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The following discussion should be read in conjunction with the annual consolidated financial statements, including the notes to these financial statements, which are included with this annual report. These 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 consolidated 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 2005, 30 June 2004 and 30 June 2003 as fiscal 2005, fiscal 2004 and fiscal 2003 respectively. We have referred to the three fiscal years ended 30 June 2005 as the three-year period.

Overview of key factors affecting our business and financial performance

We are Australia's largest telecommunications and information services company. We offer a full range of telecommunications products and services throughout Australia and various telecommunications services in certain overseas countries. During the three-year period, we have increased our sales revenue and net profit, maintained a healthy statement of financial position and continued to generate strong operating cash flows. In addition, we have continued to develop our core infrastructure network, acquire strategic investments and increase our returns to shareholders through special dividends and share buy-backs. We have maintained our strong financial position despite intense competition in the telecommunications market and migration of customers from traditional to emerging products and services.

To continue as an Australian market leader in the telecommunications industry, our strategy involves the management of the following:

- migration of customer demand from traditional products and services to the emerging products and services of the business;
- cost and productivity improvements;
- continual improvement of customer service levels; and
- alignment of investment with revenue growth drivers.

We consider the effective management of these areas will require a market based management approach and a change in how the company operates. It also requires a regulatory environment that allows us to compete on an equal basis.

In addition, we face a series of business operating issues that we expect will impact the future results of our Company. These issues range from the potential full privatisation of the Company, regulatory issues including regulated price caps, and establishing the appropriate business structure to drive future growth.

During the three-year period, our increase in sales revenues was led by revenue growth in mobiles, Internet and IP solutions, and advertising and directory services. Our challenge moving forward will be to consolidate the growth in these areas, while managing an accelerating decline in our PSTN revenues experienced in the second half of fiscal 2005. We have continued to focus on maximising revenues from our higher margin

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traditional products such as PSTN products, while managing the shift in customer demand to our lower margin emerging products such as broadband. We have aligned our investment strategies with our new growth products and continue to focus on identifying cost efficiencies to protect operating margins, while improving our customer service levels. Our overall operating margins are under constant pressure from the product mix change to lower margin products.

Most of our revenues are generated from basic access, fixed and mobile call charges, specialised data, Internet and IP solutions, advertising and directories services and intercarrier services. We are focussing on a range of key products and services within these categories as opportunities to maximise our current revenues. This is further described below:

- **PSTN products:** Performance in this market has been limited by competition and product substitution. This market remains a key focal point and a significant part of our Company in terms of sales revenue. It continues to provide us with strong cash flows enabling us to invest and develop our business.

  We continue to focus on maximising returns and improving customer service in this area by offering a broad range of product packages that include packaging traditional products with new products, and re-balancing initiatives that have increased our basic access fees while reducing call charges. In fiscal 2005, total PSTN revenues are declining at an accelerating rate, led by the migration of customers to mobiles and other product and services;

- **Mobiles:** Growth in this area has been driven by the introduction of low access fee plans and the increasing popularity of prepaid offerings. We continue to increase revenues by providing more innovative products on our mobile networks, such as the roll out of super high speed wireless services, known as evolution data optimised (EVDO), and the launch of i-mode that gives access to a wide range of Internet products through mobile handsets. In addition, revenues continue to increase with the higher number of mobile users;

- **Data and Internet services:** Growth in this area is attributable to an increase in revenue from Internet and IP solutions products, predominantly due to the increase in both retail and wholesale broadband subscribers. We expect the Internet and IP solutions portfolio to continue its expansion. This market is in a growth phase and our strategy to capitalise on this growth involves the provision of high speed, innovative Internet products to our customers, combined with aggressive pricing strategies. Over the three-year period, our broadband subscribers (including both retail and wholesale) increased from 169,000 as at 30 June 2002 to 1,744,000 subscribers as at 30 June 2005;

- **Advertising and directories**: Growth in this area has been led by an increase in revenue from our Yellow Pages® and White Pages® printed publications, predominantly driven by product innovation and customer demand. In addition, 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 converging markets. In fiscal 2004, we acquired 100% of the issued share capital of Trading Post (Australia) Holdings Pty Ltd and its controlled entities (Trading Post), an Australian publishing and Internet classified business;

- **Solutions management:** We have continued to strengthen our position in the managed services and information and communication technology (ICT) market. In fiscal 2005, we acquired 100% of the issued share capital of KAZ Group Limited and its controlled entities (KAZ), and Telstra PSINet Limited (formerly PSINet UK Limited) and its controlled entities (PSINet). KAZ is a provider of business process

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outsourcing, systems integration, consulting, applications development and IT management services. PSINet is a provider of e-business infrastructure solutions and corporate Internet protocol based communication services. These acquisitions have expanded our IT services capability to both our Australian and international customers, complementing our core strength in telecommunications. Our recent acquisitions combined with our pre-existing solutions management business have significantly broadened our solutions management services, which we believe will assist us achieve our goal of becoming an Australian leader in the ICT market; and

- **International operations:** Our offshore controlled entities contributed 7.3% of our total sales revenue in fiscal 2005, 6.9% in fiscal 2004 and 7.5% in fiscal 2003. This is primarily attributable to the CSL operations in Hong Kong and the TelstraClear operations in New Zealand, which generate revenues mainly from the mobiles market and from fixed network services respectively. We continue our focus on improving returns from our current international investments in CSL and TelstraClear.

We have maintained our attention to managing the performance of these individual product and service categories. However, as a fully integrated telecommunications company, we aim to build on our existing customer base and capture the market trend towards integrated access and seamless voice, data and content offerings. To achieve this, we continue to bundle our individual products and provide customers with price discounts reflecting this initiative. The prices we charge our retail customers for most of our fixed telephony products, however, are still subject to price controls. Refer to 'Rates we charge our customers are subject to regulated price caps' for further discussion.

During the three-year period, we have focussed on our operating efficiency. Our efforts have included:

- streamlining our systems and processes, including the consolidation of our implementation of the Six Sigma process improvement techniques;
- improving work practices;
- cross company process reviews, which has involved the appointment of process owners within the Company with responsibility to review cost structures; and
- systematically reviewing our cost structures and the way we deliver service to our customers.

These initiatives have allowed us to identify cost efficiencies in many areas, while at the same time improving customer service. They have also resulted in a reduction in the overall number of full time employees and equivalents from 44,977 as at 30 June 2002 to 42,739 as at 30 June 2005, excluding the impact of our significant acquired controlled entities during the three-year period.

We are committed to continuing our review of areas of the business where cost efficiencies can be gained, while improving the customer experience. We believe opportunities to achieve this include:

- obtaining better value from our capital expenditure;
- extracting synergies from our recent investment acquisitions;
- rationalising our various IT and network platforms;
- streamlining our business operations;
- improving network efficiency; and
- managing total labour costs more efficiently.

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Despite these initiatives, our total expenses grew in fiscal 2005, following the decline in fiscal 2004 compared with fiscal 2003. In fiscal 2005, the increase in our total expenses was led by the consolidation of expenses of our recently acquired controlled entities such as KAZ, and the inclusion of a full year of expenses for Trading Post that was acquired in fiscal 2004. In addition, we experienced expense growth across various categories to support our emerging business areas such as broadband and pay television, as well as to meet our customer service requirements. The increase in expenses was partly offset by our cost reduction projects.

Our revenue and expense movements are also subject to inflation rate variations. During the three-year period, the Reserve Bank of Australia has maintained a target inflation rate of between 2% and 3% per annum. As a result, the effects of inflation are not deemed to be significant to our overall operating performance.

We strive to continually improve our customer service. As evidenced by the quarterly service reports from the Australian Communications Authority, our customer service results have shown steady overall improvements over the three-year period. Our focus remains in the following key areas:

- upgrading our networks and reducing fault incidence;
- placing additional trained staff in our call centres to directly deal with our customers;
- improving the technology of voice recognition and in the direction of customer assisted calls;
- enhancing the skills of our staff, enabling them to become specialists in our emerging business areas such as broadband;
- ensuring customer appointments are met, as well as reducing our response times and queue lengths; and
- further improving our performance under the customer service guarantees.

The Telstra Country Wide® business unit ensures we continue to have a strong commitment to telecommunication services in the major rural, minor rural and remote areas of Australia. In addition, under the universal service obligation (USO) regime, we deliver the standard telephone service and prescribed carriage services to all people, wherever they reside or carry on business. Through our continued focus on providing excellent customer service, we aim to satisfy our existing customers and drive future revenue growth by providing quality services to all our customers.

During the three-year period, we have devoted substantial capital to upgrade our telecommunications networks, eliminate components that are no longer useful and improve the systems used to operate our networks. We continue to upgrade our core infrastructure networks to meet customer demands, particularly for those growth product areas such as broadband. In addition to our ongoing capital expenditure, we are in the process of a A$210 million deployment of the latest broadband on copper wire technology, ADSL2+. We are deploying this enhancement to meet customer demand for higher speed Internet services. In fiscal 2005, we also successfully commissioned and began testing our next generation Voice over IP (VoIP) platform that we believe will offer value added broadband services to our residential customers in fiscal 2006.

On 6 December 2004, we signed agreements with Hutchison 3G Australia Pty Ltd (H3GA), a subsidiary of Hutchison Telecommunications (Australia) Limited, to jointly own and operate H3GA's existing third generation (3G) radio access network (RAN) and fund future network development. The H3GA RAN is the core asset of the joint venture. In return for 50% ownership of the asset, we will pay H3GA A$450 million in instalments over 2 years. We anticipate that the H3GA RAN will be operating during fiscal 2006. As a result of this agreement, we expect to accelerate our customers' access to leading mobile services and open opportunities for new revenues. In addition, our agreement with H3GA is expected to provide significant

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savings in 3G network construction expenditure and operating expenses, such as site rental and maintenance, offset by an increase in depreciation and amortisation charges.

During the three-year period, in addition to growth in ordinary dividends, we have also returned A$2,884 million to shareholders through special dividends and share buy-backs, as part of our capital management program. In fiscal 2005, we paid a special interim dividend of A$747 million (6 cents per share), and in fiscal 2003 we paid a special interim dividend of A$386 million (3 cents per share). We have also undertaken two share buy-backs over the three-year period.

In fiscal 2005, we bought back 185,284,669 ordinary shares. In total, 1.47% of our total issued ordinary shares, or 3.00% of our non-Commonwealth owned ordinary shares, were bought back. The cost of the share buy-back comprised the purchase consideration of A$750 million and associated transaction costs of A$6 million. The ordinary shares were bought back at A$4.05 per share, comprising a fully franked dividend of $2.55 per share and a capital component of A$1.50 per share. In fiscal 2004, we bought back 238,241,174 ordinary shares. In total, 1.85% of our total issued ordinary shares, or 3.71% of our non-Commonwealth owned ordinary shares, were bought back. The cost of the share buy-back comprised the purchase consideration of A$1,001 million and associated transaction costs of A$8 million. The ordinary shares were bought back at A$4.20 per share, comprising a fully franked dividend of $2.70 per share and a capital component of A$1.50 per share. The shares bought back from both share buy-backs were subsequently cancelled, reducing the number of fully paid ordinary shares on issue. The Commonwealth Government did not participate in the share buy-backs and as a result its shareholding increased from 50.1% before the buy-backs to 51.8%. The share buy-backs have improved our earnings per share as we now have less shares outstanding and have not hindered the ability of the Company to take advantage of profitable investment opportunities when they arise.

Our major international investments held during the three-year period were CSL, TelstraClear and REACH. CSL operating revenues improved in fiscal 2005, following a decrease in fiscal 2004 compared with fiscal 2003. However, its net profit continued to decrease in the current year as a result of higher costs associated with the launch of 3G services. TelstraClear recorded sales revenue growth over the three-year period and is focussed on achieving further revenue growth and operational efficiencies. REACH has been operating in a difficult environment and the industry is expected to remain challenging for a period of time, mainly due to aggressive pricing and oversupply of capacity.

In January 2005, REACH announced that its data capacity would be consumed entirely by its shareholders. PCCW and Telstra have experienced significant traffic growth in recent years, which will see both companies utilising virtually all of REACH's capacity. REACH has continued to provide its third party voice and satellite services to customers other than PCCW and us. In April 2005, the shareholders also announced improvements to the REACH operating model. As part of the improvements, the shareholders each acquired dedicated components of REACH's international cable capacity by way of an indefeasible right of use (IRU). The shareholders each paid REACH A$205 million (US$157 million) for the IRU, which in our case was settled by a discharge of REACH's liabilities under the capacity prepayment agreement. The shareholders have also each committed to fund a half share of REACH's committed capital expenditure up to fiscal 2022, which is estimated to amount to US$106 million in total. REACH will manage allocated capacity on behalf of its shareholders for a fee determined on a cost plus mark up basis. In fiscal 2003, we wrote down our investment in REACH by A$965 million to a carrying value of nil. Refer to 'Related party transactions' for further details on our transactions with REACH.

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Outlook

We expect our financial results in fiscal 2006 and future years to be impacted by the following key factors:

- continuing changes to our competitive environment, as competition intensifies and the Commonwealth Government reviews the applicable laws and regulations to continue changing 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;
- the potential full privatisation of Telstra and potential business and structural changes arising from the privatisation;
- our ability to capitalise on the growth areas of the business, such as wireless, broadband, and advertising and directories;
- 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 emerging businesses such as KAZ, PSINet and Trading Post and our ability to effectively integrate these businesses into our operations;
- the intense price competition in the business and government segment;
- the ability of CSL to maintain and improve its financial position following the recent market consolidation in Hong Kong and the strong price competition in this market;
- our ongoing efforts to control our costs and improve productivity;
- the effectiveness of our customer service initiatives; and
- economic conditions globally and in Australia.

Our traditional revenues are continually being substituted by wireless, high bandwidth Internet, IP telephony, and web and managed services, where the market growth is occurring. We expect to continue our investment in new platforms and technologies that will align with the growth drivers of these emerging areas, while optimising the performance and returns from our existing networks and products.

As a result of the outlined factors impacting our business, we believe:

- the PSTN voice decline will continue to put pressure on our Company's sales revenue and operating margins. Total PSTN voice revenue is expected to fall in fiscal 2006 at an accelerating rate;
- our growth drivers for broadband, and advertising and directories are expected to be strong in fiscal 2006, however we expect further aggressive pricing from the further adoption of capped plans in the mobiles market to impact the rate of growth in our mobiles business;
- our cash flows will be impacted in fiscal 2006 by the payments to H3GA and higher capital expenditure to meet broadband demand. In addition, we expect to make certain investments in a number of business improvement projects, such as the broadband management system, customer access network rehabilitation and new billing platforms; and
- margin pressure is expected to continue as our revenue mix changes from traditional products such as PSTN to emerging areas such as broadband. We believe that our key management indicators such as earnings before interest, income tax expense, depreciation and amortisation (EBITDA) and earnings before interest and income tax expense (EBIT) will decline in fiscal 2006. Refer to table 1

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'Results of operations' for further details on our results for EBITDA and EBIT during the three-year period and a detailed reconciliation of these measures to net profit. We expect EBIT will also be impacted by an increase in depreciation and amortisation led by the 3G network depreciation and 3G spectrum licence amortisation.

In addition, a number of our competitors are investing in digital subscriber line access multiplexors (DSLAMs) and acquiring our unconditioned local loop (ULL) services to create their own networks. These networks will provide them with efficient voice and data capability. As a result, the incremental ULL rental revenue recognised by our Telstra Wholesale segment is anticipated to be significantly less than the expected decline in PSTN revenues across our retail and wholesale areas. Wholesale broadband sales will also decline. The impact in fiscal 2006 will be offset to some extent by one-off ULL connection charges.

In this difficult environment, new sources of revenue and further cost reductions will be necessary for future EBITDA and EBIT growth.

Effective from 1 July 2005, the Board appointed Solomon Trujillo as our new chief executive officer (CEO) and an executive director, replacing Ziggy Switkowski. The new CEO is undertaking an operational and strategic review to be completed within 3 to 4 months of his appointment. Our outlook may change once the review is finalised and the plans are implemented.

Improving the quality of customer service will remain our key priority, as higher levels of customer service are being demanded by our customers. Understanding our customers by accurate market segmentation and tailoring services to meet their needs is a core requirement of our future performance.

We have adopted the following capital management policies from fiscal 2005:

- declaration of ordinary dividends of around 80% of net profit after tax (before any unusual items such as write downs of assets and investments); and
- the return of A$1,500 million to shareholders each year until fiscal 2007 through special dividends and/or share buy-backs, subject to maintaining our target financial parameters.

On 11 August 2005, the directors declared a fully franked final dividend of 14 cents per share (A$1,742 million) and a fully franked special dividend of 6 cents per share (A$747 million). In addition, we announced our intention to pay a fully franked special dividend of 6 cents per share (A$747 million) with the interim dividend in fiscal 2006. The dividends are in accordance with our capital management program and have been disclosed as a post balance date event in our financial statements for fiscal 2005. The financial effect of these dividends will be recognised in fiscal 2006.

The Commonwealth Government has recently stated that it will introduce legislation to enable the further sale of its interest in us. In March 2005, the Government appointed external business advisers to undertake a scoping study to assess the possibility of a sale and to make recommendations to the Government. The objective of the scoping study was to produce a comprehensive report addressing commercial, policy, regulatory, financial, industry, project management and other issues relevant to divesting the Commonwealth's remaining interest. The scoping study was completed in June 2005 and advised that the preferred timing for any sale of the Commonwealth's remaining interest is late 2006. The Government has stated that it will make a further decision in early 2006 about proceeding with a sale. This decision will include an assessment of whether the level of demand for the shares would allow a partial or full sale of the Commonwealth's remaining interest in us.

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The Government has indicated that any sale legislation will form part of a package of legislation, which will give effect to a number of regulatory reforms including the introduction of an Australian model of operational separation that will apply to our internal structure. We expect further regulatory developments to impact our Company as we progress towards full privatisation. We will continue to assess the impact of these regulatory changes on us as the Government makes further announcements with greater detail about its proposals for regulatory reform.

We will continue to focus on our existing Australian, New Zealand and Asian operations, and upon global services to our multinational customers. After appropriate capital expenditure and returns to shareholders, we expect that we will have sufficient remaining capacity to support well targeted acquisitions of moderate scale that satisfy our strict financial evaluation criteria.

Competitive and regulatory environment

Refer to the 'Competition and regulation' section of this annual report for information regarding the competitive and regulatory environments in which we operate.

Management estimates and judgements in the application of our critical accounting policies

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Australia. Our significant accounting policies are 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 off balance sheet arrangements, including contingent liabilities. We continually evaluate our estimates and judgements, including those related to investments, intangible assets, capitalisation of costs, property plant and equipment, software assets developed for internal use, receivables and provisions.

We base our estimates and judgements on historical experience, various other assumptions we believe to be reasonable under the circumstances and, where appropriate, practices adopted by international telecommunications companies. This forms the basis for making judgements about the carrying values of assets and liabilities, as well as reported revenues and expenses for the period, that are not readily apparent from other sources. Actual results may differ from these estimates in the event that the scenarios on which our assumptions are based prove 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. The future impact of adopting Australian equivalents to International Financial Reporting Standards (A-IFRS) on our accounting policies has been evaluated as part of our A-IFRS convergence project. Refer to 'Changes in accounting policies' for further details.

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 apply to all segments of our Company.

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The following are the critical accounting estimates and judgements we have applied in producing our AGAAP financial statements:

Carrying value of investments, goodwill and other intangibles

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 semi-annually. 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 revenue or earnings multiples, or in the case of listed investments, monitoring of market share prices. These methodologies rely on factors such as forecasts of future operating performance, long term growth rates in the business, and the selection of appropriate market determined, risk adjusted discount rates.

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, goodwill and other intangibles. In applying our assessments, we have not written down significant amounts of these assets during the three-year period, except for the write down of our joint venture investment, REACH, by A$965 million in fiscal 2003. This investment was written down due to strong competition and excess capacity in the global market for international data and Internet capacity that adversely impacted the profitability of REACH and therefore the recoverability of our investment.

The carrying value of our investments in joint venture entities, associated entities and other listed and unlisted entities was A$49 million as at 30 June 2005, A$120 million as at 30 June 2004 and A$255 million as at 30 June 2003. The carrying amount has reduced over the three-year period due to the recognition of our share of equity accounted net losses and the disposal of our interests in certain entities.

The carrying value of goodwill was A$2,287 million as at 30 June 2005, A$2,104 million as at 30 June 2004 and A$2,018 million as at 30 June 2003. On initial acquisition, and at each subsequent reporting date, we assess the useful life of goodwill and other intangible assets as part of our assessment of the carrying value of our investments. During the three-year period, the increase in the carrying value of goodwill was attributable to our investment acquisitions including KAZ, PSINet and the Trading Post, partially offset by the amortisation of goodwill.

The carrying value of our patents, trademark and licences, brandnames, customer bases and mastheads was A$1,581 million as at 30 June 2005, A$1,501 million as at 30 June 2004 and A$1,146 million as at 30 June 2003. The carrying value of these intangible assets is assessed semi-annually and adjusted down where it exceeds recoverable amount. Recoverable amount is based on estimates of the discounted value of expected future cash flows to be derived from the assets future use. These intangible assets, with the exception of the 3G spectrum licence and mastheads, are amortised on a straight-line basis over the period of expected benefit. The 3G spectrum licence, amounting to A$302 million, has been held since 22 March 2001 and is not yet being amortised. Amortisation of this licence will commence in fiscal 2006 in conjunction with the commencement of our 3G service. The mastheads, amounting to A$448 million, were acquired as part of our acquisition of the Trading Post during fiscal 2004. The mastheads have been assessed as having an indefinite life and are therefore not amortised, however the carrying value continues to be re-assessed at each reporting date.

Based on our most recent assessment of recoverable amount, we believe that as at 30 June 2005 our investments, goodwill and other intangible assets are recoverable at the amounts at which they are stated in our financial statements.

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Capitalisation of costs

When we incur costs, we classify them as either operating or capital expenditure. 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 reported in our statement of financial position based on the asset class considered most appropriate to those costs. Management judgement is applied in determining costs to be capitalised in relation to the following major asset categories:

- **Deferred expenditure**

  We defer expenditure where it is probable that the future benefits embodied in the particular asset will eventuate and can be reliably measured. Otherwise the expenditure is expensed as incurred. As a result, we are required to identify future benefits expected to arise from the deferral of expenses, which relate to the revenue that is to be recognised in future periods. Each year we use management judgement to determine the average period in which the related benefits of our deferred expenditure are expected to be realised. 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. A substantial portion of our deferred expenditure relates to costs deferred under Staff Accounting Bulletin (SAB) 104 “Revenue recognition”. These costs directly relate to the deferred revenue associated with basic access installation and connection costs, which are taken to the statement of financial performance in line with the release of revenue as earned. Installation and connection fee revenues are deferred and recognised over the average estimated customer contract life, which for basic access is an average of 5 years.

  Mobile handsets are sold as part of a service contract and are treated as a subscriber acquisition cost. When the mobile handset contract is for at least a period of two years, the cost of any associated subsidy is deferred and written off over the average contract term, consistent with the recognition of revenue from the contract. In addition, incentive and administration fees associated with the acquisition of mobile subscribers in relation to contracts that are for at least a period of two years are also deferred over the average contract period. This average period takes into account various factors such as contract length and early termination, and is reviewed by management each fiscal year to ensure the amortisation of subscriber acquisition costs remains appropriate. Our deferred expenditure after amortisation, including deferred mobile handset subsidies, was A$935 million as at 30 June 2005, A$894 million as at 30 June 2004 and A$796 million as at 30 June 2003.

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

  We capitalise 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, the volume of costs capitalised as part of a project and the amortisation period applied.

  Costs within software assets for internal use include:

  - external direct costs of materials and services consumed;
  - payroll and direct payroll related costs for employees associated with a project; and
  - borrowing costs incurred while developing the software.

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Our capitalised software assets developed for internal use, after amortisation, were A$2,003 million as at 30 June 2005, A$1,923 million as at 30 June 2004 and A$2,001 million as at 30 June 2003. The recoverability of capitalised software assets is assessed semi-annually at each reporting date. Where an incorrect assessment has been made about the probability of the success of a project, we may be required to write down the value of the software assets we have recorded. In applying our assessment, we have not written down significant amounts of software assets developed for internal use during the three-year period.

The service lives of software developed for internal use service lives are reviewed with reference to global industry practices. As a result, in fiscal 2005 it was judged that for administrative simplicity, internally developed software would, on average, have a useful life of 6 years. The average useful life of 6 years has remained unchanged over the three-year period and continues to be reviewed each year to ensure its appropriateness.

- **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 overhead costs are generally attributable to the construction of assets, but can only be allocated to specific projects on an arbitrary basis, as they do not usually vary with construction activity volumes. Examples of indirect overhead costs include planning and design of construction projects and the management of construction contracts. Management judgement is used in determining this indirect cost pool.

Where a part of a business unit consists of a work force whose role is predominantly the management, design and construction of communication assets, then all indirect overhead costs associated with the operations and management of that work force are allocated to the projects undertaken by them. Indirect overheads are allocated monthly on the following basis:

- the total indirect overhead pool is determined for the organisational area;
- a listing of work in progress is generated by project that includes all direct costs of that project. These projects are classified as either capital or operating in nature;
- the indirect overhead pool is allocated to each open project using either the project costs or labour hours as the percentage weighting factor. As a result, those projects that are classified as capital expenditure will be allocated their proportion of indirect overheads; and
- the remaining indirect overheads are then expensed as incurred, usually representing indirect overheads in relation to operational expenditure projects.

Borrowing costs are capitalised on all assets constructed up to the point of completion of construction. We do not specifically borrow to fund construction of assets due to the constant nature of our construction process. We therefore maintain an underlying level of borrowings to fund our construction. The allocation of borrowing costs to these assets is general and does not reflect funds specifically borrowed for each asset.

Refer to ‘Critical accounting policies applied in our USGAAP reconciliation’ for discussion on amounts capitalised under USGAAP that have not been historically capitalised under AGAAP.

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Carrying value and depreciation of property, plant and equipment

Property, plant and equipment assets made up 64% of our total assets in fiscal 2005, 65% in fiscal 2004 and 65% in fiscal 2003. We therefore consider our accounting policies in relation to 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. Land and buildings are subject to valuation for disclosure purposes at least every three years, except properties that are on a disposal program, which are subject to valuation every year.

We assess the recoverable amounts of our property, plant and equipment semi-annually, based on expected future net cash flows discounted to present value. The discount rate used is a market determined, risk adjusted rate. Where 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. We have assessed our Australian telecommunications network to be working together for the purposes of this assessment with the exception of the broadband network asset, as we do not consider the broadband HFC network to be integrated with the rest of our telecommunications infrastructure. In addition, the assessment of the carrying amount of property, plant and equipment for our offshore controlled entities is also separately undertaken. If our estimates of future cash flows prove to be incorrect we may be required to write down our assets in the future. In applying our assessments, we have not written down significant amounts of property, plant and equipment during the three-year period.

We assess the appropriateness of the service lives of our property, plant and equipment assets on an annual basis. This assessment 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 our asset may be superseded technologically. We use an 'end date lifing' methodology where we believe technologies will be replaced by a certain date. Assets are grouped into classes based on technologies when making the assessment of useful lives.

The review of service lives is carried out prior to commencement of each new fiscal year. The Director, Business and Finance Services approves all management judgments used in assessing useful lives and changes to service lives. If our assessment of useful lives proves 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. As part of our review, certain assets are reassessed with lives being extended or in some cases being reduced. The net effect of the reassessment for fiscal 2005 was a decrease in our depreciation expense by A$60 million, compared with decreases of A$30 million in fiscal 2004 and A$94 million in fiscal 2003. The reassessment affects our current year and future reporting period's depreciation expense, and ultimately our net profit. The reassessment each particular year has reduced depreciation expense in that year, but increases depreciation expenses recognised in subsequent years through to the end of the reassessed useful life.

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. A provision for doubtful debts is raised when it is considered that there is a credit risk, insolvency risk or incapacity to pay a legally recoverable debt. We have adopted a number of methodologies depending on the different customer portfolio to determine the appropriate provision for doubtful debts in each of our business segments. 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 raised will not sufficiently cover bad debts arising from the receivables we currently have on hand.

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Our provision for doubtful debts was A$159 million as at 30 June 2005, A$196 million as at 30 June 2004 and A$199 million as at 30 June 2003. Trade debtors before any provision for doubtful debts was A$2,630 million as at 30 June 2005, A$2,459 million as at 30 June 2004 and A$2,436 million as at 30 June 2003.

Included in our receivables is the loan to REACH of A$232 million as at 30 June 2005, compared with A$226 million in fiscal 2004. During fiscal 2004, we together with our co-shareholder PCCW, bought out a loan facility previously owed to a banking syndicate by REACH, and its controlled entity Reach Finance Ltd. We have provided for this loan to REACH, amounting to A$232 million in fiscal 2005. The original provision of A$226 million was raised in fiscal 2004, significantly affecting our net profit during fiscal 2004. We believe the amounts owed by REACH of A$232 million as at 30 June 2005 should continue to be fully provided for due to the uncertainty of repayment in the medium term.

Provisions

Our provision for employee benefits predominantly relates to the provisions for annual leave and long service leave entitlements. The calculation of annual leave entitlements should be based on remuneration rates expected to be paid when the obligation is settled. Ordinarily this would require the provision for annual leave entitlements to use estimated remuneration rates at the time leave is expected to be settled or taken. We have used nominal remuneration rates in determining the annual leave provision on the basis that the difference between the nominal rates and applying the estimated future rates would not be material to our provision.

We accrue for long service leave entitlements not expected to be paid or settled within 1 year of balance date at present values of the future amounts expected to be paid. The calculation is actuarially determined and includes the following factors:

- the estimated projected increases in wage and salary rates over an average of 10 years;
- the probability of employees reaching their long service leave entitlement;
- the employee leave taking rate; and
- the weighted average discount rate.

In relation to the discount rate, we apply the weighted average government bond rate for the 1 year period ended 30 June, rather than the government bond rate as at 30 June. This approach was taken to limit the impact of volatility in government bond rates experienced in previous years. Our provision for employee benefits was A$946 million as at 30 June 2005, A$871 million as at 30 June 2004 and A$851 million as at 30 June 2003.

We self-insure for workers' compensation liabilities. A provision is taken up for the present value of the estimated liability, based on an actuarial review of the liability. This review includes an assessment of actual accidents and estimated claims incurred but not yet reported. Our provision for workers' compensation was A$214 million as at 30 June 2005, A$216 million as at 30 June 2004 and A$236 million as at 30 June 2003.

In relation to our other provisions, we provide for our future obligations in regards to the fit-out of our general purpose leased buildings when we have a legal, equitable or constructive responsibility to do so. These costs include dismantling, removal, remediation and restoration associated with the fit-outs. The provision for restoration costs is based on our estimate of these costs, after due consideration of historical information and the appropriate review of lease contracts and legal agreements. Restoration costs associated with mobile tower communication assets situated on land held under operating leases are expensed as they become payable as they are not considered to be significant to our financial results.

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Management estimates and judgements 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 prior to 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, the actual balance may have been greater or less than the adjustment calculated. This impacts the adjustment made to property, plant and equipment each fiscal year and the resulting annual amortisation expense in our USGAAP reconciliation.

Property, plant and equipment with a net book value of A$493 million as at 30 June 2005, A$567 million as at 30 June 2004 and A$659 million as at 30 June 2003 has been capitalised for USGAAP purposes, which was not capitalised under AGAAP. Additional depreciation and disposals have also been recorded of A$74 million in fiscal 2005, A$92 million in fiscal 2004 and A$167 million in fiscal 2003 as a result of this difference.

Defined benefit plan prepaid pension asset and retirement benefit gain/(loss)

We engage an actuary to assist in the determination of our prepaid pension asset and the retirement benefit gain/(loss) under USGAAP. There is no requirement under AGAAP to recognise this asset or the movement in the net pension asset in our statement of financial performance. The following are the main assumptions 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.

As at 30 June 2005, the net pension asset recognised under USGAAP was A$78 million, compared with A$253 million as at 30 June 2004 and A$4,217 million as at 30 June 2003. The decrease in fiscal 2005 was due to the increase in the fair value of the plan assets being less than the increase in the actuarially determined projected benefit obligations. The reduction in the net pension asset recognised in fiscal 2004 compared with fiscal 2003 was mainly due to the settlement of obligations under the Commonwealth Superannuation Scheme (CSS).

The CSS is a defined benefit scheme for Commonwealth Public Sector employees. Under the CSS, we were responsible for funding all employer financed benefits that arose from 1 July 1975 for our employees who were members. The settlement of the CSS by the Commonwealth on 17 June 2004 resulted in a total loss of A$3,870 million being recognised in the statement of financial performance in fiscal 2004 under USGAAP. This loss comprised the recognition of previously unrecognised actuarial losses of A$2,725 million and a loss on settlement of A$1,145 million. The unrecognised actuarial losses represented the balance of accumulated losses in relation to the CSS, which arose as a result of applying the ‘corridor approach’ permitted by Statement of Financial Accounting Standards (SFAS) 87: “Employers’ Accounting for Pensions”.

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For USGAAP purposes, settlement of the CSS obligations by the Commonwealth has crystallised the actuarial losses. The loss on settlement of A$1,145 million represents the net pension surplus of A$765 million in the statement of financial position as at 30 June 2003 under USGAAP and an increase in the surplus of A$380 million in the period from 30 June 2003 to the settlement date. These amounts were not recovered as part of the A$3,125 million received from the Commonwealth, as these amounts were based on an actuarial review obtained at 30 June 2000 as required for USGAAP reporting. The payment of A$3,125 million was based on a ministerial determination made in June 1997.

Refer to 'Off balance sheet arrangements' for further details on the settlement of the CSS.

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

We are not currently 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 a market adjusted yield curve to take into consideration the cost of funding for Telstra. We adjust the base curves to reflect our borrowing margin. Our borrowing margin 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 we could borrow. If market yield curves were applied which did not adjust for our borrowing margin, this would result in different fair values being recognised.

The adjustment to the statement of financial position under USGAAP to recognise the fair value of our forward foreign currency contracts, interest rate swaps and cross currency interest rate swaps (along with the foreign currency borrowing) was a decrease to net assets in fiscal 2005 of A$95 million, an increase to net assets in fiscal 2004 of A$269 million and a decrease to net assets in fiscal 2003 of A$405 million. Refer to note 30(l) to our financial statements for further information.

Changes in accounting policies

Australian entities reporting under the Corporations Act 2001 must prepare their financial statements for financial years commencing on or after 1 January 2005 under A-IFRS as adopted by the Australian Accounting Standards Board (AASB). This will involve preparing our first full year set of financial statements applying A-IFRS for the financial year ended 30 June 2006.

The transitional rules for first time adoption of A-IFRS require that we restate our comparative financial statements using A-IFRS, except for AASB 132: "Financial Instruments: Disclosure and Presentation" (AASB 132) and AASB 139: "Financial Instruments: Recognition and Measurement" (AASB 139) where comparative information is not required to be restated.

For reporting in the 2006 financial year, comparatives will be remeasured and restated for the financial year ended 30 June 2005. Most of the adjustments on transition are required to be made to opening retained profits at the beginning of the first comparative period (ie. at 1 July 2004).

We have a formal IFRS project team to manage the transition to A-IFRS and enable us to be prepared to report for the first time in accordance with the timetable outlined above. The project team is monitored by a governance committee comprising senior members of management, which reports regularly on progress to the Audit Committee of the Telstra Board of Directors. The governance committee is monitoring our adoption of A-IFRS in accordance with an established project implementation plan. The committee has also been following the developments in IFRS and the potential impact for our transition to A-IFRS.

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The IFRS project is comprised of dedicated workstreams with project teams responsible for evaluating the impact of a specific group of accounting changes resulting from the adoption of A-IFRS. The technical evaluation phase of each workstream is substantially complete and the project is in the implementation and review phases. The project is achieving its scheduled milestones and we expect to be in a position to fully comply with the requirements of A-IFRS for the 2006 financial year.

Under A-IFRS, we expect our net profit after tax to be more volatile compared with our existing Australian reporting requirements. However, we expect that the adoption of A-IFRS will not affect our net cash flow, our ability to borrow funds or our capacity to pay dividends to our shareholders. In note 1.4 to our financial statements, we have identified the key differences in accounting policy and our known estimable transitional differences from application of A-IFRS. In addition we have included the likely impacts on the fiscal 2005 result and financial position where known, and the transitional adjustments for AASB 132/AASB 139 as at 1 July 2005. The following areas have been identified as significant for our A-IFRS disclosure:

- share based payments;
- business combinations;
- income taxes;
- property, plant and equipment;
- employee benefits;
- changes in foreign exchange rates;
- borrowing costs;
- investments in associates and joint ventures;
- impairment of assets;
- intangible assets; and
- financial instruments.

Refer to note 1.4 to our financial statements for further details regarding the explanation of key differences in accounting policies and the quantitative effects that are expected to arise on the adoption of A-IFRS.

During fiscal 2005, no significant changes in accounting policies have been required or implemented. Refer to note 1.2 to our financial statements for details regarding changes in our accounting policies during the three-year period.

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Results of operations

Table 1 – Results of operations

	Year ended 30 June				
	2005	2004	2003	**2005/2004**	2004/2003
	(in $ millions)			(% change)	
Sales revenue	**22,161**	20,737	20,495	**6.9**	1.2
Other revenue (excluding interest revenue)	**496**	543	1,121	**(8.7)**	(51.6)
Total operating revenue (excluding interest revenue)	**22,657**	21,280	21,616	**6.5**	(1.6)
Operating expenses (excluding borrowing costs, depreciation and amortisation)	**11,895**	11,027	11,421	**7.9**	(3.4)
Share of net (profit)/loss from joint venture entities and associated entities	**(9)**	78	1,025	**(111.5)**	(92.4)
Earnings before interest, income tax expense, depreciation and amortisation (EBITDA) (1)	**10,771**	10,175	9,170	**5.9**	11.0
Depreciation and amortisation	**3,766**	3,615	3,447	**4.2**	4.9
Earnings before interest and income tax expense (EBIT) (1)	**7,005**	6,560	5,723	**6.8**	14.6
Net borrowing costs	**736**	712	795	**3.4**	(10.4)
Profit before income tax expense	**6,269**	5,848	4,928	**7.2**	18.7
Income tax expense	**1,822**	1,731	1,534	**5.3**	12.8
Net profit	**4,447**	4,117	3,394	**8.0**	21.3
Outside equity interests in net loss	**-**	1	35	**(100.0)**	(97.1)
Net profit available to Telstra Entity shareholders	**A$4,447**	A$4,118	A$3,429	**8.0**	20.1

(1) *EBITDA reflects our net profit prior to including the effect of interest revenue, borrowing costs, income taxes, depreciation and amortisation. We believe that EBITDA is a relevant and useful financial measure used by management to measure the Company's operating profit. Our management uses EBITDA, 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 our business, EBITDA is a useful supplement to net income in understanding cash flows generated from operations that are available for payment of income taxes, debt service and capital expenditure. In addition, we believe EBITDA is useful to investors because analysts and other members of the investment community largely view EBITDA as a key and widely recognised measure of operating performance. EBITDA is not a USGAAP measure of income or cash flow from operations and should not be considered an alternative to net income as an indication of our financial performance, or as an alternative to cash flow from operating activities as a measure of our liquidity. EBIT is a similar measure to EBITDA, but takes into account the effect of depreciation and amortisation.*

During the three-year period, we have increased our sales revenue and net profit. Our operating performance has been impacted by our recently acquired controlled entities and one-off significant items.

In fiscal 2005, we acquired KAZ, PSINet and Universal Publishers Pty Ltd (Universal Publishers). In addition, we acquired ESA Holding Pty Ltd and its controlled entity Damovo (Australia) Pty Ltd (now known as Telstra Business Systems), and Damovo HK Limited. In fiscal 2004, we acquired Trading Post and Cable Telecom (GB) Limited (Cable Telecom). As a result, our sales revenue and operating expenses increased over the three-year period to reflect the consolidation of the trading activity of these entities from their respective acquisition dates.

During fiscal 2005, we had no significant items that affected our overall movements in net profit, other than our recent investment acquisitions. However, in fiscal 2004 and fiscal 2003, our operating results were impacted by a number of one-off significant items, which gave rise to movements in our overall net profit.

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During fiscal 2004, the following items significantly affected our overall movements in net profit:

- on 17 June 2004, Telstra and PCCW bought out a loan facility previously owed to a banking syndicate by REACH and its controlled entity, REACH Finance Limited. Our share of the payment in relation to this acquisition amounted to US$155.5 million. At 30 June 2004, we provided for the non recoverability of the debt, amounting to A$226 million, as we considered that REACH will not be in a position to repay the amount in the medium term. Refer to 'Related party transactions' for further details; and
- on 28 August 2003, we sold our 22.6% shareholding in our associated entity IBM Global Services Australia Limited (IBMGSA). Proceeds from the sale of this investment amounted to A$154 million, resulting in a profit before income tax expense of A$149 million. As part of this disposal, we modified a 10 year IT service contract with IBMGSA that resulted in an expense of A$130 million being recognised in the statement of financial performance and the removal of A$1,596 million of expenditure commitments disclosed as at 30 June 2003. The sale of this investment and the modification to our IT services contract was completed to enhance the flexibility of our options in future reporting periods. The net impact on our profit before income tax expense of this transaction was a profit of A$19 million (A$58 million after taking into account income tax benefits).

During fiscal 2003, the following items significantly affected our overall movements in net profit:

- on 21 February 2003, we wrote down our investment in REACH, resulting in an increase to our share of net loss from joint venture entities and associated entities of A$965 million. The write down occurred due to the impact of the competitive environment in which REACH operates, with excess capacity and falling Internet and data prices. Refer to 'International business ventures' for more detail;
- on 1 August 2002, we sold a number of office properties which contributed gross proceeds of A$570 million and resulted in a profit before income tax expense of A$131 million (A$90 million after income tax expense). In addition, we entered into operating leases totalling A$518 million in relation to these properties. See 'Contractual obligations and commercial commitments' for further detail; and
- during fiscal 2003, Australian legislation was enacted which enabled the Telstra Entity and its Australian resident wholly owned entities to be treated as a single entity for income tax purposes. The Telstra Entity, as the head entity in this tax consolidated group, adopted this legislation from 1 July 2002. On formation of the group, the Telstra Entity was able to elect to reset the tax values of a subsidiary member under certain allocation rules. The reset of tax values resulted in a tax benefit of A$201 million being recognised in fiscal 2003 and subsequent analysis resulted in an additional benefit of A$58 million being recognised in fiscal 2004. Refer to note 4 to our financial statements and the 'Income tax expense' section for further discussion.

Excluding these one-off significant items, our net profit before income tax expense was A$6,269 million in fiscal 2005, compared with A$6,055 million in fiscal 2004 and A$5,762 million in fiscal 2003. During the three-year period, our sales revenue has shown steady growth as we continue to manage the shift in customer demand from our traditional products such as PSTN to our emerging products such as broadband. In relation to our operating expenses, we continue to focus on our operating efficiency to improve our cost structure and identify cost reductions. In fiscal 2005, our expense increase was led by the consolidation of expenses of our recently acquired controlled entities such as KAZ. In addition, we experienced further expense growth across various categories to support our growth products such as broadband and pay television, as well as improving our customer service.

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Operating revenue

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

- mobiles;
- Internet and IP solutions;
- advertising and directories; and
- Pay television bundling (included within our other sales and services revenue category).

In fiscal 2005, our sales revenue growth was partially offset by a 3.4% decline in PSTN product revenues as the market continues to move towards new products and services to satisfy their requirements. This decline was partly offset by the ongoing impact of price re-balancing initiatives. In fiscal 2004 compared with fiscal 2003, PSTN product revenues increased by A$68 million or 0.9%.

Over the three-year period, we have continued our program of price re-balancing for our PSTN products that commenced in fiscal 2000. As part of this program, we have increased basic access charges and reduced local, national and international long distance call charges. At the same time, competition has continued to intensify and as a result, we have lost market share in some of our retail products. Over the three-year period, we have also seen a continued shift in revenue from our traditional higher margin retail operations (such as our PSTN products) to our emerging lower margin retail products (such as mobiles, broadband, and application and content services). In addition to the price re-balancing that has impacted PSTN, we have continued to concentrate on product bundling initiatives, improving our call completion rates and managing the migration of customers to other 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. We expect to continue to lose market share in some of our retail markets as a result of the increasing competition. However, the volume of telecommunications services purchased in Australia has increased and the range of products and services offered continues to expand. Based on the overall growth anticipated in the volume of telecommunication services, we expect our operating revenue to continue to benefit from this growth.

Our PSTN products have historically generated most of our sales revenue and continue to be a significant cash flow generator for the Company, representing 34.0% of our total operating revenue (excluding interest revenue) in fiscal 2005. While revenue from these products declined in fiscal 2005, we have evidenced continued growth in mobiles, and the other emerging areas of our business such as broadband.

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

	Year ended 30 June					
	2005		2004		2003	
	(in millions, except percentage of revenue)					
	$	**% of total**	$	% of total	$	% of total
PSTN products						
Basic access	**3,362**	**15**	3,237	15	3,083	14
Local calls	**1,284**	**6**	1,504	7	1,567	7
PSTN value added services	**250**	**1**	259	1	280	1
National long distance calls	**1,013**	**4**	1,121	5	1,162	6
Fixed to mobile	**1,566**	**7**	1,597	8	1,517	7
International direct	**234**	**1**	266	1	307	2
	7,709	**34**	7,984	37	7,916	37
Mobiles						
Mobile services	**3,760**	**17**	3,470	16	3,239	15
Mobile handsets	**381**	**2**	352	2	386	2
	4,141	**19**	3,822	18	3,625	17
Data and Internet services						
Internet and IP solutions	**1,377**	**6**	1,013	5	817	4
ISDN products	**890**	**4**	927	4	942	4
Specialised data	**966**	**4**	1,035	5	1,059	5
	3,233	**14**	2,975	14	2,818	13
Other products and services						
Advertising and directories	**1,585**	**7**	1,341	7	1,205	6
Intercarrier services	**1,146**	**5**	1,103	5	1,136	5
Inbound calling products	**449**	**2**	476	2	494	2
Solutions management	**931**	**4**	508	2	501	2
Offshore controlled entities	**1,611**	**7**	1,431	7	1,544	7
Other sales and services	**1,356**	**6**	1,097	5	1,256	6
	7,078	**31**	5,956	28	6,136	28
Total sales revenue	**22,161**	**98**	20,737	97	20,495	95
Other revenue (excluding interest revenue) (1)	**496**	**2**	543	3	1,121	5
Total operating revenue (excluding interest revenue)	**A$22,657**	**100**	A$21,280	100	A$21,616	100

(1) *Other revenue includes miscellaneous revenue and revenue from sale of assets and investments. Refer table 18. Interest revenue is included in net borrowing costs. Refer table 25.*

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Categorisation of our operating revenue

We categorise revenue from the products and services we sell to wholesale customers according to the nature of the product or service. For example, we categorise operating revenue from interconnect charges as intercarrier services revenue. On the other hand, we categorise operating revenue from other resale services according to the product or service resold. For instance, basic access and local call revenue is recognised against basic access and local call products.

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 continue to move from one category to another. For example, as our customers continue to switch from buying basic access services to buying other forms of access services, such as ADSL, operating revenue from some customers will shift from the basic access category to the Internet and IP solutions category.

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

The rates we charge our retail customers for some telephony products are subject to price controls. These controls impose caps based on annual increases in the consumer price index (CPI) for the previous year adjusted, in some cases, by a specified percentage. The retail price controls that applied from fiscal 2003 to fiscal 2005 include a cap of CPI plus 4% for line rental and CPI less 4.5% on a calls basket comprising local calls, long distance calls, international calls and fixed to mobile calls. We are required to ensure that the average price for local calls in non metropolitan areas does not exceed the average price for local calls in metropolitan areas from the prior year. In addition, our local call prices in all areas of Australia must not exceed the current A$0.22 (GST included) per call, except for calls from payphones which are capped at A$0.40 (GST included) per call, or calls 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 in order to be competitive.

Amendments to the price control regulations in fiscal 2000 allowed us to re-balance line rental and calling charges, which we have been implementing since then. We have continued the introduction of a number of calling plan options during the three-year period aimed at creating options to suit different customer segments.

The Commonwealth Government has extended its existing price control arrangements for a further six months from 30 June 2005 to 31 December 2005. In August 2005, the Commonwealth Government announced new retail price controls for Telstra that will apply from 1 January 2006 once the required legislation has passed through Australian parliament. These new price controls will require us to:

- maintain the A$0.22 cap (GST included) on untimed local calls;
- ensure parity in the local call prices offered to regional and metropolitan customers;
- cap increases in the charges for fixed line connections to the inflation rate;
- ensure that on average, a basket of line rental, local calls, long distance calls, international calls and fixed to mobile calls will not increase in price; and
- ensure we have a package of services targeted specially to low income customers.

The new price controls will no longer cover services provided to large businesses.

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

Table 3 - Basic access

	Year ended 30 June				
	2005	2004 (in millions)	2003	**2005/2004** (% change)	2004/2003
Retail	**2,725**	2,717	2,669	0.3	1.8
Domestic wholesale	**637**	520	414	22.5	25.6
Basic access revenue	**A$3,362**	A$3,237	A$3,083	3.9	5.0
Basic access lines in service					
Residential [1]	**5.60**	5.87	6.10	(4.6)	(3.8)
Business	**2.45**	2.57	2.71	(4.7)	(5.2)
Retail	**8.05**	8.44	8.81	(4.6)	(4.2)
Domestic wholesale	**2.07**	1.84	1.55	12.5	18.7
Total access lines in service	**10.12**	10.28	10.36	(1.6)	(0.8)

Note: statistical data represents management's best estimates.

(1) Excludes incontact services (a free service with restrictive calling access) and advanced access services such as ISDN services. Comparatives have been restated to reflect the exclusion of incontact services.

Our operating revenue from basic access services increased in both the retail and domestic wholesale markets over the three-year period, primarily as a result of access price re-balancing first introduced in fiscal 2000, which more than offset decreasing total services in operation (SIOs). Price re-balancing relates to our initiative of increasing basic access charges within our regulatory allowances to counteract the price reductions in local, national long distance and international calls.

Under our basic access pricing structure, we have a range of access and call pricing packages to give our residential and business customers choice in the plan they select, along with a range of reward options. These pricing packages are reviewed regularly to reflect the changing needs of customers. At different times, a variety of promotions and different pricing options are also offered to encourage our customers to connect additional lines. For the most part, wholesale customers receive the pricing plan which only incorporates the basic telephone service with local call rates, excluding long distance and fixed to mobile calls (with a 'residential' and 'business' differentiation still applying).

Our operating revenue from basic access services was also affected by competition during the three-year period. These competitive forces have resulted in a shift from retail to wholesale access lines. Over the three-year period, the number of residential and business basic access lines decreased due to strong competition

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and migration to alternative products such as ISDN, broadband and mobiles. Domestic wholesale basic access lines in service grew, reflecting the increased penetration of our competitors into the basic access market.

During the three-year period, basic access revenue for retail operations grew primarily due to increases in basic access prices, partly offset by a decrease in retail SIOs and the inclusion of pensioner discounts. From March 2003, the pensioner discounts were removed from PSTN calling products and applied to basic access charges. Our domestic wholesale revenue also increased over the three-year period, reflecting a rise in the number of wholesale access lines in service, competition and price increases as part of our re-balancing initiatives.

During the three-year period, we introduced various basic access packages, which had a positive effect on revenue growth in this area, despite an overall decrease in basic access lines in service. Some of these significant price initiatives included:

- a range of fixed line price changes from June 2004, which included a rise in basic access prices for residential plans, an increase in concessions for pensioners, the introduction of fees for credit card payments and a new rewards program for customers with multiple eligible services; and
- increases in certain residential and business basic access prices from July 2003.

We believe our focus on bundling of products encourages customers to stay with us as their sole service provider. In fiscal 2004, we introduced our rewards program, known as the T-time Reward Options. This program provides customer rewards such as free local calls and free text messages for those customers with multiple eligible services.

Local calls (including PSTN value added services)

Our local call revenue comes from our local call charges and from 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 local calls revenue are affected by:

- the number of basic access lines in service and customers moving from our basic access service to our enhanced access services, such as ISDN and broadband;
- competition;
- customers migrating to mobile and fixed to mobile calling;
- pricing changes; and
- general economic conditions.

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Table 4 – Local calls (including PSTN value added services)

	Year ended 30 June				
	2005	2004	2003	**2005/2004**	2004/2003
		(in millions)		(% change)	
Local call revenue					
Retail	**1,032**	1,263	1,348	**(18.3)**	(6.3)
Domestic wholesale	**252**	241	219	**4.6**	10.0
	1,284	1,504	1,567	**(14.6)**	(4.0)
PSTN value added services					
Retail	**200**	221	247	**(9.5)**	(10.5)
Domestic wholesale	**50**	38	33	**31.6**	15.2
	250	259	280	**(3.5)**	(7.5)
Total local call revenue	**A$1,534**	A$1,763	A$1,847	**(13.0)**	(4.5)
Number of local calls	**8,469**	9,397	9,794	**(9.9)**	(4.1)

Note: statistical data represents management's best estimates.

During the three-year period, local call revenue decreased to A$1,284 million in fiscal 2005 mainly due to the decline in retail local call revenue, partly offset by growth in wholesale local call revenue. Retail revenue for local calls has been negatively affected by price decreases, primarily as a result of price re-balancing between our basic access charges and calling products. In addition, intense price competition has adversely affected our retail local call revenue. This competition resulted in our wholesale local call revenue increasing due to a higher number of wholesale access lines in service. In fiscal 2005, the yield in the wholesale market also declined as a result of a rise in volume discounts. Overall call usage declined due to the migration to mobile usage as a substitute.

During the three-year period, we decreased local call prices as an offset to higher basic access fees. We continue to offer a certain number of free local calls to eligible customers as part of our T-time Reward Options program, which was first introduced in fiscal 2004. We also accelerated our package and volume discounts (including various free calling offers) during the second half of fiscal 2005. In fiscal 2004 compared with fiscal 2003, our price reductions were partly offset by the transfer of pensioner discounts to basic access in March 2003, and the removal of reduced rate neighbourhood calls for certain customers on various plans.

Generally, call volumes have continued to fall over the three-year period, reflecting the impact of customers migrating to other products, such as mobiles, fixed to mobile, Internet and ISDN products. This is highlighted by the fact that SIOs decreased by only 1.6% over fiscal 2005 and 0.8% over fiscal 2004, while the number of local calls reduced by 9.9% over fiscal 2005 and 4.1% over fiscal 2004.

Our revenue from PSTN value added services declined over the three-year period. This decrease was driven by a reduction in revenue from MessageBank® (our voicemail service), reflecting the continual migration to our free product offering Telstra Home Message 101™, discounts offered as part of bundling offers and a price reduction in May 2003. In addition, in fiscal 2005 certain products neared the end of their product lifecycle such as PABX indial, resulting in customer migration to other product offerings such as ISDN and other premium voice communication applications.

Call Return (*10#) revenue also steadily declined over the three-year period. In fiscal 2005, the reduction was led by an increase in our calling number display subscriptions and higher call completion rates. In fiscal 2004 compared with fiscal 2003, the decrease was due to advertising campaigns focused on alternative product offerings such as Call 1# Feature Assistant™ and Telstra Home Message 101™.

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National long distance calls

Our operating revenue from national long distance consists of revenue from national long distance calls made from our PSTN network to the 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. 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. Competitive activity continues to negatively affect this revenue category directly through override and preselection, and indirectly through competition for access lines. In addition, national long distance calls are also impacted by customers migrating to mobile and fixed to mobile calling.

Table 5 - National long distance calls

	Year ended 30 June				
	2005	2004	2003	**2005/2004**	2004/2003
		(in millions)		(% change)	
National long distance call revenue	**A$1,013**	A$1,121	A$1,162	**(9.6)**	(3.5)
National long distance minutes (1)	**7,743**	8,520	9,161	**(9.1)**	(7.0)

Note: statistical data represents management's best estimates.
(1) Includes national long distance minutes from PSTN and independently operated payphones to Australian fixed telephones. Excludes minutes related to calls from non PSTN networks, such as ISDN and virtual private networks.

Our operating revenue from national long distance calls declined during the three-year period to A$1,013 million in fiscal 2005, primarily due to:

- capping of prices for some national long distance calls due to the competitive pricing environment in which we operate, partially offset by increases in call connection costs;
- increased take up of re-balanced packages with capped calls by customers;
- 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 mobiles and Internet products.

Over the three-year period, the decline in minutes in use was also attributable to the shorter call durations. In addition, in fiscal 2004 compared with fiscal 2003, we were impacted by the transfer of pensioner discounts to basic access charges and the cessation of the '1c Saturday' promotion, where calls to long distance locations were capped at 1 cent per minute. This promotion had increased minutes of use in fiscal 2003.

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We continue to respond to competition with competitively priced packages. However, with the strong growth in mobile and Internet services in the Australian market, we expect national long distance call revenue to continue to be negatively impacted by customer migration to fixed to mobile, mobiles and Internet products.

Fixed to mobile

Our fixed to mobile revenue is generated by calls originating on our fixed networks and terminating on any mobile network. We generally charge for fixed to mobile calls based on time of day and mobile carrier, however packages are also offered on a capped price basis. Our operating revenue for fixed to mobile calls is approximately split between business and residential customers. The growth of the Australian mobile telecommunications market has driven revenue expansion in this product category.

The fixed to mobile environment is influenced by fixed to mobile preselection, whereby the carriage service provider (CSP) selected by a customer for national long distance calls automatically became the customer's provider for fixed to mobile calls.

Table 6 - Fixed to mobile

	Year ended 30 June				
	2005	2004 (in millions)	2003	**2005/2004** (% change)	2004/2003
Fixed to mobile revenue	**A$1,566**	A$1,597	A$1,517	**(1.9)**	5.3
Fixed to mobile minutes	**4,375**	4,226	3,944	**3.5**	7.2

Note: statistical data represents management's best estimates.

Over the three-year period, we experienced strong growth in call volumes mainly due to the continued expansion of mobile services in the Australian market.

In fiscal 2005, our fixed to mobile revenue decreased by 1.9% to A$1,566 million due to increased competitive pricing pressures in the business sector, partly offset by growth in call minutes and a rise in call connection rates. Our fixed to mobile revenue increased by 5.3% to A$1,597 million in fiscal 2004 compared with fiscal 2003 due to the rise in minutes of use and higher call connection rates. This growth was partly offset by reduced per minute prices for fixed to mobile calls and lower capped calling.

Fixed to mobile revenue may be negatively affected in future reporting periods if we lose market share in local calls. This is because customers will generally choose the same carriage service provider for fixed to mobile and national long distance calls as they do for local calls.

International direct

Our operating revenue from international direct relates to revenue we generate from international calls made from Australia to a destination outside Australia (outbound).

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, and promotion and advertising.

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Table 7 - International direct

	Year ended 30 June				
	2005	2004 (in millions)	2003	**2005/2004** (% change)	2004/2003
International direct revenue	**A$234**	A$266	A$307	**(12.0)**	(13.4)
International direct minutes	**580**	651	740	**(10.9)**	(12.0)

Note: statistical data represents management's best estimates.

Our international direct revenue continued to decline over the three-year period to A$234 million in fiscal 2005 primarily due to the reduction in call minutes. The decrease reflects the continued impact of aggressively priced prepaid calling cards by our competitors and the migration of customers to other products such as email and Internet chat facilities. In fiscal 2004 compared with fiscal 2003, the yield also declined as a result of an increase in capped call usage and discount plan offerings, offset by the removal of pensioner discounts from calling products to basic access and a call connection rate increase.

Various packages, such as HomeLine™ Plus, were introduced as part of our price re-balancing strategy and to address competitive pressures. These packages encourage customer loyalty and provide them with options to select pricing structures that suit their telephony spending patterns. These packages have significantly reduced the calling rates we charge for some international countries, and consequently our outbound international revenue also decreased over the three-year period.

Mobiles

Our operating revenue from mobiles consists of revenue from access fees and call charges, as well as value added services comprising international roaming, mobile MessageBank® and mobile data. We operate two primary mobile networks, GSM and CDMA. The CDMA provides extensive coverage and high speed wireless data services. As a result, new customers are increasingly connecting to our CDMA network and it continues to be one of the fastest growing areas of our mobiles business.

In fiscal 2003, we launched high speed data services into selected areas of our CDMA network that was based on the 1 times radio transmission technique (1xRTT). We also launched Telstra Mobile Loop® on 1xRTT to our customers, featuring downloadable games and ringtones, email access and picture messaging. In fiscal 2004, we commenced the rollout of 1xRTT across the balance of the CDMA1x network, providing high speed wireless data services across the complete CDMA coverage footprint. In fiscal 2005, we continued the technological improvements including the roll out of super high speed wireless services, known as EVDO, and further improvements in our Blackberry products. These product enhancements have contributed to the strong growth in the number of our mobile customers, as evidenced by us exceeding 8 million mobile customers, including 1 million CDMA mobile customers, during fiscal 2005.

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. While voice continues to be the largest contributor to mobiles revenue, value added services is also expanding, representing 25.8% of mobile services revenue in fiscal 2005. With competition intensifying,

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technology continues to be a source of differentiation and competitive advantage. Further improvement is expected in value added services, particularly data revenues through the introduction of our 3G offerings and improvements in customer retention.

Table 8 - Mobiles

	Year ended 30 June				
	2005	2004 (in millions)	2003	**2005/2004** (% change)	2004/2003
Access fees and call charges	**2,765**	2,649	2,570	**4.4**	3.1
Value added services:					
International roaming	**243**	174	153	**39.7**	13.7
Mobile MessageBank®	**187**	178	166	**5.1**	7.2
Mobile data	**541**	454	338	**19.2**	34.3
Total value added services	**971**	806	657	**20.5**	22.7
Mobile services revenue – retail	**3,736**	3,455	3,228	**8.1**	7.0
Mobile services revenue – wholesale	**24**	15	11	**60.0**	36.4
	3,760	3,470	3,239	**8.4**	7.1
Mobile handset sales	**381**	352	386	**8.2**	(8.8)
Mobiles revenue (1)	**A$4,141**	A$3,822	A$3,625	**8.3**	5.4
Mobile retail voice telephone minutes (2)	**6,746**	6,145	5,255	**9.8**	16.9
Number of SMS sent (3)	**2,289**	1,944	1,426	**17.7**	36.3
		(in thousands)			
Mobile SIO:					
GSM	**6,894**	6,653	5,812	**3.6**	14.5
CDMA	**1,333**	951	757	**40.2**	25.6
Total mobile SIO (4)	**8,227**	7,604	6,569	**8.2**	15.8
Mobile SIO:					
Prepaid	**3,570**	3,102	2,288	**15.1**	35.6
Postpaid	**4,657**	4,502	4,281	**3.4**	5.2
Total mobile SIO (4)	**8,227**	7,604	6,569	**8.2**	15.8
Deactivation rate (4)	**19.2%**	17.1%	18.4%	**2.1**	(1.3)
		(in A$ per SIO)			
Average retail revenue per user per month (5)	**39.33**	40.62	42.99	**(3.2)**	(5.5)
Average retail prepaid revenue per user per month (5)	**12.24**	13.84	13.78	**(11.6)**	0.4
Average retail postpaid revenue per user per month (5)	**59.06**	57.05	57.59	**3.5**	(0.9)
Average mobile data revenue per user per month	**5.70**	5.34	4.51	**6.7**	18.4

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Table - 8 Mobiles (continued)

Note: statistical data represents management's best estimates.

(1) Mobile revenue excludes revenue from:
- *call termination charges, including calls from our fixed network which we categorise as fixed to mobile; and*
- *CSL, which we recognise within our offshore controlled entities revenue category. See table 16.*

(2) Includes all calls made from mobile telephones including long distance and international calls. Excludes international roaming, MessageBank®, mobile data and CSL.

(3) Comparatives have been restated to reflect business access manager and online SMS previously excluded in error.

(4) Excludes CSL SIOs and includes the impact of the deactivation policy change to the standard recharge period. Deactivations have been impacted by the recharge period for prepaid services being extended to six months during fiscal 2004 in line with the general market position. The deactivation rate excludes transfers of account names, services between Telstra's GSM and CDMA networks, and services between prepaid and postpaid categories.

(5) Average retail revenue per user per month is calculated using average SIOs and includes international roaming, MessageBank® and mobile data revenues.

During the three-year period, mobile service revenue increased mainly due to the continued strong growth in the number of mobile telephone customers and expanding minutes of use. In addition, we experienced further growth in our value added services revenue.

Access fees and call charges grew over the three-year period to A$2,765 million in fiscal 2005 reflecting the increase in prepaid and postpaid SIOs in conjunction with an increase in retail voice telephone minutes. In fiscal 2005, the growth was partly offset by yield reductions from various special offers such as the 1 cent per minute and double recharge offers on our prepaid services, and the Bonus Options, Telstra Rewards and T-time Rewards options on our postpaid services. In fiscal 2004 compared with fiscal 2003, our growth was partly offset by a rise in loyalty bonuses and discounting provided due to customers receiving various benefits on Telstra Rewards offers such as free family call credits. Wholesale mobile service revenue increased over the three-year period due to a rise in the resale of services and minutes of use.

Over the three-year period, volumes and SIOs accelerated, however there has been a continual change in customer mix with new customers preferring to connect to prepaid services. As at 30 June 2005, prepaid SIOs comprised 43.4% of total SIOs, up from 40.8% as at 30 June 2004 and 34.8% as at 30 June 2003. Prepaid customers generally have lower usage patterns than postpaid customers and the myriad of discounting initiatives on offer led to a decline in the average retail prepaid revenue per user per month to A$12.24 in fiscal 2005 compared with A$13.84 in fiscal 2004 and A$13.78 in fiscal 2003. The market trend to prepaid services also contributed to the average retail revenue per user per month decreasing over the three-year period to A$39.33 in fiscal 2005 compared with A$40.62 in fiscal 2004 and A$42.99 in fiscal 2003.

Revenue from international roaming grew over the three-year period to A$243 million in fiscal 2005. The rise in fiscal 2005 was primarily due to an increase in outbound roaming minutes in line with the continued growth in international travel. In addition, inbound roaming prices charged to wholesale partners grew, reflecting our alignment to international standards. In fiscal 2004 compared with fiscal 2003, revenue was higher mainly due to increased volumes coinciding with the Rugby World Cup and the recovery in international travel after various world events such as the SARS virus outbreak.

Revenue from MessageBank® increased over the three-year period to A$187 million in fiscal 2005 primarily due to growth in MessageBank® minutes resulting from higher mobile usage. In fiscal 2005, the growth was partly offset by discounting initiatives. In fiscal 2004 compared with fiscal 2003, the growth in minutes was partially offset by lower retrieval charges.

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Mobile data revenue increased over the three-year period to A$541 million in fiscal 2005 led by growth in the total subscriber base and SMS usage. The growth was partially offset by a rise in the availability and use of discounting initiatives such as Telstra Rewards and Bonus Options, which provides various free and discounted text and picture messaging services. In addition, mobile data growth was also experienced in the corporate segment through the accelerated usage of General Packet Radio Service (GPRS) products, including Blackberry and Telstra Mobile Broadband™ products on the CDMA network. This is reflected in the average mobile data revenue per user per month increasing over the three-year period.

Revenue from handset sales increased by 8.2% to A$381 million in fiscal 2005 primarily due to growth in the number of CDMA prepaid customers taking advantage of the CDMA double recharge offers, which increased the number of prepaid phones sold. In fiscal 2004, revenue from handset sales decreased by 8.8% compared with fiscal 2003 due to the higher number of mobile users moving to lower cost prepaid handsets and higher volumes of subsidised handsets expensed.

Our deactivation rate has remained fairly stable over the three-year period. Our deactivation rate is influenced by a number of factors, the most significant of which is competition from other carriers. In fiscal 2004 the 'recharge only' period for prepaid services was extended to six months in line with our competitors. This change resulted in the continuation of approximately 202,000 prepaid services as at 30 June 2004 that would have been deactivated in previous periods. Other factors influencing the deactivation rate included customer payment defaults and short term disconnections.

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 to medium enterprises (SMEs);
- 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 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 various data and Internet services.

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Table 9 – Internet and IP solutions

	Year ended 30 June				
	2005	2004	2003	**2005/2004**	2004/2003
	(in millions, except subscriber numbers in thousands)			(% change)	
BigPond® narrowband	**275**	295	297	**(6.8)**	(0.7)
BigPond® broadband (1)	**463**	274	212	**69.0**	29.2
Wholesale broadband	**261**	143	49	**82.5**	191.8
Wholesale Internet direct	**31**	16	20	**93.8**	(20.0)
Internet direct	**123**	117	111	**5.1**	5.4
IP solutions	**207**	160	120	**29.4**	33.3
Other	**17**	8	8	**112.5**	-
Internet and IP solutions revenue	**A$1,377**	A$1,013	A$817	**35.9**	24.0
Narrowband subscribers - retail	**1,205**	1,194	1,158	**0.9**	3.1
Broadband subscribers - retail (2)	**856**	427	240	**100.5**	77.9
Broadband subscribers - wholesale (2)	**888**	379	121	**134.3**	213.2
Total broadband subscribers	**1,744**	806	361	**116.4**	123.3
Total online subscribers	**2,949**	2,000	1,519	**47.5**	31.7

Note: statistical data represents management's best estimates.

(1) Included in this category are revenues derived from Hyperconnect and Business DSL.

(2) Within broadband, retail products include cable, satellite, Hyperconnect, ADSL and Business DSL, while wholesale products include DSL layer 1, DSL layer 2, DSL layer 3, spectrum sharing and virtual Internet service provider (VISP) broadband.

Our narrowband products allow customers to connect to the Internet from any telephone line in Australia. These products are often an entry point for new customers to the Internet. Our broadband products allow customers to experience an 'always on' connection to the Internet. In fiscal 2005, new innovative broadband products combined with aggressive pricing led to customers migrating their services to this access method. As a result, this trend placed additional price pressure on our narrowband products.

We offer a range of Internet products and packages under our BigPond® brand. Telstra BigPond® home and business packages offer dial-up modem services to residential and business customers across Australia. Telstra BigPond® broadband provides broadband Internet services to consumer and business customers via HFC cable, ADSL and satellite access technologies.

During the three-year period, our Internet and IP solutions revenue grew strongly, despite our reduction in prices. The subscriber base for our narrowband and broadband products also expanded during the three-year period. As at 30 June 2005, we have signed approximately 1.7 million broadband customers following a significant rise in demand resulting from our aggressive pricing strategies.

Narrowband revenue decreased over the three-year period to A$275 million in fiscal 2005 even though we increased the number of our narrowband subscribers. In fiscal 2005, revenue growth from an increase in subscribers was offset by the migration of high yield users to broadband services, and price reductions driven by price pressure from high bandwidth products. In fiscal 2004 compared with fiscal 2003, our revenue was adversely impacted by the two weeks of rebates provided to customers as a result of performance issues in October 2003.

BigPond® broadband revenue increased over the three-year period to A$463 million in fiscal 2005 mainly due to strong subscriber growth in ADSL and cable subscribers. The rise was driven by an increase in Internet

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usage, easy to use ADSL self-installation kits, successful broadband marketing campaigns and competitive pricing plans. In fiscal 2004, we introduced aggressive new pricing plans and a two month free broadband offer to new subscribers that accelerated market demand for this product. In addition, Business DSL (launched in August 2003) contributed to the growth in fiscal 2005, with key customer contracts driving subscriber growth and the migration of customers from premium data services. In fiscal 2004 compared with fiscal 2003, the revenue growth was partly offset by two weeks of rebates provided as described above, the introduction of the usage toolbar in May 2003 reducing excess usage billing, and unlimited usage and higher volume capped plans.

During the three-year period, wholesale broadband revenue increased to A$261 million in fiscal 2005 driven by subscriber growth of 134.3%, partially offset by significant price competition. In fiscal 2004 compared with fiscal 2003, the rise in wholesale broadband was also attributable to improved Wholesale DSL Layer 2 revenue, resulting from the higher take up in the residential and small business market by on-selling a price competitive broadband DSL service, as provided by our ADSL network. In fiscal 2003, wholesale DSL was sold only to the business market.

During the three-year period, Internet direct revenue increased to A$123 million in fiscal 2005. The increase in fiscal 2005 was mainly due to the new VISP product launch that led to an increase in customers as we satisfied the growing demand for high speed global Internet direct connectivity. In fiscal 2004 compared with fiscal 2003, the growth was mainly attributable to the continued take up of our simplified packages, offering customers integrated Internet and connectivity solutions and flexibility with access to various connection types. In addition, our competitive pricing continued to encourage our customers to upgrade both access and speed capabilities.

IP solutions revenue increased over the three-year period to A$207 million in fiscal 2005 mainly due to its respective products being in the growth phase of its lifecycle. Over the three-year period, increases in IP MAN/Ethernet was primarily due to new major contract wins and the continued expansion of existing services and applications. IP WAN also continued to rise mainly due to the introduction of large corporate contracts as customers migrate away from older product technologies such as frame relay and ISDN. In fiscal 2004 compared with fiscal 2003, growth was also impacted by aggressive price competition.

Table 10 - ISDN products

	Year ended 30 June				
	2005	2004	2004	**2005/2004**	2004/2003
	(in millions, except access lines in thousands)			(% change)	
Access	**421**	401	381	**5.0**	5.2
Calls:					
Data	**165**	221	282	**(25.3)**	(21.6)
Voice	**304**	305	279	**(0.3)**	9.3
	469	526	561	**(10.8)**	(6.2)
ISDN products revenue	**A$890**	A$927	A$942	**(4.0)**	(1.6)
ISDN access lines (basic access line equivalents) (1)	**1,327**	1,288	1,213	**3.0**	6.2

Note: statistical data represents management's best estimates.
(1) Expressed in equivalent number of clear voice channels.

ISDN is a flexible, switched network based on digital technology. It can support many applications at one time (such as voice, data and video) while using a single access point to the network. ISDN services are offered to residential and business customers across Australia.

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Over the three-year period, ISDN access revenue grew to A$421 million in fiscal 2005 mainly due to our continued penetration into the SME and consumer market, partly offset by corporate customers migrating to more advanced data products such as IP solutions. As a result, the number of ISDN access lines grew by 3.0% in fiscal 2005 and 6.2% in fiscal 2004 compared with fiscal 2003. In fiscal 2005, ISDN basic access lines also benefited by campaign activity in the SME and consumer market. The rise in access lines also reflects the continual movement of customers towards using ISDN for voice instead of data calls.

Call revenues decreased over the three-year period to A$469 million in fiscal 2005 mainly due to the decrease in data calls. ISDN data calls fell over the three-year period due to changes in our customer mix, as customers migrate to products that offer higher bandwidth at reduced prices such as ADSL. In fiscal 2005, ISDN voice call revenue declined slightly due to a reduction in yield as a result of competitive pricing pressure. In fiscal 2004 compared with fiscal 2003, voice call revenue increased, driven by the introduction of a significant new pricing structure in January 2003 that included charging customers for 30 minute blocks, rather than charging on a per minute basis. This pricing structure fuelled our initial revenue expansion and assisted our move into SME and consumer segments.

Table 11 – Specialised data

	Year ended 30 June				
	2005	2004	2003	**2005/2004**	2004/2003
	(in millions, except frame access in thousands)			(% change)	
Frame relay	**351**	371	354	**(5.4)**	4.8
Digital data services	**226**	256	287	**(11.7)**	(10.8)
Leased lines	**236**	258	271	**(8.5)**	(4.8)
Other	**153**	150	147	**2.0**	2.0
Specialised data revenue	**A$966**	A$1,035	A$1,059	**(6.7)**	(2.3)
Domestic frame access ports	**34**	30	28	**13.3**	7.1

Note: statistical data represents management's best estimates.

Specialised data revenue is comprised mainly of revenue from frame relay, digital data services and leased lines. Frame relay offers high speed data transmission from 64Kb to 45Mb per second to customers connecting any number of sites to other national or international locations. It is frequently used as a building block to construct corporate wide area networks. Digital data services provide high quality, leased line digital data transmission offering dedicated bandwidth from 1.2Kb to 1,984Kb per second, which may be used for communications between all major capital cities, and most regional and country areas in Australia. Analogue leased lines provide high quality, low cost, low bandwidth, and dedicated end-to-end connections between customer sites. They support customer specific applications that do not yet have viable commercial alternatives.

Over the three-year period, total specialised data revenue decreased to A$966 million, reflecting a decline in mature products such as digital data and leased line services. This decline has been driven by product substitutions for technologically advanced IP and DSL based product options, included within our Internet and IP solutions revenue category.

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In fiscal 2005, frame relay revenue decreased as this product entered the declining stages of its product lifecycle with customers migrating to new technologies such as Business DSL. In addition, we introduced price discounts to retain existing customers. In fiscal 2004 compared with fiscal 2003, frame relay increased primarily due to the strong performance of our IP WAN product and the migration from previous technologies such as digital data services, leased lines and international private lines to frame relay.

Digital data services and leased lines are mature products that have declined over the three-year period due to customers transferring to newer technologies. In relation to digital data services, revenue also fell in fiscal 2005 due to competitive pricing pressures. In fiscal 2004 compared with fiscal 2003, customers explored other options such as outsourcing and building their own IP platforms. In relation to leased lines, revenue reduced in fiscal 2004 compared with fiscal 2003 due to declines in megalink and voice graded dedicated lines revenue.

Other specialised data revenue increased over the three-year period as growth in ATM revenue was partly offset by a decline in certain older technologies such as international private lines. In fiscal 2005, growth in ATM revenue was led by new government and ATM contracts and the introduction of a new Ethernet MAN product. International private line revenue declined due to intense competition and excess capacity in the market, driving prices down in Asia.

Advertising and directories

Our advertising and directories revenue is predominantly derived from our controlled entity, Sensis. This wholly owned subsidiary provides innovative advertising and local search solutions through a network of print, online, voice, wireless and in-car services. Product innovation and customer demand continue to drive growth in our online and electronic advertising and non-directories advertising businesses.

Over the three-year period, Sensis continued to focus on product innovation and successfully delivered new products in print and online directories, enhanced search solutions and launched the new Accommodation Finder™ (national accommodation guide containing accommodation advertisements distributed with the metropolitan Yellow Pages® directories). In fiscal 2005, Sensis launched a new service, known as Sensis 1234® (a premium operated assisted voice service) and shortly after launched the BidSmart™ Pay for Performance search engine marketing system.

On 20 December 2004, we, through Sensis, acquired 100% of the issued share capital of Universal Publishers for A$46 million, including incidental acquisition costs. Universal Publishers is a publisher of mapping and travel related products, including street directories, guides, maps and road atlases. From the acquisition date, we consolidated 100% of the results of Universal Publishers. Sales revenue from the date of acquisition to the period ended 30 June 2005 was A$14 million and the consolidation of Universal Publishers' results for this period had no impact on profit before income tax expense (including all Telstra consolidation adjustments).

On 5 March 2004, we, through Sensis, acquired 100% of the issued share capital of the Trading Post. The Trading Post is an Australian publishing and Internet classified business. We paid A$638 million, including incidental acquisition costs, to acquire this investment. From this date, we have consolidated 100% of Trading Post's results. This acquisition contributed sales revenue of A$152 million in fiscal 2005 and A$44 million from the date of acquisition to the period ended 30 June 2004. Profit before income tax expense contributed by Trading Post was A$52 million in fiscal 2005 and A$9 million from the date of acquisition to the period ended 30 June 2004 (including all Telstra consolidation adjustments).

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Table 12 - Advertising and directories

	Year ended 30 June				
	2005	2004 (in millions)	2003	**2005/2004** (% change)	2004/2003
Advertising and directories revenue	**A$1,585**	A$1,341	A$1,205	**18.2**	11.3

Excluding our revenue from the acquisitions of the Trading Post and Universal Publishers, our advertising and directories revenue grew by 9.4% in fiscal 2005 compared with fiscal 2004, and 7.6% in fiscal 2004 compared with fiscal 2003.

Over the three-year period, Yellow pages® revenue increased primarily due to the continued strong performance from providing full and half page advertising options. In fiscal 2005, we benefited from the introduction of full page advertising options for additional product categories and guide panel display enhancements. In fiscal 2004, Yellow pages® revenue also increased compared with fiscal 2003 due to a rise in non-metro publications and online display advertising options.

Over the three-year period, White pages® revenue grew, reflecting the introduction of new initiatives such as colour listing options and quarter page listing advertisements. In fiscal 2004 compared with fiscal 2003, White Pages® revenue also benefited from growth in email and web listings.

Our other directory products also experienced considerable growth over the three-year period largely driven by new customer take up. In fiscal 2005, we also benefited from a revenue increase in location and navigation products such as Citysearch, as well as a rise in Yellow pages® online advertising revenue due to customer and yield growth. In fiscal 2004, revenue growth compared with fiscal 2003 was also attributable to attractive product enhancements.

Intercarrier services

Our operating revenue from intercarrier services comprises a number of products and services relating to the provision of telecommunications services to other carriers (including REACH), CSPs and Internet service providers (ISPs). The majority of this revenue base is derived from interconnect and access services which is a highly regulated area of the Australian telecommunications market. While volumes for these services are seen to be increasing, ongoing cost efficiencies and consequent reduction in prices within the regulatory framework means that we do not expect significant revenue growth from this group of products in future years.

The remaining revenue component in intercarrier services is derived from wholesale specific product offerings which, while they are subject to significant price pressures resulting from ongoing capacity over-supply in the market place, are a focus for delivering incremental revenue growth for us in the coming years.

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Table 13 - Intercarrier services

	Year ended 30 June				
	2005	2004	2003	**2005/2004**	2004/2003
		(in millions)		(% change)	
Intercarrier service revenue	**A$1,146**	A$1,103	A$1,136	**3.9**	(2.9)

During the three-year period, our volumes from intercarrier services increased, generally offset by a decline in prices. Our volumes 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 also provided by other carriers, many of which use our networks 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 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.

In fiscal 2005, our growth in intercarrier service revenue was driven by an increase in wholesale mobile and wholesale transmission solutions. The increase in mobile solutions reflected the rise in mobile services and continued popularity of text messaging. The increase in transmission solutions was primarily due to a rise in international revenue, resulting from higher volumes led by special rate offers on international carriage and the introduction of new product offerings such as Global Linx Lite (developed to provide calling card services for international destinations at competitive prices).

Growth in domestic wholesale leased transmission was led by a rise in SIOs due to an expanding level of services provided, partially offset by lower yields from the oversupply of capacity in the market. In addition, we experienced growth in facilities access revenues lead by increased demand for exchange and associated equipment, as well as mobile tower access as other carriers seek to expand their infrastructure. Partly offsetting the overall increase in intercarrier revenue was the reduction in PSTN and ISDN interconnect access due to yield reductions arising from regulatory driven price reductions.

In fiscal 2004, our decline in intercarrier revenue compared with fiscal 2003 was driven by a reduction in wholesale transmission products. This reduction was due to price pressures from an oversupply of capacity in the market, including a significant increase in the discount on access network transmission contracts and the cancellation of the Optus Nullabor service. In addition, wholesale long distance and international revenue declined due to decreased volumes. The decline was partly offset by a significant rise in SMS interconnect revenues driven by increases in volumes.

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Inbound calling products

Our operating revenue from inbound calling products consists principally of:

- the fees we charge our business customers for the provision of inbound calling numbers:
  - for Freecall™ 1800, the cost of the call, charged to the party called, with no cost incurred by the caller;
  - for Priority® 1300 and Priority® One3:
    - the calling party from a PSTN service incurs a cost of A$0.25 (including GST) from anywhere in Australia. Different charges apply for calls made from ISDN, mobiles and payphones;
    - the service owner incurs the other components of the call charges as applicable; 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.

Our inbound calling products revenue therefore is driven by two different streams, from the caller (A party) and the lessee of the inbound service (B party). A party revenues are affected by substitution to other voice products such as mobiles and the Internet. B party revenues are affected by increased customer competition impacting prices.

Table 14 - Inbound calling products

	Year ended 30 June				
	2005	2004 (in millions)	2003	**2005/2004** (% change)	2004/2003
Inbound calling products revenue	**A$449**	A$476	A$494	**(5.7)**	(3.6)
B Party minutes	**2,773**	2,708	2,655	**2.4**	2.0
A Party calls	**940**	938	918	**0.2**	2.2

Note: statistical data represents management's best estimates.

Revenue from inbound calling products declined over the three-year period to A$449 million in fiscal 2005 mainly due to intense price competition leading to reduced yields and a declining customer base in our Freecall™ 1800 product.

Our overall revenue from Priority® 1300 and Priority® One3 declined in fiscal 2005 due to competitive market pressures resulting in lower yields, partially offset by higher call minutes on our Priority® One3 product. Our overall revenue from Priority® 1300 and Priority® One3 in fiscal 2004 remained fairly consistent with fiscal 2003.

In addition, our other inbound calling products such as Infocall (190) decreased over the three-year period. In fiscal 2005, this decrease was primarily attributable to product substitution and lower usage. In fiscal 2004, the decrease compared with fiscal 2003 was mainly due to the exit of Internet dialler applications in August 2003.

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Solutions management

Our operating revenue from solutions management is derived from managing all or part of a customer's IT and communications solutions and services covering:

- managed voice, data and mobility services: network based voice and data switching products, including IP based networks and IP telephony as well as management of customer's mobile phone services, radio networks and new wireless based technologies;
- managed IT services: managed customer infrastructure (eg desktop and end user devices), managed storage and security services, in addition to hosting and application development and support;
- IT outsourcing: incorporating a range of the above solutions and managing these solutions on behalf of the customers either on the customers premises or on our premises; and
- business process outsourcing: leveraging our networks to manage customer business processes in areas such as superannuation administration, insurance policy processing and the automotive industry.

On 19 July 2004, we acquired 100% of the issued share capital of KAZ. KAZ is a provider of business process outsourcing, systems integration, consulting, applications development and IT management services. It operates mainly in Australia, but also conducts business in the United States and Asia. Combined with our pre-existing solutions management business, we have acquired KAZ with the goal of becoming an Australian leader in the ICT market. We paid A$340 million, including incidental acquisition costs, to acquire this investment. From the acquisition date, we have consolidated 100% of KAZ's results. Sales revenue from the date of acquisition to the period ended 30 June 2005 was A$390 million and the consolidation of KAZ's results for this period reduced our profit before income tax expense by A$15 (including all Telstra consolidation adjustments).

Table 15 - Solutions management

	Year ended 30 June				
	2005	2004 (in millions)	2003	**2005/2004** (% change)	2004/2003
Solutions management revenue.	**A$931**	A$508	A$501	**83.3**	1.4

In fiscal 2005, solutions management revenue increased by 83.3% to A$931 mainly due to the acquisition of KAZ and Telstra Business Systems (formerly Damovo (Australia) Pty Ltd), contributing solutions management revenues of A$380 million and A$14 million respectively. Excluding these recently acquired controlled entities, our solutions management revenue increased by 5.7% in fiscal 2005 due to the commencement of new business contracts and incremental growth in existing contracts. In addition, radio services revenue also increased due to the construction of government radio sites.

In fiscal 2004, solutions management revenue grew by 1.4% compared with fiscal 2003 as we commenced several new contracts including a whole of business contract with a large banking institution and experienced incremental growth in existing contracts. In addition, Managed WAN (growth product offering design, installation and management of a tailored wide area network) increased following a rise in activity relating to two major corporate contracts. The growth in solutions management revenue was partly offset by the close out of some contracts. This includes the termination of a government contract for satellite capacity of approximately A$20 million per annum, which we were restricted from renewing due to an agreement with our joint venture entity, Xantic B.V. (Xantic). Radio services revenue declined due to the completion of a major bank and design construction contract in fiscal 2003.

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Offshore controlled entities

Our domestic controlled entities' operating revenue is included in the product categories to which they relate. The offshore controlled entities category of revenue relates to our offshore subsidiaries, which provides a variety of products and services. Included in this category are the following significant offshore controlled entities:

- CSL, which generates its revenues from the Hong Kong mobiles market;
- TelstraClear, which generates its revenues from providing full integrated services to the New Zealand market; and
- other offshore controlled entities predominantly in the Telstra Business and Government segment, which mainly generate revenues from the provision of global communication solutions to multinational corporations through our interests in the United Kingdom, Asia and North America.

On 25 August 2004, we acquired 100% of the issued share capital of PSINet for A$124 million. PSINet is a leading provider of e-business infrastructure solutions and corporate IP based communication services. This acquisition was to increase our offshore services supporting Australian and multinational corporations overseas. From the acquisition date, we have consolidated 100% of PSINet's results. Sales revenue from the date of acquisition to the period ended 30 June 2005 was A$71 million and the consolidation of PSINet results for this period increased our profit before income tax expense by A$3 million (including all Telstra consolidation adjustments).

Table 16 – Offshore controlled entities

	Year ended 30 June				
	2005	2004 (in millions)	2003	**2005/2004** (% change)	2004/2003
CSL	**734**	726	908	**1.1**	(20.0)
TelstraClear	**625**	574	548	**8.9**	4.7
Other offshore controlled entities	**252**	131	88	**92.4**	48.9
Offshore controlled entities' revenue	**A$1,611**	A$1,431	A$1,544	**12.6**	(7.3)

Our consolidated revenue from offshore controlled entities increased in fiscal 2005 primarily due to the following factors:

- CSL experienced revenue growth across the majority of its revenue streams except for local voice, which continues to be impacted by price competition. Mobile handset sales grew due to CSL's entry into new markets such as 3G and the introduction of new models with advanced features. CSL revenue growth was partly offset by adverse foreign currency movements;
- revenue growth in TelstraClear was due to its continued strong retail performance in conjunction with favourable foreign exchange movements, partly offset by a slight decrease in wholesale revenue; and
- other offshore controlled entities increased due to the inclusion of PSINet and growth achieved in Telstra Europe Limited following the development of a voice reseller sales channel. In addition, we benefited from the inclusion of the full 12 months of activity for Cable Telecom and Powergen.

Our consolidated revenue from offshore controlled entities decreased in fiscal 2004 compared with fiscal 2003 primarily due to CSL reporting a decline in revenue due to unfavourable currency fluctuations and price competition.

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The decrease in revenue in fiscal 2004 was moderated by:

- a revenue increase in TelstraClear due to retail revenue growth, partly offset by a decline in wholesale revenue; and
- revenue growth in Telstra Europe Limited due to the inclusion of customers and network base from Cable Telecom and Powergen, acquired in February 2004 and October 2003 respectively.

Refer to '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;
- information and connection services;
- external construction;
- customer premises equipment;
- Pay television bundling; and
- other minor revenue items, including recorded services, card services, commercial works and other enhanced calling products.

On 17 September 2004, we acquired 100% of the issued share capital of ESA Holding Pty Ltd and its controlled entity Damovo (Australia) Pty Ltd (now known as Telstra Business Systems), and Damovo HK Limited for A$66 million. Telstra Business Systems provides advanced voice and data business communication solutions and services to large enterprises and government departments. We have aligned this entity with our pre-existing areas to provide an integrated range of CPE based products and services to our Telstra Business and Government customers. From the acquisition date, we have consolidated 100% of Telstra Business Systems' results. Sales revenue from the date of acquisition to the period ended 30 June 2005 was A$71 million, split between customer premises equipment revenues of A$57 million and solution management revenues of A$14 million. The consolidation of Telstra Business Systems results for this period reduced our profit before income tax expense by A$11 million (including all Telstra consolidation adjustments).

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Table 17 - Other sales and services

	Year ended 30 June				
	2005	2004	2003	**2005/2004**	2004/2003
	(in millions, except statistical data in thousands)			(% change)	
Payphones	**121**	141	148	**(14.2)**	(4.7)
Information and connection services	**134**	118	139	**13.6**	(15.1)
External construction	**85**	70	159	**21.4**	(56.0)
Customer premises equipment	**229**	184	197	**24.5**	(6.6)
Pay television bundling	**263**	154	23	**70.8**	569.6
Other minor items	**524**	430	590	**21.9**	(27.1)
Other sales and services revenue	**A$1,356**	A$1,097	A$1,256	**23.6**	(12.7)
Number of payphones	**61**	64	67	**(4.7)**	(4.5)
FOXTEL Pay television bundling subscribers	**280**	235	127	**19.1**	85.0
AUSTAR Pay television bundling subscribers	**55**	23	-	**139.1**	N/M
Pay television bundling subscribers	**335**	258	127	**29.8**	103.1

Note: statistical data represents management's best estimates.

Over the three-year period, our payphones revenue continued to decline, impacted by the substitution to other products, particularly mobiles and prepaid calling cards, and the increased competition from private payphone operators (a significant contributing factor in the fiscal 2005 movement). The reduction of payphone SIOs was mainly attributable to the loss of some privately operated payphones and a fall in the number of Telstra operated payphones reflecting the gradual removal of low usage and older technology payphones.

In fiscal 2005, our information and connection revenue grew mainly due to the launch of Sensis 1234® call connection services in April 2004. In fiscal 2004, our revenue fell compared with fiscal 2003 due to customers moving to online services rather than using traditional operator assisted directory services.

In fiscal 2005, external construction revenue increased due to new projects and the commencement of the H3GA asset sharing arrangement relating to the maintenance and build out of the 3G network. In fiscal 2004, our revenue declined compared with fiscal 2003 due to lower construction activity domestically and the closure of our international construction operations. This decline was also attributable to the break up and re-integration of our former subsidiary Network Design and Construction Limited (NDC) into Telstra in fiscal 2004.

Customer premises equipment revenue increased in fiscal 2005 due to the acquisition of Telstra Business Systems (formerly Damovo (Australia) Pty Ltd), partly offset by product substitution to mobile phones, and continued retail competition for fixed line handsets. In fiscal 2004, revenue decreased compared with fiscal 2003 mainly due to retail competition for fixed line handsets.

Over the three-year period, our revenue from pay television bundling services grew due to the introduction of bundling for FOXTEL and AUSTAR services from December 2002. This is reflected in our bundled SIOs, which have significantly expanded over the three-year period to 335,000 subscribers as at 30 June 2005. In fiscal 2005, growth was also driven by the launch of FOXTEL digital services, a rise in the number of services provided and free installation/upgrade campaigns.

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In fiscal 2005, other minor items increased by 21.9% mainly due to increases in overdue account fees and payment processing fees that were introduced in July 2004. In addition, we have increased our HFC cable usage and commercial works revenue as a result of higher demand and associated infrastructure upgrades required to support growth in digital pay television.

In fiscal 2004, our revenue from other minor items declined by 27.1% compared with fiscal 2003 mainly due to lower revenues from card services and the cable recovery and recycling project. Card services decreased as a result of the migration of customers to other products such as mobiles, and the migration of customers to cheaper calling cards for international calls. Cable recovery revenue decreased due to winding down of work to recover and recycle disused copper cable.

In addition, included in other minor items was sales revenue for Telstra Multimedia Pty Ltd that declined in fiscal 2004 due to customer sales and service centres now being directly operated by FOXTEL. Our share of FOXTEL's cable revenue reduced due to the renegotiation of our revenue share agreement to include bundling and external subscription television subscribers. This revenue is now recognised within the 'pay television bundling' revenue category.

Other revenue

Table 18 - Other revenue

	Year ended 30 June		
	2005	2004	2003
		(in millions)	
Miscellaneous revenue	**270**	213	262
Revenue from the sale of:			
Property, plant and equipment	**50**	102	811
Investments in controlled entities	**-**	-	17
Investments in joint venture entities	**30**	-	3
Investments in associated entities	**-**	204	17
Investments in listed securities and other investments	**146**	24	7
Businesses	**-**	-	4
Total revenue from sale of assets and investments	**226**	330	859
Total other revenue (excluding interest revenue) (1)	**A$496**	A$543	A$1,121

(1) Interest revenue discussion is included in net borrowing costs. Refer table 25.

In fiscal 2005, the increase in our miscellaneous revenue was mainly due to the redemption of the converting note issued by PCCW for a cash consideration of A$76 million. In fiscal 2004, the decline in our miscellaneous revenue compared with fiscal 2003 was due to a decrease in IBMGSA loyalty receipts and miscellaneous billings. In addition, our miscellaneous revenue decreased due to the winding down of the rural telecommunications infrastructure fund project. As part of this project, we received government subsidies for work performed under the extended zone untimed local call tender.

Over the three-year period, the following gross proceeds received from the sale of assets and investments significantly impacted our other revenue:

- the sale of our investment in Intelsat Limited for A$69 million in fiscal 2005;
- the sale of our investment in Infonet Services Corporation for A$65 million in fiscal 2005;
- the sale of our shareholding in our associated entity, IBMGSA for A$154 million in fiscal 2004;
- the sale of our shareholding in our associated entity, PT Mitra Global Telekomunikasi Indonesia (MGTI) for A$50 million in fiscal 2004; and

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- the sale of 7 office properties around Australia for A$570 million in fiscal 2003.

Operating expenses

We categorise our operating expenses into labour, goods and services purchased, other expenses, and depreciation and amortisation. In addition, we have grouped our share of net (profit)/loss from joint venture entities and associated entities with our operating expenses. Borrowing costs are not included in operating expenses. Refer to 'Net borrowing costs' for discussion on this category.

Table 19 - Operating expenses including share of net (profit)/loss from joint venture entities and associated entities

	Year ended 30 June				
	2005	2004 (in millions)	2003	**2005/2004** (% change)	2004/2003
Labour	**3,693**	3,218	3,204	**14.8**	0.4
Goods and services purchased (1)	**4,147**	3,554	3,713	**16.7**	(4.3)
Other expenses (1)	**4,055**	4,255	4,504	**(4.7)**	(5.5)
	11,895	11,027	11,421	**7.9**	(3.4)
Share of net (profit)/loss from joint venture entities and associated entities	**(9)**	78	1,025	**(111.5)**	(92.4)
	11,886	11,105	12,446	**7.0**	(10.8)
Depreciation and amortisation	**3,766**	3,615	3,447	**4.2**	4.9
Total operating expenses including share of net (profit)/loss from joint venture entities and associated entities	**A$15,652**	A$14,720	A$15,893	**6.3**	(7.4)

(1) In fiscal 2005, we have reassessed our classification of managed service expenses. We have included in goods and services purchased those expenses that are directly associated with our managed services customer contracts, as these costs vary according to business activity. Prior year comparatives have been restated to reflect the transfer of these expenses from the other expenses category to goods and services purchased in the current year.

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

- a A$226 million expense in fiscal 2004 in relation to the provision for non recoverability of amounts owed by REACH. We consider that REACH will not be able to repay this loan in the medium term;
- a A$130 million expense resulting from a modification to an IT service contract with IBMGSA upon the sale of our shareholding in this entity in fiscal 2004;
- a A$439 million expense reflecting the carrying value of 7 office properties sold in fiscal 2003; and
- A$965 million for the write down of our investment in REACH in fiscal 2003, reflected in 'Share of net (profit)/loss from joint venture entities and associated entities'.

Excluding these one-off significant items, our total operating expenses (including share of net (profit)/loss from joint venture entities and associated entities) was A$15,652 million in fiscal 2005, compared with A$14,364 million in fiscal 2004 and A$14,489 million in fiscal 2003.

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

- the consolidation of operating expenses of A$666 million in fiscal 2005 from our acquired controlled entities, including Universal Publishers from December 2004, Telstra Business Systems (formerly Damovo (Australia) Pty Ltd) from September 2004, PSINet from August 2004, KAZ from July 2004 and the Trading Post from March 2004;
- various expense increases in fiscal 2005 arising in a number of expense categories, attributable to supporting our emerging business areas such as broadband and pay television and meeting our customer service requirements;
- the benefit of ongoing cost control and cost containment programs; and
- growth in our communications plant asset base and capitalised software, which subsequently increased our depreciation and amortisation expense.

Labour

Labour expense includes:

- salary and wages and related on-costs, including superannuation contributions, 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 do not include employees in our offshore controlled entities, or casual and part time employees. Our full time employees and equivalents include the total of our domestic and offshore full time employees, and casual and part time equivalent employees.

Table 20 - Labour

	Year ended 30 June				
	2005	2004	2003	**2005/2004**	2004/2003
	(millions, except staff numbers in whole numbers)			(% change)	
Labour	**A$3,693**	A$3,218	A$3,204	**14.8**	0.4
Domestic full time employees [1]	**39,657**	36,159	37,169	**9.7**	(2.7)
Full time employees and equivalents [2]	**46,336**	41,941	42,064	**10.5**	(0.3)

(1) Excludes offshore, casual and part time employees.
(2) Includes all domestic and offshore employees, including those of our controlled entities.

During fiscal 2005, the number of full time employees and equivalents increased predominantly due to the consolidation of the operations of our recently acquired controlled entities. In fiscal 2004, the number of full time employees and equivalents decreased compared with fiscal 2003 as part of the review of the appropriateness of employee numbers, within our cost control and cost containment strategy. We have incurred redundancy expenses of A$91 million in fiscal 2005, A$170 million in fiscal 2004 and A$281 million in fiscal 2003. The higher redundancy expense in prior years reflects the implementation of cost control initiatives to improve our operational structure.

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Our labour expense increased in fiscal 2005 mainly due to the consolidation of labour expense of A$330 million from our recently acquired controlled entities, including KAZ, Telstra Business Systems (formerly Damovo (Australia) Pty Ltd), PSINet and Universal Publishers. In addition, our expense reflected the inclusion of labour costs of the Trading Post for the full financial year. In fiscal 2004, the Trading Post acquisition resulted in additional labour expense of A$14 million. These acquisitions resulted in the inclusion of full time employees and equivalents of 3,597 in fiscal 2005 and 598 in fiscal 2004.

Excluding these entities, our labour expense increased by 5.0% to A$3,363 million in fiscal 2005 due to the following factors:

- salary increases of 3.9% due to enterprise agreements and normal annual salary reviews;
- an increase in full time employees and equivalents to further improve service and account management, and meet our customer service demands;
- a rise in the use of overtime and contractor and agency payments to improve customer service, and support the increased field volumes across broadband and pay television; and
- a reclassification of NDC capitalised overhead costs, resulting in the reduction to labour expense for capitalised overhead costs now being included as a reduction in the other expenses category.

The above increases in labour expense were partially offset by:

- a decrease in redundancy expense of A$79 million; and
- a higher number of employees working on capital projects.

Excluding our acquisition of the Trading Post, our labour expense in fiscal 2004 remained consistent compared with fiscal 2003. A rise in labour expense was due to the following factors:

- salary increases of 4.0% due to enterprise agreements and normal annual salary reviews;
- increased use of casual and part time employees to manage costs more closely, and improve our utilisation of employees to provide enhanced flexibility to meet our customer requirements; and
- a reclassification of NDC labour from goods and services purchased and other expenses to the labour expense category following the integration of NDC into Telstra in fiscal 2004.

The above increases in labour expense were offset by:

- a reduction in redundancy expense of A$111 million;
- lower aggregate labour expense resulting from the decline in the number of full time employees and equivalents; and
- a reduction in CSL labour costs due to favourable exchange rate movements.

Based on the latest detailed actuarial report provided on the financial position of the Telstra Superannuation Scheme (Telstra Super) as at 30 June 2003, we have reported that a surplus in this superannuation fund continues to exist. In accordance with the recommendations within the actuarial investigation, we were not expected to, and did not make employer contributions to Telstra Super during the three-year period. As at 30 June 2005, the vested benefits index (the ratio of fund assets to members' vested benefits) of the defined benefit divisions of Telstra Super was 111%. Our contributions to Telstra Super will recommence when the vested benefit index of the defined benefit divisions falls to 103%. The continuance of our contribution holiday is dependent on the performance of the fund.

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Goods and services purchased

The largest component of our goods and services purchased category is network 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 category include:

- cost of goods sold including items such as mobile handset and Internet modems;
- usage commissions;
- mobile handset subsidies;
- commercial project payments;
- service fees predominantly in relation to our pay television services;
- managed services costs, including service contracts and agreements, leases and subcontractors;
- dealer bonus incentives; and
- paper purchases and printing costs.

This expense category relates to core costs of our business that vary according to business activity.

Table 21 – Goods and services purchased

	Year ended 30 June				
	2005	2004	2003	**2005/2004**	2004/2003
		(in millions)		(% change)	
Goods and services purchased	**A$4,147**	A$3,554	A$3,713	**16.7**	(4.3)

Our goods and services purchased expense category increased in fiscal 2005 mainly due to the consolidation of the trading activities of our recently acquired controlled entities in addition to an increase across a number of categories within goods and services purchased. In fiscal 2004, the decline compared with fiscal 2003 was mainly driven by reduced network and commercial project payments.

Our goods and services purchased increased by 16.7% to A$4,147 million in fiscal 2005 due to the following factors:

- consolidation of goods and services expense of A$206 million from our recently acquired controlled entities, including KAZ, Telstra Business Systems (formerly Damovo (Australia) Pty Ltd) and PSINet, as well as the inclusion of the Trading Post for the full financial year;
- growth in network payments, which was attributable to a rise in international payments, driven by higher international mobile roaming volumes. Our network payments also increased due to the inclusion of a full 12 months of activity for Cable Telecom and Powergen, acquired in February 2004 and October 2003 respectively. TelstraClear network payments grew due to foreign exchange variations and growth in retail revenue. In addition, international network payments to REACH increased as a result of a higher traffic volumes;
- an increase in cost of goods sold resulting from strong ADSL demand due to broadband growth, a rise in CSL handset volumes partially offset by favourable exchange rate movements, and costs related to the 3G network under our asset sharing arrangement with H3GA. In addition, we have commenced a two way satellite service for the HiBis scheme, which relates to a four year government initiative to provide more affordable broadband services to regional, rural and remote Australia;

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- usage commissions grew following a rise in dealer activity, in conjunction with a further increase in marketing commissions;
- an increase in mobile handset subsidies, attributable to an increase in subsidy amortisation expense following the strong take up of the MRO offer in fiscal 2004. In addition, we have been impacted by higher handset sales and related subsidies in CSL; and
- service fees increased by 73.9% led by the rise in bundling of pay television services fees due to growth in bundled FOXTEL and AUSTAR subscribers, as well as the higher costs of digital content paid to FOXTEL.

These increases were partly offset by a decrease in managed services costs due to the completion of a defence contract, a reduction in major outsourced contracts, and lower costs required to support major corporate customer contracts.

Our goods and services purchased decreased by 4.3% to A$3,554 million in fiscal 2004 compared with fiscal 2003, due to the following factors:

- a decrease in network payments driven by a reduction in international call volumes and charges from REACH for international network connection following the commencement of a new pricing structure from January 2003. In addition, there was a benefit arising from favourable US$ exchange rate movements. Our decrease in network payments was partially offset by continuing volume increases in mobile and SMS terminating traffic;
- a decline in cost of goods sold from reduced purchases due to lower handset sales with the continual take up of the MRO and a shift in product mix towards lower cost prepaid phones; and
- reduced expenditure on commercial project payments due to the closure of our international construction business and a reduction in the domestic construction market. The integration of NDC into Telstra in fiscal 2004 also resulted in the reclassification of expenses from goods and services purchased to the other expense category.

These reductions were partly offset by an increase in pay television bundling service fees due to the growth in bundled FOXTEL and AUSTAR subscribers.

Other expenses

Our other expenses include such costs as:

- rental expense on operating leases;
- bad and doubtful debts;
- net foreign currency translation losses/(gains);
- service contracts and other agreements for activities such as IT, pre-provisioning and customer installations, maintenance, customer sales support and consultancy;
- promotion and advertising;
- general and administration expenses including IT costs, printing and postage, accommodation, travel and rent. In addition this category includes property costs such as maintenance, municipal rates, land tax and light and power;
- the carrying value of assets and investments disposed;
- write downs of assets and investments to recoverable amount; and

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- other operating expenses, including material usage, the cost of running motor vehicles, bank costs, capitalised overhead costs and other miscellaneous costs of the Company.

Table 22 - Other expenses

	Year ended 30 June				
	2005	2004	2003	**2005/2004**	2004/2003
		(in millions)		(% change)	
Other expenses	**A$4,055**	A$4,255	A$4,504	**(4.7)**	(5.5)

During the three-year period, the following significant events have impacted our other expenses:

- a A$226 million expense in fiscal 2004 in relation to the provision for non recoverability of a loan owed by REACH. We consider that REACH will not be able to repay their loan in the medium term;
- a A$130 million expense resulting from a modification to an IT service contract with IBMGSA upon the sale of our shareholding in this entity in fiscal 2004; and
- a A$439 million expense reflecting the carrying value of 7 office properties sold in fiscal 2003.

Excluding the above significant items, our other expenses were A$4,055 million in fiscal 2005, A$3,899 million in fiscal 2004 and A$4,065 million in fiscal 2003. Our other expenses in fiscal 2005 also include A$72 million of expenses attributable to our controlled entities acquired throughout the year. The movement in the significant categories of other expenses is discussed below.

Rental expenses on operating leases increased by 12.6% to A$597 million in fiscal 2005 mainly due to a property lease termination payment adversely impacting CSL as well as growth in rental costs due to general rises in rental rates and property requirements. In fiscal 2004, rental costs decreased by 9.2% to A$530 million compared with fiscal 2003 following the reclassification of IT rental costs previously relating to Telstra Enterprise Services Pty Ltd (TES) to general and administrative costs.

Bad debts and doubtful debts reduced over the three-year period from A$172 million in fiscal 2003 to A$152 million in fiscal 2005 due to improved credit management policies that led to lower provision requirements and write offs. In fiscal 2005, bad debts and doubtful debts was also impacted by the proceeds received from the sale of debt.

Net foreign currency conversion costs represents the remaining foreign currency exposure after taking under account our hedging activities. The movement to a gain of A$9 million in fiscal 2005 compared with a loss of A$17 million in fiscal 2004 and a gain of A$17 million in fiscal 2003 reflects the movement of the Australian dollar against other currencies. In addition, it is also impacted on occasions by the close out of hedge contracts where the underlying hedged position changes.

Service contracts and other agreements decreased over the three-year period from A$1,677 million in fiscal 2003 to A$1,556 million in fiscal 2005, driven by cost reduction initiatives including the reduction in IT service costs through the renegotiation of contracts. Partly offsetting the expense reduction in fiscal 2005 was the growth driven by volume based increases, including activations and fault rectifications for broadband, digital pay television and the PSTN network, as well as higher volumes in call centres for broadband and Sensis 1234® services. In addition, we were impacted by increased network maintenance activations and a significant new contract for the shipment of goods from our warehouse to dealer and retail shops. In fiscal 2004, the decrease in service contracts and agreements compared with fiscal 2003 was also attributable to the different accounting on the integration of NDC into Telstra and the winding down of the cable recovery and recycling project. The decrease was partly offset by an increase in outsourced field work and

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consultancy costs for special project work, and expenditure growth due to improved customer service standards and customer retention rates in rural areas.

Promotion and advertising expenses decreased by 1.5% to A$330 million in fiscal 2005 mainly due to reduced marketing costs resulting from focussed and well managed advertising campaigns. In fiscal 2004, our promotion and advertising expenses increased by 6.0% to A$335 million compared with fiscal 2003 due to new initiatives and sponsorships, as well as the identification of broadband as a major growth opportunity, resulting in additional resources being devoted to promote this product.

General and administration expenses increased over the three-year period from A$702 million in fiscal 2003 to A$806 million in fiscal 2005. In the current year, our expenses have increased to reflect the consolidation of operating activities of our recently acquired controlled entities. This was partially offset by lower IT costs resulting from savings achieved in IT repairs and maintenance through entering new agreements and lower project costs, offset by an increase in new licensing arrangements. In addition, we reduced our legal expenses by completing more legal work internally, and reducing our travelling expenses through the continued focus on managing discretionary costs. In fiscal 2004, our general and administration expense growth was driven by increases in light and power, training, postage and travel. In addition, costs relating to TES were reclassified from rental expenses to this category.

During the three-year period, we did not sell any assets and investments with a significant carrying value, other than:

- the redemption of our PCCW converting note with a carrying value of A$80 million in fiscal 2005;
- the sale of investments in listed securities and other investments with a carrying value of A$79 million in fiscal 2005, predominantly attributable to the sale of our investments in Intelsat Limited and Infonet Services Corporation; and
- the sale of 7 office properties around Australia with a carrying value of A$439 million in fiscal 2003.

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 'Management estimates and judgements in the application of our critical accounting policies'. During the three-year period, our only significant write down in our assets and investments included in this category was the A$226 million write down of a loan provided to REACH as already indicated. In addition, we wrote down our investment in REACH by A$965 million to nil, which we recorded within our share of net (profit)/loss from joint venture entities and associates entities.

Other operating expenses decreased by 11.8% to A$380 million in fiscal 2005 mainly due to the current year reclassification of NDC capitalised overhead costs from labour expense to this category, as well as a write off of cancelled capital projects. In addition, we have incurred lower bank costs following a customer preference shift from payment options that incur a merchant service fee after the introduction of a processing fee on credit card payments in July 2004. In fiscal 2004, our other operating expenses increased by 23.5% to A$431 million compared with fiscal 2003, driven by various factors including general increases across repairs and maintenance, materials usage and vehicle operating costs, and a reduction in capitalised overhead costs.

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Share of net (profit)/loss from joint venture entities and associated entities

Table 23 - Share of net (profit)/loss from joint venture entities and associated entities

	Year ended 30 June				
	2005	2004 (in millions)	2003	**2005/2004**	2004/2003 (% change)
Share of net (profit)/loss from joint venture entities and associated entities	**A$(9)**	A$78	A$1,025	**(111.5)**	(92.4)

Our share of net (profit)/loss from joint venture entities and associated entities includes our share of both profits and losses from equity accounted investments. Details of our equity accounted investments are included in note 24 to our financial statements.

In fiscal 2003, the write down of our investment in REACH, amounting to A$965 million, adversely impacted our net equity accounted results. Excluding this write down, our share of net (profit)/loss from joint venture entities and associated entities for the three-year period was a profit of A$9 million in fiscal 2005, compared with losses of A$78 million in fiscal 2004 and A$60 million in fiscal 2003.

In fiscal 2005, our net equity accounted results improved due to:

- reduced losses from FOXTEL following the suspension of equity accounting during fiscal 2004, partly offset by a A$5 million equity injection in the current year;
- improved results from Keycorp, resulting in the recommencement of equity accounting for this investment; and
- reduced losses in Xantic, as fiscal 2004 included write offs for restructuring.

In fiscal 2004, our net equity accounted results compared with fiscal 2003 (excluding the REACH write down) were impacted by:

- reduced losses in Australia-Japan Cable Holdings Limited (AJC) and FOXTEL following the suspension of equity accounting;
- reduced contribution from REACH following the suspension of equity accounting; and
- increased losses in Xantic following write offs as a result of restructuring.

Depreciation and amortisation

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

Table 24 - Depreciation and amortisation

	Year ended 30 June				
	2005	2004 (in millions)	2003	**2005/2004**	2004/2003 (% change)
Depreciation	**2,946**	2,873	2,754	**2.5**	4.3
Amortisation (excluding goodwill)	**675**	619	577	**9.0**	7.3
Amortisation of goodwill	**145**	123	116	**17.9**	6.0
Total depreciation and amortisation	**A$3,766**	A$3,615	A$3,447	**4.2**	4.9

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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, which is consistent with our level of capital expenditure over recent years. In fiscal 2005, an increase in these assets was required to support the expanding demand for broadband ADSL services; and
- additional depreciation expense associated with the acquisition and consolidation of various recently acquired controlled entities including KAZ, PSINet and Trading Post.

Factors which partially offset these increases were:

- reductions in depreciation expense as a result of changes to service lives for communications assets; and
- lower depreciation in fiscal 2004 compared with fiscal 2003 was also driven by the general downsizing of owned vehicles.

We capitalise expenditure incurred in the development and enhancement of computer systems as business software. Software developed for internal use is amortised, on average, over a useful life of six years. This useful life has remained unchanged over the three-year period.

Over the three-year period, our goodwill amortisation expense increased mainly due to the additional goodwill arising from our recently acquired controlled entities. In fiscal 2005, we acquired KAZ, PSINet, Telstra Business Systems (formerly Damovo (Australia) Pty Ltd) and Universal Publishers, which led to a higher balance of goodwill recognised in our statement of financial position and an associated rise in the amortisation of goodwill expense during the current year. In fiscal 2004, we acquired Trading Post and Cable Telecom, and the remaining 41.6% share of TelstraClear was acquired in fiscal 2003. Amortisation expense also increased in those years due to the higher goodwill balance carried.

We believe our depreciation and amortisation expense will further increase in fiscal 2006, reflecting the higher capital expenditure expected in fiscal 2006 and future amortisation of the 3G network and spectrum licence.

Net borrowing costs

Table 25 – Net borrowing costs

	Year ended 30 June				
	2005	2004	2003	**2005/2004**	2004/2003
	(in millions)			(% change)	
Gross borrowing costs	**929**	841	984	**10.5**	(14.5)
Less capitalised interest	**(90)**	(74)	(105)	**21.6**	(29.5)
Borrowing costs	**839**	767	879	**9.4**	(12.7)
Interest revenue	**103**	55	84	**87.3**	(34.5)
Net borrowing costs	**A$736**	A$712	A$795	**3.4**	(10.4)

Our borrowing costs are influenced by:

- our debt level;
- interest rates;
- our debt maturity profile; and
- our level of cash assets (affects net debt).

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In fiscal 2005, borrowing costs increased by 9.4% due to an increase in our average borrowings required to fund our recent share buy-backs, higher dividend payments and various investment acquisitions including KAZ, Telstra Business Systems (formerly Damovo (Australia) Pty Ltd) and PSINet. Additional funding was also required to manage the increased levels of capital expenditure in fiscal 2005. The increase was partially offset by lower interest rates charged on our new and re-financed long term debt. Capitalised interest increased following the higher work in progress associated with the increased capital expenditure.

Our borrowing costs decreased by 12.7% to A$767 million in fiscal 2004 compared with fiscal 2003 mainly due to a reduced debt portfolio in fiscal 2004. In addition, in fiscal 2003 we incurred further interest costs in closing out TelstraClear interest rate swaps early due to the refinancing of TelstraClear bank loans in September 2002.

In fiscal 2005, interest revenue increased to A$103 million primarily due to our higher level of short term liquid assets held. In addition, we have recognised interest revenue on the REACH capacity prepayment and loan facility following the change in REACH's operating model, see 'Related party transactions' for further detail.

Our interest revenue decreased by 34.5% to A$55 million in fiscal 2004 compared with A$84 million in fiscal 2003 due to lower interest received on the PCCW converting note after it was partially redeemed and a lower level of short term liquid assets held. During fiscal 2003, we received interest on a US$190 million converting note until April 2003 when the note was reduced to US$53 million upon partial redemption as consideration for our entry into a capacity prepayment arrangement with REACH.

Income tax expense

Table 26 – Income tax expense

	Year ended 30 June				
	2005	2004 (in millions)	2003	**2005/2004** (% change)	2004/2003
Income tax expense	**A$1,822**	A$1,731	A$1,534	**5.3**	12.8
		%			
Effective tax rate	**29.1**	29.6	31.1	**(0.5)**	(1.5)

In fiscal 2005, our income tax expense increased by 5.3% to A$1,822 million. Income tax expense in fiscal 2005 was impacted by a 7.2% increase in profit before income tax expense. In fiscal 2005, the effective tax rate decreased to 29.1% compared with the effective tax rate of 29.6% in fiscal 2004.

The 0.5% decrease in the effective tax rate was driven by a number of different factors led by adjustments to income tax expense in fiscal 2004 that did not impact our fiscal 2005 income tax expense. This included the provision for the non recoverability of the loan to REACH and further benefits arising from our entry into tax consolidation. In addition, our current year income tax expense has been impacted by the differing treatment of FOXTEL's losses for accounting and tax purposes. For accounting purposes, these losses are no longer being booked due to the suspension of equity accounting. For tax purposes, these losses continue to be available.

In fiscal 2004, our income tax expense increased by 12.8% to A$1,731 million compared with fiscal 2003. Income tax expense in fiscal 2004 was impacted by an 18.7% increase in profit before income tax expense. In fiscal 2004, the effective tax rate decreased to 29.6% compared with the effective tax rate of 31.1% in fiscal 2003.

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The 1.5% decrease in effective tax rate was driven by a number of different factors including the write down of our investment in REACH in fiscal 2003, partly offset by the provision for the non recoverability of the loan to REACH in fiscal 2004. In addition, in fiscal 2003 a A$201 million benefit to income tax expense was recorded reflecting an increase in future tax deductions being recognised in our deferred tax balances as a result of applying tax consolidation legislation. Further analysis was performed on these future tax deductions, which enabled us to recognise a subsequent A$58 million benefit in fiscal 2004.

The A$201 million benefit to income tax expense resulted from our election to form a tax consolidation group from 1 July 2002. On formation of the tax consolidated group, the head entity was able to elect to reset the tax values of a subsidiary member under certain allocation rules. The reset of tax values resulted in a benefit to income tax expense reflecting the increase in future tax deductions available from these reset values.

Refer to note 4 to our financial statements for further details on our election to enter tax consolidation and its impact on income tax expense.

International business ventures

We continue to focus on improving returns from our current international investments by consolidating our opportunities in the following ventures in the Asia-Pacific region.

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). On the sale of our global wholesale business, we recognised 50% of the profit (A$852 million), with the remaining balance deferred and recognised over 20 years.

Since the original transaction, REACH has been operating in a difficult environment. Prices for international voice and data carriage have fallen, but growth in usage has not been sufficient to compensate for the loss in revenue caused by the 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 that date and remains suspended. As a result, our share of net profits/(losses) in relation to REACH is not booked in the Telstra Group results.

Under AGAAP, REACH's profit in fiscal 2005 was A$328 million, compared with a loss of A$1,418 million in fiscal 2004 and A$47 million in fiscal 2003. In fiscal 2005, the result was primarily driven by a one-off profit upon entering the IRU agreement. In fiscal 2004, REACH booked an impairment write down on property, plant and equipment and intangibles of A$1.2 billion as a result of the continued deterioration in the global wholesale communications industry, as well as other one-off provisions of A$116 million.

In January 2005, REACH announced that its data capacity would be consumed entirely by its shareholders. We along with our joint venture partner, PCCW, have experienced significant traffic growth over recent years. As a result, PCCW and we have provided forecasts for data capacity requirements, which is expected to absorb virtually all of REACH's existing inventory for the foreseeable future. REACH has continued its profitable third party voice and satellite business. As part of the process to gain improved operational and financial efficiencies, we along with PCCW announced a number of improvements to the REACH operating model to drive the future performance of this company. Refer to 'Related party transactions' for full discussion regarding our dealings with REACH and changes to the REACH operating model.

As at 30 June 2005, the operational performance of REACH is tracking satisfactorily against plan, with a continued focus on core business activities and cost containment. A suite of new IT systems platforms have been progressively introduced to enhance operational performance and customer satisfaction.

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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. In June 2002, we acquired the remaining 40% ownership interest in CSL as part of our redemption of a convertible note from PCCW.

CSL operates in the highly competitive Hong Kong mobile market and has delivered a solid revenue performance in fiscal 2005 despite an adverse operating environment, characterised by significant market competition and local voice price erosion. CSL remains Hong Kong's premium provider of mobile voice and data services.

Table 27 –CSL financial summary

	Year ended 30 June				
	2005	2004	2003	**2005/2004**	2004/2003
		(in millions)		(% change)	
Total revenue [(1)]	**HK$4,308**	HK$4,022	HK$4,224	**7.1**	(4.8)
Net profit [(1)]	**HK$236**	HK$329	HK$654	**(28.3)**	(49.7)

(1) *Amounts presented in HK$ have been prepared in accordance with AGAAP.*

Until recently, Hong Kong had experienced one of its worst economic downturns in decades with the situation worsened by the outbreak of the SARS virus in March 2003. Furthermore, the Hong Kong mobile market continues to remain highly competitive, with CSL impacted by sustained declines in local voice revenue. In fiscal 2005, CSL revenue increased by 7.1% following a 4.8% decline in fiscal 2004 compared with fiscal 2003. In fiscal 2005, significant revenue increases were achieved in data, international voice and prepaid revenues. Mobile handset sales also increased due to the continued focus on the move into the mass market as well as the launch of new models with advanced features.

For fiscal 2005, the increase in revenue however has been offset by an increase in total expenditure. This increase was largely due to the launch of 3G services in October 2004, with higher handset costs including subsidies and commission expenses, as well as disbursement charges. In fiscal 2004 and fiscal 2003, CSL was adversely impacted by one of its competitors initiating an aggressive price reduction to attract new subscribers. CSL elected not to participate in the price war and instead competed on quality of service, which adversely impacted revenues and net profit in these years.

CSL's capital expenditure increased over the three-year period to HK$755 million (A$128 million) in fiscal 2005, compared with HK$524 million (A$94 million) in fiscal 2004 and HK$320 million (A$68 million) in fiscal 2003. This growth was primarily driven by the implementation and rollout of 3G services.

During fiscal 2005, in addition to launching its integrated 3G network, CSL had a number of other significant launches including the first Chinese language support for Blackberry services. In the field of mobile entertainment services and content, CSL launched Hong Kong's first full song download over 3G, MP3 Ringtones, Interactive Online Gaming and Mobile Drama. Active data users represent a significant portion of CSL's postpaid customer base.

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TelstraClear

TelstraClear, the second largest full service carrier in New Zealand, has been operating in its current form since December 2001. In December 2001, we merged our 50% owned joint venture, TelstraSaturn and CLEAR Communications, to form TelstraClear. As part of this transaction, we acquired an additional 8.4% interest in the merged entity and began the consolidation of 58.4% of TelstraClear's results. In April 2003, we acquired the remaining 41.6% interest in TelstraClear for A$25 million and consolidated 100% of TelstraClear's results from that date.

Table 28 –TelstraClear financial summary

	Year ended 30 June				
	2005	2004	2003	**2005/2004**	2004/2003
	(in millions)			(% change)	
Total revenue [(1)]	**NZ$716**	NZ$692	NZ$651	**3.5**	6.3
Net profit/(loss) [(1)]	**NZ$7**	NZ$3	NZ$(138)	**133.3**	102.2

(1) *Amounts presented in NZ$ have been prepared in accordance with AGAAP.*

During the three-year period, TelstraClear has continued to grow revenue while managing cost levels, with strong retail revenue growth in the consumer and small business markets resulting from aggressive marketing strategies, as well as some major corporate customer wins. Growth in the retail segment has been partly offset by reduced wholesale revenues driven by competition and rate reductions. Regulatory change in fiscal 2004 allowed TelstraClear the opportunity to resell residential services to the 90% of New Zealand homes that previously had no choice of service provider. This was a major strategic focus for TelstraClear in fiscal 2005.

In November 2004, TelstraClear acquired a local ICT player, Sytec Resources Limited and its controlled entities (Sytec). This investment is an important step to leverage TelstraClear's existing ICT capability and provides future growth opportunities in this segment.

New Zealand is a strategically important market for our trans-Tasman customers and the combination of TelstraClear and Telstra enables us to provide customers on both sides of the Tasman with seamless communication and IT solutions.

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Financial position

Table 29 shows our summarised statement of financial position in accordance with AGAAP as at 30 June 2005.

Table 29 - Summarised statement of financial position [(1)]

	As at 30 June (in millions)		
	2005 A$	**2005 US$ [(2)]**	2004 A$
Current assets			
Cash assets	**1,540**	**1,174**	687
Other current assets	**4,637**	**3,532**	4,640
Total current assets	**6,177**	**4,706**	5,327
Non current assets			
Property, plant and equipment	**23,351**	**17,789**	22,863
Intangibles - goodwill	**2,287**	**1,742**	2,104
Intangibles - other	**1,581**	**1,204**	1,501
Other non current assets	**2,914**	**2,219**	3,198
Total non current assets	**30,133**	**22,954**	29,666
Total assets	**36,310**	**27,660**	34,993
Current liabilities			
Interest bearing liabilities	**1,518**	**1,156**	3,246
Other current liabilities	**4,864**	**3,705**	4,330
Total current liabilities	**6,382**	**4,861**	7,576
Non current liabilities			
Interest bearing liabilities	**11,816**	**9,001**	9,014
Other non current liabilities.	**3,231**	**2,462**	3,042
Total non current liabilities	**15,047**	**11,463**	12,056
Total liabilities	**21,429**	**16,324**	19,632
Net assets	**14,881**	**11,336**	15,361
Shareholders' equity			
Telstra Entity	**14,879**	11,334	15,359
Outside equity interests	**2**	2	2
Total shareholders' equity [(3)]	**14,881**	11,336	15,361

(1) *Our detailed statement of financial position measured and classified under AGAAP is included in our financial statements. Refer to note 30 to our financial statements for our statement of financial position measured and classified under USGAAP.*

(2) *Translated at the noon buying rate on 30 June 2005 of A$1.00 = US$0.7618.*

(3) *Total shareholders' equity under USGAAP is A$14,367 million in fiscal 2005 and A$15,291 million in fiscal 2004. Outside equity interests are not classified as shareholders' equity under USGAAP.*

We continue to maintain a strong financial position with net assets of A$14,881 million, compared with A$15,361 million as at 30 June 2004. The decrease in net assets by A$480 million comprised an increase in total liabilities of A$1,797 million, offset by an increase in our total assets of A$1,317 million.

The increase in total liabilities of A$1,797 million was primarily driven by a A$1,074 million rise in total interest-bearing liabilities in order to fund the special dividend and share buy-back during fiscal 2005. The increase was facilitated by bond issues in Europe, Switzerland, New Zealand and Australia. A stronger Australian dollar also contributed to increased interest-bearing liabilities as our cross currency swap position has moved from a net receivable to a net payable. In addition, our payables increased to reflect the deferred payment settlement terms on our acquisition of the 3G RAN assets.

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The increase in total assets of A$1,317 million was primarily due to the following movements during the year:

- cash assets grew by A$853 million partially due to the proceeds on our EUR1 billion bond issue being received just prior to 30 June 2005, which was subsequently invested in the short term money market;
- our property, plant and equipment increased by A$488 million, largely due to the recognition of our share of 3G RAN assets acquired as part of a partnership formation with H3GA;
- goodwill and other intangibles grew by A$183 million and A$80 million respectively, mainly due to intangible assets acquired as part of our investment acquisitions including KAZ, Telstra Business Systems (formerly Damovo (Australia) Pty Ltd) and PSINet; and
- other non current assets decreased by A$284 million mainly due to movement in our cross currency swaps portfolio to a net payable position as a result of the appreciating Australian dollar. In addition, we terminated our capacity prepayment with our joint venture entity, REACH, and entered into an IRU arrangement with REACH with a carrying value of A$216 million as at 30 June 2005.

We have made a number of significant acquisitions during fiscal 2005 to strengthen our operational capabilities and provide additional opportunities for growth. These acquisitions include KAZ, Telstra Business Systems (formerly Damovo (Australia) Pty Ltd) and PSINet. We believe our acquisitions will enable us to capitalise on the expertise of these entities and provide additional opportunities for us to compete in emerging strategic markets. The consideration of these acquisitions amounted to A$530 million, with an equivalent amount recognised across the Telstra Group financial position on consolidation.

For further details on our financial condition, refer to ‘Overview of key factors affecting our business and financial performance’ and ‘Liquidity and capital resources’ below.

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Liquidity and capital resources

Capitalisation

Table 30 shows our capitalisation in accordance with AGAAP as at 30 June 2005.

Table 30 - Capitalisation

	As at 30 June 2005 (in millions) A$	US$ [1]
Cash	**1,540**	**1,174**
Short term debt [2] [3] [4]	**1,514**	**1,153**
Long term debt		
Telstra bonds (unsecured)	**2,608**	**1,987**
Other Loans (unsecured)	**8,297**	**6,321**
Cross currency swap hedge (net) [4]	**864**	**658**
Finance leases	**47**	**36**
Total long term debt [4]	**11,816**	**9,002**
Shareholders' equity		
Contributed equity (12,443,074,357 (2004: 12,628,359,026) fully paid ordinary shares issued) [5]	**5,793**	**4,413**
Reserves	**(157)**	**(120)**
Retained profits [5] [6]	**9,243**	**7,041**
Outside equity interests [7]	**2**	**2**
Total shareholders' equity [8]	**14,881**	**11,336**
Total capitalisation [9]	**28,211**	**21,491**

(1) Translated at the noon buying rate on 30 June 2005 of A$1.00 = US$0.7618.
(2) Includes the current portion of long term debt.
(3) No interest-bearing liabilities are guaranteed by third parties. All of our significiant interest-bearing liabilities were unsecured, except for finance leases which are secured, as the rights to the leased assets revert to the lessor in the event of default.
(4) Both our current and non current cross currency swap hedge receivables and payables are included in our debt position and classified as short term and long term debt as per their maturity.
(5) On 15 November 2004, we completed an off-market share buy-back of 185,284,669 ordinary shares as part of our ongoing capital management program. The ordinary shares were bought back at A$4.05 per share comprising a fully franked dividend component of A$2.55 per share and a capital component of A$1.50 per share. The Commonwealth of Australia did not participate in the share buy-back. The shares bought back were subsequently cancelled, reducing the number of fully paid ordinary shares on issue. In total, 1.47% of our total issued ordinary shares or 3.0% of our non Commonwealth owned ordinary shares, were bought back.
(6) On 11 August 2005, we declared a fully franked final dividend of A$0.14 and a special dividend of A$0.06 per ordinary share, payable on 31 October 2005. These dividends were not deducted from retained profits as at 30 June 2005 and are disclosed as a post balance date event, refer to note 28 to our financial statements for further detail.
(7) Outside equity interests are not classified as shareholders' equity under USGAAP.
(8) Total shareholders' equity under USGAAP is A$14,367 million. Refer to note 30 to our financial statements.
(9) Total capitalisation consists of short term debt, long term debt and shareholders' equity, including minority interests.

Cash assets as at 30 June 2005 were A$1,540 million, compared with A$687 million as at 30 June 2004 and A$1,300 million as at 30 June 2003. Our cash assets held are predominantly Australian dollars. As at 30 June 2005, our total interest-bearing liabilities (debt) were A$13,330 million, net of cross currency swap hedge receivables. After deducting cash assets, net debt as at 30 June 2005 was A$11,790 million, compared with A$11,167 million as at 30 June 2004 and A$10,972 million as at 30 June 2003.

Approximately 27.2% of our total debt consisted of Australian dollar denominated borrowings, with the balance sourced from a variety of foreign currency markets. Our current interest-bearing liabilities that mature in less than 12 months amount to A$1,514 million (including current cross currency swap hedge receivables of A$4 million), representing approximately 11.4% of our total debt. This primarily includes

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commercial paper of A$449 million, loans of A$523 million and Telstra bonds of A$516 million maturing within the fiscal 2006 year. For a summary of the maturity profile of our debt, see note 16 to our financial statements.

As at 30 June 2005, we had access to A$625 million and US$200 million of committed standby bank lines. These comprise bilateral arrangements with approximately one year duration with nine major banks that fall due for renewal at various times throughout the year. We have four commercial paper programs with a total nominal borrowing capacity of A$2 billion, US$4 billion, EUR4 billion and NZ$0.30 billion (the New Zealand dollar facility is technically unlimited but we estimate a practical limit of around NZ$0.30 billion based on the efficient capacity of the New Zealand market). In each case, we issue commercial paper through dealers on a quotation (non underwritten) basis. Our commercial paper facilities are not committed and do not provide guaranteed access to funds. As at 30 June 2005, we had drawn down US$156 million of our United States dollar facility and NZ$266 million of our New Zealand dollar facility. We had not drawn down on our Australian dollar and Euro commercial paper facilities at year end. Generally, our facilities are available unless we default on any terms applicable under the relevant agreements or we become insolvent.

Our objective with our short term facilities is to provide ready and efficient access to substantial borrowings capacity in order to ensure that we can comfortably meet any unforseen demands for funding. We have established commercial paper programs as outlined above that provide diverse and reliable sources of funding. The maturity of our total debt portfolio is generally aligned to meet our cash flow requirements.

Our foreign currency exchange risk refers to the risk that the values of our financial commitments or investments will fluctuate due to changes in foreign exchange rates. Other than borrowings in foreign currency specifically held as hedges against foreign currency assets, foreign currency borrowings are fully hedged at draw down to Australian dollars by applying cross currency swaps with similar maturities, this effectively provides funding in Australian dollars at draw down. Foreign currency risk also arises on the translation of the financial results of non-Australian controlled entities. The foreign exchange exposure on our offshore investments is commonly termed ‘translation risk’. Hedging of this risk is sometimes undertaken using foreign currency borrowings to provide a natural hedge position. Where this is not an option, we use derivative instruments such as forward foreign currency contracts to hedge our translation risk.

Our foreign currency exchange risk is managed centrally by our treasury department, which is part of our Finance and Administration business unit. For additional information regarding our foreign currency position, the management of our foreign currency exchange risk and interest rate profiles, see ‘Quantitative and qualitative disclosures about market risk’, ‘Key information – Risk factors’, and notes 16 and 29 to our financial statements.

Our current liabilities are typically in excess of our current assets, as common with most international telecommunications companies. We have negative working capital of A$205 million as at 30 June 2005, A$2,249 million as at 30 June 2004 and A$77 million as at 30 June 2003. We define our working capital as the difference between current assets and current liabilities. 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. In addition, our commercial paper programs and standby bank lines provides us with readily available sources of liquidity at short notice when the need arises. As a result, these contributing factors and our existing working capital enables us to meet our present and future expenditure obligations, including the potential realisation of any contingencies, as required.

In fiscal 2005, the improvement in our negative working capital position to A$205 million reflects the high level of cash assets held at year end, in conjunction with a lower level of short term debt. The increase in cash assets was driven by the proceeds received from a Eurobond issued in late June 2005, which was largely undertaken as pre-funding for the fiscal 2006 funding requirements. In fiscal 2005, we undertook several new

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long term bond issues to manage our working capital requirements and re-finance our maturing long term debt. In fiscal 2004, the increase in negative working capital compared with fiscal 2003 reflected the reclassification of a portion of long term debt to current debt as an increased component was due to mature in fiscal 2005.

In fiscal 2005, net cash provided by operating activities amounted to A$8,163 million, compared with A$7,433 million in fiscal 2004 and A$7,057 million in fiscal 2003. Cash generated from operations continue to be our primary source of liquidity. Strong operational cash flows continue to generate funding for capital expenditure, investment acquisitions in accordance with our strategic objectives, dividend payments to our shareholders and funding of share buy-backs undertaken.

Over the three-year period, our operating cash flows have remained strong and relatively consistent each month. The major spikes in cash flows across the Company arise from significant receipts such as asset and investment sales, and from significant outgoings such as the acquisition of large assets and investments, capital returns, dividend payments and tax instalments. In general, we use our cash generated and other liquid assets, as well as our short term debt to cover our major outgoings.

The majority of our funding is generated by the operations of Telstra Corporation Limited, the parent entity in the group. As a result, we do not rely on dividends from controlled entities for our liquidity needs. We are not aware of any restrictions on the payment of dividends apart from those specified in the Corporations Act 2001, common law requirements or through local jurisdictional obligations.

During fiscal 2005, we undertook several new long term borrowings that included:

- a EUR500 million 10 year bond that will mature in July 2014;
- two A$500 million domestic bonds of 8 and 10 years duration that will mature in November 2014 and April 2015 respectively;
- two NZD$100 million bonds of 7 and 10 years that will mature in November 2011 and November 2014 respectively;
- a CHF300 million 8 year bond that will mature in April 2013; and
- a EUR1,000 million bond, comprising a EUR500 million tranche that will mature in June 2010 and a further EUR500 million tranche that will mature in July 2015.

During fiscal 2004, we did not undertake any new significant long term borrowings as existing maturing long term debt of A$679 million in fiscal 2003 was funded by cash flow from operations and a reduction in the holdings of liquid assets.

In June 2004, our Board of Directors announced that it had undertaken a review of the Company's capital management strategy. Based on this review, the Board announced its intention to return an additional A$1,500 million to shareholders each fiscal year until fiscal 2007 through special dividends and share buy-backs, subject to us maintaining our target financial parameters. As part of this capital management program, we completed an off-market share buy-back of A$750 million and paid a special dividend of 6 cents per share with our interim dividend during fiscal 2005. On 11 August 2005, we declared a fully franked special dividend of 6 cents per share to be paid with the final dividend during fiscal 2006 and the intention to pay a fully franked special dividend with the interim dividend during fiscal 2006 of 6 cents per share. Refer to 'Overview of key factors affecting our business and financial performance – Outlook' for further details on our capital management policies.

In June 2004, immediately following the capital management announcement, our long term credit rating was lowered by the major rating agencies; Standard and Poors to A+, Moody's Investors Service to A1 and Fitch Ratings to A+. All three rating agencies assigned a stable outlook on their ratings. In May 2005,

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Standard and Poors and Moody's Investors Service subsequently changed their outlook from stable to negative. This change was generated by the uncertain environment that we are operating in, as evidenced by our regulatory setting and also the speculation surrounding the privatisation of our Company. The privatisation of Telstra is dependent upon many factors including the passing of appropriate legislation through parliament and market conditions. Notwithstanding these reviews, our credit rating remains strong within the global telecommunications sector. Ratings are not a recommendation to purchase, hold or sell securities, and may be changed, superseded or withdrawn at any time.

We believe capital expenditure will continue to be financed largely from our cash flow from operations. Maturing long term debt of A$1,055 million in fiscal 2006 is expected to be principally re-financed by a reduction in liquid assets and an increase in short term debt.

Cash flow information

Table 31 provides information regarding our cash flows and liquidity during the three-year period.

Table 31 – Cash flow

	Year ended 30 June				
	2005	2004	2003	**2005/2004**	2004/2003
	(in millions)			(% change)	
Net cash provided by operating activities	**8,163**	7,433	7,057	**9.8**	5.3
Net cash used in investing activities	**(3,809)**	(3,270)	(2,492)	**16.5**	31.2
Net cash used in financing activities	**(3,512)**	(4,776)	(4,317)	**(26.5)**	10.6
Net increase/(decrease) in cash	**A$842**	A$(613)	A$248	**237.4**	(347.2)

Net cash provided by operating activities

Our primary source of liquidity is cash generated from our operations. Net cash provided by operating activities includes receipts from trade and other receivables, and payments to suppliers and employees. In addition, this category includes income tax paid, GST received, paid and remitted to the Australian Taxation Office (ATO), borrowing costs paid and interest received.

During fiscal 2005, net cash provided by operating activities increased by A$730 million, or 9.8% to A$8,163 million. The main drivers of this change included growth in receipts from trade and other receivables of A$1,321 million and payments to suppliers and employees of A$687 million, as well as a decline in income tax paid by A$138 million. Higher revenue and expenses, led by the consolidation of the trading activities of our recently acquired controlled entities drove the rise in receipts and payments. However, this increase was partly offset by a continued focus on working capital management. Income taxes paid reduced in fiscal 2005 mainly due to a lower final tax payment in December 2004 relating to the 2004 financial year. The final payment was higher in fiscal 2004 as the Pay As You Go (PAYG) tax instalment rate set by the ATO for fiscal 2003 was too low.

During fiscal 2004, net cash provided by operating activities increased by A$376 million, or 5.3% to A$7,433 million compared with fiscal 2003. The main drivers included growth in receipts from trade and other receivables of A$443 million, and a decline in payments to suppliers and employees of A$104 million and borrowing costs paid of A$153 million. The increase was predominantly due to improvements in working capital and a reduction in interest paid from lower debt levels. Offsetting this increase to some extent was the rise in income tax paid of A$320 million due to differences in the final tax payments and the PAYG instalment rates as mentioned above.

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Net cash used in investing activities

Net cash used in investing activities represents amounts paid for capital assets and investments, offset by cash receipts from the sale of capital assets and investments. During the three-year period, we continued to commit a substantial amount of capital and other resources to upgrade and rationalise our network infrastructure and improve a number of our systems.

Table 32 - Net cash used in investing activities

	Year ended 30 June				
	2005	2004	2003	**2005/2004**	2004/2003
		(in millions)		(% change)	
Switching	**344**	298	376	**15.4**	(20.7)
Transmission	**367**	378	378	**(2.9)**	-
Customer access	**887**	794	959	**11.7**	(17.2)
Mobile telecommunications networks	**511**	416	449	**22.8**	(7.3)
International assets	**279**	192	193	**45.3**	(0.5)
Capitalised software	**543**	452	583	**20.1**	(22.5)
Specialised network functions (1)	**307**	221	216	**38.9**	2.3
Other	**385**	336	210	**14.6**	60.0
Operating capital expenditure	**3,623**	3,087	3,364	**17.4**	(8.2)
Less: capitalised interest	**(90)**	(74)	(105)	**21.6**	(29.5)
Capital expenditure (excluding capitalised interest)	**3,533**	3,013	3,259	**17.3**	(7.5)
Add: patents, trademarks and licences (including 3G spectrum)	**6**	2	2	**200.0**	-
Add: investments	**590**	668	71	**(11.7)**	840.8
Capital expenditure (excluding capitalised interest) and investments	**4,129**	3,683	3,332	**12.1**	10.5
Sale of capital equipment, investments and other assets	**(320)**	(413)	(840)	**(22.5)**	(50.8)
Net cash used in investing activities	**A$3,809**	A$3,270	A$2,492	**16.5**	31.2
Capital expenditure (including capitalised interest, and patents, trademarks and licences) and investments	**A$4,219**	A$3,757	A$3,437	**12.3**	9.3

(1) Specialised network functions refer to specialised (Automated Data Processing (ADP) type) hardware and software dedicated to our telecommunciations network that performs a network function associated with the provision of products, services or functionaility.

In fiscal 2005, our operating capital expenditure increased by 17.4% to A$3,623 million. This growth was led by the increased demand for broadband ADSL services and the development of our 3G infrastructure. The increase in our operating capital expenditure was across all capital expenditure categories, with the exception of a decrease in transmission expenditure reflecting the prior year acquisition of a significant transmission system. The key areas of expansion in operating capital expenditure for fiscal 2005 included:

- higher domestic switching as a result of increased demand for broadband ADSL and specialised wideband services driven by new government and large corporate customer contracts;
- increased expenditure on the customer access network (CAN) largely due to the significant rise in broadband ADSL demand;
- expenditure on mobile networks grew primarily due to the 3G program of works, as well as improvements in the depth of coverage in the GSM and CDMA networks. The 3G program includes the A$22 million cash payment for our new asset sharing arrangement with H3GA. The remaining consideration of A$428 million under this arrangement was deferred and is not included in our investing cash flows as at 30 June 2005. The deferred consideration will be payable over the next two financial years, with the last instalment due on 1 July 2006. We have also capitalised A$26

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million of transaction costs paid in relation to the 3G asset purchase. Partially offsetting this increase were reductions in the traditional 2G, 1XRTT and untimed local calls extended zone programs;

- growth in international capital expenditure driven by the purchase of dedicated components of REACH's international cable capacity to satisfy additional demand following the change in the operating model for REACH, refer to 'Related party transactions' for additional details. In addition, CSL expenditure increased reflecting the development of their own 3G infrastructure;
- increased expenditure in capitalised software resulting from the purchase of a long term Microsoft desktop licence and enterprise resource planning system (SAP) licences. We also acquired 3G software development and other specialised IT programs such as billing rationalisation, privacy compliance and the next generation cost reduction programs;
- growth in specialised network function expenditure relating to the provision of 3G mobile data solutions for areas such as i-mode content, development of a new BigPond® system for customer management and product billing, as well as increased broadband content development; and
- a rise in the other capital expenditure category was led by higher expenditure on Internet data centres to accommodate commercial hosting products, systems and platforms, as well as growth in telepower programs due to the increased ADSL broadband demand. The increase was partially offset by a reduction of expenditure on land and buildings following project completions.

In fiscal 2004, our operating capital expenditure decreased by 8.2% to A$3,087 million compared with fiscal 2003. Our operating capital expenditure declined in fiscal 2004 predominantly due to the tight control over our capital expenditure program resulting from process efficiencies. The key areas of movement in operating capital expenditure for fiscal 2004 compared with fiscal 2003 include:

- lower domestic switching expenditure due to reduced demand for traditional wideband technology services and a more efficient utilisation of existing infrastructure to support high speed products and capacity to meet customer demand. Underpinning the reduction is the continued trend in delivering services utilising broadband technology alternatives;
- decreased expenditure on the CAN mainly due to the increased efficiency of our network resulting from the combined broadband and narrowband program. We improved our focus on pro-active work programs and other processes resulting in lower unit costs and reduced held orders, as well as a more targeted technology deployment. Offsetting this reduction to some extent was the increase in demand for new estates and redevelopment programs, particularly in regional areas and the increased demand for ADSL broadband technology;
- decreased expenditure in mobile networks was driven by the CDMA 1xRTT deployment program and government sponsored works nearing completion. In fiscal 2004, we also completed the majority of customer demand capacity and core installation requirements for mobile data bearer networks. Offsetting this reduction was the one-off purchase of EVDO equipment. This broadband-like wireless service creates 'Hot Regions' of high speed data in capital cities, key regional cities and all major airports; and
- expenditure on capitalised software reduced primarily due to the reclassification of fiscal 2003 expenditure to other items and improvements in productivity, as well as reduced cycle times. In addition, expenditure in fiscal 2003 included the rollout of some significant projects such as an amalgamation of the field workforce systems.

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Our expenditure on investments amounted to A$590 million in fiscal 2005, compared with A$668 million in fiscal 2004 and A$71 million in fiscal 2003. This expenditure was significantly higher in both fiscal 2005 and fiscal 2004 compared with fiscal 2003, predominantly due to our acquisitions of KAZ and PSINet during fiscal 2005, and the Trading Post during fiscal 2004. Over the three-year period, our cash investment acquisitions resulted from the following significant items:

- A$340 million for the acquisition of 100% of the issued share capital of KAZ in fiscal 2005;
- A$124 million for the acquisition of 100% of the issued share capital of PSINet in fiscal 2005;
- A$66 million for the acquisition of 100% the issued share capital of ESA Holding Pty Ltd and its controlled entity Damovo (Australia) Pty Ltd (now known as Telstra Business Systems), and Damovo HK Limited for A$66 million in fiscal 2005;
- A$46 million for the acquisition of 100% of the issued share capital of Universal Publishers in fiscal 2005;
- A$638 million for the acquisition of 100% of the issued share capital of Trading Post in fiscal 2004;
- A$38 million for the acquisition of 100% of the issued share capital of Cable Telecom in fiscal 2004;
- additional investments in FOXTEL of A$5 million in fiscal 2005 and A$50 million in fiscal 2003; and
- A$25 million for the acquisition of the remaining 41.6% shareholding in TelstraClear in fiscal 2003.

As part of our investment acquisitions, we have acquired cash assets of A$13 million in fiscal 2005, A$7 million in fiscal 2004 and nil in fiscal 2003.

Our sale of capital equipment, investments and other assets amounted to A$320 million in fiscal 2005, compared with A$413 million in fiscal 2004 and A$840 million in fiscal 2003. Over the three-year period, our cash proceeds resulted from the following significant items:

- the redemption of the converting note issued by PCCW with a cash consideration of A$76 million in fiscal 2005;
- the sale of our 1.7% shareholding in Intelsat Limited for A$69 million in fiscal 2005;
- the sale of our 5.3% shareholding in Infonet Services Corporation for A$65 million in fiscal 2005;
- the sale of our 22.6% shareholding in IBMGSA for A$154 million in fiscal 2004;
- the sale of our 20.4% shareholding in MGTI for A$50 million in fiscal 2004; and
- the sale of 7 office properties around Australia for A$570 million in fiscal 2003.

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

- meeting ongoing customer demand for existing products and services, while ensuring service levels are 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;
- upgrading our customer access network;
- further development 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
- further investment to complement and fit with our existing strategies including the joint operation and continued development of the 3G RAN.

We believe our total capital expenditure will increase in fiscal 2006 to meet our 3G commitments, the broadband demand and investment in a number of business improvement projects, such as the broadband management system, customer access network rehabilitation and new billing platforms.

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

Net cash used in financing activities

Our net cash flow used in financing activities decreased by A$1,264 million to A$3,512 million in fiscal 2005. The difference was mainly attributable to a movement of A$1,775 million on our net proceeds/repayments on our borrowings. In fiscal 2005, we received net proceeds of A$1,409 million (compared with net repayments of A$366 million in fiscal 2004) resulting from the re-financing of debt which matured during fiscal 2005. Other contributing factors include the rise in dividend payments due to the higher level of dividends (including special dividends) paid in the current year. In addition, an off-market share buy-back involving 185,284,669 shares in fiscal 2005 was A$253 million lower than the share buy-back undertaken in prior year. The prior year also included funding to acquire REACH's loan facility, amounting to A$226 million.

Our net cash flow used in financing activities increased by A$459 million to A$4,776 million in fiscal 2004 compared with fiscal 2003. This increase was mainly due to the share buy-back undertaken and funding provided to acquire REACH's loan facility. In fiscal 2004, we completed an off-market share buy-back of 238,241,174 ordinary shares. The cost of the share buy-back comprised purchased consideration of A$1,001 million and associated transaction costs of A$8 million. No share buy-back was undertaken in fiscal 2003. In addition, we bought out, with our co-shareholder PCCW, a loan facility owed by REACH and its controlled entity, Reach Finance Limited as mentioned above. Our share of the payment amounted to A$226 million. These increases were partly offset by a reduction in the net repayments of borrowings. In fiscal 2004, we made net repayments of A$366 million compared with A$983 million in fiscal 2003. The higher net repayment in fiscal 2003 was mainly due to the timing of our borrowing maturity.

Refer to 'Liquidity and capital resources' for details of our financing arrangements and debt balances.

Contractual obligations and commercial 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. While the liability under these agreements only arises on supply, we have a commitment to acquire the particular products and services under the relevant agreements. In addition, we are obligated to meet our long term debt requirements.

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Table 33 – Contractual obligations and commercial commitments as at 30 June 2005

	Total amounts committed	Within 1 year	Within 1 - 2 years	Within 2 - 3 years	Within 3 - 4 years	Within 4 - 5 years	After 5 years
		Amount of expiration per period (in millions)					
Expenditure commitments in relation to:							
Capital expenditure [(1)]	**677**	537	27	10	11	13	79
Non-cancellable operating leases	**1,523**	380	260	209	149	128	397
Finance leases	**52**	7	6	6	4	2	27
FOXTEL other commitments	**1,689**	144	144	118	93	80	1,110
Other expenditure commitments	**1,013**	494	181	96	69	33	140
Total contractual obligations and commercial commitments	**4,829**	1,554	610	430	316	245	1,674
Long term debt obligations:							
Long term debt obligations (including current obligations of long term debt) [(2)]	**12,028**	1,013	890	1,297	583	792	7,453
Unamortised discount [(2)]	**(84)**	(1)	(3)	(2)	(2)	(5)	(71)
	11,944	1,012	887	1,295	581	787	7,382
Total contractual obligations and commercial commitments (including long term debt obligations)	**A$16,773**	A$2,566	A$1,497	A$1,725	A$897	A$1,032	A$9,056

(1) *Included in our capital expenditure commitments is our share of FOXTEL capital commitments. Our share amounted to A$133 million, which relates to the purchase of digital set top box units. The presentation of our commitments is consistent with note 20 to our financial statements.*

(2) *Our long term debt obligations (including the current portion of long term debt) exclude our cross currency swap hedge position. In addition, it excludes our finance leases as these commitments are included separately in the above table. Additional details regarding the split of our long term debt obligations is provided in note 16 to our financial statements. Refer to 'Liquidity and capital resources' for further discussion regarding our debt obligations.*

Our capital expenditure commitments predominantly relate to expenditure to which we have committed with external parties to build and improve our networks, enhance our network software and meet our software and hardware requirements. In addition, we have a share of commitments relating to FOXTEL for the purchase of digital set top box units.

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, including the operating leases entered into regarding the 7 office properties sold as part of our sale and leaseback transaction in fiscal 2003;
- rental of motor vehicles, caravan huts, trailers and mechanical aids over an average term of between 2 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 our non-cancellable operating leases, we have commitments under cancellable operating leases amounting to A$343 million. These commitments include leases of IT equipment and motor vehicles. It also includes commitments for leased assets used in the supply of desktop services to our customers.

Our finance lease commitments of A$52 million relate to capitalised property leases and leases for IT equipment to support our client requirements for managed service solutions. In addition, we have previously entered into US finance leases with several entities incorporated in the Cayman Islands relating to communications exchange equipment, with an average term of 11 years. We have provided guarantees

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over the performance of these entities under defeasance arrangements, whereby lease payments are made on our behalf by the entities over the remaining term of the finance leases. Refer to note 20 to our financial statements for further details.

The FOXTEL commitments primarily relate to our 50% share of the FOXTEL partnership's commitment to acquire subscription television programming that is subject to minimum subscriber guarantee levels. The minimum subscriber payments fluctuate in accordance with price escalation/reduction formulae contained in the agreements. During fiscal 2005, FOXTEL reviewed and reassessed the applicable commitment period for the minimum subscriber guarantee contracts. As a result, our share of the commitment was adjusted down from those commitments previously expected to eventuate. Due to the joint and several nature of the FOXTEL partnership agreements, we are also 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.

Our other expenditure commitments include the following items:

- commitments relating to service contracts for maintenance and support of our software and hardware, amounting to A$308 million;
- expenditure commitments of A$191 million over the next 12 years in relation to CSL's acquisition of a 3G spectrum licence in October 2001;
- commitments for general maintenance and other expenditure in our voice and mobility area, amounting to A$166 million; and
- commitments for general maintenance and other expenditure in our data and online area, amounting to A$169 million.

Until 1 March 2005, we were committed to an International Services Agreement Australia (AISA) agreement with our joint venture entity, REACH, which required us to purchase from REACH a certain percentage of our annual capacity requirements of switched voice, international transmission and global Internet access services. Our commitment was terminated as part of the lead up to the restructure of our arrangements with REACH and as a result, we have no further commitments under this arrangement, refer to 'Related party transactions' for further details.

Off balance sheet arrangements

Indemnities, performance guarantees and financial support

As at 30 June 2005, we had provided indemnities, performance guarantees and financial support to various entities. This includes arrangements with our joint venture entities such as REACH, FOXTEL and the 3GIS Partnership. The features and counterparties involved in these contingent liabilities 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 forward foreign currency contracts, interest rate swaps and cross currency swaps.

The principal and net market value of our interest rate swaps and cross currency swaps are not consolidated in our statement of financial position under AGAAP. The net notional principal amount and net fair value of our outstanding interest rate swaps was A$2,027 million and A$379 million respectively as at 30 June 2005. The net fair value represents the market value of both the fixed and floating components of our interest rate swaps. Our accrued interest payable on the interest rate swaps is included within current payables in our statement of financial position and amount to A$41 million. Our interest rate swap position as at 30 June

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2005 reflected that on a net basis, we pay interest on the interest rate swaps at variable rates and receive interest on the interest rate swaps at fixed rates.

The net notional principal amount of the payable leg of our outstanding cross currency swaps was A$9,259 million and the net fair value was a negative A$864 million as at 30 June 2005. The net fair value represents the market value of our outstanding cross currency swaps. The hedge receivables and hedge payables arising from our cross currency swaps entered to hedge our foreign currency borrowings amounts to a net borrowing (including accrued interest) of A$871 million. This carrying amount is recorded in current and non current interest-bearing liabilities, as well as current receivables in our statement of financial position under AGAAP.

The nature, business purposes and importance of our derivative instruments is discussed in note 29 to our financial statements. Gains and losses arising from our derivative transactions are recognised in the statement of financial performance in accordance with the accounting policy detailed in note 1 to our financial statements.

Share trusts

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. These trusts have been established to administer our employee share plans as described in note 19 to our financial statements.

We incur expenses on behalf of TESOP97 and TESOP99 in relation to administration costs of these trusts. We also provide all of the funding to the Telstra Growthshare Trust to enable it to purchase Telstra shares on market to underpin our employee share plan issues. Under AGAAP, we do not consolidate or equity account these trusts as we do not control or significantly influence them. Refer to note 1 to our financial statements for further information regarding its accounting treatment.

TESOP97, TESOP99 and the Telstra Growthshare Trust are considered to be variable interest entities under FASB Interpretation No. 46 revised December 2003 (FIN 46), 'Consolidation of Variable Interest Entities'. We are considered to be the primary beneficiary of these trusts under FIN 46 and have consolidated them for USGAAP purposes. Refer to note 30(s) to our financial statements for further information.

Superannuation commitments

Over the three-year period, we sponsored the following defined benefit schemes:

- CSS, up until settlement on 17 June 2004;
- Telstra Super; and
- the CSL Retirement Scheme.

Under AGAAP, the financial position of these schemes is not recorded in our statement of financial position. As at 30 June 2005, the net surplus of our defined benefit schemes measured under AGAAP was A$1,158 million for Telstra Super and A$5 million for the CSL Retirement Scheme.

On 17 June 2004, the Commonwealth paid Telstra Super A$3,125 million in settlement of obligations under the CSS. As part of the settlement arrangement, the Commonwealth assumed the present obligation for past, present and future liabilities in respect of former and current Telstra employees who remain in the CSS. This money was owed to Telstra Super as a result of the transfer of our staff from the CSS to Telstra Super, either when the fund started in 1990, or when a subsequent opportunity to transfer arose in 1992. When the fund started in 1990, an agreement was struck whereby the money owed to Telstra Super would be paid to them over an extended period. The settlement of these payments in June 2004 was taxed at the rate of 15%.

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

Property leases

During fiscal 2005 and fiscal 2004, we have had no significant sale and leaseback transactions. In fiscal 2003, we entered into a sale and leaseback transaction on a portfolio of 7 office properties for sales proceeds of A$570 million. Operating leases totalling A$518 million at that time were taken out over these properties. The non-cancellable operating leases for these 7 office properties are included within table 33 'Contractual obligations and commercial commitments'.

Related party transactions

The following discussion summarises our significant transactions with related parties, other than our controlled entities. For discussion on all our related party transactions including transactions with directors and specified executives, refer to note 27 to our financial statements.

REACH

In fiscal 2001, we formed REACH, a 50/50 joint venture with PCCW, which merged our respective international infrastructure assets. REACH is a major carrier of international voice traffic. It provides outsourcing services in support of Telstra and PCCW's international voice and data services. In addition, it also provides third party voice and satellite services to customers other than PCCW and us. Upon the formation of REACH, we agreed with PCCW to enter into contractual arrangements with the joint venture company for the provision of voice, data and Internet connectivity services. We use these services primarily in connection with our retail international telecommunications business.

During the three-year period, our purchases from REACH were A$226 million in fiscal 2005, A$231 million in fiscal 2004 and A$506 million in fiscal 2003. These amounts were for both the purchase of, and entitlement to, capacity and connectivity services. The purchases were made in line with market prices. The significant decrease in fiscal 2004 compared with fiscal 2003 resulted from reduced demand and falling prices for capacity services. We made sales to REACH for international inbound call termination services, construction and consultancy of A$71 million in fiscal 2005, A$89 million in fiscal 2004 and A$109 million in fiscal 2003.

In January 2005, REACH announced that its data capacity would be consumed entirely by its shareholders. PCCW and Telstra have experienced significant traffic growth in recent years, which will see both companies utilising virtually all of REACH's capacity. REACH has continued to provide its third party voice and satellite services to consumers other than PCCW and us.

In April 2005, we along with PCCW, announced further improvements to REACH's operating model. As part of these changes, REACH allocated its international cable capacity between PCCW and us, via an IRU agreement. As consideration for the IRU, we discharged our rights under the capacity prepayment with REACH of A$187 million (US$143 million), the accrued interest on the prepayment of A$16 million (US$12 million), and the accrued interest on the REACH loan facility of A$2 million (US$2 million). As a result, total consideration amounted to A$205 million (US$157 million). The IRU is included in the other assets category in our statement of financial position. The carrying value of the IRU is amortised over the contract periods for the capacity on the various international cable systems, which range from 5 to 22 years. Over the period of the IRU, we will pay REACH an outsourcing fee for managing our cable usage on a cost plus mark up basis, which is recorded as an expense as incurred.

As part of the acquisition of the IRU, we have agreed to fund half of the committed capital expenditure that REACH is contractually obliged to pay to its capacity providers. Our commitment is for the period until 2022 and is estimated to be up to US$106 million in total. PCCW has also made the same commitment to fund the

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other half of REACH's capital expenditure. In the event that PCCW fails to make payments under the commitment, we have no obligation to fund PCCW's share of the commitment. Any capital expenditure we incur will be added to the value of the IRU and amortised over its remaining life. Since we acquired the IRU, REACH has drawn down A$14 million from us to fund its capital expenditure commitments. We have disclosed this funding arrangement as a contingent liability in our financial report, refer to note 21 to our financial statements for further details.

In fiscal 2004, we together with PCCW, bought out a loan facility previously owed to a banking syndicate by REACH and its controlled entity, Reach Finance Ltd. The original value of the syndicate bank facility was US$1,200 million and it was acquired for US$311 million by the REACH shareholders. Our share of the acquisition cost was US$155.5 million, which was recognised as a receivable. We have provided for the non recoverability of the loan as we do not consider that REACH is in a position to repay the loan in the medium term. No interest accrued or was payable on the loan until after 17 December 2004. The loan earned interest equivalent to the 3 month US LIBOR rate plus an additional 2.5% from 17 December 2004 until 16 April 2005, the date on which we entered the IRU. We waived our right to receive further interest under the loan facility as part of the termination of the capacity prepayment and acquisition of the IRU. The interest accrued through to the date of waiver was A$2 million. Other than the interest rate, the terms of the loan remained the same as that of the original loan facility provided by REACH's banking syndicate with full repayment of the principal due on 31 December 2010. As part of entering the IRU agreement, the terms of maturity of the loan facility were altered such that the facility is now due to be repaid on or after 31 December 2010 upon the giving of 6 months notice by both PCCW and us.

In addition, during fiscal 2004 we agreed with PCCW to provide a US$50 million revolving working capital facility to REACH to assist them in meeting their ongoing operational requirements. Our share of this facility is US$25 million. Draw downs under this facility must be repaid at the end of each interest period and fully repaid by 31 December 2007. As at 30 June 2005, REACH had not made any draw down under this facility. We have no joint or several liability relating to PCCW's US$25 million share of the working capital facility. The loan facility and working capital arrangement provides REACH with greater flexibility and a more viable capital structure. It also certifies our ongoing ownership of this core infrastructure, ensuring that we have the continued capacity to meet our international carriage service requirements.

In fiscal 2003, we agreed with PCCW to enter into a capacity prepayment arrangement with REACH and some of its subsidiaries, whereby each joint venture partner contributed A$230 million (US$143 million) for the prepayment of capacity to be used in the future. The payments (which were compounded to reflect the time value of money) were to be applied against the cost of the services and capacity supplied to the joint venture parties by REACH, as and when REACH had available surplus cash in accordance with a prescribed formula. Until REACH had such available surplus cash, we purchased capacity from REACH as required for continued operations. REACH's prices under these arrangements were adjusted to levels we believe were in line with market prices. The arrangements had regard to our future capacity needs and opportunities for growth. As previously detailed, on 16 April 2005 we discharged our rights under the capacity prepayment arrangement and entered into an IRU agreement with REACH. The carrying value of the REACH capacity prepayment amounted to A$208 million as at 30 June 2004 and A$214 million as at 30 June 2003, and was recognised as a receivable in our statement of financial position. We classified the capacity prepayment as non current as no draw down was expected in the following 12 months. Recoverability of this receivable revolved around REACH's credit risk and the ability of REACH to provide future services to us.

To fund the capacity prepayment arrangement with REACH, we partially redeemed a US$190 million (A$337 million) mandatorily converting secured note issued by PCCW. After partial redemption, the converting note had a face value of US$54 million. The remaining obligations of PCCW under the note were secured by an equitable mortgage of shares over all of PCCW's 50% shareholding in REACH. This note had a three-year term and an interest coupon compounding at a rate of 5% per annum. On 30 June 2005, we redeemed the

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converting note for a cash consideration of A$76 million. The note had a carrying value of A$80 million, which resulted in us realising a loss of A$4 million. This loss represented a 5% discount, which was negotiated for the redemption of the note in cash. The carrying value of the converting note was A$85 million as at 30 June 2004 and A$83 million as at 30 June 2003.

In fiscal 2003, we wrote down our investment in REACH by A$965 million to a carrying value of nil and suspended equity accounting. The write down occurred due to depressed conditions in the global market for international data and Internet capacity resulting in high levels of excess capacity, intense price competition and lower than expected revenues. Equity accounting for this investment remained suspended as at 30 June 2005 and 30 June 2004.

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. We also 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 – Subscription television' section of this annual report.

We have also entered into arrangements with FOXTEL, whereby we are able to bundle and resell FOXTEL services to our customers. During the three-year period, our purchases from FOXTEL of pay television services were A$218 million in fiscal 2005, compared with A$134 million in fiscal 2004 and A$25 million in fiscal 2003. The increase was primarily driven by higher service fees as a result of growth in bundled FOXTEL subscribers. The purchases enabled us to resell FOXTEL services to our customers and facilitate product bundling initiatives. These purchases were made on normal commercial terms and conditions.

FOXTEL has other commitments amounting to A$3,377 million as at 30 June 2005 of which we have a 50% share amounting to A$1,689 million. The majority of these commitments relate to minimum subscriber guarantees for pay television programming agreements. Due to the joint and several nature of the FOXTEL partnership agreements, we are also 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. Refer to 'Contractual obligations and commercial commitments' and note 21 to our financial statements for further information.

In fiscal 2004, FOXTEL entered into a A$550 million bank facility arrangement to fund its full digital conversion and launch of new digital services. As part of this arrangement, we and FOXTEL's other ultimate shareholders entered into an Equity Contribution Deed (ECD) whereby FOXTEL is required to call on a maximum of A$200 million in equity contributions in certain specified circumstances, as necessary to avoid default of a financial covenant. These equity contributions are based on ownership interests and as a result, our maximum contingent liability is A$100 million. The ECD expires on 30 April 2009. We have no joint and several liabilities relating to our partners' obligations under the ECD. Refer to note 21 to our financial statements for further information.

3GIS Partnership

During fiscal 2005, we established a joint venture partnership with H3GA to jointly own and operate H3GA's existing 3G RAN and fund network development. In establishing the joint venture, known as the 3GIS Partnership, we have agreed to supply the use of our spectrum licences, operating and maintenance services, transmission capacity services and construction services. In fiscal 2005, we have received an insignificant amount for these transactions. All the services we provide are on normal terms and conditions.

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As at 30 June 2005, we had provided the use of our 3G property, plant and equipment to the partnership. We anticipate that in future reporting periods, we will receive a fee for the use of these assets. As at balance date, the amount received was insignificant. In addition, during fiscal 2005 we provided funding to the partnership for operational expenditure purposes. The balance owing as at 30 June 2005 of A$32 million will be settled within twelve months and has been provided interest free.

IBMGSA

In fiscal 2004, we sold our 22.6% interest in our associated entity IBMGSA. Proceeds from the sale of our investment amounted to A$154 million resulting in a profit before income tax expense of A$149 million recognised in fiscal 2004. As part of the disposal, we also modified a 10 year contract with IBMGSA to provide IT services. The modification to our service contract resulted in an expense of A$130 million being recognised in fiscal 2004 and the removal of A$1,596 million of expenditure commitments reported as at 30 June 2003.

During the period of ownership, our purchases from IBMGSA were A$73 million in fiscal 2004 and A$413 million in fiscal 2003. These amounts were for IT services resulting from the now modified 10 year service contract that commenced in July 1997. For the period of ownership, we outsourced our data centre operations and a proportion of our applications maintenance and enhancement activities to IBMGSA in accordance with this service contract.

Research and development

Our research and development activities cover diverse areas of our business and focus on developing

- new competitive products for our customers;
- product innovation and differentiation;
- service quality improvements; and
- long term strategic positioning.

Licensed telecommunications carriers in Australia have a responsibility for maintaining and implementing plans for the development of the Australian telecommunications supply and information industries, in addition to meeting our commercial objectives. 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 us in our research laboratories;
- research and development expenditure contracted out by us, for which the resultant intellectual property 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 expenditure is not determined until the following December of each fiscal year. For fiscal 2003 expenditure based on the above classification was estimated to be A$187 million, which was later determined to be A$240 million. For fiscal 2004, we estimated expenditure of A$165 million, which later was determined to be A$159 million. For fiscal 2005, we estimate that we have spent A$148 million.

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We included research and development operational expenses in our statement of financial performance of A$29 million in fiscal 2005, A$26 million in fiscal 2004 and A$41 million in fiscal 2003. These amounts do not include items we capitalise to software developed for internal use or our infrastructure assets and include only expensed amounts.

In future years, we expect our research and development to include expenditure on the following key activities:

- broadband access provision (both fixed and mobile);
- convergence of mobile and online services;
- IP networks; and
- network and service management.

Segment information

Our business is organised and managed by business unit, as described under 'Information on the Company – Organisational structure'. Our internal management reporting structure drives how our Company is organised and managed. This internal structure provides the initial basis for determining our business segments. Our business segments are predominantly distinguishable by the type and location of customers for our key products and services delivered.

The main adjustment from our internal management reporting structure to our reported business segments is that TelstraClear and Telstra Asia are reported as part of a segment we have called Telstra International for segment reporting purposes. For internal management reporting purposes, TelstraClear is included within Telstra Business and Government and Telstra Asia is a business unit in its own right. In accordance with the applicable accounting standard, we consider that the risks and returns of TelstraClear differ from those of our local operations, and as a result, we have grouped these operations with our other like international businesses.

Our reportable business segments as at 30 June 2005 were:

- Telstra Consumer and Marketing;
- Telstra Country Wide®;
- Telstra Business and Government;
- Telstra International;
- Infrastructure Services;
- Telstra Wholesale; and
- Telstra Technology, Innovation and Products.

In addition, various business units that do not qualify as business segments in their own right have been aggregated into an 'Other' category for segment reporting purposes. The 'Other' category consists of the Telstra BigPond®, Telstra Media and Sensis business units as well as our corporate areas. Please refer to note 5 to our financial statements for details of the major products and services provided by each of our business segments.

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Effective from 1 July 2005, the Board appointed Solomon Trujillo as our new CEO and executive director, replacing Ziggy Switkowski. The new CEO is undertaking an operational and strategic review to be completed within 3 to 4 months of his appointment. As a result, our reportable business segments may change in fiscal 2006.

During fiscal 2005, we restructured our pre-existing business unit, known as the BigPond, Media and Sensis group. This restructure resulted in the establishment of Telstra BigPond, Telstra Media and Sensis as separate business units. During fiscal 2004, we formed a new group being Telstra Technology, Innovation and Products. This business segment brought together product development areas, network technologies, IT systems and the Telstra Research Laboratories. Those business segments not impacted by these restructures were substantially consistent to their structure in prior years.

Analysis of segment results

We have discussed the segment results of each reportable segment separately over the three-year period. A detailed discussion and analysis of the changes in the operating revenue in each of our major product groups and our principal operating expense categories is provided in ‘Operating revenue’ and ‘Operating expenses’ respectively.

Table 34 provides a summary of our sales revenue and EBIT for each of our business segments. For additional detailed financial information on our business segment results, including intersegment revenues, see note 5 to our financial statements.

During fiscal 2005, we changed our segment accounting policy regarding the allocation of SME revenue. In previous financial years, our segment accounting policy was to recognise sales revenue relating to our SME’s below a certain limit in the Telstra Consumer and Marketing segment. In fiscal 2005, the revenue earned from our SME’s was allocated to Telstra Business and Government in accordance with a revised threshold. In addition, the related expenses of these customers have also been allocated to Telstra Business and Government.

We have restated all our comparative information to reflect the current reporting position as if all our new business segments and segment accounting policies existed in those prior years.

Our segment sales revenue and EBIT do not reflect actual operating results achieved for our business segments in certain circumstances. We are unable to reallocate some individual items to their appropriate business segment in accordance with the applicable accounting standard due to there being no reasonable allocation basis for this adjustment. As a result, for financial reporting purposes these items are reported within the same business segment as for internal management reporting purposes.

Currently, sales revenue associated with mobile handsets for Telstra Consumer and Marketing, Telstra Business and Government and Telstra Country Wide® are allocated totally to the Telstra Consumer and Marketing segment with the exception of products sold in relation to SMEs which are allocated to Telstra Business and Government. Ongoing prepaid and postpaid mobile revenues derived from our mobile usage is recorded in each of our customer facing business units depending on the type and location of customer serviced. However, the majority of goods and services purchased associated with our mobile revenues are also allocated to Telstra Consumer and Marketing. These allocations reflect management's accountability framework and internal reporting system and accordingly no reasonable basis for reallocation to the respective business segments in accordance with the applicable accounting standard exists.

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In addition, revenue derived from our BigPond Internet products are recorded in the customer facing business units of Telstra Consumer and Marketing, Telstra Business and Government and Telstra Country Wide®. Certain distribution costs in relation to these products are also recognised in these business segments. The Infrastructure Services and the Telstra Technology, Innovation and Products segments, recognise expenses in relation to the installation and running of the broadband cable network. In accordance with our application of the definition of business segment per the applicable accounting standard, we have not reallocated these items to the Telstra BigPond business segment.

Table 34 - Segment summary results

	Year ended 30 June				
	2005	2004	2003	**2005/2004**	2004/2003
		(in millions)		(% change)	
Sales revenue from external customers					
Telstra Consumer and Marketing	**5,030**	4,956	4,908	**1.5**	1.0
Telstra Country Wide®	**5,751**	5,508	5,281	**4.4**	4.3
Telstra Business and Government	**5,214**	4,786	4,764	**8.9**	0.5
Telstra International	**1,359**	1,301	1,471	**4.5**	(11.6)
Infrastructure Services	**67**	60	138	**11.7**	(56.5)
Telstra Wholesale	**2,940**	2,631	2,519	**11.7**	4.4
Telstra Technology, Innovation and Products	**1**	1	1	**-**	-
Other [(1)]	**1,799**	1,494	1,413	**20.4**	5.7
Total sales revenue	**A$22,161**	A$20,737	A$20,495	**6.9**	1.2
Earnings (loss) before interest and income tax expense (EBIT) [(2)]					
Telstra Consumer and Marketing	**2,493**	2,551	2,551	**(2.3)**	-
Telstra Country Wide®	**4,944**	4,784	4,601	**3.3**	4.0
Telstra Business and Government	**3,263**	3,614	3,528	**(9.7)**	2.4
Telstra International	**(18)**	(34)	(954)	**47.1**	96.4
Infrastructure Services	**(1,702)**	(1,625)	(1,457)	**(4.7)**	(11.5)
Telstra Wholesale	**2,973**	2,709	2,573	**9.7**	5.3
Telstra Technology, Innovation and Products	**(1,374)**	(1,557)	(1,444)	**11.8**	(7.8)
Other [(1)]	**(3,577)**	(3,900)	(3,493)	**8.3**	(11.7)
Eliminations	**3**	18	(182)	**(83.3)**	109.9
Total EBIT	**A$7,005**	A$6,560	A$5,723	**6.8**	14.6

(1) *Sales revenue for our 'Other' segment primarily relates to our advertising and directories revenue earned by Sensis. The Asset Accounting Group is the main contributor to the segment result for this segment, which is primarily depreciation and amortisation charges. The Asset Accounting Group centrally manages all of the Telstra Entity's fixed assets, including network assets. In fiscal 2004, EBIT for the 'Other' segment was adversely impacted by the provision for the non recoverability of the loan to REACH of A$226 million. In fiscal 2003, EBIT included proceeds from the sale of 7 office properties totalling A$570 million and the associated cost of A$439 million, resulting in a net profit before income tax expense of A$131 million.*

(2) *Most internal charges between business segments are charged on a direct cost recovery basis. For segment reporting purposes, transfer pricing is not used within the Company. EBIT reflects our intercompany and external charges.*

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Telstra Consumer and Marketing

Telstra Consumer and Marketing sales revenue increased over the three-year period to A$5,030 million in fiscal 2005 compared with A$4,956 million in fiscal 2004 and A$4,908 million in fiscal 2003. This increase was driven by the continued strong performance in mobile services, led by growth in international roaming, mobile data usage and handset sales. In addition, continued strong growth in BigPond broadband and pay television services was also experienced due to the rise in marketing activities and the improved retention of existing customers through bundling initiatives. Bundled pay television revenue has increased significantly over the three-year period off a low base in fiscal 2003. Offsetting this growth in sales revenue was a decline in total PSTN revenue over the three-year period as a result of competition, product substitution and decreased consumer usage.

Telstra Consumer and Marketing EBIT decreased by 2.3% to A$2,493 million in fiscal 2005 predominantly led by expense growth in dealer remuneration negotiation costs, the resolution of historical issues including dealer claims, inventory write downs and increased labour costs in line with this segment's customer focus priority. In addition, all business expenditure associated with mobile services for our Company are incurred by Telstra Consumer and Marketing. This expenditure includes subsidies and dealer commissions. In fiscal 2005, A$205 million of our subsidy expense related to the amortisation of activities that commenced in fiscal 2004 across the business.

Telstra Consumer and Marketing EBIT remained unchanged in fiscal 2004 compared with fiscal 2003 as the revenue growth experienced was offset by the growth in expenses. Expense growth was largely driven by increases in bundled pay television services, offset by reduced domestic and international network payments due to lower termination rates and the stronger Australian dollar.

Telstra Country Wide®

Telstra Country Wide® sales revenue increased over the three-year period to A$5,751 million in fiscal 2005 compared with A$5,508 million in fiscal 2004 and A$5,281 million in fiscal 2003. This increase was primarily due to continued strong growth in SIOs for broadband, ISDN, CDMA mobiles and bundled pay television. This segment has also experienced increased volumes for fixed to mobile calling and various mobile products such as mobile calls, mobile data and international roaming. The growth was partially offset by reductions in local and international direct revenues as a result of product substitution and competitor activity. In addition, basic access and national long distance revenues increased in fiscal 2005, following a decline in fiscal 2004 compared with fiscal 2003. The decline in fiscal 2004 was also driven by product substitution and competitor activity, with basic access revenue increasing in fiscal 2005 mainly as a result of a price increase in June 2004.

Telstra Country Wide® EBIT increased by 3.3% to A$4,944 million in fiscal 2005 predominantly due to the continued strong growth in sales revenue, which was partially offset by an increase in expenses. The expense growth was attributable to higher cost of goods sold and service fees driven by the growth in broadband and bundled pay television revenue.

Telstra Country Wide® EBIT increased 4.0% to A$4,784 million in fiscal 2004 compared with fiscal 2003 with the solid rise in revenue also being partially offset by an increase in expenses. The main contributing factors to the higher expenses in fiscal 2004 were the increased volumes for calls terminating on other carrier's networks, as well as increased costs associated with bundled pay television revenue streams.

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Telstra Business and Government

Telstra Business and Government sales revenue increased by 8.9% to A$5,214 million in fiscal 2005 predominantly due to additional revenues from the acquisition of KAZ, Telstra Business Systems (formerly Damovo (Australia) Pty Ltd) and PSINet. This increase was partially offset by a reduction in sales revenue from the underlying business, mainly due to the decline in traditional PSTN and certain specialised data revenues. Price re-balancing initiatives continued in fiscal 2005 with basic access revenues increasing. This segment continues to see changes in usage patterns with traditional product usage migrating to alternative offerings such as mobiles, broadband and other IP product offerings.

Telstra Business and Government sales revenue totalled A$4,786 million in fiscal 2004, an increase of 0.5% compared with fiscal 2003. This slight increase was mainly due to an environment of continuing price re-balancing initiatives and tough competition in the SME customer segment. Solid growth in fixed to mobile revenue in fiscal 2004 was achieved due to an increase in call volumes and growth in the number of mobile phone users in the Australian market, as well as continued growth in Internet and IP solutions related revenue. Basic access revenue increased in fiscal 2004 as a result of higher rental and subscription charges, however local call, national long distance and international direct revenue decreased due to the migration of customers to other telecommunication solutions. In fiscal 2004, further contributions to sales revenue arose from the acquisition of the United Kingdom based Cable Telecom in February 2004 and the business assets of Powergen in October 2003.

Telstra Business and Government EBIT decreased by 9.7% to A$3,263 million in fiscal 2005 predominantly due to the reduction in PSTN revenue and from the inclusion in fiscal 2004 of the profit arising from the sale of our investment in IBMGSA and Commander Communications Limited. In fiscal 2005, this segment had no significant asset and investment sales.

Telstra Business and Government EBIT grew by 2.4% to A$3,614 million in fiscal 2004 compared with fiscal 2003. This growth was driven by profits made on the disposal of our investments in IBMGSA and Commander Communications Limited as described above.

Telstra International

The Telstra International segment is the combination of our Telstra Asia business unit and TelstraClear. Telstra Asia is responsible for our Asia-Pacific investments. In particular this includes our operations in Hong Kong that mainly generate revenues from the mobiles market. TelstraClear is our New Zealand subsidiary that provides full integrated services to the New Zealand market.

Telstra International sales revenue increased by 4.5% to A$1,359 million in fiscal 2005 due to an increase in revenues from both CSL and TelstraClear. CSL revenues increased across most revenue streams including international voice, data and prepaid revenues, as well as growth in mobile handsets due to CSL's move into new markets and the launch of new models with advanced features. This growth was partly offset by a decline in local voice revenues that continues to be impacted by price competition. In addition, CSL's contribution to our revenues continue to be impacted by adverse foreign exchange movements. TelstraClear achieved solid revenue rises due to its continued strong retail performance in conjunction with favourable foreign exchange movements. The increase in retail revenue was led by further growth in the SME market and the recent acquisition of Sytec.

Telstra International sales revenue declined by 11.6% to A$1,301 million in fiscal 2004 compared with fiscal 2003 driven by the decline in revenues from CSL partly offset by revenue growth in TelstraClear. CSL revenues decreased due to the continued impact of aggressive pricing in the Hong Kong mobiles market and adverse foreign currency movements. TelstraClear has experienced revenue growth from significant new corporate customers and aggressive marketing in the SME and consumer markets.

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Telstra International EBIT improved by 47.1% to an EBIT loss of A$18 million in fiscal 2005 following the enhanced result for the Telstra Asia business unit. EBIT increased for Telstra Asia following the divesting of non core investments and the improved equity accounting results for our joint venture entity Xantic. This was partially offset by the decline in CSL resulting from higher handset costs involved with the launch of 3G. TelstraClear's EBIT remained fairly consistent as the growth in revenue was offset by the increase in expenses. The expense growth was driven by the acquisition of Sytec, with additional staff numbers increasing its labour expense.

Telstra International EBIT improved in fiscal 2004 compared with fiscal 2003 mainly due to the write down of the carrying value of our investment in REACH and AJC to nil being included in fiscal 2003. As a result, we suspended equity accounting for both of these entities. These write downs resulted in negative impacts to the fiscal 2003 segment result of A$965 million and A$24 million respectively.

Excluding our write downs in REACH and AJC, EBIT remained consistent with fiscal 2003. A decline in CSL as a result of price competition in the Hong Kong mobiles market (particularly in the local voice segment) and adverse foreign currency movements has been offset by the improved TelstraClear result as it continues to focus on increasing revenue, driving expense efficiencies and investing capital expenditure wisely.

Infrastructure Services

Infrastructure Services sales revenue increased in fiscal 2005 following a decline in fiscal 2004. The increase in fiscal 2005 was primarily driven by higher commercial works activity. The decline in fiscal 2004 compared with fiscal 2003 was driven by lower offshore construction revenue following the wind down of our international construction operations. In addition, the cable recovery and recycling project that was implemented in fiscal 2003 ceased in fiscal 2004 following its scheduled completion.

Infrastructure Services EBIT is negative as this segment does not recover all the costs it incurs on behalf of the other segments. EBIT loss declined over the three-year period mainly due to the wind down of our offshore construction revenue and the completion of the cable recovery and recycling project as mentioned. In addition, expenses grew due to the increased sales activity of our emerging products such as broadband, where Infrastructure Services incurs the installation and maintenance expense and the customer facing business segments recognise the related revenue. The expense increase was partly offset by management's continued focus on lower discretionary spending and cost reduction initiatives.

Telstra Wholesale

Telstra Wholesale sales revenue increased over the three-year period to A$2,940 million in fiscal 2005 compared with A$2,631 million in fiscal 2004 and A$2,519 million in fiscal 2003. The increase was driven by the growth in the number of local service customers and the demand for broadband services. During the three-year period, Telstra Wholsesale experienced a continuation of re-balancing initiatives and commercial negotiations, which generally reduced prices across wholesale PSTN call revenue categories, while increasing basic access revenues. Over the three-year period, intercarrier service revenue was impacted by continued growth in SMS interconnect revenue and mobile interconnection volumes, driven by mobile substitution and growth in the overall mobile market. However this growth was offset by reduced yields for these products. In addition, in fiscal 2004, revenue streams from a number of other transmission products were significantly impacted by aggressive price competition from various alternative suppliers. Over the three-year period, data and Internet service revenues showed solid growth, which was mainly driven by wholesale broadband offerings that led to a significant increase in the number of wholesale broadband subscribers.

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Telstra Wholesale EBIT increased over the three-year period to A$2,973 million in fiscal 2005 compared with A$2,709 million in fiscal 2004 and A$2,573 million in fiscal 2003. The increase in EBIT over the three-year period was driven by sales and inter-segment revenue growth, partly offset by an increase in expenses. The expense growth consisted of increases in Telstra Wholesale's allocated share of domestic outpayments, offset by a significant reduction in volumes and costs for international voice traffic, which was also assisted by an appreciating Australian dollar. Increases in labour expense were attributable to the increase in staff numbers required to support the significantly higher than planned volumes of access and broadband customers, as well as further development in, and the expansion of, the wholesale market. In addition, total IT professional services costs grew due to the revised contract conditions for system support and increased program of work to support the revenue growth and operational efficiency.

Telstra Technology, Innovation and Products

Telstra Technology, Innovation and Products' EBIT is negative as this segment does not recover all the costs it incurs on behalf of the other segments, similar to Infrastructure Services. In fiscal 2004, EBIT was significantly impacted by the cost associated with the modification of a 10 year IT service contract with IBMGSA that resulted in an expense of A$130 million being recognised. Excluding this significant item, EBIT improved over the three-year period with a negative EBIT of A$1,374 million in fiscal 2005, compared with A$1,427 million in fiscal 2004 and A$1,444 million in fiscal 2003.

The EBIT improvement in fiscal 2005 was driven by an increase in total revenues and a reduction in expenses. In fiscal 2005, total revenues included proceeds from the debt forgiveness on the wind up of our wholly owned subsidiary, Telstra New Wave Pty Ltd. In relation to expenses, significant savings were achieved in contract renegotiations with vendors. These improvements were partly offset by an increase in adjustments for inventory to its net realisable value, and project write offs due to the cancellation of some capital program initiatives.

The EBIT improvement in fiscal 2004 compared with fiscal 2003, excluding the IT service contract expense with IBMGSA, was driven by a decline in expenses reflecting the significant restructuring of the segment to better align skills and capabilities to customer needs, as well as the renegotiation of important supplier contracts. This was partially offset by increases in general and administrative costs which reflect leasing charges arising from the sale and leaseback of certain server assets as well as some increases in light, power and accommodation costs.