23 March 2006

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Dr Ian Holland
Secretary
Senator Environment, Communications, Information Technology and the Arts Legislation Committee
Parliament House
Canberra ACT 2600

Dear Dr Holland

I am writing in response to your 8 March letter to Mr Trujillo, which included a copy of correspondence from SingTel Optus regarding unbundled local loop (ULL) services. Mr Trujillo has asked that I respond on Telstra's behalf.

Telstra rejects the claim by SingTel Optus concerning any misrepresentation of publicly available information on SingTel Optus' expected margins arising from the migration of resale to ULL based service.

At the Senate Estimates hearing (dated Monday, 13 February 2006,) Senator Ronaldson posed a question to Telstra on whether Telstra's decision to lift the access prices in metropolitan areas (from $22 to $30) would result in increased broadband prices.

Telstra's response was in essence that we did not believe that prices would increase due to the margin gains that Telstra's competitors have been talking about from shifting from a resale base to a ULL base.

In responding to this question, Telstra made clear the reference to GROSS margins and acknowledged that there are other costs that the competitor would have to incur. This is totally consistent with SingTel Optus' publicly available information (April 05, and more recently Feb 06) and there has been no misrepresentation.

Telstra's view remains that regardless of whether ULL is set at $22 or $30, there is substantial gross margin for the competitor that would negate any pressure to increase broadband prices.

The claim by SingTel Optus (in a letter to Senator Eggleston dated 20 February 2006) that ULL will initially deliver a negative EBITDA margin is a very simplistic statement and needs to be closely scrutinised. Telstra suspects that SingTel Optus is reporting a cash outcome and not an accounting (p/l) outcome (i.e. that, at the time of migrating a customer to ULL, customer ARPU of $120 is more than offset by their cost estimates of $98.00 for connection and $50.00 for call diversion fees). This is, in itself, potentially misleading as it is too short term and does not recognise the significant margin improvement once upfront costs are covered.

The correct analysis would be to undertake a full business case of the proposed ULL investment and assess the EBITDA margins having applied the appropriate accounting treatments to various revenue, costs and equipment related capital expenditure. As with any investment that involves start up costs, we would anticipate that margins would be lower in the earlier years, increasing over time as scale is achieved.

Attached for your reference is internal analysis undertaken by Telstra that assesses the economics of ULL build. This analysis does not support SingTel Optus view of negative EBITDA margins and Telstra would be happy to take the Committee through this assessment.

Yours sincerely

David Quilty
General Manager – Government Relations

The Economics of ULL Build

for Telstra's Competitors

March 2006

Competitors enjoy substantial profit boost from ULL

- There is a strong business case for Telstra's competitors to move from traditional resale to ULL investment (covering both voice and data).
- Produce sharp drop in costs (estimated at around $25/month per service) with consequential significant increase in profit margins (gross profit margins up by around $40/month per service).
- Singtel Optus and iiNet have particularly highlighted this in major presentations to investors.
- Our analysis shows that the financial gains from shifting from re-sale to ULL jump significantly in years 2 and 3.

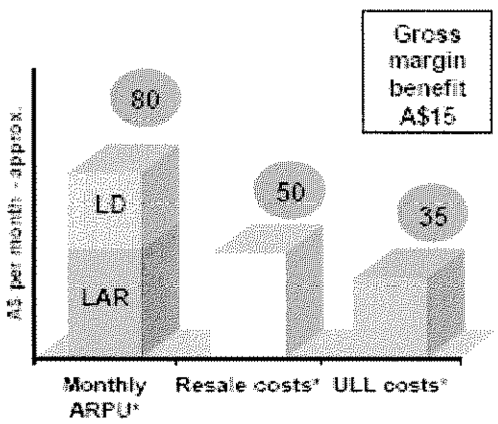
This is what Optus has had to say ....

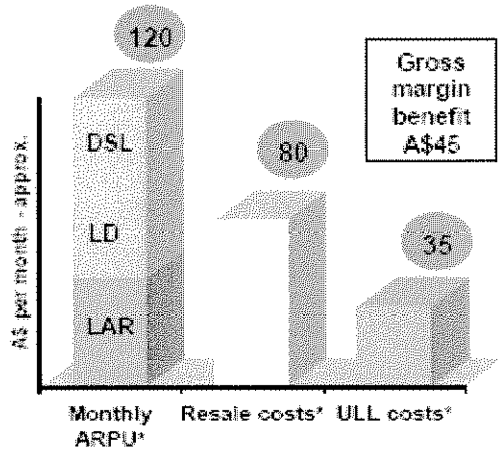
ULL offers potential for gross margin improvement

'yes' OPTUS

Today's opportunity >500k
- offnet LD/local voice only

Growing opportunity >80k
- combined – voice/DSL





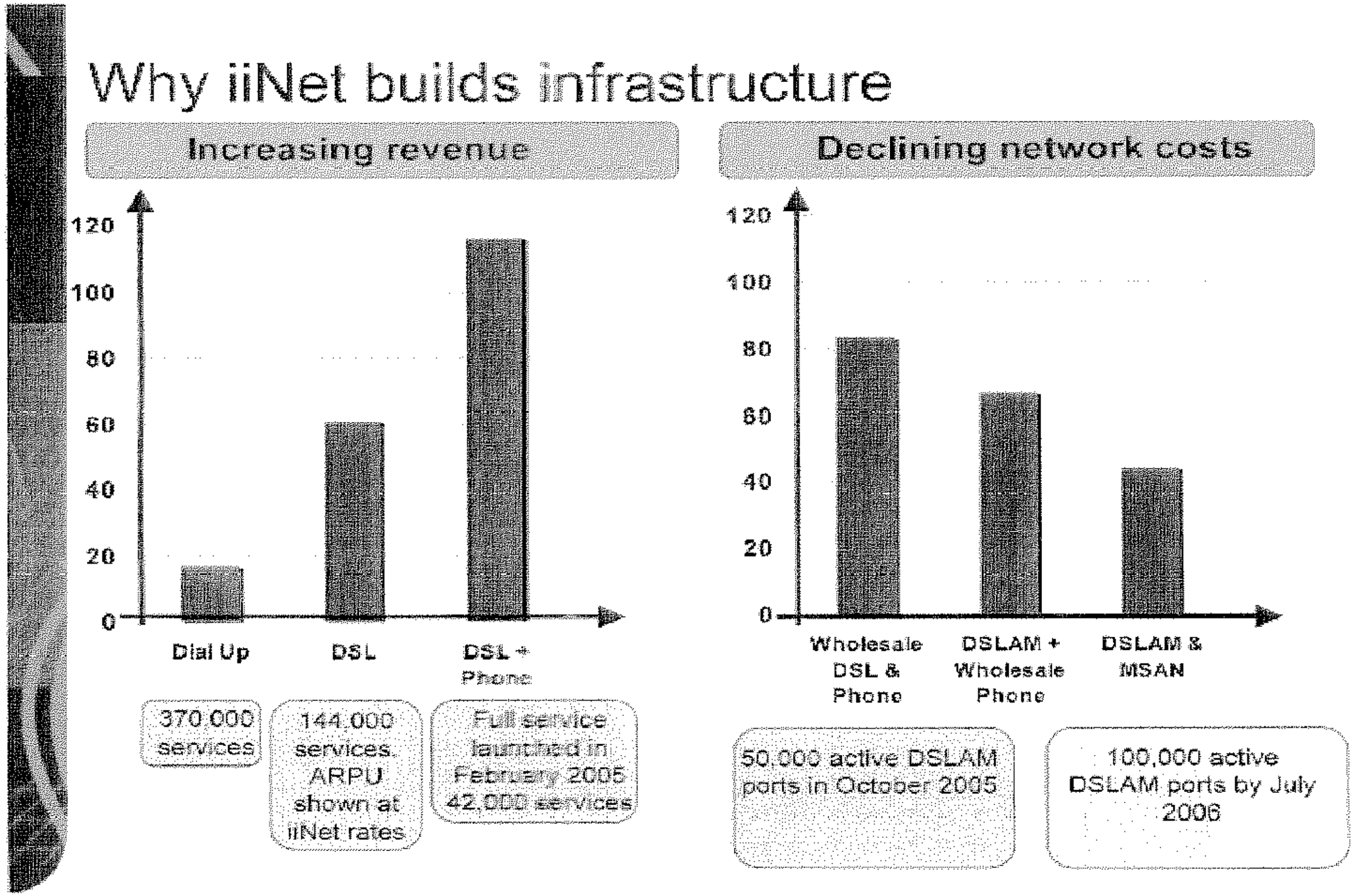
To realise potential benefits requires scale and good execution

* Approximate amounts based on Q3 FY05 and 'Band 2' ULL undertaking of A$22/mth – includes LD interconnect

Source: Optus Consumer & Multimedia briefing 5 April 2005

Telstra

And this is what iiNet has had to say ...



Source: UBS Small Cap Telco Conference – 7 Nov 2005

Telstra

Our analysis supports this position – Part 1

Voice/DSL – $/mth/SIO

Current Resale *		Build *	
Telstra DSL:	**$27.00**	Infrastructure:	**$16.00**
DSL Install (over 2yrs):	**$3.12**	ULL Rental:	**$30.00**
Basic Access:	**$27.60**	Migration*:	**$4.00**
Interconnection :	**$5.00**	Increased O&M and BoH:	**$2.00**
Local calls (80*13.61):	**$10.89**		
Total:	**$73.61**	**Total:**	**$52.00**

* Includes Managed Network Migration and CDNO costs.

Gross Margin improvement: $37.61

Total Resale ($73.61) less ULL ($30.00) less Migration costs ($4.00) less O&M, BoH ($2.00)

Net Savings: $21.61

Total Resale ($73.61) less Total Build ($52.00)

* Expense numbers based on our generic estimates of costs and include rounding

Our analysis supports this position – Part 2

$ per SIO/mth		Yr 1	Yr2	Yr 3
Revenue				
	Total Revenue - ADSL+Voice *	**120.00**	**120.00**	**120.00**
Operating Expenses **				
	ULL Charge	30.00	30.00	30.00
	Customer Migration Costs	4.15	4.15	
	Transmission Charges	5.50	5.50	5.50
	Exchange related costs			
	Rack charges, Power & Connection	1.87	1.87	1.87
	Customer acquisiton costs	23.70	-	-
	Ongoing costs (Tech support, billing, Network and Systems costs, Admin)	18.61	16.00	14.00
	Total Opex	**83.83**	**57.52**	**51.37**
	EBITDA	**36.17**	**62.48**	**68.63**
	EBITDA Margin	**30.14%**	**52.07%**	**57.19%**
Depreciaton & Amortisation **				
	ULL specific equipment			
	DSLAM, BRAS & Core elements	2.81	2.81	2.81
	Switching	4.82	4.82	4.82
	Systems/Product Development	0.97	0.97	0.97
	Total Depreciation & Amortisation	**8.60**	**8.60**	**8.60**
	EBIT	**27.57**	**53.88**	**60.03**
	EBIT Margin	**22.98%**	**44.90%**	**50.03%**

* Optus Consumer & Multimedia briefing 5 April 2005

** Expense numbers based on our generic estimates of costs and include rounding

Telstra

Financial benefits for competitors would be even higher at $22/month ULL price – Part 1

Voice/DSL - $/mth/SIO

Current Resale *	
Telstra DSL:	**$27.00**
DSL Install (over 3- years):	**$3.12**
Basic Access:	**$27.60**
Interconnection :	**$5.00**
Local calls (80*13.61):	**$10.89**
Total:	**$73.61**

Build *	
Infrastructure:	**$16.00**
ULL Rental:	**$22.00**
Migration*:	**$4.00**
Increased O&M and BoH:	**$2.00**
Total:	**$44.00**

* Includes Managed Network Migration and CDNO costs.

Gross Margin improvement: $45.61

Total Resale ($73.61) less ULL ($22.00) less Migration costs ($4.00) less O&M, BoH ($2.00)

Net Savings: $29.61

Total Resale ($73.61) less Total Build ($44.00)

* Expense numbers based on our generic estimates of costs and include rounding

Telstra

Financial benefits for competitors would be even higher at $22/month ULL price – Part 2

$ per SIO/mth		Yr 1	Yr2	Yr 3
Revenue				
	Total Revenue - ADSL+Voice *	**120.00**	**120.00**	**120.00**
Operating Expenses **				
	ULL Charge	22.00	22.00	22.00
	Customer Migration Costs	4.15	4.15	
	Transmission Charges	5.50	5.50	5.50
	Exchange related costs			
	Rack charges, Power & Connection	1.87	1.87	1.87
	Customer acquisiton costs	23.70	-	-
	Ongoing costs (Tech support, billing, Network and Systems costs, Admin)	18.61	16.00	14.00
	Total Opex	**75.83**	**49.52**	**43.37**
	EBITDA	**44.17**	**70.48**	**76.63**
	EBITDA Margin	**36.81%**	**58.73%**	**63.86%**
Depreciaton & Amortisation **				
	ULL specific equipment			
	DSLAM, BRAS & Core elements	2.81	2.81	2.81
	Switching	4.82	4.82	4.82
	Systems/Product Development	0.97	0.97	0.97
	Total Depreciation & Amortisation	**8.60**	**8.60**	**8.60**
	EBIT	**35.57**	**61.88**	**68.03**
	EBIT Margin	**29.64%**	**51.57%**	**56.69%**

* Optus Consumer & Multimedia briefing 5 April 2005

** Expense numbers based on our generic estimates of costs and include rounding

Telstra