabetes Foundation Inc. and Member Advisory Board Australian Graduate School of Management.

### **John W. STOCKER** - MB, BS, BMedSc, PhD, FRACP, FTSE

Director since October 1996.

Director, Cambridge Antibody Technology Group plc, Circadian Technology Ltd, Foursight Associates Pty Ltd; Chief Scientist, Commonwealth of Australia; Chairman, Australian Science Technology and Engineering Council, Grape and Wine Research and Development Corporation and Chiron Technologies Ltd.

### **Stephen W. VIZARD** - AM, LLB, BA, FAICD

Director since October 1996.

Chairman, Artist Services Group; Board Member, Australian Commercial Television Production Fund, Victorian Multimedia Taskforce, State Library of Victoria Foundation; Member of the Committee, Melbourne Cricket Club; President, Council of Trustees for the National Gallery of Victoria.

### **Directors appointed on 8 September 1998:**

#### **Donald McGAUCHIE**

Director since September 1998.

Senior Partner, C&E McGauchie - Terrick West; Director, Australian Centre for International Agricultural Research, Vicgrain Pty Ltd, Victorian Grain Service Pty Ltd; Member, Foreign Affairs Council, Trade Policy Advisory Council, International Policy Council on Agriculture, Food and Trade; Immediate Past President National Farmers Federation.

#### **Cecilia A. MOAR** - Dip Teaching

Director since September 1998.

Graduate of the Australian Rural Leadership Program, Member of the Mallee Catchment Management Authority, Member of the Swan Hill Rural City Development & Marketing Board.

### **Executive Officers who are not Directors:**

#### **Doug Campbell** - BEng

Mr. Campbell was formerly Group Managing Director, Network and Technology of Telstra. He has also been the Deputy Managing Director of Telecom and President of Canadian National Communications. He is a Fellow of the Australian Institute of Company Directors and of the Institution of Engineers, Australia.

#### **Robert Cartwright** - BA (Hons), MBA

Mr. Cartwright worked in the CRA Group of Companies for over 15 years, predominantly in manufacturing with a special focus on change management, operations, finance and strategy. He was formerly President, An Mau Steel, Taiwan and Managing Director, Comalco Rolled Products.

#### **Gerry Moriarty** - BEng (Hons)

Mr. Moriarty has 30 years experience in the telecommunications and broadcasting industries in business leadership, strategic business development, content venture management, major project management, engineering management and technical operations with Telstra, the ABC, TVNZ, Broadcast Communications Ltd and NZBC.

#### **Paul Rizzo** - BCom, MBA

Before joining Telstra, Mr. Rizzo was Chief General Manager, Retail Banking, of the Commonwealth Bank of Australia. He was previously CEO of the State Bank of Victoria, and prior to that, a member of the Executive Committee of Australia and New Zealand Banking Group Limited where he held a number of senior positions over a period of about 25 years.

#### **Peter Shore** - BSc

Mr. Shore was formerly Managing Director of Telstra's International Business Unit and General Manager of OTC's international operations. He has 16 years experience in telecommunications.

#### **Ziggy Switkowski** - BSc (Hons), PhD

Dr. Switkowski has been Chief Executive Officer of Optus and Managing Director of Kodak (Australasia) Pty Ltd. He is a Director of Amcor Limited.

#### **Graeme Ward** - BEc (Hons)

Mr. Ward has extensive telecommunications industry experience, including senior positions in corporate strategy and planning. He currently leads Telstra's relationship with the Commonwealth Government on regulatory, shareholder and industry policy matters and is the Company's prime interface with the industry regulators.

#### **Lindsay Yelland** - BSc

Prior to joining Telstra, Mr. Yelland held numerous positions in the computer industry, including Vice President, Asia-Pacific, Data General Corp and Vice President of Apollo Computer Corporation. Mr. Yelland is a Director of the Australian Information Industry Association.

The business address of each of the above directors and executive officers is c/- the Company Secretary, Telstra Corporation Limited, Level 41, 242 Exhibition Street, Melbourne VIC 3000, Australia.



## Corporate Governance

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The Telstra Board aims for best practice in the area of corporate governance. This section describes the main corporate governance practices in place for the whole of the year ending 30 June 1998 and those which have been introduced more recently.

Telstra's corporate governance practices continue to evolve as the company moves from a Commonwealth Government-owned business enterprise to a major publicly-listed company with a wide shareholder base. While the Government owns more than 50 per cent of the Shares in Telstra the Company will remain subject to various Ministerial and other controls to which other publicly-listed companies are not subject, including a Ministerial power to give Telstra written directions which the Communications Minister believes are in the public interest (Section 9 Telstra Corporation Act 1991). Nevertheless, within these constraints, the Board will continue to strive to achieve best corporate governance practice.

### The Board of Directors

#### The role of the Board

The Board is accountable to shareholders for the business and affairs of Telstra and delegates responsibility for day-to-day management of the company to the Chief Executive Officer.

#### Size and composition of the Board

As at 26 August 1998 there were 11 Directors on the Board - 10 non-executive Directors, including the Chairman, and the Chief Executive Officer.

The maximum number of Directors fixed by Telstra's Articles of Association, in the absence of a resolution of shareholders to the contrary, is 13. A person may be appointed as a Director, either to fill a casual vacancy or as an additional director up to the maximum number, only by the Directors after consulting with the Communications Minister or by Telstra by ordinary resolution in general meeting.

Apart from the Chief Executive Officer, one third of the Directors are subject to re-election by rotation each year. A Director appointed by the Directors is subject to re-election at the next Annual General Meeting.

On 8 September 1998, two additional non-executive Directors, Cecilia A Moar and Donald McGauchie were appointed.

#### The work of the Board

The Board normally meets 11 times each year for scheduled meetings and on other occasions to deal with specific matters which require attention between scheduled meetings.

The regular business considered by the Board includes the following areas:

- Business investments and strategic matters;
- Governance and compliance;
- Chief Executive Officer's report;
- Financial report by the Group Managing Director, Finance and Administration; and
- Business Unit reviews on a rotational basis, ensuring that Directors receive detailed briefings from each of Telstra's senior executives several times during the year.

Directors also liaise with senior management as required.

#### Committees of the Board

To increase its effectiveness, the Board has operated with committees with responsibility for particular areas.

Until July 1998, there were three Board committees as follows:

- **Finance Committee** - The role of this committee was to consider the Group's financial and strategic position, develop appropriate strategies and recommend decisions to the full Board and monitor the financial performance of the Group.
- **Audit & Compliance Committee** - The role of this committee was to provide oversight of the Group's compliance with external and internal obligations, review of the annual audit program and to provide advice to the Board on matters of due diligence, financial systems integrity and financial risks.
- **Appointments & Compensation Committee** - The role of this committee was to consider senior executive remuneration and to review the reward system for executive management within the Group.

Since the end of the financial year, it was decided that the matters previously considered by the Finance Committee would in future be dealt with by the full Board and accordingly the Finance Committee was dissolved. Other changes include:

- The Audit & Compliance Committee's role was expanded to include overseeing Telstra's risk management program.
- The role of the Appointments & Compensation Committee, renamed the Appointments, Nominations & Compensation Committee was expanded to include overseeing the composition of the Board, the performance of the Board and the appointment and remuneration of the Chairman, Directors, Chief Executive Officer and senior executives.

#### Non-executive Directors' remuneration

Remuneration of non-executive Directors is determined by the Board within the parameters approved by shareholders from time to time. The maximum aggregate amount of non-executive Directors' remuneration provided for at present is A\$750,000. This remuneration is for all services provided by the Directors as Directors including service on committees. Directors are also entitled to be reimbursed for reasonable travelling, accommodation and other expenses incurred in travelling to or from meetings of the Board or committees or when otherwise engaged on the business of the Company in accordance with Board policy.

## Corporate Governance

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### Independent professional advice

Individual Directors and Board committees are able to obtain professional advice independent of advice received from management or the Company's professional advisers, obtainable at the Company's cost after consultation with the Chairman. Such advice would be made available to all Directors. Directors also have access to Company employees, advisers and information on request.

### Directors' share dealings

Telstra has in place a share trading policy which prohibits Directors and senior management (and their associates) from engaging in short term trading of the Company's securities and restricts their buying or selling of Telstra securities to the three "window" periods following the release of Telstra's annual results, half-yearly results and the close of Telstra's Annual General Meeting, and at such other times as the Board permits. In addition, Directors and senior management must notify the Company Secretary before they or their close relatives buy or sell Telstra securities. The Company Secretary maintains a register for this purpose.

Furthermore, as required by law, buying or selling of Telstra securities is not permitted at any time by any person who possesses price-sensitive information in relation to Telstra securities.

### Conflicts of interest

The Corporations Law and Telstra's Articles of Association require Directors to disclose any conflicts of interest and to abstain from participating in any discussion or voting on matters in which they have a material personal interest. In addition, the Board has developed procedures to be followed by a Director who believes he or she may have a conflict of interest or material personal interest.

## Item 11: Compensation of Directors and Officers

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For the 1998 fiscal year, the aggregate amount of remuneration earned by the Directors and Executive Officers of Telstra as a group was A\$7,677,165.

This amount consists of:

- A\$513,572 that has been set aside or accrued by Telstra during fiscal 1998 to provide pension and retirement benefits; and
- A\$7,163,593 representing remuneration, other than amounts for pension and retirement benefits.

Executive Officers, as shown under Item 10, participate in two incentive plans and amounts paid and accrued under these plans for fiscal 1998 are included in the above remuneration figures. A general description of the plans is provided under Note 26 to the Financial Statements.

## Item 16: Use of Proceeds

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The Commonwealth received all the net proceeds of the Initial Public Offering payable under the First Instalment. The net proceeds of the Final Instalment will also be received by the Commonwealth. None of the proceeds have been, or will be, received by the Company.