Financial information

This section contains certain information from Telstra's audited consolidated financial information for the 1993 to 1997 financial years and a commentary on dividends. The profit and loss information is presented both on an historical reported basis and also as adjusted for changes in accounting policies adopted by Telstra in the 1997 financial year.

Historical financial information

The table below shows historical profit and loss information derived from Telstra's audited statutory Financial Statements.

PROFIT AND LOSS STATEMENT DATA	Year ended 30 June				
	1993	1994	1995	1996	1997
	(in $ millions, except per share amounts)				
Operating revenue	12,656	13,363	14,081	15,239	15,983
Operating expense before interest expense and abnormals	9,379	9,673	10,602	11,464	11,654
Operating profit before interest expense and abnormals	3,277	3,690	3,479	3,775	4,329
Interest expense	921	748	506	533	524
Operating profit before abnormals	2,356	2,942	2,973	3,242	3,805
Abnormals (1)	(362)	(414)	(568)	205	(1,732)
Operating profit before income tax expense	1,994	2,528	2,405	3,447	2,073
Income tax expense (1)	1,090	823	649	1,145	464
Operating profit after income tax expense	904	1,705	1,756	2,302	1,609
Minority interests	1	(6)	(3)	3	8
Operating profit attributable to the shareholder	905	1,699	1,753	2,305	1,617
Earnings per share (2)	8.2¢	13.7¢	13.6¢	17.9¢	12.6¢
Dividends provided for or paid	674	738	944	1,368	4,146 (3)
Dividends per share (2)	6.1¢	6.0¢	7.3¢	10.6¢	32.2¢
OTHER DATA					
EBITDA before abnormals	5,316	5,744	5,576	6,021	6,597
EBIT before abnormals	3,194	3,621	3,372	3,670	4,244

(1) *Abnormals of $1,732 million in the 1997 financial year comprise $1,126 million for redundancy and associated costs related to Telstra's workforce reduction and restructuring programme, $342 million and $476 million in relation to the Broadband Network writedown and provision respectively, $394 million in relation to loss on a long-term construction contract (the JORN project), offset by a $606 million benefit arising from changes in accounting policies described below under 'Adjusted profit and loss information.' Income tax expense has been reduced accordingly. In addition, income tax expense includes an abnormal income tax benefit of $216 million relating to depreciation of revalued assets. For a discussion of abnormals in prior years see Appendix 2 of the separate Appendices volume.*

(2) *Calculated based on 12,866,600,200 shares, being the number of shares on issue at the date of this Public Offer Document. For the 1993 and 1994 financial years this has been adjusted to reflect the lower number of shares on issue in those years. Fully diluted earnings per share for the 1995, 1996 and 1997 financial years is the same as basic earnings per share. Fully diluted earnings per share in the 1993 and 1994 financial years was 7.4 cents and 13.4 cents, respectively.*

(3) *Includes a $3.0 billion special dividend paid to the Commonwealth on 30 June 1997, as part of a recapitalisation of the Company.*

The separate Appendices volume contains a detailed review of Telstra's profit and loss performance and capital expenditures over the last three financial years. The discussion below provides an indication of certain key factors affecting the Company's profit and loss performance (before abnormals) during that period.

Operating revenue grew at an average rate of 6.5% per year from the 1995 to the 1997 financial years, principally reflecting strong growth in mobile telecommunications services, data and text services, and other sales and services, particularly toll-free services. Intercarrier services revenue grew during the period reflecting increased sales to Optus and Vodafone. Telstra continued to experience competitive pressures and migration to other products that resulted in lower revenue from national long-distance calls and international telephone services.

Overall, Telstra's operating expense (before interest expense and abnormals) grew at an average rate of 4.8% per year from the 1995 to the 1997 financial years, but fell as a percentage of revenue. Labour expense rose more slowly than other costs, and decreased as a percentage of revenue during the period, reflecting reductions in staff numbers in the 1997 financial year. Direct cost of sales rose, principally due to the growth in the mobile telecommunications market, which resulted in increased mobile handset purchases, dealer bonuses and payments to other mobile Carriers to terminate calls. Depreciation and amortisation increased during the period reflecting the effect of increased capital investment, offset by the extension of the service lives of certain capital assets as a result of a change in Telstra's depreciation methodology. Other operating expense, which is influenced by the size of the workforce, the extent of outsourcing activities, performance of strategic investments, business growth, competitor activity, market trends and economic conditions, fell as a percentage of revenue in the 1997 financial year, reflecting reduced workforce and discretionary expenditures.

The tables below show historical balance sheet and cash flow information derived from Telstra's audited statutory Financial Statements, adjusted to conform with changes in presentation in the 1997 financial year.

			As at 30 June		
	1993	**1994**	**1995**	**1996**	**1997**
BALANCE SHEET DATA			*(in $ millions)*		
Cash and cash equivalents	1,443	308	2,270	1,219	742
Other current assets	2,962	3,762	3,726	3,847	4,367
Property, plant and equipment	16,942	15,504	16,304	17,969	18,943
Other non-current assets	1,813	1,565	1,783	1,327	1,806
Total assets	23,160	21,139	24,083	24,362	25,858
Current borrowings	1,675	723	1,982	793	1,560
Other current liabilities	4,028	3,635	4,904	5,003	5,704
Non current borrowings	5,795	5,010	3,872	4,350	6,421
Other non-current liabilities	776	1,016	1,598	1,548	2,235
Total liabilities	12,274	10,384	12,356	11,694	15,920
Shareholder's equity	10,886	10,755	11,727	12,668	9,938 (1)

(1) Reflects payment of a $3.0 billion special dividend paid to the Commonwealth on 30 June 1997, as part of the recapitalisation of the Company.

			Year ended 30 June		
	1993	**1994**	**1995**	**1996**	**1997**
CASH FLOW DATA			*(in $ millions)*		
Net cash provided by operating activities	3,961	4,118	5,414	4,478	5,254
Net cash used in investing activities	(2,301)	(2,132)	(3,112)	(3,870)	(4,171)
Net cash used in financing activities	(892)	(3,121)	(340)	(1,659)	(1,572)
Net increase (decrease) in cash and cash equivalents	768	(1,135)	1,962	(1,051)	(489)
Capital expenditures and investments	2,608	2,496	3,282	4,071	4,504

Adjusted profit and loss information

The adjusted profit and loss information below is derived from the Investigating Accountant's Report prepared by Price Waterhouse. During the 1997 financial year, Telstra changed certain accounting policies to capitalise software developed for internal use and to capitalise interest and indirect overheads incurred during the self-construction of assets. This has the effect of treating these amounts as assets on Telstra's balance sheet. These assets are then depreciated as an expense over a number of subsequent years, reflecting their expected service life. This delays the effect on the profit and loss statement, on the basis that the assets continue to benefit the Company beyond the year in which they were acquired. The purpose of these changes was to further align Telstra's accounting policies with common practice in the telecommunications industry. Prior to these changes, these costs were expensed as incurred rather than capitalised. The effect of these changes in accounting policies in the 1997 financial year was a material increase in operating profits. The information below has been adjusted to reflect these changes in accounting policies as if they had always been in place.

	Year ended 30 June				
	1993	**1994**	**1995**	**1996**	**1997**
ADJUSTED PROFIT AND LOSS STATEMENT DATA	*(in $ millions, except per share amounts)*				
Operating profit before abnormals	2,668	3,149	3,226	3,431	3,984
Abnormals	(362)	(414)	(568)	205	(2,338)
Operating profit before income tax expense	2,306	2,735	2,658	3,636	1,646
Operating profit after income tax expense	1,223	1,844	1,852	2,423	1,336
Operating profit attributable to the shareholder	1,224	1,838	1,849	2,426	1,344
Earnings per share (1)	11.1¢	14.9¢	14.4¢	18.9¢	10.4¢
OTHER DATA					
EBITDA before abnormals	5,765	6,174	6,107	6,546	7,130
EBIT before abnormals	3,360	3,754	3,552	3,786	4,319

(1) Calculated based on 12,866,600,200 shares being the number of shares on issue at the date of this Public Offer Document. For the 1993 and 1994 financial years this has been adjusted to reflect the lower number of shares on issue in those years. Fully diluted earnings per share for the 1995, 1996 and 1997 financial years is the same as basic earnings per share. Fully diluted earnings per share in the 1993 and 1994 financial years was 9.8 cents and 14.4 cents, respectively.

Dividends

In determining actual dividends, the current policy of Telstra's Board of Directors is to declare dividends of at least 60% of operating profit attributable to shareholders, subject to taking into consideration a number of commercial factors, including the interests of shareholders, cash requirements for future capital expenditures and investments, as well as relevant industry practice. In relation to the 1998 financial year, the current intention is to pay an interim dividend in March 1998 and a final dividend in October 1998. Payment of $4.146 billion in dividends to the Commonwealth for the 1997 financial year significantly reduced the balance of Telstra's franking credit account. The Board expects the 1998 dividends to be fully franked, and will endeavour to ensure that the Company provides shareholders with fully franked dividends in future years. However, the Board can give no assurance about the future level of dividends, if any, or the level of franking credits. These levels will depend on a number of factors, including those discussed in the 'Investment risks' section, government legislation and the taxation position of Telstra. Telstra does not intend to operate a dividend reinvestment scheme.

Appendix 2 of the separate Appendices volume contains selected consolidated financial and statistical data, further information about dividend policy, a Management's Discussion and Analysis of Telstra's results for the 1995 to the 1997 financial years, selected unaudited adjusted profit and loss statement data, the Investigating Accountant's Report prepared by Price Waterhouse and Telstra's consolidated Financial Statements.

Investment risks

You should recognise that the price of Telstra shares can fall as well as rise. The price at which the shares trade may be higher or lower than the price you pay for the shares. Many factors will affect the price of the shares of Telstra, including overall economic conditions, changes in government policies and movements in interest rates or stock markets.

Before making an investment decision, you should also carefully consider all of the following risks which may affect Telstra or the industry in which it operates, as well as the other information in this document.

Increased competition

The Australian telecommunications market has become increasingly competitive as a result of the phased liberalisation of the industry beginning in the late 1980s. The introduction of limited competition resulted in an increase in the number of competitors and lower prices for many telecommunications products and services. The commencement of open competition on 1 July 1997 is further changing the competitive environment and its full effects are difficult to predict. Telstra expects to continue to lose market share in a number of its principal markets where it presently has a leading market position. The extent of Telstra's future market share loss cannot be predicted with accuracy, but it may be markedly higher than losses of market share experienced to date. Telstra also expects competitors to market aggressively to key niche segments.

In addition, new technologies are lowering the barriers to entry, reducing cost structures and enabling the delivery of new products and services. While Telstra expects competitors to engage in vigorous price competition, there is a further risk that competitors could engage in sustained and extreme price competition in a bid to win market share. Such conduct would be likely to have a material adverse effect on Telstra's results of operations in the market or markets in which it occurs.

The new regulatory regime facilitates competition in a number of ways. For example, it removes the limit on the number of Carriers and requires Telstra to provide competitors with greater access to its telecommunications services and facilities. The new regime also expands the availability of preselection (which provides automatic access to the customer's preferred telecommunications service provider without the need to dial a special code). Further, the Communications Minister has announced that Telstra will be required to provide local number portability services to Optus by 1 May 1998. These changes facilitate the ability of customers to change their provider of telecommunications products and services.

As the Australian telecommunications market becomes increasingly competitive, the regulatory environment evolves and new technologies are introduced, Telstra's success will depend, to a large extent, on its ability to become more effective operationally and to continue to improve its corporate culture, competencies and practices. Challenges include changing the nature of employee functions to increase focus on delivering value to customers, providing performance-based compensation incentives, instituting procedures to measure productivity and strengthen accountability, and implementing more stringent internal control procedures. See 'Industry environment – Competitive and regulatory environment' on page 46.

New regulatory regime

The open competition regulatory regime, which began on 1 July 1997, represents a move toward general competition law and away from industry-specific competition regulation. Although some previous restrictions on Telstra have been removed, Telstra is governed by a number of regulatory requirements over and above the general competition law.

As the new regime has recently been introduced, there is uncertainty about its practical operation and the manner in which the participants in, and regulators of, the Australian telecommunications industry will respond. For example, because Telstra is likely to be considered to have a substantial degree of market power in some of its markets, the ACCC could issue a competition notice that would expose Telstra to potentially substantial penalties and damages awards if the Federal Court were to determine that Telstra had taken advantage of its market power with the purpose, effect or likely effect of substantially lessening competition in a particular telecommunications market. Given the substantial nature of these potential penalties and damages awards, Telstra may choose to cease the behaviour specified in a competition notice prior to the Federal Court making such a determination. Telstra is also required to give advance notification of certain price changes to the ACCC which could affect the Company's ability to change prices rapidly and could lead to the publication of such pricing information. In addition, the Communications Minister can make rules and impose licence conditions, at his discretion, in connection with the implementation and operation of certain aspects of the new regulatory regime. For example, the Communications Minister has recently announced his intention to impose interim licence conditions (including pricing) on Telstra in relation to the provision of local number portability services to Optus. In complying with these interim licence conditions, Telstra expects that it will recover only part of its costs. In the longer term, Telstra may have to incur substantial additional capital expenditure to implement new number portability solutions which may be required by the Australian Communications Authority (ACA).

In addition, Telstra and other Carriers are required to provide access to some of their services and infrastructure to industry participants, and Telstra may be required to provide access to additional services and infrastructure if to do so would be in the long-term interests of end users. The ACCC access determinations could require Telstra to provide access to discrete services and infrastructure on terms which Telstra would consider unfavourable. Also, unlike its competitors, Telstra is subject to price controls, including a new requirement to reduce local call prices in areas where competition has yet to emerge. There is a risk that Telstra's commercial freedoms may be affected by the application of these regulatory provisions. For example, the ACCC may take action which would have the effect of impeding Telstra's ability to offer product and pricing packages or to withdraw or vary its product or service offerings on a timely basis. In addition, there is no statutory cap on Telstra's tort liability for its supply of telecommunications services. See 'Industry environment – Competitive and regulatory environment' on page 46.

Industrial relations and potential industrial action

A substantial majority of Telstra's employees are covered by a single enterprise agreement which expires on 4 October 1997, although the terms of the existing agreement will continue in effect until a new agreement is concluded. In negotiating the new agreement, Telstra aims to achieve increased management and labour flexibility. There is a risk that it will be unable to achieve agreement with the unions and the support of a majority of its employees and, as a consequence, may not realise any or all of these aims and may be subject to industrial action initiated by employees or unions. While it is not possible to determine the effect of any industrial action, severe or extended industrial action would have a material adverse effect on Telstra's results of operations. Telstra is also currently pursuing changes to its retrenchment and redundancy arrangements, the non-achievement of which would continue to constrain Telstra's ability to ensure that it retains all employees with the most appropriate skills and highest performance levels for areas affected by redundancies.

Rapid technological change

Rapid changes in telecommunications and information technology are redefining the markets in which Telstra operates, the products and services demanded by customers and the ability of enterprises to compete in the telecommunications industry. Such changes are broadening the range, reducing the costs and expanding the capacities and functions of infrastructures capable of delivering these products and services. Partially as a result of these changes, the prices that can be charged for many products and services are falling. Telstra has invested substantial capital and other resources in the development and modernisation of its networks and systems. With the accelerating pace of technological change, the outcome of such investments is increasingly less certain. There is a risk that competitors will deploy or develop technologies that provide them with lower costs or other operating advantages relative to Telstra, which could require it to incur significant capital expenditures in addition to those already planned in order to remain competitive or which could render previous capital investments ineffective.

Uncertain pay television industry environment

Telstra and News Corporation are 50/50 partners in FOXTEL, which offers pay television services over the Broadband Network. The pay television industry in Australia has been operating since 1995 and is characterised by high programming costs, high operating and capital expenditures, duplication of infrastructure and a high level of competition between operators and from free-to-air networks. To date, this has led to a high level of customer churn on the Broadband Network and significant start-up losses in pay television. Pay television services are in an early stage of development in Australia and churn rates are variable but have shown an overall downward trend since operations began. In the 1997 financial year, the monthly churn rate on the Broadband Network, including cable Internet customers, was approximately 5.3%, and in June 1997 was approximately 4.5%. Churn is measured as gross number of disconnects (not adjusted for reconnections, such as where the customer moves homes or reconnects in the same home) in the period divided by the average number of customers during the period. Telstra estimates that the loss before interest expense and income tax expense in relation to the Broadband Network and pay television operations in the 1997 financial year was $394 million. The conditions in the industry present risks to Telstra's and FOXTEL's revenues from the delivery of pay television services over the Broadband Network and, if FOXTEL's services are not widely taken up relative to competing services, Telstra's ability to co-market other services with pay television, with possible adverse effects on Telstra's telephony revenues.

Telstra, News Corporation and Australis have executed agreements for Australis to acquire FOXTEL. There are several conditions to and approvals required for the completion of the transaction. If this transaction is not completed, Telstra and FOXTEL would lose certain anticipated longer-term benefits of the merger, such as, in Telstra's case, the removal of certain guarantees of FOXTEL's minimum subscriber numbers. Australis is highly leveraged, has a net asset deficiency and has incurred significant operating losses and negative cash flow to date. If the transaction is completed, there is no assurance that the merged business will be able to continue to finance its ongoing development and operations. There may also be broader structural developments in the industry, which may adversely affect Telstra. Telstra anticipates further rationalisation of programming interests. The proposed acquisition of FOXTEL by Australis and Telstra's reduced control of programming, would diminish Telstra's ability directly to influence the outcome of such programming rationalisation.

Closure of analogue AMPS mobile telecommunications network and sale of spectrum

The Telecommunications Act 1997 provides for the closure of Telstra's analogue AMPS mobile telecommunications network by 1 January 2000 and prohibits the installation and operation of any other analogue AMPS mobile telecommunications networks. This closure may be subject to exceptions in regional and rural areas specified in a determination to be made by the Communications Minister. The Government has announced that it will be giving consideration before the forthcoming auction of 800 megahertz band spectrum to the retention of a regional and rural AMPS mobile telecommunications network beyond 2000. According to a predetermined schedule leading up to 1 January 2000, Telstra is required to vacate the radiocommunications spectrum currently used by the analogue AMPS network. Telstra is actively encouraging the migration of its analogue customers to its digital service. However, there is a risk that customers will switch instead to the mobile telephone services of Telstra's competitors. The Commonwealth has announced, in the context of the forthcoming auction of 800 megahertz spectrum, that it proposes to establish limited rights for successful bidders for that spectrum to resell Telstra's analogue mobile telephone service and limited reciprocal roaming rights between the analogue services and digital services operating in the 800 megahertz band. The Communications Minister has also indicated that, in deferring the spectrum auctions, he has asked the ACCC to consider the establishment of intercarrier roaming rights between digital networks. The establishment of intercarrier roaming rights between digital networks, as well as the retention of a regional and rural analogue AMPS network after 2000, could each have a significant adverse effect on Telstra's competitive position and results of operations.

Litigation

Telstra is engaged in a number of legal proceedings. While Telstra believes that it has made appropriate provisions in respect of these proceedings, there is a risk that the ultimate resolution of these proceedings may result in the provisions being exceeded. There is also a risk that its reputation may suffer due to the profile of, and public scrutiny surrounding, certain of these legal proceedings, regardless of their outcome. Furthermore, there is a risk that, with the advent of open competition and the uncertainty surrounding the manner in which the regulators and competitors will respond to the new regulatory regime, Telstra faces increased exposure to threatened or actual litigation. Optus, a major industry participant, commenced proceedings against the Company on 10 September 1997 alleging that Telstra has been misusing market power in various markets. The claim by Optus seeks relief related to the Company's pricing and operational practices and, if successful, could have a material adverse effect on Telstra's operations, financial results and competitive position. See 'Additional information – Legal and regulatory proceedings' commencing on page 50.

Losses relating to Jindalee Operational Radar Network

Telstra is the Commonwealth's prime contractor to design, construct, install and maintain the Jindalee Operational Radar Network (JORN) for the Department of Defence. Management of the JORN project has been sub-contracted to RLM Management Pty Ltd (RLM), a company jointly owned by Lockheed Martin Corporation and Transfield Defence Systems Pty Ltd. Telstra is presently evaluating means to satisfy its obligations to the Department of Defence by arranging for RLM to assume the entire management role for the project. The JORN project has proven unprofitable for Telstra and completion is not expected until 2002. Accordingly, as at 30 June 1996, Telstra had established a provision of $211 million relating to its ongoing obligations in relation to the JORN project. In addition, in the 1997 financial year, the Company recognised an abnormal charge of $394 million in relation to the JORN project. There is a risk that the provisions made will not be adequate. Telstra is currently in negotiations with RLM to settle arrangements whereby Telstra will have a right, on certain events happening, to require RLM to assume full responsibility for the completion of the JORN project. While there can be no assurance that there will be a successful conclusion to the negotiations, Telstra expects this to occur. If successfully concluded, the arrangements should ensure that Telstra is able to complete the project at a level consistent with such provisions. Although there would be a residual risk that further costs may be incurred by Telstra in relation to the project, no such costs are presently anticipated.

Year 2000 date change – potential effect on networks and systems

In common with users of computers around the world, Telstra is investigating if and to what extent the date change from 1999 to 2000 may affect its networks and systems. Telstra has established a programme designed to ensure that the impact of the transition to the year 2000 on the Company and its customers is minimised by seeking to ensure that Telstra's key networks and systems are year 2000-compliant before 31 December 1999. There can be no assurance that this programme will be successful or that the date change from 1999 to 2000 will not materially affect Telstra's operations and financial results. Telstra's operations may also be affected by the ability of third parties dealing with Telstra to also manage the effect of the year 2000 date change.

Disaster recovery – billing systems

The computer systems used by Telstra for the processing of data for billing purposes are situated principally in one location. Telstra does not presently have back-up processing facilities adequate for the timely processing of this data in the event of the destruction or substantial impairment of its primary processing facilities, which could occur as a result of fire, flood or other disaster. Were such an event to occur, Telstra could experience significant delays in the processing of customer bills and the receipt of related payments.

Relationship with the Commonwealth – continuing Commonwealth control of Telstra

All issued shares of Telstra are presently owned by the Commonwealth. After completion of the Telstra Share Offer, the Commonwealth will own at least two-thirds of the shares (and possibly more, depending on the extent to which the over-allotment option is exercised) and, as a result, will retain effective control of Telstra. So long as the Commonwealth owns a majority of Telstra's shares, it will have the right under the Company's Articles of Association to decide any matter requiring approval by the holders of a majority of the shares, including matters relating to the election of directors. Under the Telstra Act, the Communications Minister has certain discretionary powers to direct Telstra in relation to matters involving the public interest. Subject to a duty to ensure that Telstra complies with any such direction and the provisions of the Telstra Act, Telstra's Board must meet its fiduciary duties to the Company. The Commonwealth is also responsible for regulation of the telecommunications industry. The Commonwealth and its regulatory agencies, in carrying out their functions, have taken actions and may take further actions which constrain Telstra's conduct or affect its commercial operations. Telstra expects that the Government will continue to exercise its legislative and regulatory responsibilities and powers so as to promote industry competition and that the Government's separate interest in Telstra shareholder value will not be a determinative consideration in that context. There can be no assurance that the current or future governments will not take further steps which alter Telstra's competitive position or the manner in which the Australian telecommunications industry is regulated.

Perceived health risks associated with electromagnetic energy

Allegations have been made, but not proven, that mobile telecommunications equipment may pose health risks due to emissions of electromagnetic energy from such devices. The weight of national and international scientific opinion is that there is no substantiated evidence of public health effects from such energy at typical levels. In its operations, Telstra complies with the electromagnetic energy emissions levels permitted by Australian Standard 2772. However, there is a risk that an actual or perceived health risk associated with mobile telecommunications equipment could lead to litigation, could adversely affect Telstra through a reduction in the number or the growth rate of mobile telecommunications services or reduced usage per customer or could hinder the Company's placement of new mobile telecommunications equipment. Two claims have been filed against Telstra and its affiliates, including a claim alleging that an individual developed cancer due to electromagnetic energy emitted from one of Telstra's base stations.

Prospects

The assessment by Telstra's directors of the Company's prospects for the 1998 financial year is based on assumptions concerning future business decisions and the success of Telstra's business strategy and on other estimates, expectations and assumptions developed by Telstra that, while quantified and considered reasonable by the Company, are subject to significant regulatory, competitive, business and economic uncertainties which are outside the control of Telstra and are not capable of precise prediction. In particular, the directors' assessment is based on Telstra's best estimates as to the effect of the new regulatory regime, historical trends and performance (although historical trends may not be indicative of future performance), market surveys and the experience of other telecommunications companies in overseas markets.

The directors' assessment is likely to vary from actual results, and these variations may be materially positive or negative. Investors' attention is drawn to the developments and uncertainties affecting Telstra's business that are discussed throughout this document. Inclusion of the prospective financial information set out below is a statement of the directors' present belief as to the Company's prospects for the 1998 financial year and is not a representation by Telstra, its directors or any other person that the results set out below will be achieved.

Of particular significance for the directors' assessment are the assumptions concerning the effect of the new regulatory regime introduced on 1 July 1997 and the effect of open competition under that regime. Many of the changes introduced by the new regulatory regime and increased competition will not have their full impact in the 1998 financial year. For example, the recent announcements concerning local number portability are unlikely to have a material adverse effect on Telstra in the 1998 financial year but may have such an effect in later years.

For these and other reasons, the prospective financial information for the 1998 financial year should not be taken as a guide to results in later years.

Although the directors' assessment is based on Telstra's best estimate assumptions, Telstra has only limited prior experience on which to base its estimates as to the effects of the new regulatory regime and open competition both during the 1998 financial year and in later years. Prospective investors are cautioned not to place undue reliance on this information. This information should be read together with the assumptions and sensitivity analysis set out below, the 'Investment risks' section commencing on page 30 and the other information contained in this document.

1998 financial year prospective financial information

	Reported Financial Information Year ended 30 June 1997	Year ending 30 June 1998
	(in $ millions, except per share amounts and percentages)	
PROFIT AND LOSS STATEMENT DATA		
Operating profit before income tax expense (1)	2,073	4,243
Income tax expense	464	1,421
Operating profit attributable to shareholders (2)	1,617	2,805
OTHER DATA		
EBITDA before abnormals (3)(5)	6,597	7,311
EBIT before abnormals (4)(5)	4,244	4,850
Capital expenditures and investments	4,504	4,395
Earnings per share (1)(6)	12.6¢	21.8¢
Dividends per share (6)(7)	32.2¢	13.0¢
Total debt to total capitalisation as at end of period (8)	44.5%	42.3%
Net debt to capitalisation as at end of period (9)	41.5%	40.9%

Note: The effect of the proposed acquisition of FOXTEL by Australis in a transaction among Telstra, News Corporation and Australis is not reflected in the prospective financial information. The prospective financial information could vary if the transaction is consummated. See 'Basis of preparation of prospective financial information' commencing on page 37.

(1) *The 1997 financial year operating profit before income tax expense is after abnormals of $1,732 million. See 'Financial information' commencing on page 27.*

(2) *Operating profit after income tax expense and minority interests.*

(3) *Operating profit (including profits from sale of assets/investments, dividends received/receivable and miscellaneous revenue) before interest received/receivable, interest expense, abnormals, depreciation and amortisation and income tax expense. EBITDA before abnormals is used as a measure of financial performance by excluding certain variables that affect operating profits but which may not directly relate to all financial aspects of the operations of a company. EBITDA before abnormals is not a measure of operating income, operating performance or liquidity under Australian GAAP.*

(4) *EBITDA before abnormals less depreciation and amortisation.*

(5) *The Company treated the effect of certain accounting policy changes adopted in the 1997 financial year as significant abnormal benefits and, therefore, they were not reflected in EBITDA before abnormals and EBIT before abnormals in the 1997 financial year. As these benefits affect EBITDA before abnormals and EBIT before abnormals in the 1998 financial year, the amounts for the 1998 financial year are not presented on a comparable basis with the 1997 financial year.*

(6) *Calculated based on 12,866,600,200 shares.*

(7) *Assuming the Board declares dividends totalling 60% of operating profit attributable to shareholders for the 1998 financial year. See 'Financial information – Dividends' on page 29.*

(8) *Total debt consists of short-term debt and long-term debt. Total capitalisation consists of total debt and shareholders' equity including minority interests.*

(9) *Net debt consists of total debt less cash and cash equivalents and other interest-bearing financial assets. Capitalisation consists of net debt and shareholders' equity, including minority interests.*

Accounting policies

The prospective financial information has been prepared on the assumption that the accounting policies of Telstra will remain the same as those applied in preparing the financial statements for the 1997 financial year and does not take into account the effect of any changes in accounting standards which may be introduced during the 1998 financial year.

Telstra has recently introduced a number of changes to its accounting policies including, commencing in the 1997 financial year, capitalisation of some items which were previously expensed. In the preparation of the financial statements, such policies, in accordance with Australian accounting standards, were only implemented from the date of the change, with no retrospective adjustment to prior years. The prospective financial information for the 1998 financial year has been prepared on this basis. See 'Financial information' commencing on page 27. Appendix 2 in the separate Appendices volume contains a more detailed discussion of the effects of the changes in accounting policies.

In the adjusted profit and loss information (on page 29), these accounting policy changes are applied retrospectively, as though the new accounting policies had always been in force. For example, depreciation and amortisation has been restated as if all past expenditure in the relevant categories had not been expensed, but instead had been capitalised. The table below shows the adjusted prospective financial information for the 1998 financial year on a comparable basis to the data contained in the adjusted profit and loss information.

	Adjusted Financial Information	
	Year ended 30 June 1997 *(in $ millions)*	**Year ending 30 June 1998** *(in $ millions)*
PROFIT AND LOSS STATEMENT DATA		
Operating profit before income tax expense (1)	1,646	3,863
Operating profit attributable to shareholders (2)	1,344	2,562
OTHER DATA		
EBITDA before abnormals (3)	7,130	7,311
EBIT before abnormals (4)	4,319	4,470
Capital expenditures and investments	4,504	4,395

Note: The effect of the proposed acquisition of FOXTEL by Australis in a transaction among Telstra, News Corporation and Australis is not reflected in the prospective financial information. The prospective financial information could vary if the transaction is consummated. See 'Basis of preparation of prospective financial information' below.

(1) *The adjusted operating profit before income tax expense for 1997 is after abnormals of $2,338 million.*

(2) *Operating profit after income tax expense and minority interests.*

(3) *Operating profit (including profits from sale of assets / investments, dividends received / receivable and miscellaneous revenue) before interest received / receivable, interest expense, abnormals, depreciation and amortisation and income tax expense. EBITDA before abnormals is used as a measure of financial performance by excluding certain variables that affect operating profits but which may not directly relate to all financial aspects of the operations of a company. EBITDA before abnormals is not a measure of operating income, operating performance or liquidity under Australian GAAP.*

(4) *EBITDA before abnormals less depreciation and amortisation.*

Basis of preparation of prospective financial information

The prospective financial information has been prepared on the basis of numerous assumptions, including those material assumptions set out below. This information is intended to assist investors in assessing the validity of the assumptions on which the prospective financial information is based and the likelihood of the assumptions actually occurring. It is not intended to be a forecast that the assumptions will in fact occur and investors should be aware that events or outcomes which differ in size or timing from those assumed may occur and may have a positive or negative effect on the prospective financial information. In assessing the reliability of the prospective financial information, investors should have regard to all of the information in this document. An indication of the sensitivity of the prospective financial information to variations in some of the assumptions is set out below.

Operating revenue

The market for telecommunications services in Australia as estimated by Telstra (consisting of Australian sources of Telstra's sales revenue other than customer premises equipment and certain elements of other sales and services, such as pay television operations) is expected to grow in revenue terms by approximately 6.0% during the 1998 financial year, which is faster than the expected rate of non-farm GDP growth of 3.8%. This anticipated growth is due principally to the introduction of new products and services, increased usage associated with the commencement of open competition on 1 July 1997, general economic conditions, higher disposable incomes, an increasingly mobile population and growth in tourism. Principal offsetting factors include an anticipated decline in the population growth rate and a decline in the rate of growth of mobile telephone services.

Historically, the underlying rate of growth in the market for telecommunications services in Australia has been greater than the rate of growth in non-farm GDP in each of the past five years. However, there is no assurance that the estimated market growth for the 1998 financial year will occur or that historical patterns will continue.

Operating revenue in the 1998 financial year is estimated to grow by approximately 4.7% to $16.7 billion, which will include $248 million from the full-year effect of the consolidation of Pacific Access. This growth rate assumes a decrease in Telstra's estimated overall market share in terms of revenue of approximately 2.0 percentage points and is lower than the anticipated overall growth in the telecommunications market, reflecting a combination of anticipated price reductions and loss of market share. Telstra has estimated that prices for a number of its products and services will be reduced at rates that exceed the rate of reduction required under regulatory price caps, principally as a result of increased competition. See 'Industry environment – Competitive and regulatory environment' commencing on page 46. Appendix 3 in the separate Appendices volume contains a more detailed discussion of changes in the regulatory environment.

The revenue generated by Telstra's products and services is expected to be a function of the overall market performance of the relevant product category and Telstra's ability to mitigate the effects of competition. Particular factors expected to affect operating revenue in the 1998 financial year include:

- sustained competitive pressure on market share and prices, which is expected to be greatest in national long-distance calls, international telephone services and mobile telecommunications services, but is assumed to be offset in part by volume growth in these markets and concerted efforts to win back customers previously lost to competitors;
- continued active promotion of higher value-added products and services to encourage the migration of customers from basic services to higher margin services and continued measures to increase usage rates of existing products and services;
- continued loss of retail market share, although consequent losses of revenue will be offset in part by revenue from the provision of wholesale services to competitors; and
- reduced rate of decrease in average billed minutes per customer in mobile telecommunications services through various measures, including increased voicemail and call waiting usage.

Operating expense (before interest expense and abnormals)

Operating expense (before interest expense and abnormals) is estimated to increase by 5.0% in the 1998 financial year over the 1997 financial year, excluding the effects associated with changes in accounting policies adopted in the 1997 financial year, and to increase by 1.7% including those effects. The ratio of operating expense (before interest expense and abnormals) to operating revenue is estimated to be essentially flat in the 1998 financial year over the 1997 financial year, excluding the effects associated with changes in accounting policies, and to decrease by 2.1 percentage points including those effects. Depreciation and amortisation is expected to remain essentially flat (and decrease as a percentage of revenue) in the 1998 financial year compared with the 1997 financial year, excluding the effects associated with changes in accounting policies, and to increase including those effects.

Particular factors which are expected to affect operating expense (before interest expense and abnormals) in the 1998 financial year include:

- reduction in labour expense, principally as a result of staff reductions of approximately 6,900 full-time staff over the course of the 1998 financial year (of which approximately 3,100 are expected to result from the outsourcing of some operations) as well as the full-year effect of Telstra's staff reductions in the 1997 financial year, partially offset by wage increases including those resulting from the anticipated terms of a new enterprise agreement;
- rise in direct costs of sales principally due to growth in the mobile telecommunications market and an increase in payments to carriers to terminate international outgoing calls; and
- reduction in expenses attributable to bad and doubtful debts owed by Resellers.

In addition, Telstra expects operating expense (before interest expense and abnormals) in the 1998 financial year to include $166 million from its programme to ensure that its networks and systems are year 2000 compliant and $179 million from the full-year effect of the consolidation of Pacific Access. The consolidation of Pacific Access is not expected to have any significant effect on the ratio of operating expense (before interest expense and abnormals) to operating revenue in the 1998 financial year. The prospective financial information has also been prepared on the basis that the current negotiations with RLM in relation to the JORN project are successfully concluded. See 'Investment risks – Losses relating to Jindalee Operational Radar Network'. The outsourcing of Telstra's data centre operations and some applications maintenance and enhancement activities to IBM Global (see 'Telstra: the Company – Network and information technology alliances' on page 21) is not expected to have any significant net effect on operating expense (before interest expense and abnormals) in the 1998 financial year, due to the savings in labour expense referred to above and other expense savings being offset by increased costs associated with the early phase of this outsourcing.

Interest expense

Interest expense will increase in the 1998 financial year, principally due to the full-year effect of the recapitalisation that occurred on 30 June 1997, which resulted in Telstra increasing its debt by $3.0 billion. This increase in interest expense is expected to be offset, in part, by changes in accounting policies adopted in the 1997 financial year to capitalise interest costs associated with assets under self construction.

The effective interest rate on Telstra's outstanding debt is assumed to be 8.0%. Due to Telstra's fixed rate borrowings and interest rate hedging, movements in general interest rates should not have a material effect on interest expense in the 1998 financial year.

Income tax expense

Telstra's effective tax rate for the 1998 financial year is expected to be 33.5%.

Broadband Network

The estimated loss before interest expense and income tax expense, and the aggregate capital expenditures and investments for the operation and installation of the Broadband Network in the 1998 financial year are $340 million and $365 million, respectively. These figures comprise the estimated loss and capital expenditure and investments attributable to the Broadband Network (including the provision of value-added services) and pay television operations, but do not include estimated benefits relating to telephony customer retention. These benefits were included in determining the amount of the writedown of the Broadband Network assets recorded in the 1997 financial year. See 'Financial information' commencing on page 27. Appendix 2 of the separate Appendices volume contains a more detailed discussion of the writedown of the Broadband Network recorded in the 1997 financial year.

The estimated loss assumes that historical high rates of pay television churn will improve slightly during the 1998 financial year. This also reflects the impact of the writedown of the Broadband Network in the 1997 financial year and the recent agreement with News Corporation to reduce Telstra's obligation to roll out the Broadband Network from 4.0 million homes passed to 2.5 million homes passed.

Telstra, News Corporation and Australis have signed agreements for Australis to acquire FOXTEL in exchange for Australis issuing new shares to Telstra and News Corporation. See 'Telstra: the Company – Pay television' commencing on page 20 and 'Investment risks – Uncertain pay television industry environment' on page 32. Completion of the transaction is subject to various conditions beyond Telstra's control, including:

- approval by both Australis' shareholders and bondholders;
- approval by the Australian Foreign Investment Review Board; and
- legal proceedings not being instituted which prevent such completion.

There is no assurance as to when these conditions will be satisfied or that the transaction will be completed. The manner in which the transaction is implemented also depends on consents being obtained from third parties. In addition, the ACCC has powers to investigate and, if appropriate, act in relation to the proposed transaction. The ACCC has requested and been provided with certain information regarding the proposed transaction. The agreement between Telstra, News Corporation and Australis also requires that on completion of the transaction, Australis will adopt a business plan to be prepared by Telstra and News Corporation. For these reasons, the effect of the transaction is not reflected in the prospective financial information.

If the transaction were to be completed by the end of the 1997 calendar year as is currently contemplated, and on the basis of Telstra's current understanding of the financial effect of the proposed transaction, Telstra estimates that operating profit attributable to shareholders in the 1998 financial year would be reduced by approximately $60 million, including a reduction of approximately $25 million in earnings before interest and tax and loss of a tax benefit of approximately $35 million (which will arise if the transaction is completed at any time before 30 June 1998).

Capital expenditures and investments

Telstra expects to incur capital expenditures and investments in the 1998 financial year in the areas described in 'Telstra: the Company – Capital expenditures and investments' on page 22.

Asset revaluations

Telstra will undertake a triennial review of the value of its land and buildings during the 1998 financial year. It is assumed that no major variations in the book value of these assets will occur as a result of this review.

Debt

Telstra expects total debt to remain relatively constant and net debt to increase during the 1998 financial year.

Consumer price index

The prospective financial information assumes a 1.7% CPI increase for Australia in the 1998 financial year.

The estimated prices for Telstra's products and services covered by the CPI-X Regulation, which account for approximately 56% of operating revenue, have been calculated on the basis of the competitive environment and are expected to comply with the CPI-X Regulation in the 1998 financial year. Under the CPI-X Regulation, the CPI component is determined on a calendar year basis, by applying the CPI for the preceding calendar year. Revenue in product areas not covered by the CPI-X Regulation is generally not expected to be directly sensitive to changes in the CPI in the 1998 financial year. Therefore, an increase or decrease in CPI is not expected in itself to affect operating revenue significantly in the 1998 financial year.

The Company's operating expense in the 1998 financial year is not expected to be directly sensitive to changes in the CPI to any significant extent. Accordingly, in the 1998 financial year, changes in the CPI are not expected to have a significant effect on operating profit attributable to shareholders.

Key assumptions

Regulatory

In preparing the prospective financial information, Telstra has made numerous assumptions concerning the effect of the regulatory regime introduced on 1 July 1997. However, there are significant uncertainties with respect to the interpretation and implementation of the legislation and statutory instruments which give effect to the new regime and a number of these assumptions may prove to be incorrect. Also, Telstra has had only limited experience with both the Communication Minister's and the ACCC's approach to regulation of the telecommunications industry under the new regime. Material assumptions in this regard are discussed below. Appendix 3 in the separate Appendices volume contains a more detailed discussion of changes in the regulatory environment.

Access

The prospective financial information has been prepared on the assumption that there will be no material effect from any new declarations of services under the Trade Practices Act during the 1998 financial year. See 'Industry environment – Competitive and regulatory environment' on page 46. If this assumption is incorrect, there may be a material and adverse effect on Telstra's operating revenue and margins. However, it is not possible to quantify the magnitude of any such adverse effect until the details of any declaration and the response of both Telstra and its competitors are known.

Access pricing

The prospective financial information has been prepared on the assumption that during the 1998 financial year there will be reductions in the access prices payable by other providers of telecommunications services.

Because a reduction in access prices may have a negative effect on wholesale revenues (depending on demand characteristics) and may adversely affect Telstra's competitive position in retail markets (depending on competitors' pricing strategies), a sufficiently large reduction in access prices may have a material and adverse effect on Telstra's operating revenue and margin. Any such effect could be determined only after regulatory action and competitors' pricing are known.

Competitive conduct

One of the major opportunities for Telstra under the new regulatory regime is the freedom to tailor product packaging and pricing to individual retail customers or retail customer segments. This is a key component of Telstra's customer retention and market growth strategies.

The prospective financial information has been prepared on the assumption that the ACCC will not generally prevent Telstra from tailoring its products, although the ACCC's view of such tailoring is not yet clear. If this assumption is incorrect, Telstra may be less able to offer certain products effectively, which could lead to material operating revenue and margin losses in the 1998 financial year. It is not possible to estimate the size of any such losses until regulatory determinations and the strategies of Telstra's competitors are known.

Preselection

Telstra has assumed that services which are not currently preselectable will not become preselectable during the 1998 financial year and that Telstra will not be required to provide end users with the ability to preselect providers of telecommunications services on a service-by-service basis. If these assumptions are incorrect, further pressure may be brought to bear on Telstra's operating revenue and margins, although it is not possible to quantify the extent of those pressures until the nature of any deviation from the assumption is known.

Price competition

Telstra has assumed that competitors will engage in vigorous price competition. However, there is a risk that competitors could engage in sustained and extreme price competition in a bid to win market share. This conduct would be likely to have a material adverse effect on Telstra's results of operations in the market or markets in which it occurs.

Litigation

With the advent of open competition and the uncertainty surrounding the manner in which the regulators and competitors will respond to the new regulatory regime, Telstra may face increased exposure to threatened or actual litigation. See 'Investment risks' commencing on page 30 and 'Additional information – Legal and regulatory proceedings' commencing on page 50.

The prospective financial information has been prepared on the assumption that during the 1998 financial year: (i) there will be no payment or provision in respect of litigation against Telstra exceeding amounts provided for such litigation as at 30 June 1997, and (ii) there will be no new litigation arising in the 1998 financial year giving rise to a payment or provision. If this assumption is incorrect, a sufficiently large payment or provision may have a material and adverse affect on Telstra's results of operations.

Industrial relations

It is assumed that during the 1998 financial year, the activities of Telstra will not be materially affected by industrial disturbances. Telstra's planned staff reductions are not expected to lead to significant industrial action in the 1998 financial year due, in part, to Telstra's generous redundancy programme and to the fact that employees and unions have been aware of the nature of the planned reductions for over a year. There has been no significant industrial action to date.

Telstra's current enterprise agreement expires on 4 October 1997, although the terms of the existing agreement continue in effect until a new agreement is concluded. It is assumed that during the 1998 financial year, Telstra will conclude the negotiation of a new enterprise agreement, without suffering significant industrial action and that any delays in negotiating a new enterprise agreement will not adversely affect Telstra's planned staff reductions. Whilst it is not possible to determine the effect of any industrial action, severe or extended industrial action is likely to have a material adverse effect on Telstra's results of operations.

Sensitivity analysis

The prospective financial information for the 1998 financial year is sensitive to variations in certain assumptions used in its preparation. A summary of the effect that variations in certain of these assumptions may have on the prospective financial information is shown below. Care should be taken in interpreting these sensitivities. Some of the sensitivities treat each movement in the variables in isolation to the others, whereas in most cases the movements are interdependent. The effects of movements in a variable can be offset or compounded by movements in other variables. The effect on operating profit attributable to shareholders presented for each sensitivity is not intended to be indicative or predictive of the likely range of outcomes to be experienced with respect to each sensitivity.

The sensitivities have been stated on the basis of operating profit attributable to shareholders for the 1998 financial year, assuming no change in any other variable except where stated.

Market growth

A 1% increase or decrease in overall telecommunications services revenue in Australia could be expected to affect Telstra's operating profit attributable to shareholders by $82 million, assuming no change in its market share or prices for its products and services. Telstra estimates that its variable cost of sales (comprising direct cost of sales and a portion of labour and other operating expenses) is in the range of 15% to 20% of sales revenue. The calculation of this sensitivity assumes a variable cost of sales of 17.5% of sales revenue.

Market share

A one percentage point increase or decrease in Telstra's overall market share could be expected to affect its operating profit attributable to shareholders by $89 million, assuming no change in the prices for Telstra's products and services or the estimated size of the market for telecommunications services in Australia. Telstra estimates that its variable cost of sales (comprising direct cost of sales and a portion of labour and other operating expenses) is in the range of 15% to 20% of sales revenue. The calculation of this sensitivity assumes a variable cost of sales of 17.5% of sales revenue.

Prices

A 1% general decrease in the prices of Telstra's products and services covered by the CPI-X Regulation could be expected to reduce operating profit attributable to shareholders by $46 million, assuming no change in Telstra's market share. A 1% general increase or decrease in the prices of Telstra's products and services which are not covered by CPI-X Regulation could be expected to affect Telstra's operating profit attributable to shareholders by $41 million, assuming no change in Telstra's market share. Where relevant, these calculations take into account the estimated price elasticity effects of the markets in which Telstra operates. For a 1% change in price, Telstra does not anticipate a material change in variable cost of sales. In view of the CPI-X Regulation and the competitive environment, it is expected that Telstra could not generally increase the prices of its products and services.

Labour wage rate

A one percentage point increase or decrease in the labour wage rate could be expected to affect Telstra's operating profit attributable to shareholders by $28 million.

Employee numbers

The effect of increasing or decreasing full-time staff by 1,000 (uniformly throughout the 1998 financial year) relative to the planned reduction of approximately 6,900 full-time staff could be expected to affect Telstra's operating profit attributable to shareholders by $17 million. This sensitivity is calculated based solely on the average wages of employees planned to be subject to the redundancy programme and certain direct costs associated with such employees. This sensitivity also assumes that all redundancy costs are charged against the $1.1 billion redundancy provision established in the 1997 financial year and that the reductions are not related to outsourcing initiatives.

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29 September 1997

The Honourable John Fahey
Minister for Finance
Parliament House
CANBERRA ACT 2600

Board of Directors
Telstra Corporation Limited
242 Exhibition Street
MELBOURNE VIC 3000

Dear Sirs and Madam

Independent Report on Prospective Financial Information

We have prepared this report on the prospective financial information of Telstra for the year ending 30 June 1998 for inclusion in the Public Offer Document dated 29 September 1997 relating to the offer for sale of up to 4,288,866,733 ordinary shares in the Company by the Commonwealth.

The prospective financial information set out on pages 35 to 42 of the Public Offer Document, including the sensitivity analysis, has been prepared for the purpose of providing investors under the Telstra Share Offer with a guide to the future profitability of Telstra. The directors of the Company are responsible for the preparation and presentation of the prospective financial information and the information contained therein, including the assumptions on which the prospective financial information is based.

We have conducted an independent examination of the prospective financial information in order to report and express an opinion on its preparation and presentation for the purpose of the Telstra Share Offer. We disclaim any responsibility for any reliance placed on this report, or on the prospective financial information to which it relates, for any purpose other than that for which it was prepared.

Scope and Basis of Report

Our examination of the prospective financial information has been conducted in accordance with Auditing Standard AUS 804, The Audit of Prospective Financial Information, and other Australian Auditing Standards, on the basis that the prospective financial information is a forecast prepared on Telstra's best estimate assumptions. The opinion expressed in this report has been formed on the following basis.

Our procedures included:

- an examination, on a test basis, of systems and evidence supporting the basis of preparation and material assumptions, amounts and other disclosures in the prospective financial information;
- discussions with directors and management of Telstra; and
- an evaluation of accounting policies to provide reasonable assurance that the prospective financial information presents a view which is consistent with our understanding of the past, current and anticipated future operations of Telstra and the assumptions adopted by the directors.

These procedures have been undertaken to enable us to form an opinion as to whether, in all material respects, the prospective financial information has been properly prepared on the basis of the stated assumptions, that all material assumptions are disclosed, and that the prospective financial information is presented fairly in accordance with accounting policies currently prescribed in Accounting Standards and other mandatory professional reporting requirements, being Urgent Issues Group Consensus Views, and on a basis consistent with the accounting policies adopted by the Company in preparing its 30 June 1997 financial statements.

It is not possible to obtain the assurance necessary to provide the same level of assurance on assumptions underlying prospective financial information as they are predictive in nature and their achievement is uncertain. However, in undertaking the above procedures we have evaluated the evidence supporting the assumptions with a view to reporting anything that indicates they do not provide a reasonable basis for preparation of the prospective financial information.

Report on Prospective Financial Information

In our opinion:

- the prospective financial information is properly prepared on the basis of the stated assumptions;
- all material assumptions are disclosed; and
- the prospective financial information is presented fairly in accordance with accounting policies prescribed in Accounting Standards and other mandatory professional reporting requirements and on a basis consistent with the accounting policies adopted by the Company in preparing its 30 June 1997 financial statements, as disclosed in Appendix 2 – 'Consolidated financial statements' of the separate Appendices volume.

We further report, based on our examination of the evidence supporting the assumptions, nothing has come to our attention which causes us to believe that the assumptions set out on pages 37 to 41 of the Public Offer Document do not provide a reasonable basis for the preparation of the prospective financial information.

The prospective financial information is based on best estimate assumptions of directors who have noted that Telstra has only limited prior experience upon which to base its estimates as to the effects of the new regulatory regime and open competition both during the 1998 financial year and in later years. The directors have cautioned potential investors not to place undue reliance upon the prospective financial information and to have due regard to the key assumptions and the sensitivity analysis set out on page 42 of the Public Offer Document. Furthermore, as anticipated events frequently do not occur as expected, actual results are likely to be different from the results in the prospective financial information and the variation may be material. Therefore, we express no opinion as to whether the results set out in the prospective financial information will be achieved.

Due regard should also be given to the 'Investment risks' set out on pages 30 to 34 of the Public Offer Document.

Declaration of Relationships and Involvement in the Telstra Share Offer

Details of the involvement of Price Waterhouse in the Telstra Share Offer and declarations relating to interests are set out in Appendix 5 – 'Additional information' of the separate Appendices volume.

Yours faithfully

Price Waterhouse

Price Waterhouse

Industry overview

Telecommunications is one of the fastest growing industries in Australia. Carrier revenue has grown from an estimated $13.0 billion in the 1993 financial year to $17.3 billion in the 1996 financial year. Telstra and Optus are the primary providers of public telecommunications infrastructure and networks in Australia. In the 1997 financial year, Telstra reported revenue of almost $16.0 billion and Optus reported revenue of $2.5 billion. In addition, Vodafone Australia Pty Ltd operates a digital mobile phone service and reported Australian revenue of $230 million for the year ending 31 March 1997.

As at 19 September 1997, 8 new Carriers had been licensed to provide telecommunications services. In addition, other service providers use Carrier services and facilities to provide telecommunications services in competition with Carriers.

The start of competition

In 1991, the Commonwealth granted the second general carrier and mobile carrier licences. Optus took over these licences when it purchased AUSSAT in 1992. Optus began to offer national long-distance and international telephone services in November 1992. Beginning in 1993, preselection ballots were progressively conducted nationwide to allow customers to choose their main carrier for national long-distance and international telephone services. Other reforms in 1991 opened the telecommunications market to competition through resale of Telstra's services, with a number of service providers, such as AAPT Limited (AAPT), entering the market.

The introduction of mobile telephones

Telstra began offering analogue mobile telephone services in 1987 and digital mobile telephone services in April 1993. Optus began reselling Telstra's analogue mobile telephone services in June 1992 and offering digital mobile telephone services in May 1993 on its own network. A third mobile carrier licence was granted in December 1992 to Vodafone, which subsequently began offering digital mobile telephone services in October 1993 on its own network. The analogue AMPS mobile telecommunications network is currently being phased out. See 'Telstra: the Company – Mobile telecommunications services' commencing on page 17.

In order to develop a competitive mobile telecommunications market in Australia, the Commonwealth has mandated closure of Telstra's analogue AMPS mobile telecommunications network by 1 January 2000 (subject to possible exceptions in regional and rural areas specified in a determination to be made by the Communications Minister) and prohibited other Carriers from establishing new analogue AMPS networks.

According to the OECD, in 1995 Australia had the fourth highest mobile telephone penetration rate in the OECD. According to ITU World Telecommunications Indicators 1996, 3.8 million customers subscribed to mobile telecommunications services in 1996, representing a penetration rate of 21%. ITU also estimated that 2.7 million of these customers used an analogue mobile telecommunications service.

The introduction of pay television

The Australian pay television industry began in January 1995, when Australis commenced operations after securing microwave multi-point distribution system and satellite transmission licences. Optus Vision Pty Ltd (Optus Vision) began in 1995 to operate a cable system to offer pay television, local telephony, interactive broadband and other services. Also in 1995, Telstra and News Corporation formed FOXTEL and introduced, via Telstra's Broadband Network, a competing pay television service. Optus has reported that it had passed 2.2 million homes by 30 June 1997. Telstra had passed approximately 2.1 million homes by the same date. Each company's broadband network largely passes the same homes. The pay television industry has experienced relatively high customer churn rates.

The Internet

The Internet industry in Australia is growing rapidly. Australia is currently one of the largest users of the Internet by volume and in the 1997 financial year the total number of subscribers in Australia grew by 50%. There are currently estimated to be 2.9 million users in Australia with over 600,000 households subscribing to an Internet service provider. The number of Internet service providers has also expanded rapidly with over 400 currently selling Internet services. This growth has been reflected in demand for international capacity. For example, the bandwidth of Australia's Internet link to the United States was approximately 6 megabits per second in 1995. By July 1997, total bandwidth for Internet links to the rest of the world had reached 150 megabits per second. Telstra is currently the second largest Internet service provider in the residential market and the largest provider of international Internet transmission links.

Competitive and regulatory environment

Legislation that became effective on 1 July 1997 is the most recent in a series of regulatory changes since 1989 designed to increase competition in the Australian telecommunications markets. While previously there was no limit on the number of providers of telecommunications services, Government policy limited the number of Carriers. The new legislation fosters increased competition in the industry by removing the limit on the number of Carriers. It places greater emphasis upon industry self-regulation and commercial negotiation within the overall regulatory framework now overseen principally by the ACCC and the Australian Communications Authority.

Telstra will continue to be subject to competition in the provision of mobile telecommunications, national long-distance telecommunications, and international telephone, video and data services, and faces greater competition in markets such as basic access and local calls where there has previously been relatively limited competition. Telstra expects that there will be many new competitors in its markets and that new and existing competitors will develop telecommunications infrastructure, services and new products based on access to Telstra's own services and facilities. As the open-competition environment has only recently come into existence, however, there is substantial uncertainty as to how competition will continue to develop and the effect that it will have on Telstra in each of its markets.

While competition has reduced Telstra's market share in recent years, it has also stimulated market growth. These trends are expected to continue. Telstra's strategy is designed specifically to meet the challenges and take advantage of the opportunities presented in this newly competitive environment. Telstra has greater competitive flexibility under the new regulatory regime. The removal of many of the tariffing, pricing review and non-discrimination requirements of the earlier legislation allows Telstra to structure its products, marketing and pricing in a more commercial fashion.

Telstra is required to provide certain wholesale services to its competitors on terms that are generally determined through negotiation or, in the absence of agreement, on arbitrated terms. The details and implementation of this new regulatory access regime are not yet settled and may affect adversely Telstra's ability to recover costs of service and its competitive position in retail markets. Price cap regulation will continue to operate until at least 31 December 1998. The ACCC may exercise industry-specific powers based on trade practices principles in a manner that may particularly limit Telstra's activities. See 'Investment risks – New regulatory regime' on page 31.

Appendix 3 of the separate Appendices volume contains further information about the telecommunications industry in Australia, the competitive environment in each of Telstra's main product areas and the regulatory environment.

Relationship with the Commonwealth

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

The Commonwealth as shareholder

The Commonwealth is currently the sole shareholder in Telstra. After the Telstra Share Offer, the Commonwealth will retain ownership of at least two-thirds of the Company (and possibly more, depending on the extent to which the over-allotment option is exercised). The Telstra Act precludes any reduction in the Commonwealth's voting rights, paid up capital or rights to distributions of capital or profit, if any, below a two-thirds interest in Telstra without amending legislation. The effect of this is that Telstra cannot introduce a dividend reinvestment plan or raise new equity capital without Commonwealth participation. There can be no assurance that the Commonwealth would be willing to subscribe for additional shares in Telstra and Telstra's ability to raise additional equity capital could be constrained as a result. The current Government's policy is that there will be no sale beyond one-third of Telstra without an explicit mandate from the Australian people at a future federal election. The Leader of the Opposition has stated that the Australian Labor Party is opposed to the further privatisation of Telstra.

The Telstra Act requires Telstra to provide the Commonwealth with certain information that Telstra would not generally be required to disclose concurrently, if at all, to other shareholders, including, for example the annual provision of Telstra's three-year corporate plan. Representatives of Telstra are also likely to continue to be required to appear before and, with limited exceptions, provide information to Parliamentary Committees.

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

The Commonwealth as regulator

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

Telstra is also subject to a range of Commonwealth legislation, some of which does not apply to its competitors. This legislation covers a wide range of areas including administrative law, environmental law and employment related law. Subject to any exceptions that may be determined by the Commonwealth, the Government has decided to exempt Telstra and its other business enterprises from the application of statutory administrative law, subject to the passage of necessary legislation.

The Commonwealth as customer

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

Appendix 4 of the separate Appendices volume contains further information on Telstra's relationship with the Commonwealth.