

Paul Fletcher

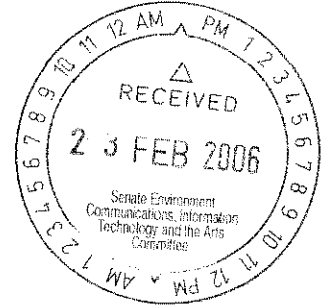
Director

Corporate & Regulatory Affairs

FAXED
21/2/06

20 February 2006

Senator Alan Eggleston
Chair
Senate Environment, Communications, Information Technology
and the Arts Legislation Committee
Parliament House
CANBERRA ACT 2601
By facsimile: (02) 6277 5818



Dear Senator ^{Alan} Eggleston,

Telstra's claims – Optus margins on 'unbundled local loop service' (ULLS)

During questioning of Telstra during the Senate Estimates process (Monday, 13 February 2005), Telstra representatives were asked about the likely effect of a geographically averaged ULLS price of \$30.00 on broadband competition in metropolitan areas.

Telstra's spokesman advised the Senate Committee there would still be "significant" ULL build despite the wholesale access price increasing from \$22.00 to \$30.00 (Band 2).

Telstra is claiming its competitors can afford an increase in the wholesale price of the ULLS because they are capable of earning greater margins when they build a broadband network over the ULLS instead of the LCR or resale DSL. Telstra alleged its conclusions are drawn from public information made available by Optus.

Telstra's comments are a misrepresentation of the information publicly available on Optus expected margins arising from the migration from resale to ULL based service.

Attached is a copy of an Optus presentation to analysts in June 2005. We believe this to be the source of data that Telstra based its responses to questioning from Senator Michael Ronaldson (Lib, VIC). The slide shows the accurate picture regarding expected margins from Optus' transition from local call resale (LCR) to resale DSL and ULLS. While the slide shows the reducing outpayments to Telstra, it does not incorporate the costs incurred by Optus to supply services, including a DSL build or any of the back office and billing systems required to provide the service.

The ULLS bar depicted on the slide only reflects the ULLS costs and does to reflect:

- Optus' payments to Telstra for renting space in Telstra's local exchanges;
- Charges levied by Telstra for transitioning customers across to the Optus service. These costs include a \$98.00 connection and \$50.00 call diversion fee; and
- Various other costs levied by Telstra for processing ULLS orders.

Optus would like the committee to note the slide indicates that the reported margin improvements were at the gross level only and that the earnings before interest, tax, depreciation and amortisation (EBITDA) measurement for the service will initially deliver a negative margin to Optus. A key requirement for Optus success with its strategy of greater reliance on ULL over LCR and resale DSL is the achievement of scale.

Optus has estimated that it will take us four and a half years for to achieve a break even point on the transition.

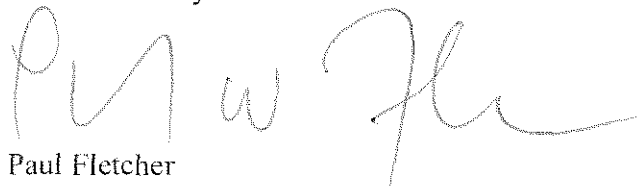
Significantly, these points were overlooked by Telstra in its commentary and misrepresentation of information made available to Optus by analysts.

Optus and Telstra's other competitors have consistently opposed Telstra proposals to mandate a nationally averaged wholesale price for the ULLS. Such an approach seriously threatens the broadband rollout plans for Optus and other competitors to Telstra, and in turn threatens the prospects of a vigorous competitive broadband market emerging in Australia.

Finally, it is important to understand that Optus' initiative will result in profit margins which, while improved from their present level, will remain well below the very high profit margins which Telstra enjoys on its fixed line network. To give just two examples, Telstra's (EBITDA) profit margin on basic access (line rental) is 55%; on long distance it is 88%! Further data is provided in the attached extract from a Telstra presentation pack which was issued to the Australian Stock Exchange on 7 September 2005.

If you would like additional information on the issue, please contact our General Manager, Government Affairs, Dean Smith on (02) 9342 8005.

Yours sincerely



Paul Fletcher

ULL – lifts “on net” homes to 2.6m

➤ offnet margins will improve in medium term

Gross margin benefit highest for combined voice/DSL customer
 ➤ over 120K customers at Mar 05

To realise ULL benefits requires scale & good execution

Gross margin improves A\$45

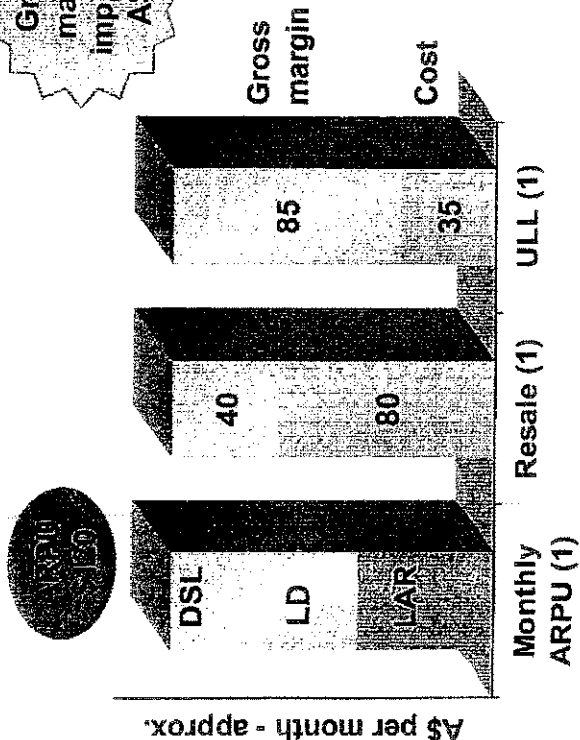
HFC “on-net” footprint
 • 38% penetration
 1.4m homes

Phase 1 ULL: A\$80m
 • 150-200 exchanges
 1.2m homes

Existing offnet base ²
 • reduces breakeven risk
 768K

Useful margin benefit for voice only
 ➤ over 500K customers at Mar 05
 A\$15

ULL will be EBITDA - ve initially
 • one-off costs and gradual migration



‘yes’
OPTUS

(1) Approximate amounts based on Q3 FY05 and ‘Band 2’ ULL undertaking of A\$22/mth – includes LD interconnect
 (2) Offnet voice plus DSL customers at Mar 05



The Mix is Shifting to Lower Margin Products



	EBITDA Margin	1999 % Revenue	2005 % Revenue
Domestic LD	88.0%	13%	8%
Int'l LD	62.6%	4%	2%
Local calls	54.3%	23%	12%
Basic access	55.0%	17%	27%
Mobile	41.9%	22%	33%
Data Services	39.5%	21%	18%
		<u>100%</u>	<u>100%</u>