

Operating and Financial Review and Prospects

The following discussion should be read in conjunction with the annual consolidated financial statements, including the notes to those financial statements, which are included with this annual report. Those financial statements have been prepared in accordance with Generally Accepted Accounting Principles in Australia (AGAAP), which differs in certain respects from Generally Accepted Accounting Principles in the United States (USGAAP). A discussion of the principal differences between AGAAP and USGAAP as they relate to us and a reconciliation of the net income and shareholders' equity to USGAAP, is provided in note 30 to our financial statements.

This section includes statements of future expectations and forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those in the forward-looking statements. A discussion of some of the principal risks that could affect our business is presented in this annual report under the heading "Key Information - Risk factors". Also refer to "Key Information - Cautionary statement regarding forward-looking statements".

In this section, we refer to our fiscal years ended 30 June 2001, 30 June 2002 and 30 June 2003 as fiscal 2001, fiscal 2002 and fiscal 2003, respectively, and we have referred to the three fiscal years ended 30 June 2003 as the "three-year period".

Application of critical accounting policies

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Australia. Our significant accounting policies are more fully described in note 1 to our financial statements. The preparation of our financial statements requires management to make estimates and judgements that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. We continually evaluate our estimates and judgements including those related to customer incentives, bad debts, inventories, investments, intangible assets, income taxes, financing activities, restructuring costs, retirement benefits, contingencies and litigation. We base our estimates and judgments on historical experience and on various other assumptions we believe to be reasonable under the circumstances. This forms the basis for making judgements about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates in the event that the scenario on which our assumptions are based proves to be different.

Our accounting policies have been developed over many years as the telecommunications industry and Generally Accepted Accounting Principles or "GAAP" have evolved. As our financial statements are prepared under AGAAP our accounting policies are necessarily compliant with all aspects of AGAAP.

In developing accounting policies, in addition to AGAAP requirements, we also consider telecommunications industry practice in other countries. Further to this, where there is no conflict with AGAAP we also align our accounting policies with USGAAP. This reduces the number of AGAAP/ USGAAP reconciliation differences required to be adjusted in note 30 to our financial statements.

In all material respects our accounting policies are applied consistently across the Telstra group of companies. To the extent that the accounting policies of entities we account for under the equity accounting method differ materially from ours, adjustments are made to the results of those entities to align them with our accounting policies. The critical accounting policies discussed below generally apply to all segments of the Company.

The following are the critical accounting policies we apply in producing our AGAAP financial statements.

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Carrying value of investments, goodwill and other intangible assets

We assess the carrying value of our investments in controlled entities, associates, partnerships and other investments, including acquired goodwill and other intangible assets, for impairment at least bi-annually based on their recoverable amount. Our assessments vary depending on the nature of the particular investment concerned and generally include methodologies such as discounted cash flow analysis, review of comparable entities' revenue or earnings multiples, or in the case of listed investees, monitoring of share prices. These methodologies sometimes rely on factors such as forecasts of future performance and long-term growth rates of the investee, selection of discount rates and appropriate risk weightings, and determination of appropriate comparable entities and multiples. If these forecasts and assumptions prove to be incorrect or circumstances change, we may be required to write down the carrying value of our investments.

The carrying value of goodwill was A\$2,018 million at 30 June 2003, A\$2,063 million at 30 June 2002 and A\$1,548 million at 30 June 2001.

The carrying value of our investments in joint ventures and associated entities and other listed and unlisted entities was A\$255 million at 30 June 2003, A\$1,302 million at 30 June 2002 and A\$1,402 million at 30 June 2001. The reduction in the value of our investments in fiscal 2003 reflects the impact of the write down of our investment in REACH.

The carrying value of our patents, trade marks and licences, brand names and customer bases was A\$1,146 million at 30 June 2003, A\$1,358 million at 30 June 2002 and A\$1,464 million at 30 June 2001.

Based on our most recent assessment of recoverable amount, we believe that as at 30 June 2003 our investments, goodwill and other intangible assets are recoverable at the amounts at which they are stated in our financial statements.

Capitalisation of costs

When we incur costs, we classify them as either operating expenses or capital costs. We expense operating expenses to the statement of financial performance as they are incurred. We only capitalise costs where we consider that they will generate future economic benefits. Capital costs are recorded as assets and shown in our statement of financial position based on the asset class considered most appropriate to those costs. Management judgement is used in determining costs to be capitalised in relation to the following major asset categories:

- **Deferred expenditure**

We defer significant items of expenditure to the extent that they are recoverable from future revenue and will contribute to our future earning capacity. Expenditure is not deferred if it only relates to revenue that has already been recorded. We amortise this deferred expenditure over the average period in which the related benefits are expected to be realised (5 years). Each year we also review expenditure deferred in previous periods to determine the amount, if any, that is no longer recoverable. The amount of deferred expenditure that is no longer recoverable is written off as an expense in the statement of financial performance. Our deferred expenditure after amortisation, including deferred mobile handset subsidies, was A\$796 million at 30 June 2003, A\$819 million at 30 June 2002 and A\$863 million at 30 June 2001.

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- **Capitalisation of software assets developed for internal use**

We capitalise direct costs associated with the development of network and business software for internal use where we regard the success of a project to be probable. Management applies judgement to assess this probability.

We capitalise costs such as external direct costs of materials and services consumed, payroll and direct payroll-related costs for employees and contractors directly associated with a project and borrowing costs incurred while developing the software.

Our capitalised software assets for internal use, after amortisation, were A\$2,001 million at 30 June 2003, A\$1,804 million at 30 June 2002 and A\$1,625 million at 30 June 2001. If management has incorrectly assessed the probability of the success of a project we may be required to write down the value of the software assets we have recorded.

- **Indirect overheads and borrowing costs related to construction activities**

The cost of our constructed property, plant and equipment includes purchased materials, direct labour, direct and indirect overheads and borrowing costs. Indirect overheads are generally attributable to the construction of assets and do not usually vary with construction activity volumes. Examples of indirect costs include planning and design of construction projects and the management of construction contracts. Where the role of a part of the work force is predominantly management, design and construction of communication assets, we allocate all indirect overheads associated with the operations and management of that work force to the projects undertaken by them. Where some projects undertaken by an organisational area do not relate to capital projects, indirect overheads are only allocated to capital projects based on the proportion that capital projects make up of the total costs of that organisational area. The remaining costs of that work force are expensed as incurred.

Borrowing costs are capitalised on all assets constructed. We do not specifically borrow to fund construction of assets due to the constant nature of our construction process. As a result the allocation of borrowing costs to these assets is general and does not reflect funds specifically borrowed for each asset.

Refer to “Operating and Financial Review and Prospects - Critical accounting policies applied in our USGAAP reconciliation” for discussion on amounts capitalised under USGAAP which have not been historically capitalised under AGAAP.

Carrying value and depreciation of property, plant and equipment assets and software assets developed for internal use

Property, plant and equipment assets made up 65% of our total assets in fiscal 2003, 62% in fiscal 2002 and 61% in fiscal 2001. We therefore consider our accounting policies around the carrying value and depreciation of these assets to be critical. We have adopted the cost basis of recording our property, plant and equipment, rather than the fair value basis. We assess the recoverable amounts of our fixed assets bi-annually, based on expected future net cash flows discounted to their net present value. Where a group of assets can be shown to be working together to generate net cash flows, this assessment is performed over the group of assets, rather than individually. If our estimates of future cash flows prove to be incorrect we may be required to write down assets in the future. In applying this policy we have not written down significant amounts of property, plant and equipment assets during the past three years.

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In addition, we assess the appropriateness of the service lives of our property, plant and equipment assets on an annual basis. This includes a comparison against our service life estimates and international trends for other telecommunications companies. In relation to communications assets, this assessment includes a determination of when the asset may be superseded technologically. If our assessments of useful lives prove to be incorrect we may incur either higher or lower depreciation charges in the future or, in certain circumstances, be required to write down these assets.

Software developed for internal use is an exception to the above annual revision of service lives. With reference to global industry practice it was judged that for administrative simplicity, internally developed software would, on average, have a useful life of 6 years. This has been increased from 5 years in fiscal 2002 and 2001 because of reassessed useful lives for some major software assets.

Valuation of Receivables

We maintain provisions for doubtful debts based on an estimate of the inability of our customers to pay amounts due to us for services rendered to them. These provisions are based on historical trends and management's assessment of general economic conditions. If the financial condition of our customers deteriorates these provisions may not be sufficient and may lead to an increase in bad and doubtful debt expenses. We have no reason to believe that the provisions we have raised will not sufficiently cover bad debts arising out of the receivables we currently have on hand.

Our provision for doubtful debts was A\$199 million at 30 June 2003, A\$221 million at 30 June 2002 and A\$192 million at 30 June 2001. Trade debtors before any provision for doubtful debts were A\$2,436 million at 30 June 2003, A\$2,535 million at 30 June 2002 and A\$2,799 million at 30 June 2001.

Revenue Recognition

We recognise revenues when they are earned through the delivery of a product or service. Telecommunications revenues are recorded at amounts billed plus an appropriate accrual for calls made since the last billing date. Revenues that relate to more than one period, such as installation and connection fees, are deferred and amortised into sales revenue over the expected period of benefit in accordance with SAB 101. The majority of our deferred revenue relates to the Telstra Consumer and Marketing business unit. Deferred revenue comprises deferral of revenue from Sensis relating to White Pages[®] and Yellow Pages[®] products, deferral of connection fees over the period of service and deferral by our billing system of telephone rental paid in advance.

Accrued revenue comprises mainly the recognition of unbilled amounts relating to telephone usage, service and maintenance. Our billing system generates most of the accrued revenue and automatically accrues revenue for billing cycles that remain unbilled at the end of each month.

Critical accounting policies applied in our USGAAP reconciliation

We disclose our AGAAP/USGAAP reconciliation differences in detail in note 30 to our financial statements. The adjustments that we believe have the most significant impact on the USGAAP reconciliation are as follows.

Capitalisation of indirect overheads and borrowing costs before 1 July 1996 for property, plant and equipment

Under AGAAP we did not capitalise indirect overheads and borrowing costs pre 1 July 1996. However under USGAAP we were required to retrospectively reflect the policy as if we had always capitalised indirect overheads and borrowing costs. This involved the use of estimation techniques and the reconstructing of records as far back as 1980. Due to the fact that we used estimation techniques to reconstruct the balances,

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the actual balance may have been greater or less than the adjustment calculated. This impacts the addition to property, plant and equipment adjustment made each year and the resulting annual amortisation expense.

As at 30 June 2003, property, plant and equipment with a net book value of A\$659 million has been capitalised for USGAAP purposes, which was not capitalised under AGAAP.

Defined benefit plan prepaid pension asset and retirement benefit gain

We engage an actuary to assist in the determination of our prepaid pension asset and retirement benefit gain. The following assumptions are used to calculate the adjustment:

- discount rate;
- rate of increase on salary levels; and
- expected long-term rate of return on assets.

These assumptions have a significant impact on the calculations and adjustments made and are disclosed in note 30(f) to our financial statements.

There is no requirement under AGAAP to recognise these assets or gains.

Use of Telstra applicable yield curves for the purposes of calculating the fair value of our derivative financial instruments

We are not required to recognise the fair value of our derivative financial instruments in the statement of financial position for AGAAP. Under USGAAP we are required to recognise the fair value of our derivative financial instruments in the statement of financial position. We calculate fair value using market adjusted yield curves to take into consideration the cost of funding for Telstra. We adjust the base curves (which are sourced directly from the market via Reuters) to reflect Telstra's borrowing margins. Telstra's borrowing margins for each currency and maturity are derived from secondary market trading levels of our bonds issued in domestic and offshore markets. Where our bonds are not widely traded the borrowing margin is derived using advice from market dealers who are close to the market and can estimate the level at which Telstra could currently borrow. If market yield curves were applied which did not adjust for Telstra's borrowing margin, this would result in different fair values being recognised.

Use of certain estimates and assumptions concerning the calculation of compensation expense relating to remuneration based share plans

Under AGAAP we only expense options and employee shares when it is certain that there is a cost that will be realised by Telstra. Under AGAAP we do not expense the fair value of our executive option plans or employee share plans, however we do expense the fair value of our employee share plans and executive option plans for USGAAP purposes each year. For fiscal 2003, this did not result in any additional expenditure. However, for USGAAP purposes we expensed an additional A\$41 million in fiscal 2002 and A\$9 million in fiscal 2001. The reason for not expensing an additional amount in fiscal 2003 was that the cost incurred and recognised under AGAAP equated to the expense determined under USGAAP.

Our compensation expense is calculated by using various assumptions and variables. For example:

- risk free rates;
- dividend yield;
- expected stock volatility;
- expected life of the options;

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- probability that performance hurdles will be met; and
- estimated forfeiture.

These assumptions have a significant impact on the calculations and adjustments made and are disclosed in note 30(m) to the financial statements.

Changes in accounting policies

Australian Accounting Standard AASB 1012 “Foreign Currency Translation” was changed from fiscal 2002 to fiscal 2003 and now requires us to separately report cross currency swaps designated as hedges of our foreign denominated borrowings as financial assets and financial liabilities. Previously the swap balance was reported as part of borrowings. This change reflects the fact that the swap contracts, although specifically hedging our borrowings, are made with different counterparties and as such are separate financial assets and liabilities in their own right. The individual swap contracts are still netted where the right of set-off legally applies.

The change in accounting policy has no impact on our statement of financial performance or our net asset position. However, as at 30 June 2003, we reported cross currency swap receivables of A\$283 million and cross currency swap liabilities of A\$426 million that would previously have been reported as a net liability of A\$143 million.

In fiscal 2001 we adopted US Securities Exchange Commission Staff Accounting Bulletin No.101 (SAB 101) “Revenue Recognition in Financial Statements”, the effect of which is described below in “Results of operations”, “Operating revenue” and “Operating expenses”.

Further information regarding the changes in our accounting policies is provided in note 1.2 to our financial statements.

Overview of key factors affecting our business and financial performance

During the three-year period, we have increased our revenues from mobile telecommunications and value-added services. We are continuing to implement operational changes to improve our productivity and operating efficiency. We have also increased our focus on wireless data and broadband applications and content.

Most of our revenues are generated from basic access, fixed and mobile call charges, data and internet services, directory services and intercarrier services. Our controlled entities contributed 9.0% of our total sales revenue in fiscal 2003, 9.9% in fiscal 2002 and 7.2% in fiscal 2001.

Looking forward we are focusing on three areas as opportunities to increase our revenues:

- **Domestic retail operations:** Growth in our revenue from this market has been limited by competition. This market remains our main focus and is the most significant part of our company, providing us with the cash flow to continue to invest and develop our business. We are improving our marketing and our customer service in this area by:
 - offering a broad range of product packages that includes traditional products packaged with new products;
 - re-balancing our prices to reduce per call charges, while increasing basic access fees;
 - providing high speed internet access products;
 - continuing to increase the number of mobile service users; and
 - providing more products on our mobile networks.

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- **Applications and content:** We have continued to grow our White Pages® and Yellow Pages® OnLine directory businesses. As telecommunications, computing and media technologies converge, we intend to focus on enhancing our capabilities to provide new and innovative application and content services and to expand further into these converged markets. We intend to enhance our capabilities across a number of content services and access and delivery technologies to position ourselves to take advantage of opportunities in these new markets as they unfold.
- **International expansion:** We intend to expand our business and grow revenues and profits outside Australia, particularly in the Asia-Pacific region. We will focus on improving returns from our existing international investments in REACH, CSL and TelstraClear. We will also continue to explore other selected international investment, acquisition and alliance opportunities.

In recent years, we have devoted substantial capital to upgrade our telecommunications networks, eliminate components that were no longer useful and improve the systems used to operate our networks. As an example, in fiscal 2001 we closed our analogue mobile network and in fiscal 2002 continued the rollout of our CDMA mobile network.

We have also focused on our operating efficiency, our efforts have included:

- streamlining our systems and processes, including the adoption of the Six Sigma management tools and techniques;
- improving work practices; and
- systematically reviewing our cost structures and the way we deliver service to our customers.

So far these initiatives have allowed us to achieve cost efficiencies in many areas, while at the same time improving customer services. They have also resulted in a substantial reduction in the number of our full-time employees.

During the three-year period, we reduced the number of our domestic full-time employees from 44,874 in fiscal 2001 to 37,169 in fiscal 2003. Domestic full-time employees do not include employees in our offshore entities or part time and casual employees, but include expatriate staff in overseas controlled entities. We refer to the total of our domestic and offshore full-time, casual and part-time employees as full-time employees and equivalents. During the three-year period full-time employees and equivalents reduced from 48,317 to 42,064. This came at a cost of A\$281 million in redundancy and restructuring expenses for fiscal 2003.

We are committed to continuing our review of areas of the business where cost efficiencies can be gained, while simultaneously maintaining or improving customer service. Opportunities to achieve this include:

- obtaining better value from our capital expenditure;
- rationalising our various IT and network platforms;
- improving network efficiency; and
- managing total labour costs more efficiently.

In February 2001, we sold our global wholesale business to REACH, our 50% owned Asian joint venture with PCCW. Revenue from this business is now recorded by REACH. At the same time, we acquired a 60% interest in CSL which is one of Hong Kong's leading wireless businesses. In June 2002 we acquired an additional 40% in CSL and now own 100% of the CSL group. In fiscal 2003, CSL performed well despite difficulties in the Hong Kong market such as a mobile price war and SARS epidemic. However, we wrote down our investment in

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REACH to nil due to its operating in a difficult environment with falling voice and data rates and not achieving a sufficient return on investment.

Our other major acquisition in the three-year period has been TelstraClear, the second largest full service carrier in New Zealand. Details of our acquisition are available under 'International Business Ventures'. This investment has demonstrated revenue growth over fiscal 2002 and 2003, and while it is currently in a loss position, margins are improving and the business is focussing on achieving operational efficiencies.

Outlook

We expect our financial results in fiscal 2004 and future years to be affected by the following principal factors:

- continuing rapid changes to our competitive environment as competition intensifies and our regulators amend the applicable laws and regulations to continue opening the markets in which we compete;
- actions taken by our regulators and by the Commonwealth Government to control our prices and mandate services that we are required to provide;
- our ability to introduce new value-added products and services to compensate for lower prices and volumes in our traditional product lines;
- the ongoing results of our investments in REACH, CSL and TelstraClear;
- our ongoing efforts to control our costs and improve our productivity; and
- economic conditions globally and in Australia.

Throughout the three-year period the Federal Government has reiterated its commitment to the sale of the Commonwealth's remaining share in Telstra. The full privatisation of Telstra will depend upon the passing of appropriate legislation through Parliament. If approved and implemented, the full privatisation of Telstra would be expected to reduce current restrictions, such as our ability to raise equity capital and use our equity for acquisition opportunities. See "The Commonwealth as shareholder" under "Major shareholders and related parties".

Through our revenue growth and expense containment initiatives, we expect to maintain strong cash flows from our operating activities. We expect that we will be able to fund planned ongoing operational capital requirements in our networks and systems through our operating cash flows. We are actively considering ways to use the strong cash flows that we generate and to this end we will:

- continue to consider strategic acquisitions, alliances and other investment opportunities, some of which may be substantial, although we intend to maintain a conservative net debt to total capital financing ratio of 40-45% and strong interest to EBITDA cover of 10 times; and
- consider returning capital to our shareholders.

On 28 August 2003, we announced plans, subject to regulatory approvals, to buy back between A\$800 million to A\$1 billion worth of the Company's shares. This off-market equal access share buyback is expected to improve our earnings per share and to increase returns to shareholders. The share buyback is being undertaken as part of the board's program of capital management and the return of this capital will not prejudice the ability of the Company to take advantage of profitable opportunities. The buyback is expected to be completed by the end of December 2003.

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Competitive and Regulatory Environment

Refer to the “Competition and Regulation” section of the annual report for information regarding the competitive and regulatory environments in which we operate.

Results of operations

Table 1 – Results of operations

	Year ended 30 June				
	2003	2002	2001	2003/2002	2002/2001
	(in A\$ millions)			(% change)	
Sales revenue	20,495	20,196	18,679	1.5%	8.1%
Other revenue	1,121	606	4,304	85.0%	(85.9%)
Total operating revenue (excluding interest revenue).	21,616	20,802	22,983	3.9%	(9.5%)
Operating expenses (excluding interest expense, depreciation and amortisation)	11,421	11,238	12,966	1.6%	(13.3%)
Share of net equity accounted losses	1,025	81	183	1165.4%	(55.7%)
Earnings before interest, income tax expense, depreciation and amortisation (EBITDA) ⁽¹⁾	9,170	9,483	9,834	(3.3%)	(3.6%)
Depreciation and amortisation	3,447	3,267	2,871	5.5%	13.8%
Earnings before interest and income tax expense (EBIT) ⁽¹⁾	5,723	6,216	6,963	(7.9%)	(10.7%)
Net borrowing costs	795	770	666	3.2%	15.6%
Profit before income tax expense	4,928	5,446	6,297	(9.5%)	(13.5%)
Income tax expense	1,534	1,796	2,236	(14.6%)	(19.7%)
Net profit	3,394	3,650	4,061	(7.0%)	(10.1%)
Outside equity interests in net profit)/loss	35	11	(3)	218.2%	(466.7%)
Net profit available to Telstra Entity shareholders	3,429	3,661	4,058	(6.3%)	(9.8%)

⁽¹⁾ *Earnings before interest, income tax expense, depreciation and amortisation (EBITDA) reflects the Company's net profit prior to including the effect of interest revenue, borrowing costs, income taxes, depreciation and amortisation. Earnings before interest and income tax expense (EBIT) reflects the Company's net profit prior to including the effect of interest revenue, borrowing costs and income taxes. The Company believes that EBITDA and EBIT are relevant and useful financial measures used by management to measure the Company's operating profit. The Company's management uses EBITDA and EBIT, in combination with other financial measures, primarily to evaluate the Company's operating performance before financing costs, income tax and non-cash capital related expenses in consideration of the capital intensive nature of the Company's business. EBITDA is a useful supplement to net income in understanding cash flows generated from operations that are available for income taxes, debt service and capital expenditures. EBITDA and EBIT are not USGAAP measures of income or cash flow from operations and should not be considered as an alternative to net income as an indication of the Company's financial performance or as an alternative to cash flow from operating activities as a measure of the Company's liquidity. In addition, the Company believes that EBIT and EBITDA are useful to investors because analysts and other members of the investment community largely view EBITDA and EBIT as key and widely recognised measures of operating performance.*

Over the three-year period our operating results were impacted by a number of one-off items which have given rise to movements in the overall net profit before income tax expense. These items include:

- the sale of our global wholesale business and certain controlled entities to REACH in February 2001. We recognised 50% of the profit on this sale in February 2001 (A\$852 million) and deferred the balance, to be recognised over 20 years. We recognised A\$18 million of this deferred profit for 5 months in fiscal 2001 and A\$43 million in fiscal 2002 and fiscal 2003;
- our fiscal 2001 results include net profit before income tax expense of A\$160 million from our global wholesale business for the 7 months to 31 January 2001. The results of this business are now recorded by REACH and we equity account our share of the results of REACH;

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- effective February 2001 we acquired a 60% controlling interest in CSL. We have consolidated the operating results from CSL in our results from this date. Based on an independent valuation of our interest in CSL, we recognised a decline in its value by writing down our investment in CSL by A\$999 million in June 2001;
- on 28 June 2002, we increased our share of CSL to 100%. The transaction involved our acquisition of the remaining 40% interest in CSL that we did not previously own and the issue of a US\$190 million mandatorily converting secured note by PCCW, in exchange for the redemption of the US\$750 million convertible note previously issued by PCCW. Prior to redemption, we valued this convertible note on a yield to maturity basis at US\$750 million and adjusted the value in our financial statements accordingly. The reduction in value of the note of A\$96 million was expensed in fiscal 2002;
- the redemption of the US\$190 million PCCW convertible note in fiscal 2003, to the value of US\$143m, and the use of the proceeds to enter a capacity prepayment agreement with REACH;
- the one-time benefit of A\$725 million in other revenue in fiscal 2001 arising from the release from our obligations under the Telstra Additional Contributions agreement to the Telstra Superannuation Scheme;
- we began applying SAB101 revenue recognition rules in the second half of fiscal 2001. This change in accounting policy decreased our net profit before taxation by A\$219 million in fiscal 2001 (A\$204 million related to periods prior to fiscal 2001). This was made up of:
 - a decrease in operating revenue of A\$779 million as shown in each of our products affected by the change, in “Operating revenue”; and
 - a decrease in operating expenses of A\$560 million, as discussed further in “Operating expenses”;
- substantial restructuring expenses were incurred over the three-year period, A\$281 million in fiscal 2003, A\$289 million in fiscal 2002 and A\$44 million in fiscal 2001;
- in December 2001 we increased our ownership interest in TelstraSaturn Limited (TelstraSaturn) and began consolidating its results. At the same time TelstraSaturn acquired CLEAR Communications Limited (CLEAR Communications) and its name was changed to TelstraClear Limited (TelstraClear). In fiscal 2001, our equity accounted share of TelstraSaturn’s loss for the year ended 30 June 2001 was A\$85 million. The consolidated net loss before taxation in relation to TelstraClear for the 7 months ended 30 June 2002 was A\$110 million, with an equity accounted share of TelstraSaturn’s loss for the 5 months to December 2001 of A\$75 million, including A\$48 million in relation to our share of restructuring costs. In fiscal 2003, TelstraClear generated a loss before and after tax of A\$123 million;
- we included a profit on sale of investments in Computershare Limited of A\$245 million in fiscal 2001;
- we wrote down our investment in REACH during fiscal 2003 resulting in a charge to profit and loss of A\$965 million as strong competition and excess capacity in the market has impacted the recoverability of our investment, refer to ‘International Business Ventures’ for more detail; and
- we sold a number of buildings during fiscal 2003 which contributed A\$131 million to profit.

Telephony products have historically generated most of our operating profit and have been more profitable than our non-telephony products such as data. Following strong growth in fiscal 2001 data and internet services revenue declined in fiscal 2002 in a softer overall market, but displayed signs of stabilisation in fiscal 2003.

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Telstra is required to deliver the USO and DDSO. Our ongoing requirement to deliver the USO and DDSO to all Australians continues to impact adversely on our profitability. Delivery of the USO and DDSO involves significant expenditures which would otherwise not be incurred. The Government has limited the amounts we can charge our customers for these services and hence a significant shortfall arises each year. This shortfall is to be funded by participants in the telecommunications industry. However, the Government has limited the contributions we may receive from the other participants towards the net cost of providing the USO and DDSO. See “Competition and Regulation – Regulation” for more detail.

As competition has intensified during the three-year period, the volume of telecommunications services purchased in Australia has increased and the range of products and services offered has continued to expand. We have greater opportunity to increase wholesale revenue by providing services to other carriers and carriage service providers. However, we expect to continue to lose market share in some of our retail markets as a result of increasing competition.

Refer to “Income tax expense” for discussion on our income tax expense over the three-year period.

Operating revenue

In the following discussion, we analyse revenue for each of our major products and services. The principal areas of strong operating revenue growth over the three-year period were:

- mobile services;
- fixed-to-mobile;
- advertising and directories; and
- revenue from various controlled entities.

Over the three-year period, we have continued our program of price re-balancing which commenced in fiscal 2000. We increased basic access charges and reduced local, national and international long distance call charges. At the same time, competition has continued to intensify during the three-year period and we have lost market share in some of our retail products as a result of this. We have seen a continued shift in growth from our traditional retail operations to services such as mobiles and new data and internet products.

We expect that there will be continued competitive pressure in some of our traditional product areas, as competition becomes more intense in the future. This is reflected in our overall revenues in fiscal 2003 being relatively flat. However, the volume of telecommunications services purchased in Australia has increased and the range of products and services offered continues to expand and we expect our operating revenue to continue to benefit from this.

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Table 2 - Operating revenue by product and service category, including percentage of total operating revenue contributed by each product and service category

	Year ended 30 June					
	2003		2002		2001	
	(in millions, except percentage of revenue)					
	A\$	% ⁽²⁾	A\$	% ⁽²⁾	A\$	% ⁽²⁾
Basic access	3,091	14	2,880	14	1,955	8
Local calls	1,567	7	1,643	8	1,915	8
PSTN value added services	272	1	261	1	263	1
National long distance	1,162	5	1,216	6	1,267	5
Fixed-to-mobile	1,517	7	1,419	7	1,287	6
International direct	307	1	336	1	338	1
Mobile services	3,227	15	3,242	16	2,906	13
Mobile handsets	381	2	226	1	213	1
Data	1,053	5	1,051	5	1,192	5
ISDN (access and calls)	951	4	1,037	5	1,094	5
Internet and IP Solutions	802	4	605	3	425	2
Sensis (advertising and directories)	1,217	6	1,135	5	909	4
Customer premises equipment	202	1	220	1	274	1
Intercarrier services	1,170	6	1,124	5	1,132	5
Inbound calling products	494	2	562	3	657	3
Solutions management	487	2	477	2	428	2
Various controlled entities	1,836	9	2,001	10	1,342	6
Other sales and services	759	4	761	4	1,082	5
Sales revenue	20,495	95	20,196	97	18,679	81
Other revenue ⁽¹⁾ (excluding Interest income)	1,121	5	606	3	4,304	19
Total operating revenue (excluding interest income)	21,616	100	20,802	100	22,983	100

⁽¹⁾ Other revenue includes revenue from sale of assets/investments, dividends received/receivable and miscellaneous revenue. Interest received/receivable is included in net interest. Refer Table 25.

⁽²⁾ Represents percentage of total operating revenue contributed by each product and service category.

Accounting policies - SAB 101

In fiscal 2001, we adopted SAB 101 "Revenue Recognition in Financial Statements" in our Australian financial statements to ensure that we have consistent revenue recognition policies. SAB 101 provides more detailed guidance to the timing of revenue recognition than AGAAP. As a result of the adoption of SAB 101 we reviewed our revenue streams and determined that we needed to change our revenue recognition policies for basic access, mobiles and directories. We now only recognise revenue when a service has been provided. We have also deferred the costs we incur in providing the services relating to this revenue. We were required to review the revenue and expenses deferred or recognised in prior periods and determine the effect of adopting SAB 101 on periods prior to fiscal 2001 and the effect in fiscal 2001.

In accordance with Australian Accounting Standards the effect of the adoption of SAB 101 was brought to account in fiscal 2001. The effect on the revenue and expenses from these products is discussed below in the section relating to each product and in "Operating expenses". For more information on the effect of this change in accounting policy see note 1.2 to our financial statements.

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Categorisation of our operating revenue

We categorise revenue from the products and services we sell to wholesale customers depending on the nature of the product or service. For example, we categorise operating revenue from interconnect and CDMA resale services as intercarrier services revenue. On the other hand, we categorise operating revenue from other resale services according to the product or service resold.

We are actively promoting alternative access services that are faster and have more capabilities than our basic access service. As more of our customers purchase these alternative services, operating revenue will move from one category to another. For example, as our customers switch from buying basic access services to buying other forms of access services, such as ISDN and ADSL, operating revenue from some customers will shift from the basic access category to the data and internet services category.

The rates we charge our customers are subject to regulated price caps

The rates we charge our retail customers for most of our telephony products are subject to price controls. These controls impose caps based on annual increases in the consumer price index for the previous year less, in some cases, a specified percentage. If the annual increase in the consumer price index is less than the percentage specified we must reduce our prices. The retail price controls that apply from fiscal 2003 to fiscal 2005 include a cap of CPI less 4.5% on a group of local calls, long distance calls, international calls and fixed to mobile calls. In addition, as we reduce our average local call prices in areas where competition exists or is likely to exist, we are required by regulation to reduce local call prices in other areas of Australia in the following year. In addition, our local call prices in all areas of Australia must not exceed the current A\$0.22 (GST included) per call price cap, except for calls from payphones which are capped at A\$0.40 (GST included) per call, or in a plan for which the line rental is lower than standard.

In recent years we have reduced prices for a number of our products and services ahead of the rate of reduction required under the regulations.

Amendments to the price control regulations in fiscal 2000 allowed us to re-balance our access and calling charges, which we did in March 2000 and continued with the introduction of a number of calling plan options during the three-year period.

Basic access

Our basic access revenue includes monthly rental fees, installation charges and connection charges, from telephone service connections between a customer's premises and our PSTN network. It excludes our internal charges to calling products for the use of our network. Basic access revenues are affected by:

- housing growth;
- general economic conditions;
- competition;
- demand for telephone services and additional lines;
- customers moving to our other higher value access services, such as ADSL and ISDN; and
- pricing changes.

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Table 3 - Basic access revenue

	Year ended 30 June				
	2003	2002	2001	2003/2002	2002/2001
	(in millions)			(% change)	
Retail	2,677	2,521	1,634	6.2	54.3
Domestic wholesale	414	359	321	15.3	11.8
Basic access revenue	A\$3,091	A\$2,880	A\$1,955	7.3	47.3
Basic access lines in service at year end ⁽¹⁾					
Residential	6.15	6.35	6.27	(3.1)	1.3
Business	2.60	2.72	2.83	(4.4)	(3.9)
Sub-total	8.75	9.07	9.10	(3.5)	(0.3)
Domestic wholesale	1.56	1.33	1.36	17.3	(2.2)
Total access lines in service	10.31	10.40	10.46	(0.9)	(0.6)

Note: statistical data represents management's best estimates.

⁽¹⁾ Excludes basic access lines for our internal use.

Our basic access revenue in fiscal 2001 included a negative adjustment of A\$539 million to reflect the effect of SAB 101 on periods prior to fiscal 2001. The adjustment reflected the deferral of revenue associated with new connections and in-place services for our retail customers. Under SAB 101 this revenue is recognised over the average life per customer account for access to our network, which is 5 years. Excluding this negative adjustment from fiscal 2001, our basic access revenue for fiscal 2001 would have been A\$2,360 million.

Our operating revenue from basic access services (excluding the impact of SAB 101) increased in both the retail and domestic wholesale markets over the three-year period, primarily as a result of access price rebalancing, first introduced in March 2000. The increases in our basic access fees were generally offset by lower local call charges and some capped long distance calls. Under the new basic access pricing structure we introduced pricing packages. We charge our residential and business customers different basic access rates depending on the package chosen. For the most part wholesale customers receive the standard (unpackaged) basic access service rates (with the "business" and "residential" differentiation still applying).

Our operating revenue from basic access services and our basic access lines in service during the three-year period was also affected by competition. While these competitive forces have resulted in a shift from retail to wholesale access lines in fiscal 2001, we acquired a number of retail customers in June 2001 following the collapse of one of our competitors, One.Tel, which partially offset this impact and resulted in our number of lines in fiscal 2001 being relatively high. In fiscal 2002 the number of residential basic access lines increased in response to attractive packaging and growth in the housing sector. However, in fiscal 2003, strong competition and migration to alternative products, such as internet and mobiles, resulted in a decline in the number of residential lines in service. The increase in business access revenue in fiscal 2003 was primarily due to price rebalancing.

Retail basic access lines increased in fiscal 2001 and decreased in fiscal 2002 and fiscal 2003. The increase in fiscal 2001 related to our acquisition of One.Tel's customers, after its collapse in May 2001. The decreases in fiscal 2002 and 2003 reflected some business customers switching to direct connections with our competitors and others migrating to other Telstra products.

Domestic wholesale basic access revenue increased during the three-year period, reflecting the increased penetration of our competitors in the basic access market.

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During the three-year period our basic access revenues have also been affected by increased penetration of pricing packages. We have introduced various basic access packages, which have had a positive effect on our basic access revenue growth, despite an overall decrease in basic access lines in service. Some of these price initiatives include:

- introduction of Telstra HomeLine™ Options in February 2001;
- introduction of Telstra BusinessLine™ packaging in June 2001;
- increases in Telstra HomeLine™ access prices and new Telstra BusinessLine™ customer access prices from September 2001; and
- increases in existing Telstra BusinessLine™ customer access prices from February 2002.

The bundling of products encourages customers to review their choices and may encourage them to either stay with us as their sole service provider or come back into our retail base of customers.

Local calls

Our local call revenue comes from our local call charges and from billable value-added services such as voicemail, call waiting, call forwarding, call conferencing and our call return feature. For the most part we charge for local calls without a time limit. Our operating revenue from local calls generally varies with changing general economic conditions, the number of basic access lines in service, customer choice of product and price changes. Our local call revenue is also affected by customers moving from our basic access service to our enhanced access services, such as ISDN, and increasing their use of internet services. It is also impacted by customers migrating usage to mobile and fixed-to-mobile calling.

Table 4 – Local calls

	2003	2002 (in millions)	Year ended 30 June		
			2001	2003/2002 (% change)	2002/2001 (% change)
Local call revenue					
Retail	1,348	1,413	1,643	(4.6)	(14.0)
Domestic wholesale	219	230	272	(4.8)	(15.4)
Sub-total	1,567	1,643	1,915	(4.6)	(14.2)
Retail	240	230	231	4.3	(0.4)
Domestic wholesale	32	31	32	3.2	(3.1)
Sub-total	272	261	263	4.2	(0.8)
Total local call revenue.	A\$1,839	A\$1,904	A\$2,178	(3.4)	(12.6)
Number of local calls	9,794	10,269	10,696	(4.6)	(4.0)

Note: statistical data represents management's best estimates.

Retail revenue for local calls has been negatively affected by price decreases, primarily as a result of price re-balancing between our products. In addition, competition through local call resale has also impacted our revenues. Over the three-year period we have decreased local call prices as an offset to higher basic access fees. During fiscal 2003, reduced rate neighbourhood calls were eliminated for Telstra BusinessLine™ Complete, Telstra Homeline™ Complete and Telstra Homeline™ Plus customers, and regular local call charges were reduced from 22c to 20c for Telstra Homeline™ Complete customers. Generally call volumes have continued to fall over the three-year period, reflecting the impact of customers migrating to other products, such as mobile and fixed-to-mobile calling and internet-based products. This is highlighted by the

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fact that SIO's have decreased by only 0.9% over fiscal 2003, while local call revenue decreased by 4.6%, as did the number of local calls made.

Our revenue from value added services has increased in the retail area due particularly to services such as Call Return, which allows customers to listen to the number of their last unanswered call, and Call Number Display, which enables customers to see the number of the caller on a display screen on their telephone handset. Call Return averages between 11 million and 13 million usages per month and the cost of the service to customers was increased in August 2002. Call Number Display subscription costs (single or package) were also increased during 2003. In addition there has been greater growth than forecasted in SIOs on packages since December 2002 due to further emphasis of product in sales and promotional activities.

National long distance calls

Our operating revenue from national long distance calls consists of revenue from national long distance calls made from our PSTN network to a fixed network.

We generally charge for national long distance calls based on the time of day, day of week, destination and duration of the call, but packages are also offered on a capped price basis. A variety of promotions and pricing options are offered to encourage our customers to use our service and to inform them about the price and value of our service, such as the "1c Saturday" promotion where calls to long distance locations are capped at 1c per minute. The majority of our operating revenue from national long distance calls comes from our residential and small business customers.

General economic conditions and customer perceptions about the cost and value of our service, relative to competitor alternatives, largely drive our national long distance call revenue. Falling prices and price rebalancing has enabled us to maintain a reasonably consistent level of volume in minutes of calls. However competitive activity continues to negatively affect our national long distance call revenue, directly through override and preselection, and indirectly through competition for access lines.

Table 5 - National long distance calls

	Year ended 30 June				
	2003	2002	2001	2003/2002	2002/2001
	(in millions)			(% change)	
Retail	1,156	1,208	1,252	(4.3)	(3.5)
Domestic wholesale	6	8	15	(25.0)	(46.7)
National long distance call revenue	<u>A\$1,162</u>	<u>A\$1,216</u>	<u>A\$1,267</u>	(4.4)	(4.0)
National long distance call minutes	9,161	9,170	9,082	(0.1)	1.0

Note: statistical data represents management's best estimates

Our operating revenue from national long distance calls declined during the three-year period, primarily due to:

- capping of prices for some national long distance calls, as part of our price rebalancing strategy. Capped call prices decreased in each of the last three fiscal years, which was partially offset by an increase in the long distance call connection cost;
- increased take up of rebalanced packages with capped calls by customers;
- increased levels of pensioner discounts offered;

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- loss of customers through increased competition in the local call market as customers who change their provider for local call services tend to select the same provider for long distance services; and
- customers using alternative products, such as fixed-to-mobile, mobile and internet-based products.

To address competition we have introduced competitively priced packages. However, with the continued strong growth of mobiles in the Australian market, we expect national long distance call revenue to continue to be negatively impacted by customer migration to mobile services and increased fixed-to-mobile calls. This revenue will also continue to be impacted by further price rebalancing.

Fixed-to-mobile calls

Our fixed-to-mobile revenue is generated by calls made on our PSTN network to a mobile network. The growth of the Australian mobile telecommunication market has driven revenue growth in this product category.

Table 6 - Fixed-to-mobile calls

	Year ended 30 June				
	2003	2002 (in millions)	2001	2003/2002 (% change)	2002/2001 (% change)
Retail	1,501	1,401	1,261	7.1	11.1
Domestic wholesale	16	18	26	(11.1)	(30.8)
Fixed-to-mobile call revenue	A\$1,517	A\$1,419	A\$1,287	6.9	10.3
Fixed-to-mobile call minutes	3,944	3,691	3,268	6.9	12.9

Note: statistical data represents management's best estimates

On 1 October 1999, fixed-to-mobile preselection was introduced, whereby the carriage service provider selected by a customer for national long distance calls automatically became the customer's provider for fixed-to-mobile calls.

In fiscal 2002, our fixed-to-mobile revenue showed strong growth, due largely to the increased number of mobile services in the Australian market. This has continued, but to a lesser extent, in fiscal 2003, as growth in the mobile market slows. Minutes of use of our fixed-to-mobile product has grown by 12.9% in fiscal 2002 and 6.9% in fiscal 2003. This strong growth reflects increased use of fixed-to-mobile calls in line with growth in the total mobile market. Although prices are still subject to competitive pressure, reductions have not been as significant as those surrounding the preselection period. Reduced per minute prices for fixed-to-mobile calls in fiscal 2002 and 2003 were mostly offset by increased call connection.

Fixed-to-mobile revenue may also be negatively affected if we lose market share in local calls. This is because, generally, customers will choose the same carriage service provider for fixed-to-mobile calls as they do for local calls.

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International telephone services

Over the three-year period our operating revenue from international telephone services included operating revenue we generated from:

- international calls made from Australia to a destination outside Australia (outbound);
- operator-assisted international calls;
- the fees we charged overseas telecommunications companies for transmitting and terminating international calls made from outside Australia to a destination in Australia (inbound); and
- the fees we charged overseas telecommunications companies for the use of our network for international calls originating outside of Australia that were destined for another country (transit).

Effective February 2001, we completed the sale of our global wholesale business to REACH. Fiscal 2001 international telephone services revenues reflected revenue from inbound calls and transit traffic of A\$361 million for the period 1 July 2000 to 31 January 2001, which are now recorded by REACH. As we account for REACH under the equity method of accounting revenues from our global wholesale business are no longer consolidated.

Our operating revenue from international outgoing calls is largely driven by general economic conditions, customer perceptions about the cost and value of our service, competition, promotion and advertising. Competition and price rebalancing has affected our international telephone services business and this is expected to continue.

Our customers are able to select between different pricing packages. These are generally based on destination, duration, time of day and day of week of the call, but may also include flexible features, such as allowing customers to make overseas calls that are charged in 30 minute blocks of time.

Table 7 - International direct

	Year ended 30 June				
	2003	2002	2001	2003/2002	2002/2001
	(in millions)			(% change)	
International direct	A\$307	A\$336	A\$338	(8.6)	(0.6)
International direct minutes ⁽¹⁾	740	781	693	(5.2)	12.7

Note: statistical data represents management's best estimates.

⁽¹⁾ International direct minutes for international settlement purposes also include international outgoing minutes from mobile telephone service, ISDN and public payphones operated by us.

Our revenue from international telephone services continued to decline over the three-year period principally as a result of competitive pricing pressures, price rebalancing and migration of customers to other products such as ISDN, internet and mobiles.

We have introduced packages, such as HomeLine™ Plus, as part of our price rebalancing strategy and in response to competitive pressures. These packages encourage our customers to stay with us and provide our customers with options to select pricing structures to suit their telephony spending patterns.

Approximately 3.1 million customers have now taken up the HomeLine™ Plus package option. These packages reduced our rates for calling some countries by up to 30% and consequently our outbound international revenue decreased over the three-year period.

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During the three-year period our outgoing volumes were affected by:

- increasing competition in the market;
- the introduction of our 0018 Easy ½ Hour[®] option from April 2001 and 10 minute capped calls option from September 2001;
- the acquisition of approximately 189,000 customers following the collapse of one of our competitors, One.Tel in May 2001;
- call connection charge increases that occurred in September 2001 and August 2002 as part of our price rebalancing initiative; and
- migration to other products such as ISDN, internet and mobiles (being a significant contributing factor in the decline in minutes in fiscal 2003).

Mobile goods and services

The mobile telecommunications market has continued its strong growth during the three-year period, stimulated by the introduction of low access fee plans and the increasing popularity of prepaid offerings. However, the rate of market growth has declined and the global mobile industry is entering a new phase. Voice traffic remains the core of the business and with competition intensifying, technology will become a source of differentiation and competitive advantage. Further growth is expected to be achieved through data/SMS usage and improvement of customer retention.

In fiscal 2000, we rolled out a new mobile network with national coverage based on digital technology known as CDMA. This CDMA network complements our existing GSM digital network and provides coverage in all areas previously covered by our analogue network. CDMA now has a substantial base of retail customers, as well as resale customers. New customers are increasingly connecting to our CDMA network and it is one of the fastest growing areas of our mobiles business.

In fiscal 2003, we launched Australia's first 3G mobile service which is based on 1xRTT technology on our CDMA network and provides high speed data capability. We also launched Telstra Mobile Loop[®] on 1xRTT to customers which features downloadable games and ringtones, e-mail access and picture messaging.

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Table 8 - Mobile goods and services data

	Year ended 30 June				
	2003 (in millions except statistics)	2002	2001	2003/2002 (% change)	2002/2001 (% change)
Access fees and call charges	2,570	2,734	2,567	(6.0)	6.5
Value-added services:					
International roaming	153	143	121	7.0	18.1
Mobile MessageBank®	166	149	96	11.4	55.2
Mobile data	338	216	122	56.5	77.0
Total value-added services	657	508	339	29.3	49.9
Total Mobile services revenue	3,227	3,242	2,906	(0.5)	11.6
Mobile handset sales	381	226	213	68.6	6.1
Mobile goods and services revenue ⁽¹⁾	A\$3,608	A\$3,468	A\$3,119	4.0	11.2
Mobile telephone minutes ⁽²⁾	6,335	5,780	5,277	9.6	9.5
Average minutes per SIO per month	84	87	95	(3.4)	(8.4)
	(in thousands)				
Mobile services in operation (SIO) ⁽⁵⁾					
GSM	5,812	5,346	4,712	8.7	13.5
CDMA	757	596	464	27.0	28.4
Total mobile SIO	6,569	5,942	5,176	10.6	14.8
Prepaid mobile SIO	2,288	1,880	1,212	21.7	36.5
Postpaid mobile SIO	4,281	4,062	3,964	5.4	2.5
Total mobile SIO	6,569	5,942	5,176	10.6	10.43
Market penetration ⁽⁷⁾	72%	64%	58%	8	6.0
Deactivation rate ⁽⁸⁾	18.4%	14.7%	17.3%	3.7	(2.6)
	(in A\$ per Service In Operation)				
Average revenue per SIO per month ⁽³⁾	42.99	48.60	52.47	(11.5)	(7.4)
Average prepaid revenue per SIO per month ⁽⁴⁾	13.78	10.05	13.24	37.1	(24.1)
Average postpaid revenue per SIO per month ⁽³⁾	57.59	63.16	61.26	(8.8)	3.1
Average mobile data revenue per SIO per month ⁽⁶⁾	4.51	3.24	2.21	39.2	49.8

Note: statistical data represents management's best estimates.

⁽¹⁾ Excludes revenue from:

- call termination charges, including calls from our fixed network which we categorise as fixed-to-mobile;
- resale of analogue and CDMA services to other carriers, which is included in intercarrier services revenue; and
- CSL which is recognised as various controlled entities revenue – see table 17.

⁽²⁾ Outbound minutes based on calling party pays billing, excluding minutes used by Telstra internal mobile services.

⁽³⁾ Based on mobile services revenue.

⁽⁴⁾ Based on mobile services revenue for fiscal 2003 and on voice only revenue for fiscal 2001 and 2002. Average prepaid revenue per SIO per month based on mobile services revenue is A\$13.01 for fiscal 2002. This data is not available for fiscal 2001.

⁽⁵⁾ Excludes mobile SIOs used internally.

⁽⁶⁾ Mobile data revenue per SIO is included in average revenue per SIO and average postpaid revenue per SIO.

⁽⁷⁾ Estimate of total market mobile SIOs divided by total population of Australia, based on population information available from the Australian Bureau of Statistics.

⁽⁸⁾ Deactivation rate excludes transfers of account names, services between Telstra's GSM and CDMA networks, and services between prepaid and postpaid.

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Mobile services revenue increased during the three-year period, principally due to strong continuing growth in the number of mobile telephone customers and minutes of use, together with increases in revenue from Mobile Value Added Services (mobile data, messaging and roaming). There has been a notable change in customer mix, with volumes and SIO's increasing across the board, but with far greater percentage increases in new customers connecting to prepaid services. Generally, prepaid customers have lower usage patterns than postpaid customers. At 30 June 2003, prepaid SIOs comprised approximately 35% of total SIOs, up from 29% as at 30 June 2002 and 23% at 30 June 2001. As a result of these factors, average revenue per SIO per month has shown a downward trend with an 11.5% decrease in fiscal 2003 compared to fiscal 2002 and a 5.4% decrease in fiscal 2002 compared to fiscal 2001.

Average revenue per SIO for postpaid connections decreased by 8.8% in fiscal 2003 due to loyalty programs rewarding users for long term commitments to Telstra. Also the average revenue per SIO for postpaid connection has been impacted by customers using to a greater extent the calls that are included in the price of their monthly connection fee. Average revenue per postpaid SIO connections increased by 3.1% in fiscal 2002 due to increased usage of value added services, particularly mobile data.

During the three-year period, revenue growth was supported by strong growth in value-added services such as:

- international roaming;
- increased usage of SMS, reported under mobile data, due to increased customer awareness and ease of use; and
- growth in CDMA service usage in response to marketing campaigns and new program offers.

Revenue from MessageBank[®], our voice message service, has increased over the three-year period. In fiscal 2001, the increase was due to growth in the usage of this product, however growth levels flattened in fiscal 2002. The increase in fiscal 2002 was primarily due to a reclassification of revenue previously included in access fees and call charges. In fiscal 2003, charges have not changed but the number of SIOs with message bank activated has increased, causing the 11.4% increase in MessageBank[®] revenue.

Revenue from handset sales increased over the three-year period. In fiscal 2002, revenue from handset sales increased under our "More 4 you" and "More 4 business" offerings, as we began to charge customers higher prices for handsets sold via our direct channels. In fiscal 2003, our continued phasing out of handset subsidies contributed to the high revenue. This change in our mobiles business model restructures handset purchase arrangements so that customers either purchase their handsets outright, or pay for them over a contract period under our Mobile Repayment Option (MRO). Our revenue from handset sales has also increased as the average cost of handsets has increased due to technological advancements.

Our deactivation rate increased to approximately 18.4% in fiscal 2003, up from 14.7% in fiscal 2002. Our deactivation rate is influenced by a number of factors, the most significant of which is competition from other carriers. Other factors influencing deactivation rate include customers' payment defaults and short-term disconnections.

In fiscal 2001, we decreased our mobile services revenue by A\$34 million to reflect the effect of the adoption of SAB 101. Under SAB 101 we now recognise revenue on some services, such as upfront connection fees and some prepaid services, over the average SIO life rather than at the point of sale. A portion of this deferred revenue was recognised in fiscal 2002 and the balance in fiscal 2003.

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Data and internet services

Our operating revenue from data and internet services is driven primarily by:

- demand for capacity to support business networking;
- the increased use of data services by small and medium-sized enterprises;
- the introduction of new products to meet customer needs;
- the increased use of the internet by businesses and consumers;
- the movement of our customers from basic access and associated calling products to other access services, such as ISDN and ADSL; and
- demand for greater bandwidth services such as frame relay and broadband.

While the data and internet markets have been experiencing growth, competition has put pressure on our prices. We expect that these trends will continue.

Tables 9, 10 and 11 show information about our data and internet services.

Table 9 - Data

	Year ended 30 June				
	2003	2002 (in millions)	2001	2003/2002 (% change)	2002/2001 (% change)
Data revenue	A\$1,053	A\$1,051	A\$1,192	0.2	(11.8)

Data revenue is comprised mainly of revenue from our frame relay service. Frame relay offers high-speed data transmission to customers connecting any number of sites to other national or international locations and digital data/leased line services. Digital data/leased line services provide high quality, leased line digital data transmission in a range of speeds and may be used for communications between all major capital cities and most regional and country areas in Australia.

Data revenues fell in fiscal 2002 with the decline in older generation products and an excess capacity in the market for leased lines with multiple market participants. In fiscal 2003, revenues were in line with fiscal 2002 with customers moving from older digital data and leased line services, to newer technologies with greater bandwidth such as frame relay.

Table 10 - ISDN

	Year ended 30 June				
	2003 (in millions, except access lines in thousands)	2002	2001	2003/2002 (% change)	2002/2001 (% change)
Access	390	452	461	(13.7)	(2.0)
Calls	561	585	633	(4.1)	(7.6)
ISDN revenue	A\$951	A\$1,037	A\$1,094	(8.3)	(5.2)
ISDN access lines (basic access line equivalents)	1,213	1,268	1,235	(4.3)	2.7

Note: statistical data represents management's best estimates.

ISDN is a digital service providing switched and dedicated integrated access to voice, data and video.

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ISDN revenues were high in fiscal 2001 due to the staging of the Sydney 2000 Olympics in September 2000. This flattened in the second half of 2001 and declined in fiscal 2002, mainly due to the impact of price rebalancing.

In fiscal 2003, access revenues decreased due to migration of customers to products such as frame relay, wholesale and DSL, and changes to the pricing structure of products, resulting in certain access fees to now be recognised as call revenue.

Call revenues also decreased over the three-year period due to migration of customers to products such as Direct Internet Access Service and Telstra Private Internet Provider Solutions. The overall decrease in ISDN call revenue was partly offset by an increase in voice call revenue. This increase was mainly due to charging for 30 minute blocks, rather than on a per minute basis, together with a greater proportion of customers using ISDN for voice instead of data.

Table 11 – Internet and IP Solutions

	Year ended 30 June				
	2003	2002	2001	2003/2002	2002/2001
	(in millions, except subscriber numbers in thousands)			(% change)	
Internet direct	120	111	133	8.1	(16.5)
IP solutions	120	84	67	42.9	25.4
Online broadband.	253	143	58	76.9	146.6
Online narrowband.	297	252	167	17.9	50.9
Other.	12	15	-	(20.0)	-
Internet and IP solutions	A\$802	A\$605	A\$425	32.6	42.4
Narrowband subscribers ⁽¹⁾⁽²⁾	1,158	1,056	864	9.7	22.2
Broadband subscribers ⁽³⁾	361	169	78	76.5	112.8
Total online subscribers	1,519	1,225	942	23.9	30.0

Note: statistical data represents management's best estimates.

⁽¹⁾ Includes subscribers to our BigPond™ Home and BigPond™ Business services.

⁽²⁾ Narrowband subscriber comparatives for fiscal 2002 have been restated to exclude Family Mail users in BigPond™ Home and Active Mail users in BigPond™ Business.

⁽³⁾ Includes subscribers to our BigPond™ ADSL, BigPond™ Cable Modem, BigPond™ Satellite, HyperConnect, ISP Connect and Flexstream® services.

During the three-year period our revenue from internet and ISP services has continued to grow strongly, even though we have reduced our prices due to competition. The subscriber base for our narrowband products, Telstra BigPond™ Home and Business, continued to grow during fiscal 2002 and 2003, as has the subscriber base for our broadband services. However, despite the higher volumes, our revenue per subscriber decreased in 2002 due to the lower prices that occurred in this highly competitive market.

In 2003, in addition to increased subscribers, our revenue increased due to:

- introduction of excess usage billing for BigPond™ broadband customers;
- focus on acquisition and retention of subscribers in a maturing dial-up market with pricing strategies such as providing BigPond™ Business customers with a price reduction with increased hours of use and a reduced additional hourly rate charged for each plan; and
- growth in Telstra Internet Direct due to simplified packages offering customers integrated internet and connectivity solutions, flexibility with access to connection types and pricing campaigns that encourage customers to upgrade both access and speed.

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Our IP Solutions portfolio of products is performing strongly in an extremely competitive market. This market is in a growth phase and we are succeeding through aggressive pricing strategies.

Sensis

Our operating revenue from Sensis is derived primarily from directory advertising, both print and online, non-directory advertising and other business services.

Table 12 – Sensis (Advertising and Directories)

	Year ended 30 June				
	2003	2002	2001	2003/2002	2002/2001
	(in millions)			(% change)	
Sensis revenue	<u>A\$1,217</u>	<u>A\$1,135</u>	<u>A\$909</u>	7.2	24.9

Sensis revenue in fiscal 2001 included a negative adjustment of A\$204 million to reflect the effect of SAB 101 on periods prior to fiscal 2001. Under SAB 101 we now recognise revenue when the Yellow Pages® directory has been published and delivered. Revenue from online directories is recognised over the life of service agreements, which is on average one year. Voice directory revenues are also recognised over the life of the service agreement (normally one year) while the associated call revenues are recognised at the time of providing the service to customers.

Over the three-year period we experienced steady growth in White Pages® directory revenue, mainly through the introduction of new advertising features, aggressive sales campaigns and the introduction, during 2002, of a new format segregating residential and business listings in metropolitan books.

In a market environment where revenues from most forms of advertising, especially print advertising, declined in fiscal 2002, our Yellow Pages® print advertising revenue grew marginally, at 0.2%. In fiscal 2003, our Yellow Pages® revenue grew by 3.6% due to the launch of new advertising features including Colour in Column, creative advertising options (eg. cover and spine advertising) and full/half page advertisements.

Our online and electronic advertising, non-directories advertising and information services also experienced considerable growth over the three-year period, largely driven by the introduction of new listing features and enhanced functionality in both our Yellow Pages® *OnLine* and White Pages® *OnLine* sites, the launch of Sensis WebWorks™, the expansion of our location and navigation services and the acquisition of CitySearch®.

Intercarrier services

Our operating revenue from intercarrier services consists of revenue from providing telecommunications services to other carriers or carriage service providers, including REACH from February 2001. Our operating revenue from resale activity is categorised according to the product or service resold.

This is a highly regulated area of the Australian telecommunications market. Due to regulated prices in this area and competitive pressures on some parts of our intercarrier services business, such as terminating calls, we do not expect significant revenue growth rates from this product in future years.

Table 13 – Intercarrier services revenue

	Year ended 30 June				
	2003	2002	2001	2003/2002	2002/2001
	(in millions)			(% change)	
Intercarrier services revenue	<u>A\$1,170</u>	<u>A\$1,124</u>	<u>A\$1,132</u>	4.1	(0.7)

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In fiscal 2002 our operating revenue from intercarrier services declined marginally compared to fiscal 2001 principally due to:

- the collapse of One.Tel in May 2001 and other reductions in wholesale SIOs;
- the progressive reduction of interconnect rates of up to 60% for PSTN/ISDN originating and terminating, local call interconnect and mobile originating and terminating through commercial negotiations with our wholesale customers. These rate reductions are consistent with the industry trend of lower interconnect rates; and
- mostly offset by increased volumes in both mobiles and PSTN/ISDN originating and terminating access.

In fiscal 2003, our intercarrier revenue growth was driven by:

- increase in volumes across both mobiles and PSTN/ISDN originating and terminating access due to increased volumes from certain major customers; and
- increase in SMS interconnect revenues driven by increasing volumes.

However, the benefit of these volume increases were offset by lower rates on our wholesale transmission products due to strong price competition in the market, with some competitors selling below cost.

Our volumes from intercarrier services during the three-year period were affected by:

- the impact of competition in the retail market in the provision of basic access, local calls, national long distance calls and mobile services. These services are now also provided by other carriers, many of which use our intercarrier services to deliver their services to their customers;
- an increase in the number of carriers in the Australian telecommunications market and increased demand from other carriers for the use of our facilities. This has occurred particularly in:
 - mobile towers, where we allow other carriers to install their equipment and share our transmission facilities; and
 - our exchanges, where other carriers co-locate their equipment needed for the provision of ULL and ADSL.

Our operating revenue from intercarrier services in fiscal 2002 includes revenue from REACH of A\$76 million. For the 5-month period to 30 June 2001, intercarrier services revenue from REACH was A\$53 million. In January 2002, we renegotiated the prices we are charged by REACH to lower levels, in line with current market prices.

In addition, our intercarrier services revenue in fiscal 2001 included A\$29 million of revenue generated by our global wholesale business, which we have sold to REACH.

The wholesale market has slowed over the past year with declining yields from oversupply of transmission infrastructure. We are not expecting any significant change in this state of affairs, but Telstra will continue its strategic focus to maintain revenues and control costs in this area.

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Inbound calling products

Our operating revenue from inbound calling products consists principally of:

- subscription and call charges for inbound calling services, such as Freecall™ 1800, Freecall™ One8, Priority® 1300 and Priority® One3; and
- revenue from enhanced call centre products using network voice processing, which provides access to advanced call-handling capabilities, without customers having to purchase and maintain their own networks.

The revenue for inbound calling services refers to:

- the fees we charge our business customers for the provision of the inbound calling numbers; and
- for Freecall™1800 and Freecall™ One8 the cost of the call.

Under Priority® 1300 and Priority® One3 the calling party from a PSTN service incurs a cost of 25 cents (including GST) from anywhere in Australia, which is recorded in local call revenue. The other components of the call charges, as applicable, are charged to the service owner. Calls made from a PSTN service under the Freecall™1800 and Freecall™ One8 service are all charged to the party called, with no cost incurred by the caller. Different charges apply for calls made from ISDN, mobiles and payphones.

Table 14 - Inbound calling products revenue

	Year ended 30 June				
	2003	2002 (in millions)	2001	2003/2002 (% change)	2002/2001 (% change)
Inbound calling products revenue	A\$494	A\$562	A\$657	(12.1)	(14.5)
Inbound calling product minutes	2,655	3,345	3,871	(20.6)	(13.6)

Note: statistical data represents management's best estimates.

Revenue from inbound calling products has declined over the three-year period. Volumes were up in fiscal 2001 as usage of our inbound calling products went through a period of growth prior to the introduction of INP on 30 November 2000. INP allows customers to switch providers of this service without changing the telephone number for the service rendered. This created a more competitive environment, having a negative impact on prices and volumes.

While the impact of INP on volumes was minimal in fiscal 2001, we started reducing prices during this period in response to increased competition. INP and competition has continued to impact fiscal 2002 and 2003 revenues as we have continued price reductions and volumes have continued to decrease. We lost one of our major customers in fiscal 2002, which also impacted our revenues and volumes.

In fiscal 2003, INP had a large impact on revenue derived from Freecall™ 1800 and Priority® One3 and Priority® 1300 products, pushing our revenues and calling minutes down.

Solutions management

Our operating revenue from our Managed Solutions™ product is derived from managing all or part of a customer's IT or telecommunications services, including managing:

- our network-based enhanced voice and data switching products and virtual private network products and the provision of related professional services;

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- our core data products including ATM, frame relay, ISDN, ADSL and dedicated data network equipment;
- a customer's call or contact centre, including network services, equipment, third party hardware and applications and professional services;
- mobile phone networks and new wireless based technologies such as wireless LANs;
- IT based products and services, including firewalls, desktops, peripheral services and application service products; and
- complex once off or whole of business solutions incorporating a range of the above services.

Table 15 - Solutions management revenue

	Year ended 30 June				
	2003	2002 (in millions)	2001	2003/2002 (% change)	2002/2001 (% change)
Solutions management revenue.	A\$487	A\$477	A\$428	2.1	11.4

During fiscal 2002, our solutions management revenue increased due to increased demand from the banking and financing sector and strong growth in our Telstra managed services business.

In fiscal 2003, growth flattened out because, even though we saw further growth in our Telstra managed services revenue which was primarily due to a combination of once off exit penalties charged to customers, the renewal of long-standing customer contracts and an increase in the number of small to medium corporate hosting services there was a decline in managed radio services revenue due to the completion of major customer contracts in fiscal 2002.

Various controlled entities' revenue

Some of our controlled entities' operating revenue is included in the product categories to which they relate, including the following:

- Sensis operating revenue is included in Directories revenue; and
- Telstra Enterprise Services' (TES') operating revenue is included in Solutions Management revenue.

Table 16 - Various controlled entities' sales revenue

	Year ended 30 June				
	2003	2002 (in millions)	2001	2003/2002 (% change)	2002/2001 (% change)
Sales revenue (100%) of:					
CSL	908	1,080	492	(15.9)	1195.1
NDC	159	175	259	(9.1)	(32.4)
TelstraClear	548	294	-	86.4	-
Other controlled entities	221	452	591	(51.1)	(23.5)
Total various controlled entities' sales revenue.	A\$1,836	A\$2,001	A\$1,342	(8.2)	49.1

Our consolidated revenue from various controlled entities grew from fiscal 2001 to fiscal 2002 due to the inclusion of revenues from:

- CSL from February 2001;
- TelstraClear from December 2001; and

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- Keycorp Limited (Keycorp) from January 2001 until June 2002, which includes Tran\$end and Argent (reporting systems used for EFTPOS) revenue, previously included in data and internet services revenue. Keycorp was equity accounted from the start of fiscal 2003 which meant the increases attributed to Keycorp in the 2002 fiscal year were reversed, contributing to the decline in revenues in 2003.

The increases in revenue in 2002 were moderated by:

- the sale of certain other minor controlled entities (included in “Other controlled entities above”) as part of the sale of our global wholesale business to REACH in February 2001. These entities recorded revenue of A\$144 million for the 7 months to 31 January 2001;
- the scale down of the operations of the Vietnam and Cambodia Business Co-operation Contract (BCC). This was wound up in fiscal 2003, contributing to the decline in revenues that occurred in fiscal 2003; and

NDC’s revenue decreased in fiscal 2002 due to the general slow down of network construction activity undertaken by NDC following a period of increased activity from new technology companies. This decline continued in 2003 in line with general reductions in telecommunications industry capital expenditure levels.

In addition to the wind up of our Vietnam and Cambodia contract and reduction in NDC’s contribution, in fiscal 2003, CSL reported a decline in revenue due to the economic downturn in Hong Kong and the effect of the SARS epidemic. Further revenue decline is attributed to the sale of our Mobitel business in Sri Lanka in October 2002.

Refer to “Operating and Financial Review and Prospects - International business ventures” for further discussion on CSL and TelstraClear.

Other sales and services

The principal components of operating revenue we record in other sales and services are:

- payphones;
- operator-assisted services; and
- other minor revenue items, including voicemail for fixed lines, recorded services, commercial works and other enhanced call products and radio services.

Table 17 - Other sales and services revenue

	Year ended 30 June				
	2003	2002 (in millions)	2001	2003/2002 (% change)	2002/2001 (% change)
Payphones	148	154	166	(3.9)	(7.2)
Telstra information and connection services	128	144	160	(11.1)	(10.0)
Other minor items.	483	463	749	4.3	(38.2)
Other sales and services revenue	A\$759	A\$761	A\$1,082	(0.2)	(29.7)
Number of payphones (in thousands)	68	71	75	(5.6)	(5.3)

Note: statistical data represents management’s best estimates.

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Over the three-year period our payphones business revenue has continued to decrease, impacted by substitution of other products, particularly mobiles. This is reflected in the number of payphones in operation.

In fiscal 2002 and fiscal 2003 operator assisted services volumes fell due to customers using alternative products, such as White Pages® and Yellow Pages® OnLine and Telstra call connect.

Decreases in other minor items have occurred mainly due to decreasing demand for products that have a mature market or are being substituted by other more modern products, such as our Virtual Private Network, which is being overtaken by migration to ISDN and IP based products.

Other revenue

Table 18 - Other revenue by category

	Year ended 30 June		
	2003	2002	2001
	(in millions)		
Other revenue			
Dividends received/receivable	1	1	16
Miscellaneous revenue	261	303	985
Sub-total other revenue	262	304	1,001
Revenue from sale of:			
Property, plant and equipment	811	246	288
Controlled entities	17	-	120
Investments in listed securities and other corporations	7	22	603
Patents, trademarks and licences	-	1	14
Businesses	4	33	2,273
Associates	17	-	-
Joint Ventures	3	-	5
Total revenue from sale of assets	859	302	3,303
Total other revenue ⁽¹⁾	A\$1,121	A\$606	A\$4,304

⁽¹⁾ Interest revenue received/receivable is now included in net interest. Refer Table 25.

Over the three-year period the following one off transactions have impacted our other revenue from the sale of assets:

- the disposal of our global wholesale business and certain controlled entities in February 2001 to REACH for A\$2,372 million;
- the sale of our 15% interest in Computershare for A\$546 million in fiscal 2001; and
- sale of seven commercial properties around Australia in fiscal 2003 contributing gross proceeds of A\$570 million to the total of A\$811 million.

Dividends received in fiscal 2002 and 2003 were lower compared with fiscal 2001 due to dividends paid by Intelsat in fiscal 2001 under contractual obligations while it was a satellite consortium. Since incorporation on 18 July 2001, Intelsat has not declared a dividend.

Fiscal 2001 miscellaneous revenue included the writeback of A\$725 million of superannuation contributions, due to the release of our obligation to continue to pay contributions to the Telstra Superannuation Scheme.

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Our miscellaneous revenue in fiscal 2002 increased (compared to fiscal 2001 exclusive of the superannuation write back) mainly due to Government subsidies we received for work under the Extended Zone Untimed Local Call tender, as part of the Rural Telecommunications Infrastructure Fund. This was offset in part by lower USO levy receipts.

In fiscal 2003, our miscellaneous revenue was impacted by lower Government tender revenue.

Operating expenses

We categorise our operating expenses into labour expense, goods and services purchased, depreciation and amortisation and other expenses. Interest expense is not included in operating expenses. Refer to “Net interest”.

Table 19 - Operating expense and share of net equity accounted losses data

	Year ended 30 June				
	2003	2002	2001	2003/2002	2002/2001
	(in millions)			(% change)	
Labour expense	3,204	3,240	3,122	(1.1)	3.8
Goods and services purchased	3,615	3,933	3,083	(8.1)	27.6
Other expenses	4,602	4,065	6,761	13.2	(39.9)
Sub total	11,421	11,238	12,966	1.6	(13.3)
Share of net equity accounted losses	1,025	81	183	1165.4	(55.7)
Sub total	12,446	11,319	13,149	10.0	(13.9)
Depreciation and amortisation.	3,447	3,267	2,871	5.5	13.8
Total operating expenses and net equity accounted losses	A\$15,893	A\$14,586	A\$16,020	9.0	(9.0)

During the three-year period, our operating expenses were affected by a number of significant events, including:

- restructuring and redundancy costs of A\$281 million in fiscal 2003, A\$289 million in fiscal 2002 and A\$44 million in fiscal 2001;
- a reduction of A\$560 million in goods and services purchased in fiscal 2001, reflecting the cumulative effect of the application of SAB 101 on recognition of operating expenses;
- Other operating expenses in fiscal 2001 included A\$1,520 million in relation to the cost of sale and deferral of 50% of the profit on sale of our global wholesale business and certain controlled entities to REACH;
- Write down of our investment in CSL in fiscal 2001 amounting to \$999 million, reflected in ‘other operating expenses’;
- A\$301 million cost of sale of our shares in Computershare in fiscal 2001, reflected in ‘other operating expenses’;
- A\$965 million for the write down of our investment in REACH in fiscal 2003, reflected in ‘share of net equity accounted losses’; and
- A\$662 million being the book value of assets sold during fiscal 2003, compared with A\$307 million in fiscal 2002 and A\$429 million in fiscal 2001, reflected in ‘other operating expenses’.

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In addition to these events, our operating expenses have also been impacted by:

- the consolidation of the operating expenses of our new business ventures CSL and TelstraClear, from February 2001 and December 2001 respectively, and deconsolidation of expenses for Keycorp in fiscal 2003;
- the removal of operating expenses, including depreciation and amortisation, associated with our global wholesale business after its sale to REACH effective February 2001;
- growth in our communications plant asset base and capitalised software development which increased our depreciation expense;
- increased goodwill amortisation expense as a result of our acquisition of CSL and TelstraClear; and
- the benefit of ongoing cost control and cost containment programs.

The following tables provide more detailed information about expenses from each of our expense groupings.

Labour expense

Labour expense includes:

- salary and wages and related on-costs, including employer contributions to superannuation funds, workers' compensation, leave entitlements and payroll tax;
- costs of engaging contractor labour and agency costs; and
- restructuring costs, including redundancy.

Our domestic full-time employees include domestic full-time staff, domestic fixed-term contracted staff and expatriate staff in overseas controlled entities. Domestic full-time employees does not include persons involved in work undertaken through outsourcing arrangements for work previously performed by employees or a full-time equivalent measure of part-time and casual staff, overtime worked, full and part-time contracted staff or a measure of overseas local hires.

Table 20 - Labour expense

	Year ended 30 June				
	2003 (millions, except staff numbers in whole numbers)	2002	2001	2003/2002 (% change)	2002/2001 (% change)
Labour expense	A\$3,204	A\$3,240	A\$3,122	(1.1)	3.8
Domestic full-time employees ⁽¹⁾	37,169	40,427	44,874	(8.1)	(9.9)
Full-time employees and equivalents ⁽²⁾	42,064	44,977	48,317	(6.5)	(6.9)

⁽¹⁾ Includes domestic full-time staff, fixed term contracted staff and expatriate staff working in overseas controlled entities.

⁽²⁾ Includes full-time, part-time and casual domestic and offshore employees, including employees of controlled entities.

Since 30 June 2001, we have reduced the number of domestic full-time employees from 44,874 to 37,169 as part of our cost reduction strategy. We have incurred redundancy expenditure over the three-year period of A\$44 million in fiscal 2001, A\$289 million in fiscal 2002 and A\$281 million in fiscal 2003.

Excluding the redundancy and restructuring costs provided for or expensed, during the three-year period labour expense decreased from A\$3,078 million in fiscal 2001 to A\$2,951 million in fiscal 2002 and A\$2,923 million in fiscal 2003.

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This decrease reflects:

- lower aggregate labour expenses as our full time staff and equivalents reduce;
- a decline in contractor agency costs due to diversion of some call centre activities to outsourcers; and
- a reduction in overtime due to continued focus on cost reductions and process improvement initiatives.

This decrease has been partly offset by:

- the use of employment agency staff in preference to full-time staff in order to manage costs more closely, better utilise staff as a variable resource in peaks and troughs and to satisfy specialised needs;
- increased labour rates across most areas of the business through award increases and the higher demand for the retention of high calibre staff; and
- additional labour expense associated with the consolidation of:
 - CSL from February 2001, which had 1,281 full-time employees and equivalents at 30 June 2001; and
 - TelstraClear from December 2001, which had 1,189 full-time employees and equivalents at 30 June 2002.

Based on the latest actuarial advice provided on the financial position of the Telstra Superannuation Schemes as at 30 June 2000, we have a surplus in the superannuation fund. As a result, employer contributions were not required over the three-year period. We are expecting this surplus to continue, however it will depend on the performance of the fund. There has been a reduction in the value of the assets of the fund over the three-year period due to the decline in financial markets over the period. We are therefore closely monitoring this situation in the light of the current financial market performance.

Goods and services purchased

The largest component of our goods and services purchased is payments we make to other carriers to terminate international and domestic outgoing calls and international transit traffic. Other significant components of our goods and services purchased over the three-year period related to costs of mobile handsets, mobile handset subsidies, dealer bonuses, commissions paid to indirect distribution channels, external construction and directory publishing costs. These are core costs to our business and vary according to business activity.

Table 21 – Goods and services purchased

	Year ended 30 June				
	2003	2002	2001	2003/2002	2002/2001
	(in millions)			(% change)	
Goods and services purchased	<u>A\$3,615</u>	<u>A\$3,933</u>	<u>A\$3,083</u>	(8.1)	27.6

Our goods and services purchased was impacted in fiscal 2001 by a once off A\$560 million adjustment to reflect the effect of SAB 101. Under SAB 101, we now defer the recognition of some revenue and the goods and services purchased associated with that revenue. The nature of these deferrals is described above in “Operating revenue”. See also “Changes in accounting policies”.

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Excluding the impact of this, our goods and services purchased increased from A\$3,643 million in fiscal 2001 to A\$3,933 million in fiscal 2002. This increase was primarily due to:

- the consolidation of the goods and services purchased of CSL from February 2001 and TelstraClear since December 2001; and
- increased network payments which comprised 41% of our goods and services purchased in fiscal 2002.

In fiscal 2002 network payments were impacted by the sale of our global wholesale business to REACH. This business recorded goods and services purchased of A\$223 million for the 7 months ended 31 January 2001. Amounts REACH charged us for terminating outgoing calls in fiscal 2001 were higher than the charges we had previously paid to other international carriers. This increased our network payments in fiscal 2001. In fiscal 2002, network payments decreased compared to fiscal 2001, mainly as a result of decreasing interconnect rates. This was offset in part by increased volumes and an increase in terminating traffic caused by:

- increased mobile voice, data (SMS) and international roaming traffic terminating on other carrier's networks; and
- higher volumes in international direct.

We have also incurred additional costs in relation to the increased use of our wholesale Global Linx product. Our revenue from this product increased by A\$79 million in fiscal 2002.

Our costs for handset subsidies and incentives and commissions paid to dealers has declined in fiscal 2002 compared to fiscal 2001, largely due to:

- the progressive removal of handset subsidies, except where mobiles are sold to corporate clients; and
- lower commission rates, as we now internally manage some MobileNet[®] customers who were previously managed externally.

In fiscal 2003, our goods and services purchased decreased by 8.1%. This was attributed to:

- goods and services purchased relating to Keycorp were consolidated for the 2002 fiscal year but were not included for the 2003 fiscal year as we now equity account for Keycorp;
- lower activity in the Hong Kong mobile market and exchange pressures on the Hong Kong dollar; and
- reclassification of costs associated with international network payments and certain costs relating to FOXTEL.

These decreases were partially offset by increased costs of mobiles sold through handset offerings under the 'more4you' and 'more4business' promotions and the increased costs associated with more technologically advanced handsets such as colour screens, MMS and polyphonic ring tones. In addition, CDMA is increasing as a percentage of the product mix, with CDMA phones having a higher cost per handset than the older technology phones.

Network payments decreased in fiscal 2003 due to reductions in international call volumes and reductions in charges from REACH for international network connections following the commencement of a new pricing structure from January 2003. Additional benefit came from a more favourable A\$/US\$ exchange rate. This was partially offset by costs associated with increases in mobile and SMS call volumes.

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Other operating expenses

Our other operating expenses include such costs as:

- service contracts and agreements for outsourced activities such as IT, cleaning services and warehousing and distribution;
- promotion and advertising;
- property costs, including rent, maintenance, municipal rates, land tax and power;
- network maintenance materials;
- travel costs;
- lease expense on operating leases;
- bad and doubtful debts;
- the carrying value of assets and investments disposed of; and
- write-downs of investments and assets to recoverable amount.

Table 22 - Other operating expenses

	Year ended 30 June				
	2003	2002	2001	2003/2002	2002/2001
	(in millions)			(% change)	
Other operating expenses	<u>A\$4,602</u>	A\$4,065	A\$6,761	13.2	(39.9)

In fiscal 2002 and 2003, we did not sell any of our significant investments or businesses. Expenses relating to investment and asset sales in fiscal 2001 are the main reason for the significantly larger operating expenses balance in 2001 compared to 2002 and 2003. Investments sold in fiscal 2001 include:

- the cost of sale of our global wholesale business and certain controlled entities to REACH of A\$1,520 million;
- the cost of sale of our investment in Computershare of A\$301 million;
- the cost of sale of our midrange IT equipment of A\$107 million; and
- the cost of sale of our interest in Extant Inc. of A\$36 million.

We assess the recoverable amount of our investments at each reporting date and where we consider that the recorded amount is not recoverable we write the investment down to recoverable amount. For more detail refer to “Application of Critical Accounting Policies”.

In fiscal 2001, we wrote down our investment in CSL by A\$999 million. We also wrote down our investments in SMS Management and Technology Limited (formerly Sausage Software), Commander Communications Ltd and other smaller investments, by a total of A\$66 million. In fiscal 2002, we wrote down a number of minor investments totalling A\$26 million.

As part of our negotiations with PCCW in relation to our purchase of an additional 40% of CSL in June 2002, we reduced the value of the convertible note issued to us by PCCW in February 2001 by A\$96 million. We now own 100% of CSL. Refer to “New Business Ventures”.

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In fiscal 2003, we sold a number of fixed assets, including seven commercial properties around Australia. The book value of fixed assets sold was A\$638 million in fiscal 2003, compared with A\$250 million in fiscal 2002 and A\$281 million in fiscal 2001.

Our other operating expenses were also impacted by the following over the three-year period:

- bad debts in the consumer market increased in fiscal 2002 and in fiscal 2001 we incurred bad debts in relation to the collapse of One.Tel. Bad debts in fiscal 2003 decreased due to lower provision requirements, partially offset by Mobile Repayment Option (MRO) debt provisions;
- in fiscal 2002, there was an increase in rental expense for our operating leases, in particular for increased leased motor vehicles and for leased computers, as a result of the sale and leaseback of our midrange IT equipment. In fiscal 2003, rental costs increased further after the sale and leaseback of seven commercial properties. However, this increase in fiscal 2003 was moderated by a reduction in rental expense associated with CSL due to substantial rent reductions in the Hong Kong property market and a reduction in the number of rented properties;
- an increase in expenses relating to service contracts and other agreements, which include network maintenance, fault repairs, pre-provisioning and activation work from A\$1,400 million in fiscal 2001 and fiscal 2002 to A\$1,706 million in fiscal 2003. This increase was attributable to increases in the number of service contracts and prices, as well as issues such as:
 - an increase in maintenance costs for the CDMA network as these costs were previously covered by warranties;
 - increased use of outsourcing agreements, particularly in relation to IT, call centre and professional services, in preference to using full-time employees. These increases were offset by decreases in labour and consultancy costs;
 - embarking on several new projects and implementing changes in the scope and pricing of our network platform; and
 - we now recognise FOXTEL's customer sales and service centre costs in 'Other expenses' whereas these were previously recognised in goods and services purchased;
- continuing decreases of A\$97 million in fiscal 2002 in our marketing, general and administration and other operating expenses as a result of our focus on cost reduction, partially reversed by increased marketing costs in 2003 due to sponsorships and high numbers of new initiatives to market (Loop™, SMS, Xgen, Telstra Home Messages 101™);
- IT expenses of A\$49 million for the implementation of GST in fiscal 2001; and
- increased currency conversion costs in fiscal 2003 due to currency gains on the Australian dollar in relation to dividends and current account hedging costs.

Share of net equity accounted losses

Table 23 - Share of net losses of associates and joint venture entities

	Year ended 30 June				
	2003	2002	2001	2003/2002	2002/2001
	(in millions)			(% change)	
Share of net losses of associates and joint venture entities	A\$1,025	A\$81	A\$183	1165.4	(55.7)

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Our share of net losses of associates and joint ventures includes both profits and losses from our equity accounted investments. Details of our equity accounted investments are included in note 24 to our financial statements.

In fiscal 2001, we wrote down our investments in Solution6 Holdings Ltd, myinternet.com.au Pty Ltd and Xantic B.V. by a total of A\$102 million.

In fiscal 2002, our net equity accounted losses were impacted by:

- increased profits from our investment in REACH. Equity accounting for REACH was for 5 months in fiscal 2001 and for a full year in fiscal 2002;
- increased losses from our investment in FOXTEL;
- increased losses from our investment in Australia-Japan Cable Holdings Ltd, due to the commencement of depreciation following the completion of the network in December 2001;
- decreased losses from our investment in Solution 6, including an adjustment to reflect the dilution in our shareholding; and
- decreased losses from our investment in TelstraSaturn. In December 2001, we increased our ownership interest in TelstraSaturn and began consolidating its results. At the same time TelstraSaturn acquired CLEAR Communications and the company's name was changed to TelstraClear.

In fiscal 2003, the vast majority of the equity accounted loss relates to the write down of our investment in REACH of A\$965 million. In addition to this, we incurred the following:

- decreased contribution from REACH, which recorded a loss of A\$47 million in fiscal 2003, compared with a profit of A\$53 million in fiscal 2002. Equity accounting for REACH was suspended on 31 December 2002 when the carrying value of the investment was written down to nil;
- increased losses or reduced profits from Xantic B.V., PT Mitra Global Telekomunikasi Indonesia, and Solution 6 (which has now been sold);
- ceasing recognition of Australia Japan Cable losses as the carrying value of the investment has been written off (carrying value of A\$34 million as at June 2002); and
- we ceased equity accounting for Dynegy since its sale in August 2001, final settlement was received in April 2003.

Depreciation and amortisation

Our depreciation and amortisation expense has been and will remain a major component of our cost structure, reflecting our capital investments.

Table 24 - Depreciation and amortisation

	Year ended 30 June				
	2003	2002 (in millions)	2001	2003/2002 (% change)	2002/2001 (% change)
Depreciation	2,703	2,612	2,402	3.5	8.7
Amortisation (excl. goodwill)	628	568	426	10.6	33.3
Amortisation of goodwill	116	87	43	33.3	102.3
Total depreciation and amortisation	A\$3,447	A\$3,267	A\$2,871	5.5	13.8

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During the three-year period, the increase in depreciation and amortisation, excluding goodwill, was mainly attributable to:

- growth in our communications plant asset base and capitalised software development, which is consistent with our level of capital expenditure activity; and
- the consolidation of the depreciation expenses of CSL in fiscal 2002 and TelstraClear in fiscal 2003.

Partially offsetting these factors were:

- the removal of the depreciation associated with the assets of our global wholesale business which were sold to REACH in fiscal 2002; and
- lower depreciation for land and buildings due to the sale of seven commercial properties and the general downsizing of owned vehicles in fiscal 2003.

We capitalise expenditure incurred in the development and enhancement of computer systems as business software. Software developed for internal use is amortised over a six-year service life. The increase in amortisation (excluding goodwill) during the three-year period reflects the growth in capitalised software assets.

Our analogue network was fully depreciated as of December 1999 and ceased operating altogether as of October 2000. We commenced depreciation of our CDMA network during fiscal 2001, from the date that components of this network were completed. In fiscal 2002, our depreciation expense reflects the first full year of depreciation of the CDMA network.

Over the three-year period goodwill amortisation increased mainly due to the amortisation of goodwill from our acquisition of 60% of CSL in fiscal 2001 and the additional 40% we acquired at the end of June 2002.

Net interest

Table 25 – Net Interest

	Year ended 30 June				
	2003	2002	2001	2003/2002	2002/2001
	(in millions)			(% change)	
Gross interest expenses	984	1,011	877	(2.7)	15.3
Less capitalised interest	(105)	(115)	(108)	(8.7)	6.5
Interest expense	879	896	769	(1.9)	16.5
Interest received/receivable	84	126	103	(33.3)	22.3
Net interest expense	<u>A\$795</u>	<u>A\$770</u>	<u>A\$666</u>	<u>3.2</u>	<u>15.6</u>

Our borrowing costs are influenced by:

- the level of our debt;
- interest rates;
- the length of our debt maturity profile; and
- our level of investments in financial assets (affects net debt).

Our level of debt increased by A\$4 billion in mid February 2000 as a result of the settlement of the PCCW transactions. This impacted fiscal 2001 for 5 months and fiscal 2002 for the whole year. In December 2001, we increased our shareholding in TelstraSaturn (now TelstraClear) to 58.43% from 50%, resulting in consolidation from December 2001 onwards. The NZ\$600 million of bank debt held by TelstraClear at 30

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June 2002 is therefore included in our group results. In September 2002, this debt was refinanced by a loan from Telstra and the bank debt repaid.

On 28 June 2002, we acquired the remaining 40% of CSL. As consideration for these shares the US\$750 million convertible note issued to us by PCCW in February 2001 was redeemed and replaced by a new mandatorily converting secured note of US\$190 million issued by PCCW. This change in convertible/converting note resulted in an increase in net debt of almost A\$1 billion.

Our interest expense increased in fiscal 2002, mainly due to:

- interest for a full year on the borrowings we incurred to invest in our Asian ventures in fiscal 2001, compared with interest on these borrowings for 5 months in fiscal 2001; and
- a lengthening of the maturity profile of our debt portfolio.

This was partially offset by reductions in interest rates generally.

Our gross interest expense decreased marginally in fiscal 2003, despite higher short-term rates, due to an overall decrease in the level of interest bearing liabilities. This reduction was tempered by the inclusion of a full year of consolidated interest from TelstraClear and costs incurred in closing out certain interest rate swaps at TelstraClear early due to the refinancing of its bank loans in September 2002.

In April 2003, there was a further redemption of the PCCW converting note, bringing the value to US\$54 million. In fiscal 2002, interest was received on the US\$750 million convertible note, whereas in fiscal 2003, we received interest on a US\$190 million converting note until April 2003 when the note was reduced to US\$53 million. This has resulted in a reduction in our interest received in fiscal 2003 compared to fiscal 2002.

Income tax expense

In fiscal 2003, our income tax expense decreased 14.6% from A\$1,796 million in fiscal 2002 to A\$1,534 million in fiscal 2003. Income tax expense was impacted by a 9.5% decrease in profit before income tax expense, as well as a decrease in the effective tax rate from 33.0% in fiscal 2002 to 31.1% in fiscal 2003.

The 1.9% decrease in effective tax rate was mainly due to a once off benefit of A\$201 million relating to our election to form a tax consolidation group from 1 July 2002. Under the tax consolidation legislation, certain tax values of subsidiaries assets are reset according to set allocation rules. This once off benefit reflects the increase in future income tax benefits arising from the reset of these tax values.

Our income tax expense decreased in fiscal 2002, down 19.7% from A\$2,236 million in fiscal 2001 to A\$1,796 million in fiscal 2002. This was impacted by a 13.5% decrease in profit before income tax expense, as well as a decrease in the effective tax rate from 35.5% in fiscal 2001 to 33.0% in fiscal 2002.

The decrease in the effective tax rate in fiscal 2002 was mainly due to the reduction in the Australian company income tax rate from 34% of taxable income in fiscal 2001 to 30% in fiscal 2002, together with a reduction in the level of investment write-downs that are not tax deductible. The reductions were partly offset by the impact of the sale of our global wholesale business in fiscal 2001, an increase in non-deductible write downs, mainly relating to REACH, the non-deductible write-down of the convertible note issued to us by PCCW and the decrease in our share of associates' net losses.

International business ventures

As part of our strategy to expand our operations outside Australia, we invested in new ventures in the Asia-Pacific region during fiscal 2001 and fiscal 2002.

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REACH

In February 2001, we sold our global wholesale business, including certain offshore controlled entities, to REACH in exchange for 50% ownership in REACH and cash of US\$375 million (A\$680 million). We obtained an independent valuation of our global wholesale business as at 31 January 2001 which resulted in a fair value of US\$1.3 billion (A\$2.37 billion) being placed on this business.

We achieved a profit on the sale of US\$935 million (A\$1,704 million). Under AGAAP, 50% of the profit, or A\$852 million, was deferred to be recognised in the share of net profits (losses) of associates and joint venture entities line in our statement of financial performance over 20 years. The profit impact of the sale, after taxation, was A\$875 million in fiscal 2001.

REACH has been operating in a difficult environment for a sustained period of time. Prices for international voice and data carriage have been falling at a rapid rate but growth in usage has not been sufficient to compensate for the loss in revenue caused by price reductions. Consequently, in December 2002 we made a non-cash write down of our investment in REACH of A\$965 million, reducing the carrying value to nil. Equity accounting was suspended at this date.

Under AGAAP REACH's loss in fiscal 2003 was A\$47 million, compared with a profit of A\$255 million in fiscal 2002, and a profit of A\$161 million in fiscal 2001. Table 26 details our equity accounted profits /(losses) in relation to REACH during the three-year period.

Table 26 – Equity accounted profit of REACH

	Year ended 30 June				
	2003	2002 (in millions)	2001	2003/2002 (% change)	2002/2001 (% change)
REACH net loss after tax (AGAAP)	(47)	255	161	(55.2)	58.4
Telstra 50% share ⁽¹⁾	57	129	80	(55.8)	61.2
Goodwill amortisation	(60)	(119)	(50)	(49.6)	138.0
Recognition of deferred profit	22	43	18	(48.8)	138.9
Non-cash write-down	(965)	-	-	-	-
REACH equity accounted share of profit/(loss)	A\$(946)	A\$53	A\$48	1884.9	10.4

⁽¹⁾ Fiscal 2003 only includes REACH's net profit after tax until suspension of equity accounting. Our share of profit up until suspension was A\$57 million.

REACH implemented a number of changes during the second half of fiscal 2003 to improve its performance, including:

- a change of CEO and replacement of a number of senior executives;
- re-negotiation of its US\$1.5 billion bank loan, which was successfully concluded in April 2003; and
- implementation of a cost reduction program with staff redundancies to further reduce overheads and rebalance the work force.

Historically, Telstra has been a substantial acquirer of cross border connectivity services from REACH and we expect this to continue. These services are important in supporting our growth in domestic businesses, particularly in areas of data and internet and the broadband rollout.

Refer to "Related Parties" for discussion regarding our dealings with REACH.

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CSL

In February 2001, we acquired a 60% ownership interest in CSL. We paid US\$1,694 million (A\$3,085 million), including incidental acquisition costs, to acquire this controlling interest.

Upon completion, in accordance with Australian Accounting Standards, a valuation was undertaken to determine the fair value of our investment. The independent valuation of CSL was US\$1,900 million (A\$3,477 million), placing a value of our 60% share at US\$1,140 million (A\$2,086 million). The difference between the valuation obtained as at 31 January 2001 and the purchase price valued at October 2000 is principally due to the movement in global telecommunication asset prices between the signing of the agreements and completion. This resulted in a write-down of our investment in CSL by A\$999 million in fiscal 2001.

On consolidation of CSL, we recognised goodwill on acquisition of A\$1,461 million, to be amortised over 20 years. On acquisition, other intangibles recognised included CSL's brands of A\$212 million, a customer base of A\$468 million and spectrum licences of A\$79 million, which we are amortising over their estimated useful lives.

CSL operates in the highly competitive Hong Kong mobile market and has delivered a solid performance despite an adverse operating environment. Hong Kong is currently experiencing one of its worst economic downturns in decades with this situation worsened by the outbreak of SARS in March 2003. Furthermore, in February 2003, one of CSL's competitors initiated an aggressive price reduction to attract new subscribers. CSL elected not to participate in the price war, rather competed on quality of service. As a result of these factors, CSL has seen its revenue decline by 4% in fiscal 2003 when compared to fiscal 2002, following a 10% decline in fiscal 2002 when compared to fiscal 2001. Revenue in fiscal 2003 decreased to HK\$4,224 million from HK\$4,433 million in fiscal 2002, and HK\$4,917 million in fiscal 2001.

CSL's capital expenditure decreased by 9% in fiscal 2003 to HK\$320 million (A\$68 million), from HK\$323 million (A\$70 million) in fiscal 2002. This follows a 34% decrease in capital expenditure in fiscal 2002 when compared to fiscal 2001.

Convertible/converting notes issued by PCCW

In February 2001, we purchased a convertible note from PCCW for US\$750 million (A\$1,372 million).

In June 2002 this note was redeemed as part of our acquisition of the remaining 40% of CSL. Prior to redemption, we valued this convertible note on a yield to maturity basis at US\$750 million and adjusted its value in our financial statements accordingly. The reduction in value of the note of A\$96 million was charged as an expense in fiscal 2002.

On redemption we acquired a US\$190 million (A\$337 million) mandatorily converting secured note issued by PCCW. This note has a three-year term and an interest coupon compounding at a rate of 5% per annum. PCCW's obligations under the note are secured by an equitable mortgage of shares over all of PCCW's 50% shareholding in REACH. In April 2003 this US\$190 million note was partially redeemed to fund the REACH capacity prepayment of US\$143 million (A\$230 million). The prepayment earns compounding interest equivalent to the three month US LIBOR rate plus an additional 2.5% and provides us the right to receive future carriage and related services capacity equivalent to the amount of the prepayment and accrued interest. We have classified the capacity prepayment as a non-current receivable as no draw down is expected until fiscal 2007. The prepayment is considered to be fully recoverable over the agreement period.

TelstraClear

TelstraClear, the second largest full service carrier in New Zealand, has been operating in its current form since December 2001. December 2001 saw the merger of our 50% owned joint venture, TelstraSaturn and

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CLEAR Communications, to form TelstraClear. As part of this transaction, we acquired an additional 8.43% interest in the merged entity and consolidated its results from that date for the 7 months to 30 June 2002. TelstraClear's revenue for this period was A\$296 million and the consolidation of TelstraClear decreased our net profit before tax by A\$110 million. In April 2003, we acquired the remaining 42% interest in TelstraClear for A\$25 million and we now consolidate 100% of TelstraClear's results. Revenue for the full year in fiscal 2003 was A\$548 million and TelstraClear made a loss for fiscal 2003 of A\$123 million.

TelstraClear improved its revenues in fiscal 2003, particularly in data and voice products and has realised operational efficiencies, achieved merger benefits and gained favourable regulatory outcomes with regards to wholesale purchasing.

New Zealand is a strategically important market for our trans-Tasman customers and this acquisition enables TelstraClear and Telstra to work together to provide customers on both sides of the Tasman with seamless communication and information technology solutions. The ability to do so was instrumental in winning a 5 year contract in fiscal 2002 with the National Australia Bank and Bank of New Zealand to provide outsourcing solutions of this nature.

Liquidity and capital resources

Capitalisation

Table 27 shows our capitalisation in accordance with Australian GAAP as at 30 June 2003.

Table 27 - Capitalisation

	As at 30 June 2003 (in millions)	
	A\$	US\$ ⁽¹⁾
Cash	1,300	871
Short-term debt ⁽²⁾	1,313	880
Long-term debt		
Telecom/Telstra bonds (unsecured)	2,403	1,610
Loans (unsecured)	8,403	5,630
Total long-term debt	10,806	7,240
Shareholders' equity		
Ordinary shares (12,866,600,200 fully paid ordinary shares issued)	6,433	4,310
Reserves	(150)	(101)
Retained earnings ⁽⁶⁾	9,137	6,122
Minority interests ⁽³⁾	2	2
Total shareholders' equity ⁽⁴⁾	15,422	10,333
Total capitalisation ⁽⁵⁾	27,541	18,452

⁽¹⁾ Translated at the noon buying rate on 30 June 2003 of A\$1.00 = US\$0.67.

⁽²⁾ Includes the current portion of long-term debt.

⁽³⁾ Minority interests are not classified as shareholders' equity under USGAAP.

⁽⁴⁾ Total shareholders' equity under USGAAP is A\$18,025 million. Refer to note 30 of the financial statements.

⁽⁵⁾ Total capitalisation consists of short-term debt, long-term debt and shareholders' equity, including minority interests.

⁽⁶⁾ On 28th August 2003, we declared a dividend of A\$0.12 per ordinary share payable on 31 October 2003.

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Cash and cash equivalents at 30 June 2003 were A\$1,300 million, compared with A\$1,070 million at 30 June 2002 and A\$1,077 million at 30 June 2001. At 30 June 2003, our total interest bearing liabilities (debt) was A\$12,555 million, with net debt of A\$10,295 million, after deducting cash, other interest bearing financial assets and loans to employees.

Approximately 25% of our total debt consisted of domestic borrowings with the balance sourced from a variety of offshore markets. Our current interest bearing liabilities that mature in less than 12 months amounted to A\$1,323 million, approximately 11% of our total debt. This comprised three main components, namely bills of exchange and commercial paper of A\$643 million, loans of A\$449 million and A\$210 million of Telstra bonds maturing within the 2003 fiscal year. For a summary of the maturity profile of our debt, see note 16 to our financial statements.

We have access to A\$550 million and US\$200 million of committed standby bank lines. These comprise bilateral arrangements with 7 banks which fall due for renewal at various times throughout the year. In addition, we have undrawn committed syndicated bank loan facilities of A\$1.25 billion and US\$0.6 billion available until September 2005. We have 4 commercial paper programs with a total borrowing capacity of A\$2 billion, US\$4 billion, Euro 4 billion and NZ\$0.25 billion (the NZ\$ facility is technically unlimited but a practical limit is around NZ\$0.25 billion due to the small size of the New Zealand market). In each case, we issue commercial paper through dealers on a best endeavours basis. Our commercial paper facilities are not committed and do not provide guaranteed access to funds. As at 30 June 2003, we had drawn down A\$643 million of our commercial paper facilities.

Other than borrowings in foreign currency specifically held as hedges against foreign currency assets, foreign currency borrowings are fully hedged at drawdown to A\$ equivalents using cross currency swaps. Our foreign currency exchange risk is managed centrally by our treasury department, which is part of our Finance & Administration business unit. For additional information regarding our foreign currency position and the management of our foreign currency exchange risk, see “Quantitative and Qualitative Disclosure about Market Risk” and note 29 to our financial statements.

We had negative working capital of A\$77 million at 30 June 2003, A\$1,855 million at 30 June 2002 and A\$3,026 million at 30 June 2001.

In fiscal 2003, our negative working capital decreased largely due to a change in Australian Accounting Standards relating to provisions. In fiscal 2002, we provided A\$1,415 million for dividends relating to that year but were declared after the 30 June reporting date. Under revised Australian Accounting Standards, we are unable to provide for dividends until they are declared, which occurs after the end of the fiscal year. Going forward, our final dividend payment is likely to always be made post year-end, so will affect working capital in October rather than June of each fiscal year.

In fiscal 2002, negative working capital decreased due to reductions in current borrowings and a reclassification of 7 commercial properties (land and buildings) to current assets, as they were held for sale at 30 June 2002.

Our current liabilities are typically in excess of our current assets, in common with most international telecommunications companies. We believe that our negative working capital position does not create a liquidity risk because we can delay the timing of our discretionary capital expenditure should cash inflows from our diverse customer base diminish at any point in time. Also, our standby bank lines and commercial paper programs provide us with additional sources of liquidity should the need arise.

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Cash flow information

Table 28 provides information regarding our cash flows and liquidity during the three-year period.

Table 28 – Cash flow

	Year ended 30 June				
	2003	2002 (in millions)	2001	2003/2002 (% change)	2002/2001 (% change)
Net cash provided by operating activities	7,057	7,098	6,599	(0.6)	7.6
Net cash used in investing activities	(2,492)	(3,258)	(6,370)	(23.5)	(48.9)
Net cash (used in) provided by financing activities	(4,317)	(3,817)	94	13.1	(4,160.6)
Net increase in cash	A\$248	A\$23	A\$323	978.3	(92.9)

Net cash provided by operating activities

Our primary source of liquidity is cash generated from our operations. Net cash provided by operating activities includes interest paid and received.

During fiscal 2003, net cash provided by operating activities has decreased marginally compared to fiscal 2002. This is because in fiscal 2002 net cash from operating activities was impacted by higher interest payments from the early swap closeouts associated with early repayment of TelstraClear's bank debt and the restructure of some of Telstra's corporate debt.

Growth in revenue receipts from customers in fiscal 2003 was offset by increased supplier, employee and tax payments.

Increased receipts from customers in fiscal 2002 were partially offset by higher payments to suppliers and an increase in tax and interest payments. In fiscal 2001, an extra tax instalment of A\$274 million was paid as a result of the introduction of the new tax system. Additionally, we incurred increased interest payments relating to the funding of our investments in CSL and the PCCW convertible note. These increased cash outflows and increased payments to suppliers and employees largely offset the increased receipts from customers in fiscal 2001 compared to fiscal 2002.

Net cash used in investing activities

Net cash used in investing activities represents amounts paid for capital assets, trademarks, licences and investments, offset by cash receipts from the sale of capital assets and investments. During the three-year period we committed a substantial amount of capital and other resources to upgrade and rationalise our network infrastructure and improve a number of our systems. However, the level of capital expenditure has declined over the three-year period.

We also invested resources in investments during the three-year period, particularly in fiscal 2001, when we acquired 60% of CSL.

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Table 29 - Net cash used in investing activities

	Year ended 30 June				
	2003	2002 (in millions)	2001	2003/2002 (% change)	2002/2001 (% change)
Switching	376	661	735	(43.1)	(10.1)
Transmission	378	416	429	(9.1)	(3.0)
Customer access network	959	929	1004	3.2	(7.5)
Mobile telecommunications networks	449	255	390	76.1	(34.6)
International infrastructure.	193	233	172	(17.2)	35.5
Capitalised software	555	559	737	(0.7)	(24.2)
Other items	454	553	677	(17.9)	(18.3)
Sub total capital expenditure.	3,364	3,606	4,144	(6.7)	(13.0)
Less: Capitalised interest.	(105)	(115)	(108)	(8.7)	6.5
Capital expenditure (excluding capitalised interest).	3,259	3,491	4,036	(6.6)	(13.5)
Add: patents, trademarks and licences (including 3G spectrum)	2	-	332	-	
Add: investments	71	171	3,236	(58.5)	(94.7)
Capital expenditure (excluding capitalised interest) and investments	3,332	3,662	7,604	(9.0)	(51.8)
Sale of capital equipment, investments and other property, plant and equipment.	(840)	(404)	(1,234)	107.9	(67.3)
Net cash used in investing activities.	A\$2,492	A\$3,258	A\$6,370	(23.5)	(48.9)
Capital expenditure (including interest and patents, trademarks and licences) and investments	A\$3,437	A\$3,777	A\$7,712	(9.0)	(51.0)

In fiscal 2003, our capital expenditure decreased in most areas compared to fiscal 2002, with the exception of expenditure on our mobile telecommunications network. The general decrease is due to our continued tight control over capital expenditure programs as a result of improved processes. The key areas of movement in capital expenditure for fiscal 2003 compared to fiscal 2002 were:

- lower domestic switching expenditure due to productivity gains from the use of higher capacity equipment installed to reduce unit costs together with reduced demand for traditional switched network services as customers shift to newer broadband related products; and
- lower international capital expenditure due to the expiration of our Vietnam BCC contract in fiscal 2003.

These were partially offset by:

- increased expenditure from the continuing rollout of new CDMA into all Australian capital cities;
- increased expenditure on Government sponsored programs such as untimed local call tender and expansion in the coverage of the GSM network; and
- increased Customer Access Network (CAN) expenditure for the ADSL rollout and for the establishment of a proactive rehabilitation program for the minor rural segment.

In fiscal 2003, we made fewer payments for investments, with our primary expenditure being on equity injections into FOXTEL of A\$50 million and the acquisition of the remaining 42% of TelstraClear for A\$25 million. We also did not receive any significant receipts for sales of investments, with the majority of our proceeds of A\$840 million coming from the sale of commercial properties.

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In fiscal 2002, our capital expenditure and investment spending decreased significantly following an increase in fiscal 2001. The key movements in fiscal 2002 compared to fiscal 2001 were:

- our investment in CSL in fiscal 2001;
- continued decreases in capital expenditure, as the level of activity on rehabilitation of our customer access network declined from its peak in fiscal 2000, and the rollout of our CDMA digital mobile network neared completion. This trend has continued over the three-year period;
- our purchase of a 3G spectrum licence for A\$302 million in fiscal 2001; and
- increased spending on capitalised software in fiscal 2001, reflecting the higher level of activity on systems to support new products and services, such as ADSL.

Our proceeds on sale of capital assets and investments was impacted in fiscal 2001 by:

- the sale of our global wholesale business and certain controlled entities to REACH. We received cash and shares in REACH as consideration for the sale;
- the sale of our shares in Computershare; and
- the sale and leaseback of our midrange IT equipment.

Over the three-year period our principal cash investments included:

- A\$25 million equity contribution to TelstraSaturn (later combined with CLEAR Communications and renamed TelstraClear), followed by A\$40 million for the acquisition of an additional 8.43% interest in TelstraClear in fiscal 2002, compared to A\$39 million in fiscal 2001;
- additional investments in FOXTEL of A\$50 million in fiscal 2003, A\$42 million in fiscal 2002 and A\$46 million in fiscal 2001;
- A\$17 million to acquire 100% of CitySearch® in fiscal 2002;
- net A\$3,045 million to acquire a 60% interest in CSL in fiscal 2001. We acquired the remaining 40% in a non-cash transaction in June 2002; and
- A\$40 million equity contribution to Australia-Japan Cable in fiscal 2002, compared to A\$11 million in 2001.

We expect to incur future capital expenditure in the following areas:

- meeting on-going customer demand for existing products and services, whilst ensuring service levels are maintained or improved;
- developing new products and services to meet the changing needs of our customers;
- asset lifecycle management;
- providing additional coverage and depth on our digital GSM and CDMA mobile networks including further 1xRTT rollout;
- upgrading our customer access network;
- further developing of our broadband and online infrastructure to meet future growth;

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- providing telecommunications services to rural and remote areas;
- internal business support infrastructure to ensure continued productivity improvements, operational efficiencies and customer relationship process improvements; and
- investment in or acquisition of enterprises that complement and fit with our growth strategies.

We expect that our cash flow from operating activities and available borrowings will be sufficient to meet our anticipated capital expenditure and investment requirements.

Net cash provided by (used in) financing activities

In fiscal 2003 and 2002, we experienced net outflows from financing activities of A\$4.3 billion and A\$3.8 billion respectively, compared with an inflow from financing activities of A\$94 million in fiscal 2001.

In fiscal 2003 and 2002, we utilised operating cash flows to reduce the level of our external borrowings, which had increased in fiscal 2001 to fund our investments in Asia. Refer to the 'Capital resources' section below for details of our financing and debt balances.

Contractual obligations and commercial commitments

Expenditure commitments

In the ordinary course of business we enter into long-term agreements for the supply of products and services to support our business needs. Whilst the liability under these agreements only arises on supply, we have a commitment to acquire the particular products and services.

Table 30 – Expenditure commitments at 30 June 2003

	Total Amounts Committed	Amount of commitment expiration per period					
		Within 1 year	Within 1 - 2 years	Within 2 - 3 years	Within 3 - 4 years	Within 4 - 5 years	After 5 years
(in millions)							
Capital commitments in relation to:							
Software developed for internal use	553	157	129	127	140	-	-
Other capital expenditure	248	209	39	-	-	-	-
Total capital expenditure commitments . . .	801	366	168	127	140	-	-
Expenditure commitments in relation to:							
Non-cancellable operating leases	1,300	251	174	144	130	114	487
Finance leases	20	20	-	-	-	-	-
FOXTEL Minimum Subscriber Guarantees . .	2,209	193	194	174	163	133	1,352
Information technology services	1,310	399	306	297	308	-	-
Other expenditure commitments	722	328	82	50	44	23	195
Total expenditure commitments, including capital expenditure commitments	A\$6,362	A\$1,557	A\$924	A\$792	A\$785	A\$270	A\$2,034

Our software development expenditure commitments predominantly relate to a two-part agreement for a period of 10-years from 30 June 1998 entered into with our previously associated entity, IBM GSA, in relation to amounts to be spent on the development of software assets for our internal use. The total remaining commitment as at 30 June 2003 under this agreement was A\$507 million.

The other part of the IBM GSA agreement relates to the acquisition of information technology services from them. The total remaining commitment as at 30 June 2003 under this agreement was A\$1,089 million, which is included in total Information Technology services commitments shown above.

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On 5 September 2003, we completed the sale of our interest in IBM GSA (see “Related Party Transactions – IBM GSA” for further details). As part of the sale agreement, we have been released from our commitment to IBM GSA of A\$1,596 million at a cost of A\$130 million.

Other capital expenditure commitments predominantly relate to expenditure to which we have committed with external parties for building and improving our networks and enhancing our network software.

Our non-cancellable operating lease commitments relate to lease agreements we have entered into for the following purposes:

- rental of land and buildings, over an average term of 7 years, in particular entering into operating leases over 7 commercial properties sold during fiscal 2003;
- rental of motor vehicles, caravan huts and trailers and mechanical aids over an average term of between 4 and 12 years, depending on the type of vehicle; and
- rental of personal computers and related equipment over an average term of 3 years.

In addition to these non-cancellable operating leases, we also have commitments under cancellable operating leases of A\$471 million. These leases relate mainly to the lease of IT equipment, motor vehicles and leased assets used in the supply of desktop services to our customers by TES.

Our finance lease commitments relate to:

- leases of communications exchange equipment, with an average term of 13 years; and
- leases of computer mainframes and associated equipment, with an average term of 3 years.

The FOXTEL minimum subscriber guarantee expenditure commitments relate to our 50% share of the FOXTEL partnership’s commitment to acquire subscription television programming that is subject to minimum subscriber guarantee levels. These minimum subscriber payments fluctuate in accordance with price escalation/reduction formulas contained in the agreements.

The FOXTEL minimum subscriber guarantee commitments increased in fiscal 2002, largely due to an arrangement entered into by FOXTEL under which it has increased its minimum subscriber guarantee commitments under a new perpetual subscription television programming agreement for Foxsports. The effect of this has been to increase our share of the FOXTEL minimum subscriber guarantee commitments by approximately A\$44 million per annum over the next 25 years from 2002.

On 1 December 2002, FOXTEL entered an unconditional content supply agreement with Optus that allowed Optus to provide a number of FOXTEL pay TV channels over the Optus cable network. Under this agreement, FOXTEL assumes some of Optus’ financial obligations under its movie and other content arrangement. This added A\$160 million to our commitments.

We have also undertaken commitments of an extra A\$419 million in fiscal 2003 relating to increased satellite capacity to meet growing digital television requirements.

Due to the joint and several nature of the FOXTEL partnership agreements, we are contingently liable to the extent of our FOXTEL partners’ share of these commitments should FOXTEL and/or the other FOXTEL partners default on their payment obligations under these agreements.

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Our other expenditure commitments include the following items:

- expenditure commitments of A\$249 million over the next 14 years in relation to CSL's acquisition of a new 3G spectrum license in October 2001;
- commitments for general maintenance and other expenditure in our wireless and wireline area of A\$320 million;
- guaranteed commissions payable to mobile phone dealers until December 2004 of A\$50 million; and
- commitments relating to naming rights of A\$40 million.

Off Balance Sheet Arrangements

Indemnities, performance guarantees and financial support

As at 30 June 2003, we have provided a number of indemnities, performance guarantees and financial support through the Telstra Entity. The features and counterparties involved in these are disclosed in detail in note 21 to our financial statements.

Derivative contracts

We maintain a portfolio of derivative contracts to enable us to manage risks of the business, the nature of which are interest rate swaps, interest rate futures and cross currency swaps.

The nature, business purpose and importance of these contracts is discussed in note 29 to our financial statements.

Share Trusts

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities". FIN 46 requires a beneficiary to consolidate a variable interest entity if it is the primary beneficiary of that entity. The primary beneficiary is defined as having a variable interest in a variable interest entity that will absorb a majority of the entity's expected losses if they occur, receive a majority of the entity's expected residual returns if they occur, or both.

We own 100% of the equity of Telstra ESOP Trustee Pty Ltd and Telstra Growthshare Pty Ltd, the corporate trustees for the Telstra Employee Share Ownership Plan Trust (TESOP97), the Telstra Employee Share Ownership Plan Trust II (TESOP99) and the Telstra Growthshare Trust. Under AGAAP we do not consolidate or equity account these trusts as we do not control or significantly influence the trusts. Refer to note 1 and note 24 to our financial statements for further information.

TESOP97, TESOP99 and the Telstra Growthshare Trust are considered to be variable interest entities under FIN 46. Our maximum potential exposure to loss as a result of our involvement with TESOP97, TESOP99 and the Telstra Growthshare Trust at 30 June 2003 is \$88 million. We are currently determining whether we are the primary beneficiary of the trusts. We are also still in the process of considering other potential variable interest entities. Management have not yet determined the full impact, if any, the adoption of FIN 46 on 1 July 2003 will have on our financial position, results of operations or cash flows.

Superannuation Commitments

Please refer to note 22 to our financial statements for our commitments and exposures in regard to superannuation schemes held for our employees in Australia and internationally.

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Property Leases

Seven commercial properties were sold during fiscal 2003 for sales proceeds of A\$570 million. Operating leases were taken out over those properties, see table 30 Expenditure Commitments.

Related party transactions

The following discussion summarises our significant transactions with related parties, other than our controlled entities. For further discussion refer to note 27 to our financial statements.

REACH

In February 2001, we formed REACH, a 50:50 joint venture with PCCW, which merged our respective international infrastructure assets. REACH provides wholesale voice, data and internet connectivity services in the Asia-Pacific region. On the sale of our global wholesale business, including certain controlled entities, to REACH in fiscal 2001 we recognised 50% of the profit on the sale (A\$852 million) and the balance was deferred to be recognised over 20 years.

Upon the formation of the REACH joint venture, we and PCCW entered into contractual arrangements with REACH for the provision of voice, data and internet connectivity services. We use these services primarily in connection with our retail international telecommunications business. Under these arrangements, we agreed to purchase these services for an initial period as required, based on prices determined before the venture commenced.

PCCW and we have been substantial acquirers of cross-border connectivity services supplied by REACH. We expect to continue to require these services to support our domestic businesses. Without access to these services we would potentially have short to medium term vulnerability.

PCCW and we have focused on expanding the market and product opportunities for bandwidth and have entered into further arrangements whereby we have committed to substantial outgoing purchase levels to the end of December 2007. REACH's prices under these agreements have been adjusted to levels we believe are in line with current market prices. These arrangements have regard to our future capacity needs and opportunities for growth.

During the three-year period, our purchases from REACH were A\$506 million in fiscal 2003, A\$788 million in fiscal 2002, and A\$311 million for 5 months in fiscal 2001. These amounts were for both the purchase of, and entitlement to, capacity and connectivity services. These purchases were made on normal commercial terms and conditions. Entitlement capacity with REACH takes into account our future needs and growth opportunities. We made sales to REACH for international inbound call termination services, construction and consultancy of A\$109 million in fiscal 2003, A\$115 million in fiscal 2002 and A\$75 million for the 5 months ended 30 June 2001.

In fiscal 2003, we wrote down our investment in REACH by A\$965 million to nil and suspended equity accounting. The write down occurred due to depressed conditions in the global market for international internet capacity resulting in high levels of excess capacity, intense price competition and lower than expected traffic volumes.

FOXTEL

FOXTEL, our 50% owned subscription television joint venture, uses capacity on our HFC cable network. As part of the partnership arrangements, we are the exclusive long-term supplier of cable distribution services for FOXTEL's subscription television services in our cabled areas and we receive a share of FOXTEL's cable subscription television revenues. Further details about our arrangements with FOXTEL are included in the "Information on the Company" section of this annual report under the heading of "Subscription television".

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IBM GSA

We held a 22.6% interest in IBM GSA over the three-year period. On 5 September 2003, we completed the sale of our interest to IBM for A\$153.5 million. For the period of our ownership, we outsourced our data centre operations and a proportion of our applications maintenance and enhancement activities to IBM GSA. Revenue from the sale of our investment in IBM GSA amounted to A\$154 million resulting in a net profit before income tax expense of A\$149 million which will be recognised in fiscal 2004. We also modified a 10 year contract with IBM GSA to provide information technology services. The modification will result in an expense of A\$130 million being recognised in fiscal 2004.

Research and development

Our research and development activities cover diverse areas of our business and focus on developing new competitive products for our customers.

Licensed telecommunications carriers in Australia have a responsibility for maintaining and implementing plans for the development of the Australian telecommunications supply and information industries. This annual plan is referred to as the Industry Development Plan and includes our planned research and development activities. Each year, the amount we report to the Government under our Industry Development plan includes amounts expensed in the statement of financial performance and amounts capitalised into software and infrastructure assets. Items reported include:

- research and development carried out directly by Telstra in our research laboratories;
- research and development expenditure contracted out by Telstra, for which the resultant IP is owned by the contractor;
- research and development expenditure incurred in the development of certain software; and
- support and other research and development expenditures.

For the purposes of this annual report, we estimate the amount of research and development expenditure incurred over the past year. The amount of the actual spending is not determined until the following December of each fiscal year. For fiscal 2001 spending based on the above classification was estimated to be A\$217 million and the actual amount determined in December 2001 was consistent with this. For fiscal 2002, we estimated spending of A\$160 million, which later was determined to be A\$170 million. For fiscal 2003, we are estimating we have spent A\$187 million.

We included research and development operational expenses in our statement of financial performance of A\$41 million in fiscal 2003, A\$28 million in fiscal 2002 and A\$29 million in fiscal 2001. These amounts do not include items we capitalise to software developed for internal use and include only expensed amounts.

Segment information

Our business is organised and managed by business unit as described under “Information on the Company – Organisational structure”.

As at 30 June 2002, the following qualified as reportable segments under Australian Accounting Standard AASB 1005 “Segment Reporting” and US Statement of Financial Accounting Standards No. 131:

- Telstra Retail;
- Telstra Mobile;
- Telstra International;
- Infrastructure Services; and
- Telstra Wholesale.

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During fiscal 2003, we re-organised our business and restructured several of our reportable segments - Telstra Retail, Telstra Mobile and Telstra Country Wide. The scope of Telstra Country Wide was increased and two new groups were formed – Telstra Consumer and Marketing and Telstra Business and Government. We also established a new group called Telstra Broadband & Media Group. This is not yet a reportable segment as defined in AASB 1005, so is included in “Other”. Our reportable segments at 30 June 2003 were:

- Telstra Consumer and Marketing;
- Telstra Country Wide;
- Telstra Business and Government;
- Telstra International;
- Infrastructure Services; and
- Telstra Wholesale.

Our analysis of results by segment

There has been extensive changes made to our customer base with all of the customers from the former Telstra Retail and Telstra Mobile segments reorganised into Telstra Business and Government, Telstra Consumer and Marketing and Telstra Country Wide. For these segments we are unable to reconstruct our segment reporting for fiscal 2002 and 2001 to be on the same basis as our reporting for fiscal 2003. We are also unable to reconstruct our segments for fiscal 2003 to be on the same basis as for fiscal 2002 and 2001. We have therefore discussed the performance of each new segment separately. Telstra International, Infrastructure Services and Telstra Wholesale have, for the most part, remained consistent and can be meaningfully compared year on year. A detailed discussion and analysis of the changes in our operating revenue in each of our major product groups and our principal operating expense categories, is provided in “Operating revenue” and “Operating expenses” respectively.

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Table 31 provides a summary of our revenue and earnings or loss before interest and income tax for each of our business segments. For more information on our business segment results, including intersegment revenues, see note 5 to our financial statements.

Table 31 - Segment summary data

	Year ended 30 June				
	2003	2002	2001	2003/2002	2002/2001
	(in millions)			(% change)	
Sales revenue from external customers					
Telstra Consumer and Marketing	5,514	-	-	-	-
Telstra Country Wide	5,031	-	-	-	-
Telstra Business and Government	4,520	-	-	-	-
Telstra Retail	-	12,560	11,620	-	8.1
Telstra Mobile	-	3,501	3,144	-	11.4
Telstra International	1,471	1,497	1,208	(1.7)	23.9
Infrastructure Services	256	253	282	1.2	(10.3)
Telstra Wholesale	2,370	2,334	2,410	1.5	(3.2)
Other ⁽²⁾	1,333	67	67	1889.6	-
Eliminations	-	(16)	(52)	-	69.2
Total sales revenue	A\$20,495	A\$20,196	A\$18,679	1.5	8.1
Earnings (loss) before interest and income tax expense (EBIT) ⁽¹⁾					
Telstra Consumer and Marketing ⁽³⁾	3,096	-	-	-	-
Telstra Country Wide ⁽³⁾	4,931	-	-	-	-
Telstra Business and Government ⁽³⁾	3,440	-	-	-	-
Telstra International	(955)	(56)	25	1605.4	(324.0)
Telstra Retail	-	7,278	6,747	-	7.9
Telstra Mobile	-	1,542	1,329	-	16.0
Infrastructure Services	(1,220)	(1,371)	(1,209)	11.0	(13.4)
Telstra Wholesale	1,628	2,076	2,119	(21.6)	(2.0)
Other ⁽²⁾	(3,403)	(4,275)	(2,765)	(19.2)	(54.6)
Eliminations	(1,794)	1,022	717	(270.5)	42.5
Total earnings before interest and income tax expense (EBIT)	A\$5,723	A\$6,216	A\$6,963	(7.9)	(10.7)

⁽¹⁾ Most internal charges between business segments are charged on a direct cost recovery basis. EBIT reflects both internal and external charges.

⁽²⁾ Other sales revenue includes primarily revenue earned by Telstra Broadband and Media Group and proceeds from the sale of seven office properties. Other EBIT result mainly includes, in addition to these, Telstra Technology and the Asset Accounting Group which centrally manages all of the Telstra Entity's fixed assets, including network assets.

⁽³⁾ These segment results do not reflect actual segment results achieved due to the majority of costs of goods and services associated with sales revenues for all three of these segments being allocated totally to the Telstra Consumer and Marketing segment. This allocation reflects management's accountability framework and internal reporting system.

Telstra Consumer and Marketing

In fiscal 2003, Telstra Consumer and Marketing was created. It is made up of parts of the former Telstra Retail segment and parts of the former Telstra Mobile segment. Telstra Consumer and Marketing is responsible for serving metropolitan consumer and small business customers with our full range of products and services including fixed, wireless and data, the overall management of Telstra's brands, advertising and sponsorships, the management of fixed and mobile products and implementing our product bundling initiatives.

Operating and Financial Review and Prospects

Telstra Consumer and Marketing reported revenue of A\$5,514 million and earnings before interest and tax of A\$3,096 million (subject to footnote 3 of table 31 above) in fiscal 2003. As this is a new segment, we are unable to compare revenue and earnings before interest and tax to prior years.

Telstra Country Wide

In fiscal 2003, the Telstra Country Wide segment was created from its original basis as part of the former Telstra Retail segment and added parts of the former Telstra Mobile and Telstra Retail segments. Telstra Country Wide is responsible for providing telecommunications services to customers in outer metropolitan, regional, rural and remote parts of Australia.

Sales revenue in fiscal 2003 comprised revenue from basic access, local calls, national and international long distance, fixed to mobile calls, data and text services, inbound calling products and internet and web hosting products for Telstra Country Wide customers.

Telstra Country Wide revenues and earnings cannot be compared to that of fiscal 2002 due to significant changes in the composition of the segment, however over the fiscal 2003 period Telstra Country Wide achieved strong fixed to mobile revenue, STD revenue and in BigPond™ Home revenue.

Telstra Business and Government

Telstra Business and Government, which has been formed out of part of the former Telstra Retail segment and part of the Telstra Mobile segment, is responsible for serving our corporate, medium enterprise and Government customers with the full range of Telstra products and services of interest to this group of customers. It also includes Customer Care and product management groups.

Sales revenue for Telstra Business and Government totalled A\$4,520 million in fiscal 2003 and was made up of revenue basic access, local calls, PSTN value added services, national long distance calls, fixed-to-mobile calls, international telephone services, mobile services & terminals, data and internet services, internet and IP solutions, ISDN access and calls, solutions management, inbound calling products, and customer premises equipment (CPE). Earnings before interest and tax for Telstra Business and Government for fiscal 2003 was A\$3,440 million (subject to footnote 3 of table 31 above). As this is a new segment we are unable to compare revenue and earnings before interest and tax to prior years.

Telstra Retail

In fiscal 2001 and 2002, Telstra Retail was responsible for our residential, business and Government customers, other than wholesale services which were and continue to be provided by Telstra Wholesale and mobile services which were provided by Telstra Mobile. This segment no longer exists and has been divided into the three new segments.

Telstra Retail sales revenue was made up of revenue from basic access, local calls, national long distance calls, fixed-to-mobile calls, international telephone services, data and internet services, solutions management, inbound calling products, CPE and directory services. In fiscal 2001, we reduced Telstra Retail sales revenue by A\$745 million to reflect the adoption of SAB 101. In addition to the impact of re-balancing initiatives and competition Telstra Retail sales revenue in fiscal 2001 was also impacted by the absorption of the impact of GST on some of our local call prices following its introduction in July 2000.

Excluding these one-off items we achieved modest revenue growth in Telstra Retail sales revenue in fiscal 2002, following a slight decrease in fiscal 2001, in an environment of ongoing price re-balancing initiatives and competition. Our basic access revenue has increased and our local call revenue, national long distance call revenue and international telephone services revenue has decreased.

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Over the fiscal 2001 and fiscal 2002 period we achieved solid growth in fixed-to-mobile revenue, due to increased call volumes and growth in the number of users of mobile phones and continued growth in Telstra BigPond™ internet related revenue.

Telstra Retail earnings before interest and income tax expense increased in fiscal 2002 and decreased in fiscal 2001. In fiscal 2001 earnings before interest and tax in this segment was impacted by:

- the SAB 101 net cumulative adjustment of A\$205 million recorded in fiscal 2001; and
- the profit on sale of our investment in Computershare Limited, of A\$245 million.

Telstra Mobile

In fiscal 2001 and 2002, Telstra Mobile was responsible for our mobile and wireless networks and associated systems within Australia and all mobile retail sales and after sales support, mobile customer service, mobile product development and mobile pricing. This segment no longer exists and has been divided into the three new segments.

Telstra Mobile sales revenue included revenue from mobile goods and services. This segment is separately discussed in “Operating revenue – Mobile goods and services”.

In fiscal 2001, we reduced Telstra Mobile sales revenue by A\$34 million to reflect the adoption of SAB 101. Mobile services revenue has increased during the three-year period, driven by:

- increases in the number of mobile SIOs;
- increased minutes of use; and
- solid growth in value-added services, such as international roaming and mobile data, such as our SMS.

We achieved strong sales revenue growth in this segment in fiscal 2002, despite lower average airtime charges and a higher percentage of new customers connecting to prepaid services. Generally prepaid customers have lower usage patterns.

Telstra Mobile earnings before interest and income tax expense grew by 16% in fiscal 2002, with solid growth in sales revenue, yet lower expense growth. Our expenses decreased with the reduction in handset subsidies, however this was offset in part by increases in:

- charges associated with mobile calls terminating on other carriers’ networks, due to increased traffic; and
- higher labour costs driven by increased staff numbers, in response to increasing SIOs and wage increases.

Fiscal 2001 earnings before interest and income tax expense grew by 9.9% after revenue growth was partly offset by increased costs, including:

- directly variable costs associated with service contracts;
- labour costs driven by increased staff in response to growth in SIO and increasing specialised product development needs; and
- payments to other carriers associated with increased international roaming activity.

Operating and Financial Review and Prospects

Telstra International

Telstra International is responsible for evaluating offshore business opportunities to enhance Telstra's long term growth as well as managing our existing investments overseas.

Telstra International sales revenue declined 1.7% for fiscal 2003 due mainly to adverse currency movements as well as our exit from a number of offshore controlled entities and operations including Mobitel, East Timor and the Business Co-operation Contract in Vietnam. This was partly offset by the effect of consolidating TelstraClear's operating result for the first full fiscal year. In fiscal year 2002, Telstra's reported results in respect of TelstraClear comprised the equity accounted result of TelstraSaturn for the 5 months to November 2001 and the consolidated result of TelstraClear for the remaining 7 months. This was one of the major reasons for the 23.9% increase in sales revenue from fiscal 2001 to 2002, along with inclusion of a full year of consolidated revenue from CSL, compared with only 5 months in fiscal 2001.

Telstra International earnings before interest and income tax expense declined in fiscal 2003 due mainly to the decision to write down the carrying value of our investment in REACH to zero effective 31 December 2002. As a consequence, we have suspended equity accounting of REACH's operating result in Telstra's accounts. The net loss of A\$946 million reflects our share of REACH's equity accounted result for the 6 months to December 2002 and the net accounting effect of the write down in the investment.

Excluding REACH, fiscal 2003 earnings before interest and taxes improved by A\$47 million largely due to a solid result from CSL as well as a strong performance from TelstraClear which was consolidated for the full fiscal 2003 year. Despite the adversity of the Hong Kong mobile price war and the outbreak of SARS, CSL reported a favourable increase in fiscal 2003 earnings before interest and taxes through taking prompt actions to reduce variable and discretionary costs to address the revenue shortfall. Its result also included a favourable currency gain. Strong financial discipline around cost and capital expenditure has facilitated the improvement in TelstraClear's overall performance.

In fiscal 2002, earnings before interest and taxes benefited from improved performance from CSL and other international entities, however this was offset by restructuring costs incurred in the merger of our New Zealand joint venture TelstraSaturn with CLEAR Communications in December 2001.

Earnings before interest and taxes in fiscal 2001 were impacted by the sale of our global wholesale business to REACH in February 2001. Fiscal 2001 earnings before interest and tax included 5 months of profits from our global wholesale business, compared with a full year in fiscal 2000. In fiscal 2002 we have recorded our share of the equity accounted profits of REACH, which now owns this business.

In fiscal 2001, this segment was also impacted by the profit on sale of our global wholesale business of A\$852 million and the write-down of our investment in CSL by A\$999 million.

Infrastructure Services

Infrastructure Services is responsible for planning, design, construction and operation of our domestic fixed communication networks and associated systems to deliver technology solutions, our products, services and customer support, including customer service installation and repairs.

During fiscal 2002, NDC was added to this segment. NDC competes for some of our annual network expenditure against other suppliers and also performs construction activities for others, including other telecommunications companies.

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Infrastructure Services sales revenue increased marginally in 2003 after it fell by 10.3% in fiscal 2002. Sales revenue principally includes consolidated revenues from NDC that have been affected by a generally weaker market for construction activity. In fiscal 2003, the effects of the weak market were offset by an improvement in cable recovery and maintenance related to non-NDC activity. Sales revenue was heavily impacted by the weak market in 2002 without much effect of such mitigating improvements in other areas of the business.

Infrastructure Services earnings before interest and income tax expense is negative as this segment does not recover all costs it incurs on behalf of other segments. In fiscal 2002 NDC restructuring costs and lower revenues, offset in part by cost containment efforts, impacted earnings before interest and tax. Labour expense excluding restructuring costs have been reduced, commercial contract costs have fallen with the weaker market for construction activity and discretionary spending is lower due to improved cost management. In fiscal 2003, there were further decreases in labour costs, and operating expenses due to reduced activity. There was also a decrease in charges from other parts of the business due to a change in the way costs are recovered.

Telstra Wholesale

During fiscal 2002, Telstra Wholesale was separated from the fiscal 2001 segment Infrastructure Services and Wholesale. Telstra Wholesale provides wholesale products and services to the Australian domestic market. It provides a wide range of products and services including fixed, wireless, data and internet, transmission and IP, interconnection, access to our network facilities and retail/rebill products.

Telstra Wholesale sales revenue is made up of revenue from our intercarrier services, wholesale broadband, data and internet services, basic local services, national long distance call revenue and mobile services revenue. Wholesale revenue increased by 1% in fiscal 2003. It should be noted that this increase is attributed to the migration of approximately 550 ISPs from Telstra Retail to the wholesale channel during the year. Excluding the impact of this transfer, external revenue was flat year on year which is generally indicative of the current telecommunication industry and the wholesale market in particular.

Fiscal 2003 saw a continuation of re-balancing initiatives and commercial negotiations which reduced prices across all wholesale revenue categories, whilst increasing basic access revenues.

Wholesale intercarrier services revenue grew by 4% in fiscal 2003. Continued SMS interconnect revenue growth and mobile interconnection volumes, driven by mobile substitution and growth in the overall mobile market, was partially offset by reduced yields for these products. Revenue streams from a number of other transmission products were significantly impacted by aggressive price competition as we now face a period of excess capacity resulting from the infrastructure over-build that occurred in prior years.

Broadband, data and internet services revenue showed quite explosive growth driven by wholesale DSL offerings. The number of wholesale services in operation grew from 25,000 at the start of fiscal 2003 to in excess of 120,000 by year-end.

In fiscal 2002, continued implementation of re-balancing initiatives and commercial negotiations reduced prices across all wholesale revenue categories, whilst increasing basic access revenues. Combined with re-balancing initiatives, the collapse of One.Tel contributed to lower local call resale, national long distance, international and inbound calling revenues in this segment in fiscal 2002.

Wholesale intercarrier services revenue remained relatively flat in fiscal 2002. Continued mobile and SMS interconnect revenue growth, driven by mobile substitution and growth in the overall mobile market, was offset by lower revenues from other products. Wholesale data and internet services revenue also remained relatively flat in fiscal 2002 as a result of the introduction of more market driven pricing and offerings.

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Telstra Wholesale earnings before interest and income tax expense fell by 21.6% in fiscal 2003. This reduction was attributable to a change in relation to inter business unit transfer pricing. Until fiscal 2003 Telstra Wholesale transferred Intercarrier termination payments to the retail business units to match to their customer revenue streams. This practice was discontinued in fiscal 2003 with the expense remaining in Telstra Wholesale accounts.

Excluding the impact of this treatment, Telstra Wholesale earnings before interest and taxes actually improved by 4%. With revenue flat year on year, this improvement was predominantly due to the reduction in carrier outpayments in fiscal 2003. These price reductions were commercially negotiated and in line with the regulators pricing principles and undertakings.

Earnings before interest and taxes fell by 2% in fiscal 2002, largely due to the reduction in sales revenue in this segment.

In fiscal 2001, earnings before interest and taxes was impacted by increased network payments to other carriers, as a result of higher volumes of outgoing calls terminating on other carriers' networks and increased interconnect rates. These increased payments were somewhat reversed in fiscal 2002 by decreasing interconnect rates, with network payments decreasing in fiscal 2002 compared to fiscal 2001.