

Telecommunication Services

Taking A Closer Look At Telstra's Mobile Strategy

Telecommunication Services | Diversified Telecommunication Services | Australia

Event:

- We explore Telstra's wireless strategy in more detail given: (1) the company is allocating \$450m of its \$1bn investment in FY11 to its wireless business and (2) mobiles, along with cost cutting, remain Telstra's key to driving earnings growth in the medium term.

Key Take-Outs:

- **Key issue is Telstra's wireless business is underperforming:**
Consider the following: (1) Telstra's handset market share has fallen from c.42% as at Jun-08 to c.38% as at Jun-10; (2) Optus's handset revenue growth has been +8.8%, almost double Telstra's growth of +4.4%, since July 2008; and (3) Telstra's smartphone penetration is low at c.28% of its postpaid base compared with Optus at c.50%.
- **Investment makes strategic sense:**
 - **Economics:** While the investment into customer acquisition is clearly negative for short-term earnings and margins, our analysis indicates that the investment to win new smartphone customers delivers a strong return on investment.
 - **Timing:** Telstra's window of opportunity has opened given: (1) the number of customers 'up for grabs' or rolling off contracts from competitors is increasing; (2) next generation smartphones will drive acceleration in handset replacement; and (3) Telstra's network advantage is likely to be sustained in the medium term as competitors invest to cope with the growth in network traffic.
- **Key risks to strategy:**
 1. **High recontracting mix:** The amount of investment allocated to recontracting existing customers (as opposed to winning new customers) needs to be monitored closely. Our analysis indicates that a high recontracting mix can reduce returns significantly.
 2. **Cap plan penetration:** Increasing cap plan penetration will hurt Telstra through: (1) downward pressure on mobile ARPU and margins (2) accelerating the migration away from fixed line calling.
 3. **Competitor response:** While competition is intense, we believe the competitor response has been relatively rational to date.
- **Global case studies:** We examine a number of case studies of mobile operators investing to drive market share. Operators have had varying levels of success with the timing/magnitude of the EBITDA uplift.

Investment View:

- No change to our earnings estimates or HOLD recommendation on Telstra (\$2.65, HOLD, Target Price \$3.54). Although Telstra is improving its operating momentum, it is early days and the key issues are whether: (1) the momentum can be sustained; (2) the \$1bn investment is enough; and (3) the strategy will translate into earnings growth given the risks noted above. We believe valuation is secondary until: (1) there is a sustained improvement in operating momentum; (2) we have greater visibility on earnings recovery, future earnings, etc; and (3) we have greater clarity on the NBN.

Analyst: Christian Guerra
+61 3 9679 1302
christian.guerra@gs.com.au

Associate Analyst: Raymond Tong
+61 3 9679 1359
raymond.tong@gs.com.au

Earlier this year, Telstra took the critical – and in our view necessary – decision to reinvigorate its mobiles business (or attempt to). Telstra decided to embrace mobile cap plans for the first time in its history. This was followed by its decision to allocate the majority of its \$1bn FY11 opex investment to driving market and revenue share in the mobile market.

While Telstra's operating momentum has improved, it remains early days. The key issues we are focused on are: (1) whether it can be sustained and (2) will whether it will translate into sustained earnings growth.

We explore Telstra's wireless strategy in more detail given:

1. The company is allocating \$450m of its \$1bn investment in FY11 to its wireless business.
2. Mobiles, along with cost cutting, remain Telstra's key to driving earnings growth.

In this *Daily Cable* article, we outline:

1. Telstra's earnings growth is dependent on wireless and cost cutting.
2. Key issue is that Telstra's wireless business has been underperforming.
3. We believe Telstra's strategy makes strategic sense.
4. Telstra's mobile strategy has three key risks.
5. Global case studies of mobile operators investing to drive market share show mixed results.
6. Telecom sector financial summary.

(1) Telstra's Earnings Growth Is Dependent On Wireless And Cost Cutting

The key challenge facing Telstra – like the majority of incumbent telcos – is managing the accelerating structural shift from fixed (high margin, high market share) to mobile (lower margin, lower market share).

We believe delivering revenue/earnings growth is not easy given the following headwinds:

1. **Worsening PSTN headwinds.**

- The decline in the PSTN business means Telstra faces headwinds of: (1) \$500m in revenue and (2) \$250-350m in EBITDA every year for the foreseeable future.

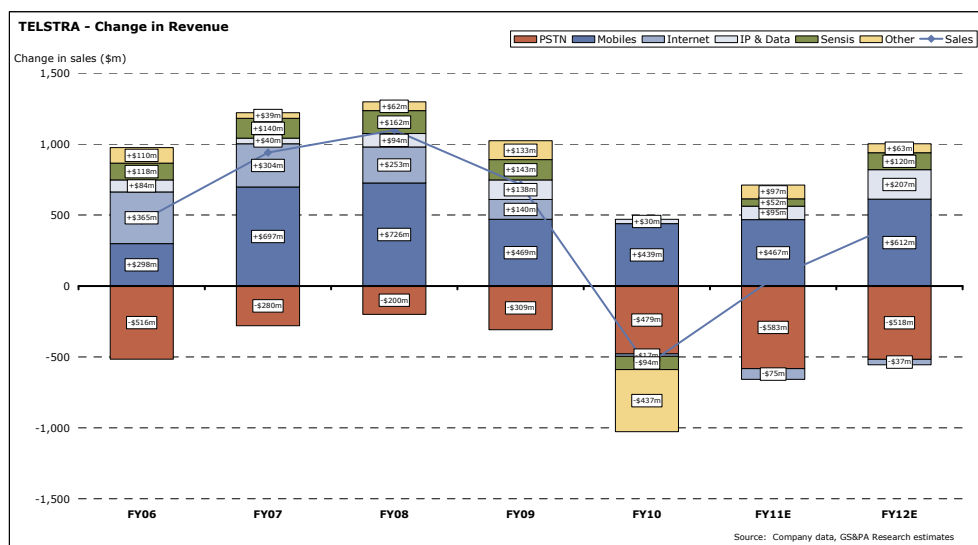
2. **Fixed broadband growth has evaporated.**

- During FY06-FY09, fixed broadband delivered incremental sales of c.\$300m pa.
- This growth has largely evaporated and could potentially be a headwind in FY11 (i.e. negative sales growth).

3. **Price deflation.**

- Telstra's repricing of its product lines is likely to place downward pressure on ARPU as the price resets flow through its existing subscriber base (i.e. backbook repricing).

The following chart illustrates our forecast revenue growth profile for Telstra, with the revenue headwinds clearly visible.



In our view, in order to drive earnings growth Telstra will need to:

1. Improve the performance of its wireless business.
2. Continue to reduce costs (Project New).

(2) Key Issue Is That Telstra's Wireless Business Has Been Underperforming

Despite Telstra's network competitive advantage and strong growth in wireless broadband, Telstra's mobiles business has underperformed the market over the past two years. To illustrate, consider that Telstra's revenue share fallen from 43.3% in FY08 to 41.9% in FY10.

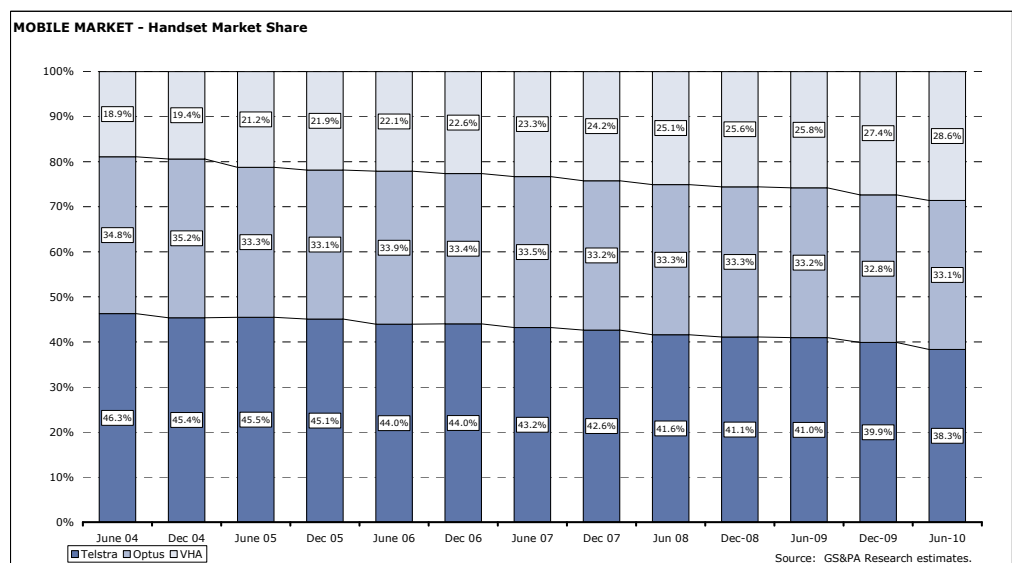
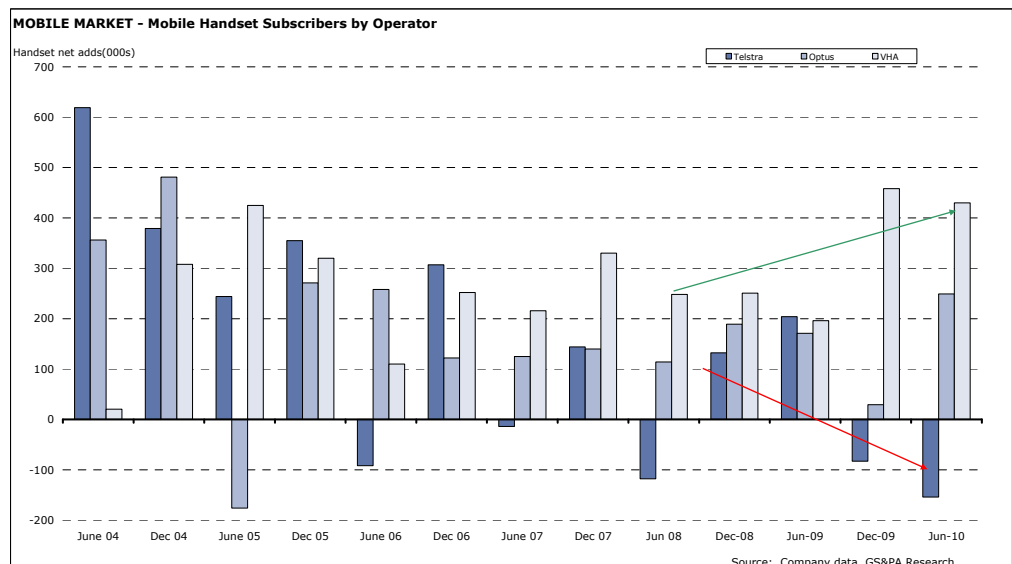
Clearly, Telstra is seeking to improve its performance with: (1) a number of pricing changes since May and (2) allocating \$450m or 70% of the FY11 DVC investment into driving postpaid market share.

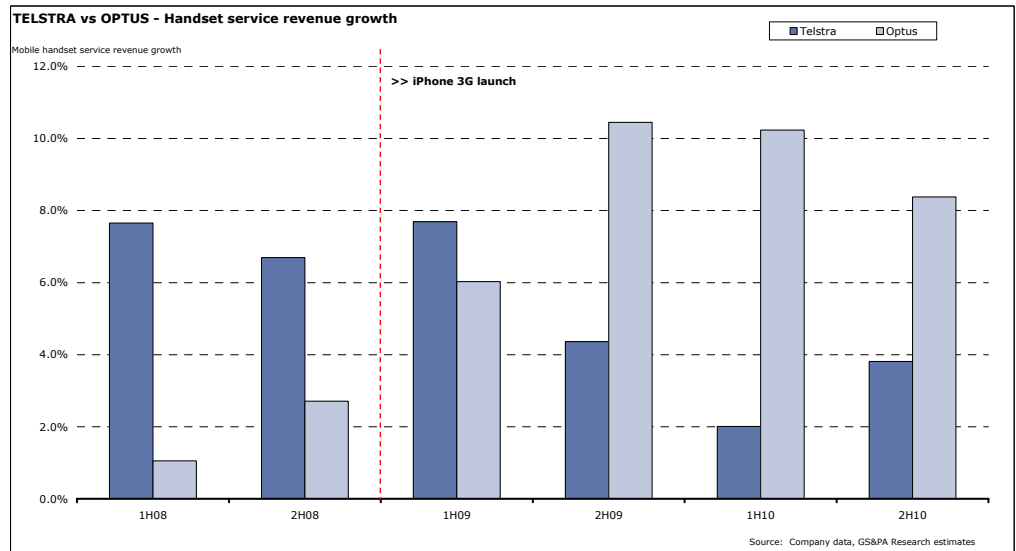
We believe the key issues Telstra is seeking to address are:

(1) Weak mobile handset performance (excludes wireless BB)

While Telstra has been gaining market share in wireless broadband, its mobile handset performance has been disappointing. Consider the following:

- Market share:** It has lost market share in both prepaid and postpaid segments to VHA and Optus. We illustrate this in the chart below.
- Revenue growth:** Since the launch of the iPhone 3G in June 2008, we estimate that Optus mobile handset service revenues have grown at +8.8%, double Telstra's growth of +4.4%.



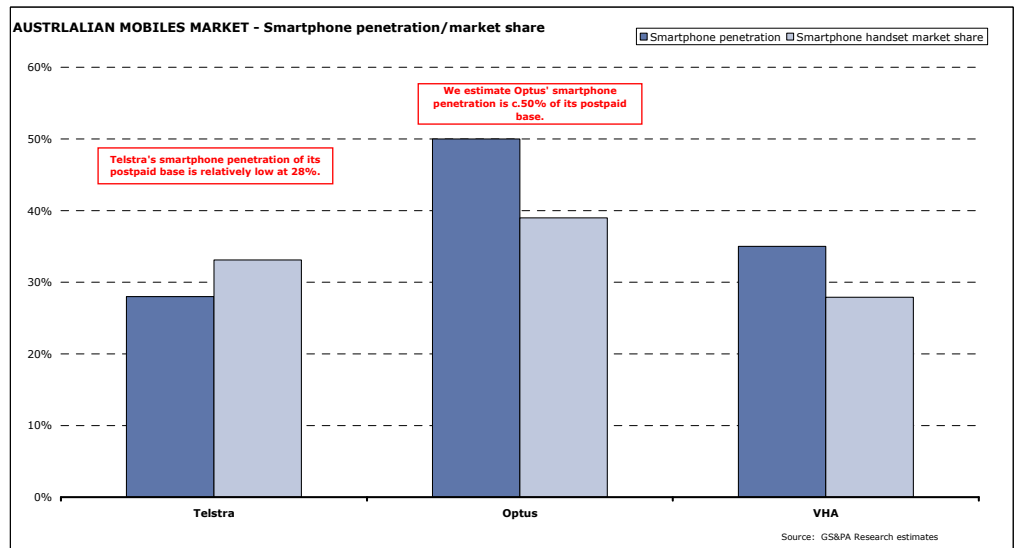


(2) Telstra's smartphone penetration is low

Smartphone take-up in Telstra's subscriber base is relatively low. For example:

- **Smartphone penetration:** Telstra's postpaid smartphone penetration is c.28% compared with Optus c.50% and VHA c.35%.
- **Smartphone market share:** We estimate Telstra only has a c.33% market share of smartphones (overall postpaid share of c.45%) compared with Optus c.39% (postpaid share c.28%) and VHA c.28% (postpaid share c.28%).

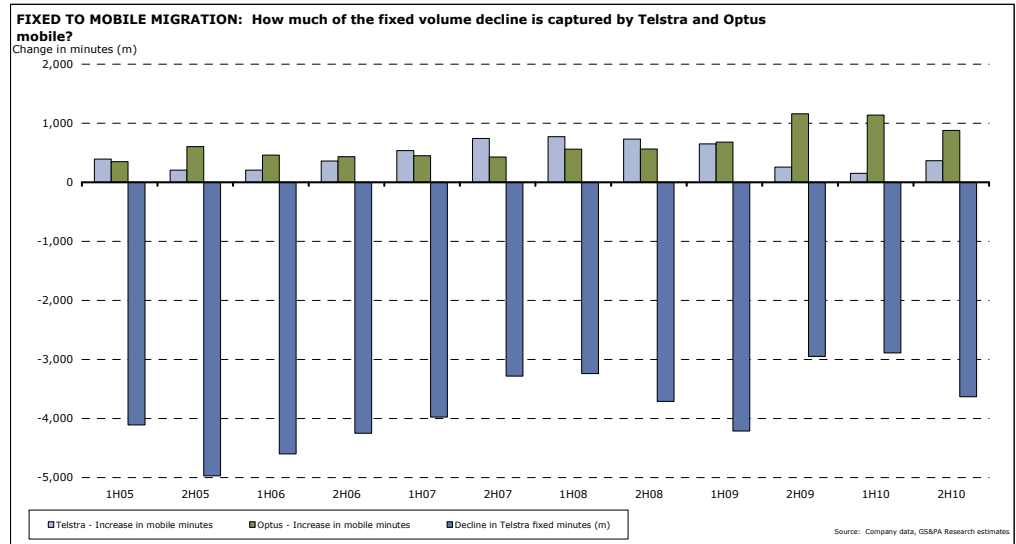
Given smartphone subscribers are typically higher value customers (ARPU c.1.5x average postpaid subscriber), we believe Telstra has an enormous opportunity to improve the quality of its postpaid customer base.



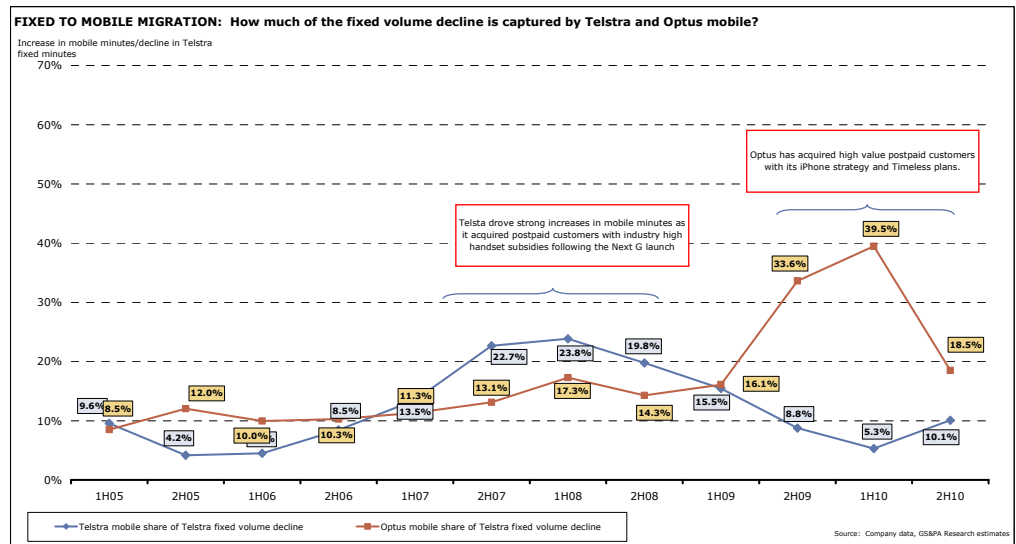
(3) Telstra captures a low proportion of minutes 'leaking' from its fixed network

Telstra only captures a minimal proportion of traffic migrating away from its fixed line PSTN network. This is amply illustrated in the chart below, which shows:

- The decline in Telstra's outgoing fixed minutes. This includes local calls (we assume average of eight minutes/call), long distance, and fixed-to-mobile calls.
- The increase in outgoing voice minutes on Telstra's mobile network. Apart from 2007-2008, when it aggressively acquired postpaid subscribers, Telstra has not captured a high percentage of the traffic migrating away from its fixed network.
- The increase in outgoing voice minutes on Optus's mobile network.



The following chart shows the same analysis but on a percentage basis. The chart shows that, in recent times, Optus has driven strong growth in mobile minutes.



(3) We Believe Telstra's Strategy Makes Strategic Sense

The next 6-18 months represent a strong opportunity for Telstra

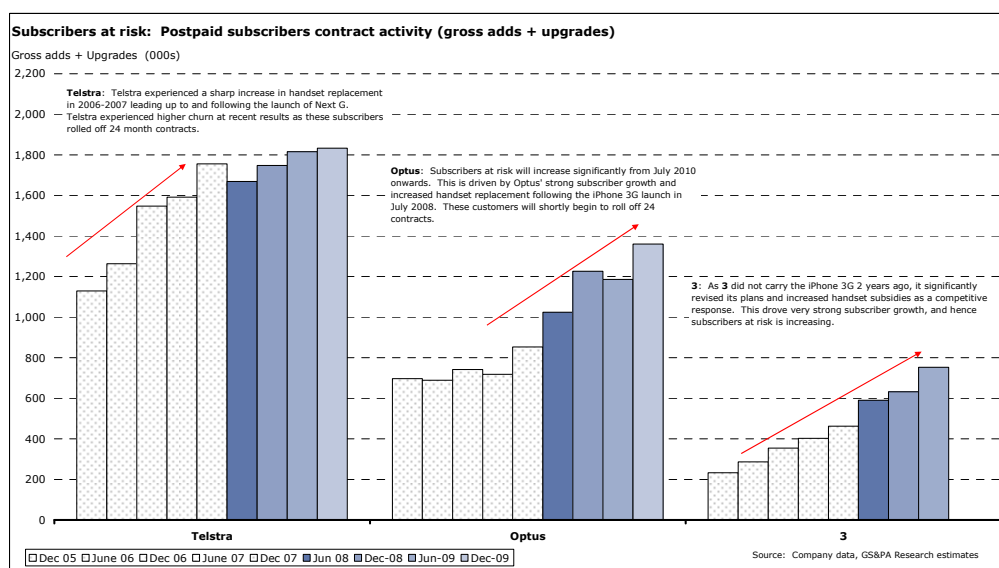
We have stated previously that the next 6-18 months represent an enormous opportunity for Telstra to increase its share in the mobiles market. For more detail, please refer to our *Daily Cable* article 'Rising competitive intensity in mobiles market', published 7 July 2010.

In summary, we believe the window of opportunity has opened for the following reasons:

(1) Increasing number of subscribers 'up for grabs'

The arrival of the iPhone 3G in July 2008 drove a significant acceleration in the handset replacement cycle across the industry. With these customers now rolling off 24 month contracts, the number of subscribers 'up for grabs' has increased significantly.

Our analysis indicates that all operators have an increasing proportion of their sub base 'at risk'. However Optus is likely to be the most vulnerable given it has by far the biggest share of the installed base of iPhones in Australia.



(2) New generation smartphones will drive another replacement cycle

There are a number of next generation smartphones that have arrived (or are arriving) onto the market which we believe will drive handset replacement. Clearly the iPhone 4 is one of these handsets, along with the avalanche of competing Android (e.g. HTC Desire, HTC Desire HD, HTC Legend, Samsung Galaxy, etc) and Windows 7 (e.g. HTC Mozart, LG Optimus 7Q) handsets available now and coming onto the market.

(3) Telstra has a sustainable network competitive advantage

Although both Optus and Vodafone are investing heavily in their networks to close the gap, we believe Telstra continues to hold a significant network competitive advantage. In our view, this will become increasingly important in a smartphone world as customers are likely to be more sensitive to network performance.

The ROI on acquiring smartphone customers is high

While the investment in customer acquisition is clearly negative for short-term earnings and margins, the key question for investors is whether this investment will deliver sustainable returns and EBITDA growth in the longer term.

Our analysis suggests that while the return from acquiring a smartphone customer is lower than a traditional feature phone subscriber, it still remains a very profitable exercise with an attractive payback on investment.

Consider the following:

- **Feature phone:** IRR of greater than 110%.
- **Smartphone:** IRR of c.65%. We have assumed: (1) smartphone SAC is 2x a feature phone SAC and (2) smartphone ARPU is c.1.3x feature phone ARPU.

We illustrate our analysis in the tables below.

Per Subscriber Returns Analysis - Feature phone				
Assumptions				
Monthly Post Paid ARPU (A\$)	65			
EBITDA Margin (%)	40%		Discount Rate	10%
Postpaid SAC (A\$)	250		Inflation	2.5%
Monthly Churn	2.8%			
Replacement cycle (yrs)	3			
Gross Value per Sub (A\$)	833			
Net Value per Sub (A\$)	583			
ROI	233%			
IRR	113%			
Pay Back (yrs)	0.8			

Year	0	1	2	3	4	
Cash Flows	-250	312	320	328	0	0
PV of Cash Flows	-250	297	277	258	0	0

Source: Company data, GS&PA Research estimates.

Per Subscriber Returns Analysis - Smartphone				
Assumptions				
Monthly Post Paid ARPU (A\$)	85			
EBITDA Margin (%)	45%		Discount Rate	10%
Postpaid SAC (A\$)	500		Inflation	2.5%
Monthly Churn	3.3%			
Replacement cycle (yrs)	2.5			
Gross Value per Sub (A\$)	1,029			
Net Value per Sub (A\$)	529			
ROI	106%			
IRR	65%			
Pay Back (yrs)	1.1			

Year	0	1	2	3	4	
Cash Flows	-500	456	468	240	0	0
PV of Cash Flows	-500	435	405	189	0	0

Source: Company data, GS&PA Research estimates.

(4) Telstra's Mobile Strategy Has Three Key Risks

Risk #1: New customers critical; high recontracting mix damages returns

One area we believe Telstra needs to monitor closely is what proportion of its investment is allocated to: (1) recontracting of existing customers versus (2) new customer acquisition.

While the acquisition of new customers delivers incremental revenue to Telstra, the recontracting of existing customers (at a similar cost per subscriber) is unlikely to deliver incremental revenue. In fact, given Telstra's aggressive product re-pricing, recontracting existing subscribers is likely to deliver lower incremental revenue/ARPU!

Thus, as long as customers out of contract do not churn, Telstra would clearly prefer to spend a greater proportion of its investment on acquiring new customers.

We estimate that: (1) Telstra would typically recontract 30%-35% of its postpaid subscriber base every year and (2) the recontracting/new postpaid customer acquisition mix is around 60%/40%. We believe that recontracting levels are likely to have increased following Telstra's pricing changes this year.

In the table below, we illustrate the potential scenarios for the ROI on Telstra's \$450m investment. The ROI is dependent on:

1. Recontracting/new customer mix.

- The higher the proportion of the \$450m invested on recontracting customers, the lower the ROI.
- However, if Telstra is successful in capturing a greater proportion of new customers, the ROI increases significantly.
- For example if 60% of the \$450m is spent on recontracting, we estimate net adds would be +390k and the ROI c.33% (assuming \$75 per month ARPU). If the recontracting proportion increases to 70%, net adds would be +310k and the ROI would reduce to c.8%.

2. Quality of customers acquired.

- Clearly the higher quality of the customer base acquired (i.e. ARPU of customers acquired), the higher the ROI.

		ROI of Telstra's mobile strategy						
		% of \$450m investment spent on recontracting customers						
ARPU of customers acquired		45%	50%	55%	60%	65%	70%	75%
	\$60	38.5%	28.0%	17.9%	8.1%	-1.3%	-10.6%	-19.7%
	\$65	50.2%	38.3%	26.9%	16.0%	5.5%	-4.6%	-14.6%
	\$70	62.5%	49.0%	36.2%	24.1%	12.5%	1.4%	-9.4%
	\$75	75.4%	60.2%	46.0%	32.5%	19.7%	7.5%	-4.3%
	\$80	89.2%	72.1%	56.1%	41.2%	27.1%	13.8%	1.0%
	\$85	103.9%	84.5%	66.7%	50.1%	34.7%	20.1%	6.3%
	\$90	119.7%	97.8%	77.8%	59.5%	42.5%	26.7%	11.7%
	\$95	136.6%	111.8%	89.5%	69.2%	50.6%	33.4%	17.2%

Key assumptions:

- (1) ROI is the IRR on the \$450m investment.
- (2) IRR is calculated over 2.5 years with all costs associated with customer acquisition expensed upfront.
- (3) The handset cost associated with acquiring a new customer/recontracting is \$500.
- (4) Postpaid churn reduces 0.1% to more normalised levels of c.1.2%/month.
- (5) Telstra's postpaid handset ARPU is c.\$70/month.

Source: GS&PA Research estimates.

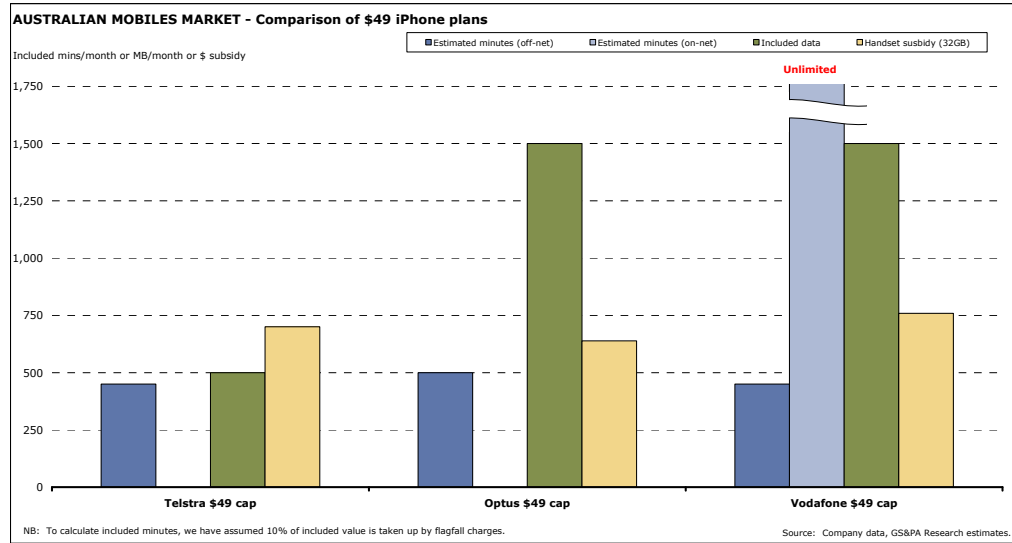
Risk #2: Rising penetration of cap plans will damage Telstra

Since May 2010, Telstra has aggressively promoted capped calling plans. Telstra's caps now include reasonable handset subsidies, more included value and form a key part of Telstra's advertising and selling strategy. This is the first time Telstra has done this in its history.

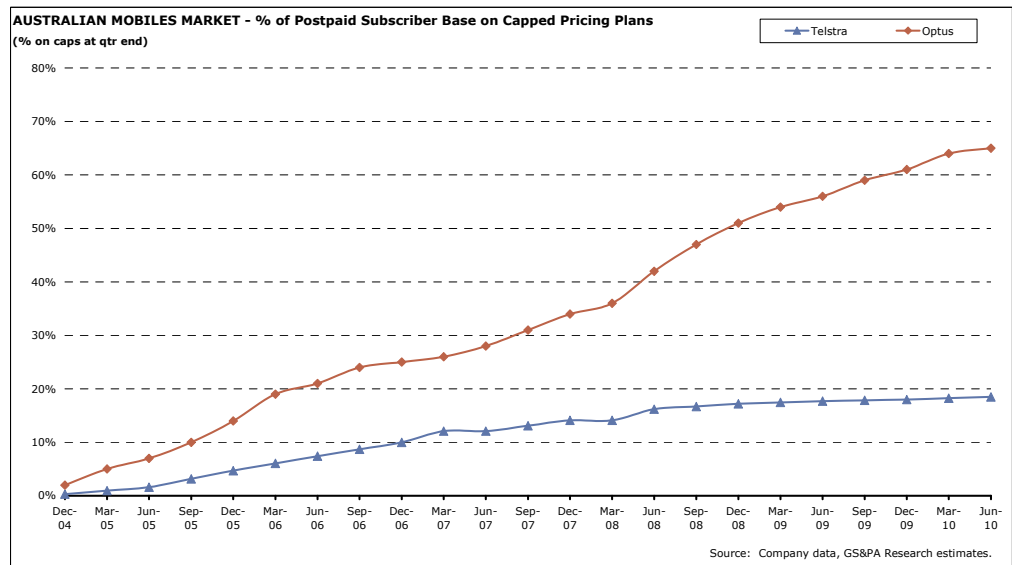
Recently, Telstra rounded off its offering by introducing a low end \$29 cap and a top of the range \$129 unlimited cap.

GS&PA TELECOMS RESEARCH Telstra's cap plans	
Date	Cap plans
May-10	Revised \$49, \$79 and \$99 cap plans. Plans now include handset subsidies.
Oct-10	Introduction of \$29 cap, \$129 unlimited cap plan

Source: Company data.



As we illustrate in the chart below, Telstra's cap plan penetration of c.20% of its postpaid base is relatively low compared with its competitors. In our view, Telstra has historically been extremely wary to promote caps given the adverse impact mobile caps have on its fixed line business (i.e. calling volumes). However, now that Telstra is promoting cap plans aggressively, we expect its cap plan penetration to increase reasonably quickly.



As cap plan penetration increases, we expect Telstra to be affected in the following ways:

1. Potential downward pressure on ARPU.

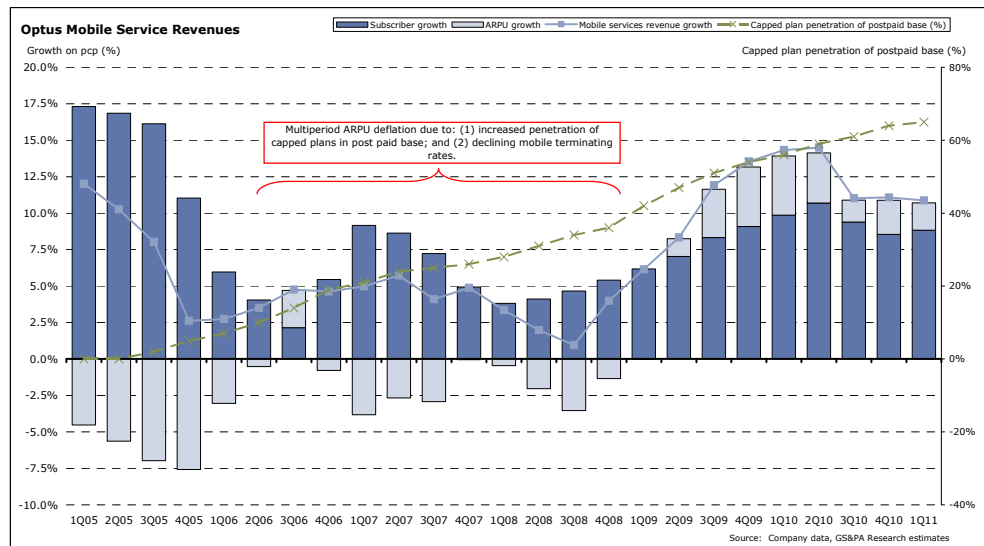
- As existing customers recontract and move from the traditional direct plans onto cap plans (e.g. customer on \$60 direct plan moving to \$29 or \$49 cap), we expect this to place downward pressure on ARPU.
- In the chart below, we illustrate how Optus experienced multiple periods of ARPU deflation and anaemic revenue growth as its cap plan penetration increased from c.20% to c.40%.

2. Increased mobile termination payments.

- As cap plan penetration increases, we believe Telstra's mobile MOU will also increase significantly. Hence, we expect mobile termination payments to other carriers to increase, placing downward pressure on mobile margins.

3. Greater F2M migration.

- Given increasing mobile MOU, we expect the decline in fixed calling volumes (particularly F2M) to continue to accelerate.



Risk #3: Competitor response has been rational so far; this could change

Telstra's operating momentum has improved following its price revisions across its product range and its more aggressive stance in the market place, as illustrated in the table below.

GS&PA TELECOMS RESEARCH			
Improving Operating Momentum - Net adds by product			
	1H10	2H10	July-Aug 10
Postpaid mobile handsets	37	54	73
Prepaid handsets - unique users	-30	-32	13
Wireless broadband	279	329	176
Fixed broadband	-30	11	32
Bundles	c.30	c.295	165
PSTN			In July-Aug 10, fewer customers lost in any 2 month period since 2007

Source: Company data, GS&PA Research estimates.

In our view, these are reasonably strong numbers. However, the key questions from here are: (1) how sustainable will the improvement in operational momentum be and (2) what will the competitor response be?

To date, we believe the response from Optus/VHA has been relatively rational, with pricing action largely focused on: (1) increasing value at certain price points and (2) increasing SAC in order to recontract customers rolling off 24 month contracts. We do not believe there have been any significant price cuts from its competitors in recent times.

We provide a summary of the major pricing changes in the table below.

GS&PA TELECOMS RESEARCH			
Mobile pricing changes			
	Telstra	Optus	Vodafone
May	Significantly revises its cap plans. Telstra has included: (1) greater included value (up to +c.60% increase in included minutes); (2) mobile data allowance (none previously); and (3) critically, reasonable handset subsidies across Telstra's handset lineup (limited previously).		
June	Telstra increases handset subsidies across smartphone range.		Significantly revises caps plans with: (1) 20-60% increase in included value across its cap plans; (2) unlimited calling between Vodafone/3; (3) increased data download allowance;
July	Telstra offers 50% discount of datapacks ahead of iPhone 4 launch.	Revised iPhone pricing. More value given on cap plans. \$59 cap continues to be main point of differentiation with competitors.	Revised iPhone pricing with tweaking of data offerings on cap plans.
August	Introduces prepaid cap plans. Optus Turbo offerings.	Plans largely market to increase value across caps. For example: (1) \$59 cap now offers \$500 in value and 1.5GB in data (was \$450, 1GB); (2) \$59 now \$700 in value and 2GB in data (was \$550, 2GB); and (3) \$79 now \$900 in value and 3GB (was \$800, 2GB).	Introduction of \$59 cap
September			
October	Introduction of \$29 cap, \$129 unlimited cap.	Introduction of \$1/day prepaid plans.	

Source: Company data, GS&PA Research estimates.

In our view, competition in the wireless market has intensified following Telstra's decision to invest \$1bn to drive market share. However, Telstra has largely met the market on price – as opposed to moving below market. We expect pricing to remain rational given Australia is a three-player market where all operators have scale and significant revenues/earnings to protect.

(5) Case Studies: Mobile Operators Invest To Drive Market Share, With Mixed Results

In this section, we examine a number of global case studies where mobile operators have made the strategic decision to invest to drive market share in mobiles.

We believe the key conclusions are: (1) the strategy is dilutive to earnings for a number of periods and (2) operators have had varying degrees of success in relation to the timing and degree of earnings uplift.

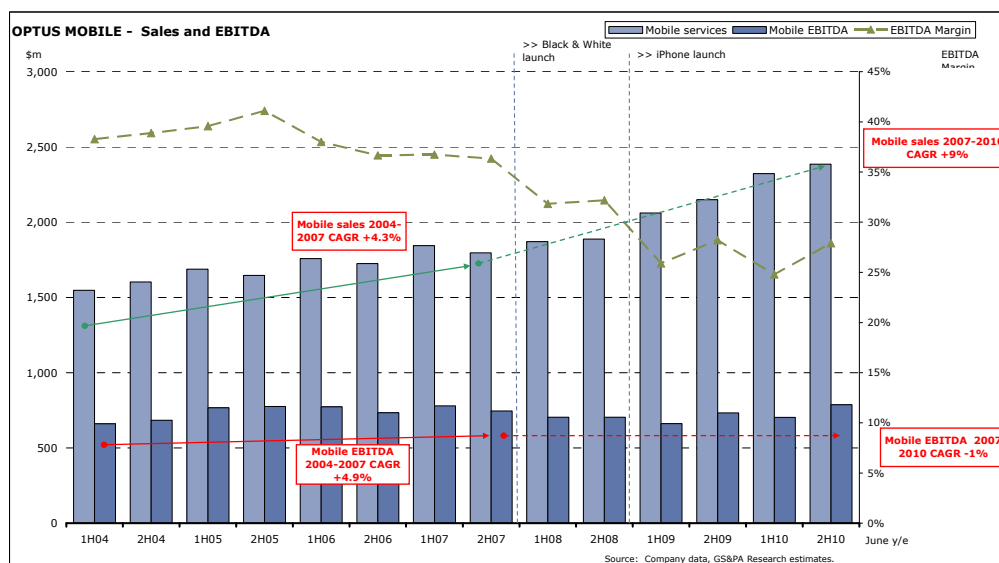
Case study #1: Optus's multi year investment yet to deliver EBITDA growth

Optus embarked on its aggressive market share strategy in 2007 with its 'Black and White' campaign, followed by the iPhone 3G launch in July 2008.

While Optus has driven increases in subscriber and revenue share, it has not delivered earnings growth since the start of the strategy.

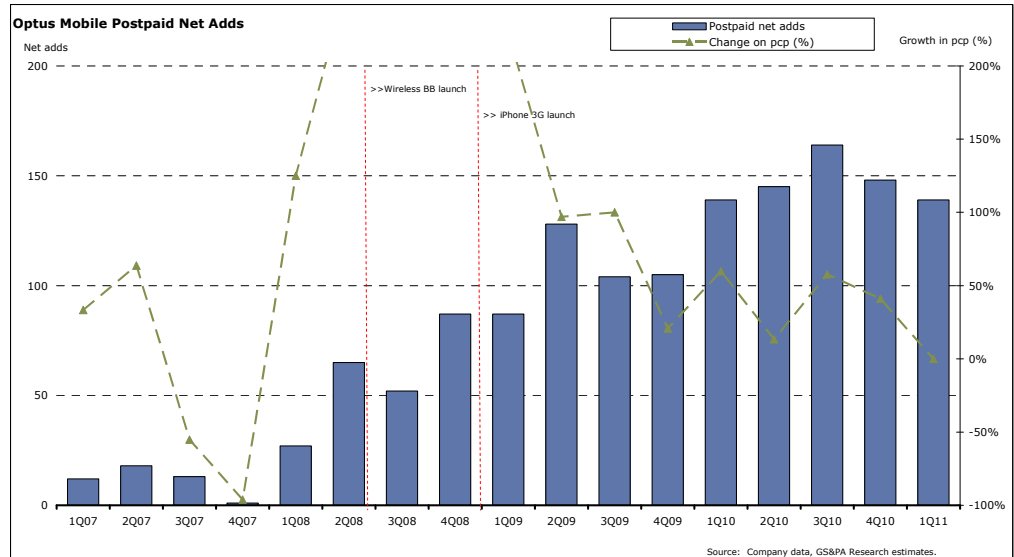
Consider the following:

- **Optus sales growth:** 2007-2010 CAGR +9%.
- **Optus EBITDA growth:** 2007-2010 CAGR -1%.
- **EBITDA margins:** From Jun-07 to Mar-10, margins declined every single quarter largely due to Optus's multi-year investment into subscriber growth. Only in the Jun-10 quarter did margins improve.



We believe the main reason why Optus has not delivered any meaningful EBITDA growth as yet is because it has been so successful in generating increasing subscriber net adds.

In our view, this was largely due to the absence of Telstra competing in the market. This has meant that the investment into customer acquisition has increased, rather than slowed over the past three years. We illustrate this in the chart below.



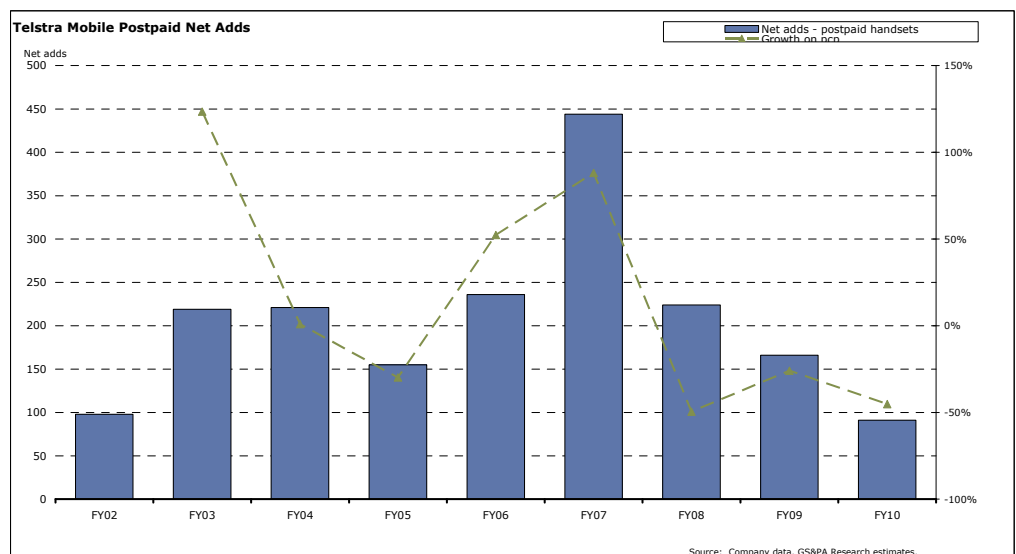
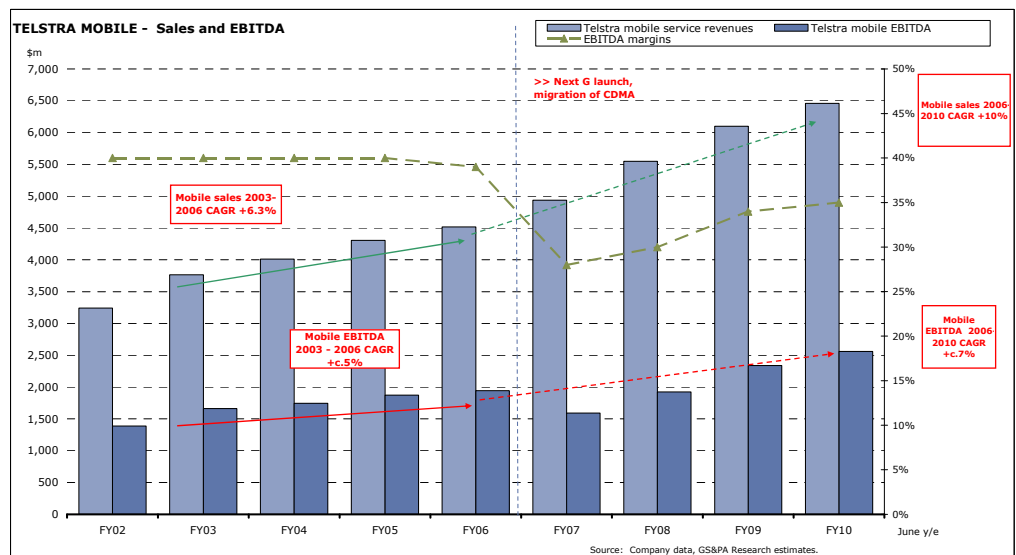
In our view, given Telstra is now competing aggressively, it is inevitable that subscriber net adds will slow at Optus. As such, we expect strong EBITDA growth over the next 12-18 months. The risk and challenge for Optus is to protect its existing subscriber base and keeping churn low, particularly as customers acquired over the past two years roll off 24 month contracts.

Case study #2: Telstra's customer acquisition binge in 2007 delivered robust EBITDA growth

In 2006-2007, Telstra sought to reinvigorate growth in its wireless business by aggressively raising handset subsidies to increase share in the postpaid market, drive 3G penetration and migrate customers onto its Next G network.

While dilutive in the short term, the strategy resulted in good revenue and EBITDA growth for Telstra's mobiles business. Consider the following:

- **Mobiles service revenue growth:** FY06-FY10 CAGR +10%.
- **Mobile EBITDA growth:** FY06-FY10 CAGR +7%.
- **Mobile EBITDA margins:** EBITDA margins declined c.1,000bp from c.40% in FY06 to c.30% in FY07. Margins have recovered to c.35% as: (1) subsidies declined as Telstra looked to meet its FY10 margin targets; (2) net adds/handset volumes fell (unlike Optus where volumes continued to increase); and (3) higher proportion of higher margin wireless BB revenues.



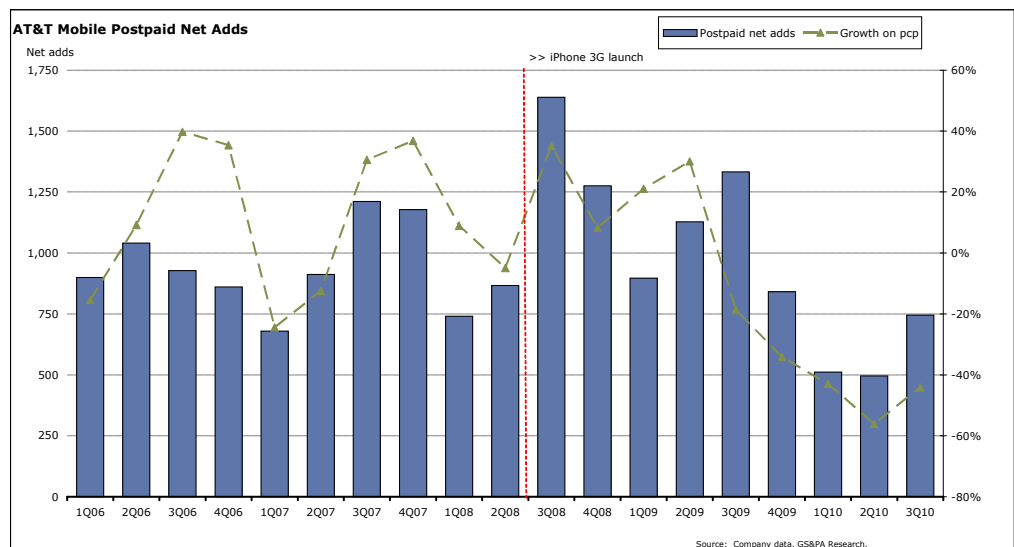
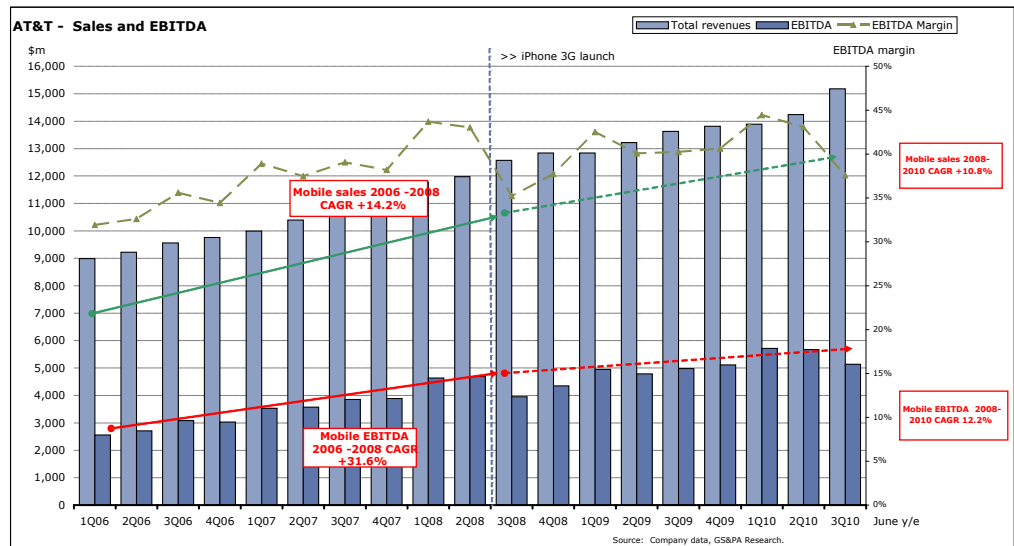
Case study #3: AT&T iPhone strategy drives short term margin dilution

AT&T, the second largest wireless carrier in the US, has benefitted from exclusive access to the iPhone to drive subscriber share and smartphone penetration.

Following the launch of the iPhone 3G in the September 2008 quarter, AT&T has increased its subscriber market share from 27.8% in 2Q08 to 31.2% in 2Q10. Despite subscriber acquisitions costs increasing, AT&T has managed to grow both the revenue line and the EBITDA line during this period.

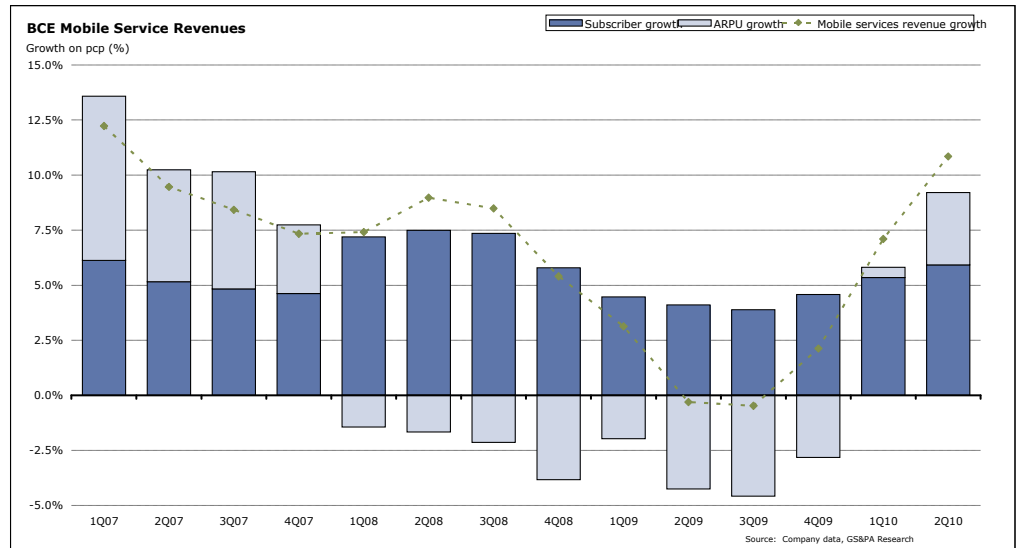
Consider the following:

- **Sales growth:** FY08-FY10 CAGR +10%.
- **EBITDA growth:** FY08-FY10 CAGR +12% (FY09 +5.8%, FY10 +19.1%).
- **EBITDA margins:** AT&T margins declined (on pcp) for four successive quarters from 2Q08 as a result of: (1) increased handset subsidies and (2) higher customer growth. With net subscriber growth slowing following the initial demand for the iPhone, margins have steadily improved.



Case study #4 - BCE fighting back to regain momentum

Bell Canada, Canada's incumbent telecoms operator, is also navigating a period of investment to reinvigorate momentum in its wireless business. This follows a number of quarters of market share losses, ARPU deflation and, as a result, revenue declines.

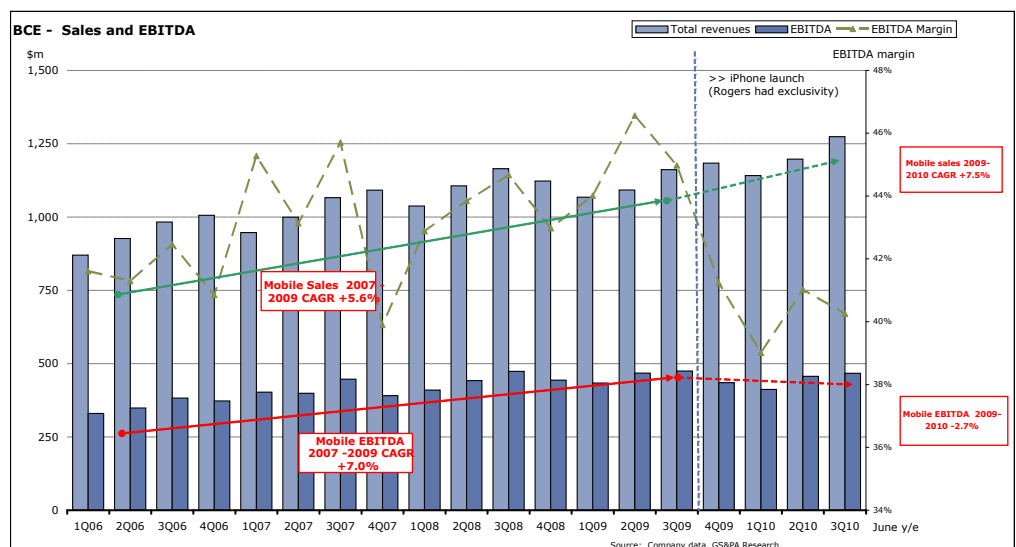


The company is currently investing (increasing handset subsidies, marketing, etc) to improve: (1) postpaid subscriber mix and (2) smartphone adoption in its wireless base.

While investments have pressured EBITDA and margins in recent quarters, Bell has improved share of gross/net postpaid adds, and has been successful in accelerating mobile service revenue growth.

Consider the following:

- **Postpaid net adds:** 4Q09 +37.4% to 110k, 1Q10 +131.9% to 81k, 2Q10 +60.1% to 103k, 3Q10 +13.4% to 138k.
- **Mobile service revenues:** 3Q09 -0.5%, 4Q09 +2.1%, 1Q10 +7.1%, 2Q10 +10.8%, 3Q10 +9.8%.
- **EBITDA:** 3Q09 +0.2% on pcp, 4Q09 -2.0%, 1Q10 -5.1%, 2Q10 -2.4%, 3Q10 -1.7%.
- **EBITDA Margin:** 3Q09 +31bp on pcp, 4Q09 -175bp, 1Q10 -500bp, 2Q10 -554bp, 3Q10 -472bp.



(6) Telecoms Sector Financial Summary

FINANCIAL RATIOS Stock Code	TLS	SGT	SGT	SGT	TEL	TEL
Year End	June	March	June	June	June	June
Currency	AUD	SGD	SGD	AUD	NZD	AUD
Recommendation	HOLD	HOLD	HOLD	HOLD	HOLD	HOLD
Current Price	265¢	329¢	329¢	253¢	212¢	165¢
12 month Target Price	354¢	324¢		260¢	210¢	162¢
Valuation methodology	Roll Fwd DCF +Yield based			Roll Fwd SOTP + Holding Co disc		Roll Fwd DCF +Yield based
Capital Growth	33.5%	(1.6%)		2.8%		(1.2%)
12 Month Target Yield	5.3%	5.0%		5.0%		7.6%
Total Return	38.8%	3.4%		7.8%		6.3%
Excess Return to ASX 200	19.9%			(11.1%)		(12.5%)
Shares on issue (m)	12397.0	15972.3	15972.3	15972.3	1920.7	1920.7
Market Cap (\$m)	\$32,852m	\$52,549m	\$52,549m	\$40,410m	\$4,072m	\$3,160m
Net Debt (\$m)	\$12,974m	\$5,266m	\$5,288m	\$4,068m	\$2,368m	\$1,832m
Associates/Investments (\$m)	(\$1,590m)	(\$25,123m)	(\$25,123m)	(\$19,330m)	\$0m	\$0m
Minorities	\$0m	\$0m	\$0m	\$0m	\$17m	\$13m
Enterprise Value (\$m) - Consolidated Operating Business	\$44,236m	\$32,692m	\$32,714m	\$25,149m	\$6,456m	\$5,004m
All Ords. Weighting	2.59	n/a	n/a	n/a	n/a	0.27
Market Performance vs. ASX/S&P 200	1 month: (9.7%) 3 months: (25.8%) 12 months: (15.9%)	n/a n/a n/a	n/a n/a n/a	(0.3%) (8.2%) 2.7%	n/a n/a n/a	(1.1%) (1.4%) (21.0%)
NET PROFIT (\$m) - GS&PA	09 A \$4073.0m 10 A \$3883.0m 11 E \$3165.8m 12 E \$3399.8m 13 E \$3956.9m	09 A \$3436.0m 10 A \$3918.0m 11 E \$3822.2m 12 E \$4042.2m 13 E \$4356.6m	09 A \$3556.5m 10 A \$3894.0m 11 E \$3877.2m 12 E \$4120.8m	09 A \$2736.4m 10 A \$2996.1m 11 E \$2983.1m 12 E \$431.9m 13 E \$495.0m	09 A \$481.0m 10 A \$380.0m 11 E \$346.3m 12 E \$431.9m 13 E \$495.0m	09 A \$372.1m 10 A \$294.0m 11 E \$267.9m 12 E \$334.1m 13 E \$382.9m
EPS (¢)	09 A 32.9 10 A 31.3 11 E 25.5 12 E 27.4 13 E 31.9	09 A 21.5 10 A 24.5 11 E 23.9 12 E 25.3 13 E 27.3	09 A 22.3 10 A 24.4 11 E 24.3 12 E 25.8	09 A 17.1 10 A 18.8 11 E 18.7 12 E 19.9	09 A 26.2 10 A 20.1 11 E 17.9 12 E 22.2 13 E 25.5	09 A 20.3 10 A 15.5 11 E 13.9 12 E 17.2 13 E 19.7
EPS Growth (%)	10 A (4.7%) 11 E (18.5%) 12 E 7.4% 13 E 16.4% 3yr CAGR 0.6%	10 A 14.0% 11 E (2.4%) 12 E 5.8% 13 E 7.8%	09 A 9.4% 11 E (0.4%) 12 E 6.3%	09 A 9.4% 11 E (0.4%) 12 E 6.3%	09 A (23.3%) 11 E (10.8%) 12 E 24.0% 13 E 14.6%	09 A (23.3%) 11 E (10.8%) 12 E 24.0% 13 E 14.6%
P.E.R. (x)	09 A 8.1 10 A 8.5 11 E 10.4 12 E 9.7 13 E 8.3	09 A 15.3 10 A 13.4 11 E 13.7 12 E 13.0 13 E 12.1	09 A 14.8 10 A 13.5 11 E 13.6 12 E 12.8	09 A 14.8 10 A 13.5 11 E 13.5 12 E 12.7	09 A 8.1 10 A 10.5 11 E 11.8 12 E 9.5 13 E 8.3	09 A 8.1 10 A 10.6 11 E 11.9 12 E 9.6 13 E 8.3
D.P.S. (¢)	09 A 28.0 10 A 28.0 11 E 26.0 12 E 26.0 13 E 28.0	09 A 12.5 10 A 14.2 11 E 13.2 12 E 14.2 13 E 12.5	09 A 12.9 10 A 14.0 11 E 13.5 12 E 13.8	09 A 9.9 10 A 10.7 11 E 10.3 12 E 10.6	09 A 24.0 10 A 24.0 11 E 16.1 12 E 16.7 13 E 19.1	09 A 18.6 10 A 18.6 11 E 12.5 12 E 12.9 13 E 14.8
YIELD (%)	09 A 10.6 10 A 10.6 11 E 9.8 12 E 9.8 13 E 10.6 Franking (%) 100	09 A 3.8 10 A 4.3 11 E 4.0 12 E 4.3 13 E 3.8	09 A 3.9 10 A 4.2 11 E 4.1 12 E 4.2	09 A 3.9 10 A 4.2 11 E 4.1 12 E 4.2	09 A 11.3 10 A 11.3 11 E 7.6 12 E 7.9 13 E 9.0	09 A 11.3 10 A 11.3 11 E 7.6 12 E 7.8 13 E 9.0
SALES (\$m)	09 A \$25371m 10 A \$24813m 11 E \$24866m 12 E \$25313m 13 E \$26059m	09 A \$14936m 10 A \$16871m 11 E \$17708m 12 E \$18612m 13 E \$19281m	09 A \$15420m 10 A \$17080m 11 E \$17934m 12 E \$18779m	09 A \$11864m 10 A \$13142m 11 E \$13798m 12 E \$14449m	09 A \$5626m 10 A \$5271m 11 E \$4877m 12 E \$4883m 13 E \$4859m	09 A \$4352m 10 A \$4078m 11 E \$3773m 12 E \$3778m 13 E \$3759m
SALES GROWTH (%)	10 A (2.2%) 11 E 0.2% 12 E 1.8% 13 E 2.9%	09 A 13.0% 11 E 5.0% 12 E 5.1% 13 E 3.6%	09 A 10.8% 11 E 5.0% 12 E 4.7%	09 A 10.8% 11 E 5.0% 12 E 4.7%	09 A (6.3%) 11 E (7.5%) 12 E 0.1% 13 E (0.5%)	09 A (6.3%) 11 E (7.5%) 12 E 0.1% 13 E (0.5%)
EBITDA (\$m) (Excl Investments, Associates & other non-operating items)	09 A \$10,945m 10 A \$10,845m 11 E \$9,854m 12 E \$10,204m 13 E \$10,925m	09 A \$4,431m 10 A \$4,845m 11 E \$4,966m 12 E \$5,106m 13 E \$5,142m	09 A \$4,535m 10 A \$4,875m 11 E \$5,001m 12 E \$5,115m	09 A \$3,489m 10 A \$3,751m 11 E \$3,848m 12 E \$3,936m	09 A \$1,768m 10 A \$1,764m 11 E \$1,726m 12 E \$1,780m 13 E \$1,799m	09 A \$1,368m 10 A \$1,365m 11 E \$1,335m 12 E \$1,377m 13 E \$1,392m
EBITDA Growth (%)	10 A (0.9%) 11 E (9.1%) 12 E 3.5% 13 E 7.1% 3yr CAGR 0.2%	09 A 9.3% 11 E 2.5% 12 E 2.8% 13 E 0.7%	09 A 7.5% 11 E 2.6% 12 E 2.3%	09 A 7.5% 11 E 2.6% 12 E 2.3%	09 A (0.2%) 11 E (2.2%) 12 E 3.1% 13 E 1.1%	09 A (0.2%) 11 E (2.2%) 12 E 3.1% 13 E 1.1%
EV/EBITDA (x)	09 A 4.0 10 A 4.1 11 E 4.5 12 E 4.3 13 E 4.0	09 A 7.4 10 A 6.7 11 E 6.6 12 E 6.4 13 E 6.4	09 A 7.2 10 A 6.7 11 E 6.5 12 E 6.4	09 A 7.2 10 A 6.7 11 E 6.5 12 E 6.4	09 A 3.7 10 A 3.7 11 E 3.7 12 E 3.6 13 E 3.6	09 A 3.7 10 A 3.7 11 E 3.7 12 E 3.6 13 E 3.6
PEG RATIO (FY11 PER/FY11&FY12 EPS CAGR)	-1.6	8.7	4.7	4.7	2.3	2.3
PRICE/SALES (FY11)	1.3	3.0	2.9	2.9	0.8	0.8

(1) Non Recurring Items include: profit/loss on asset sales/restructuring charges.

(2) IFRS Adjustments include: asset impairment, derivative/hedging, pension schemes.

Source: Company data, GS&PA Research estimates, IRESS, Bloomberg. Prices current as at 9 Nov 2010

I, Christian Guerra, hereby certify that all of the views expressed in this report accurately reflect my personal views about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to specific recommendations or views expressed in this report.

Disclosures of Interest

SINGAPORE TELECOMMUNICATIONS LIMITED:

SGT: Goldman Sachs and/or its affiliates each have research coverage of the company the subject of this report. Any views, investment opinions or recommendations relating to the subject company published by Goldman Sachs & Partners Australia are independently developed and may differ from those published by Goldman Sachs. SGT: Goldman Sachs and/or its affiliates have received during the past 12 months compensation for financial and advisory services from the company, its parent, or its wholly owned or majority owned subsidiary. SGT: Goldman Sachs and/or its affiliates expect to receive or intend to seek compensation for financial and advisory services in the next 3 months from the company, its parent, or its wholly owned or majority owned subsidiary.

Telecom Corporation of New Zealand:

TEL.NZ: Goldman Sachs and/or its affiliates expect to receive or intend to seek compensation for financial and advisory services in the next 3 months from the company, its parent, or its wholly owned or majority owned subsidiary. TEL.NZ: Goldman Sachs and/or its affiliates is acting as financial advisor to Telecom Corporation of New Zealand Limited in relation to the proposed sale of certain of the businesses of AAPT Limited. Goldman Sachs and/or its affiliates may receive fees for acting in this capacity.

Telstra Corporation Limited:

TLS: Goldman Sachs and/or its affiliates expect to receive or intend to seek compensation for financial and advisory services in the next 3 months from the company, its parent, or its wholly owned or majority owned subsidiary. TLS: Goldman Sachs and/or its affiliates have received during the past 12 months compensation for financial and advisory services from the company, its parent, or its wholly owned or majority owned subsidiary. TLS: Goldman Sachs and/or its affiliates, is advising NBN Co Limited in connection with the Financial Heads of Agreement with Telstra Corporation Limited to cooperate on the development of a wholesale-only national fibre broadband network. Goldman Sachs and/or its affiliates may receive fees for acting in this capacity.

Important Notice - Aus:

Australia - Research Important Notice

Company Specific Regulatory Disclosures

See company-specific regulatory disclosures for any of the following disclosures required as to companies referred to in the report: manager or co manager in a pending transaction; financial advisor in a strategic corporate transaction; 1% or other ownership; compensation for certain services; types of client relationships; managed/co-managed public offerings in prior periods; directorships; market making and/or specialist role.

The following are additional required disclosures: Ownership and Material Conflicts of Interest: Goldman Sachs & Partners Australia Pty Ltd ("Goldman Sachs & Partners Australia") policy prohibits its analysts, assistant analysts and their respective associates owning securities of any company in the analyst's area of coverage. Analyst compensation: Analysts are paid in part based on the profitability of Goldman Sachs & Partners Australia, which includes corporate advisory and financing revenues. Distribution of recommendations: See the distribution of recommendations disclosure on the following page.

Compendium Report

Please see disclosures at <http://www.gs.com.au/Disclosures>. Disclosures applicable to companies included in this compendium report can be found in the latest relevant published research.

Global Product; Distributing Entities

This report has been prepared by the Goldman Sachs & Partners Australia Investment Research Division for distribution to clients of affiliates of Goldman Sachs & Partners Australia and pursuant to certain contractual arrangements to clients of affiliates of The Goldman Sachs Group, Inc. (Group) (Collectively, Group and its affiliates, "GS").

Group owns 45% of the ordinary shares of Goldman Sachs & Partners Australia Group Holdings Pty Ltd, the ultimate holding company of Goldman Sachs & Partners Australia. Research views, investment opinions and recommendations published by Goldman Sachs & Partners Australia are developed independently from those published by the Goldman Sachs Global Investment Research Division.

This research is disseminated in Australia by Goldman Sachs & Partners Australia Pty Ltd (ABN 21 006 797 897); in Canada by Goldman Sachs Canada Inc. regarding Canadian equities and by Goldman Sachs & Co. (all other research); in Germany by Goldman Sachs & Co. oHG; in Hong Kong by Goldman Sachs (Asia) L.L.C.; in India by Goldman Sachs (India) Securities Private Ltd.; in Japan by Goldman Sachs Japan Co., Ltd.; in the Republic of Korea by Goldman Sachs (Asia) L.L.C., Seoul Branch; in New Zealand by Goldman Sachs & Partners New Zealand Limited; in Singapore by Goldman Sachs (Singapore) Pte. (Company Number: 198602165W); and in the United States of America by Goldman, Sachs & Co. Goldman Sachs International has approved this research in connection with its distribution in the United Kingdom and European Union. Persons who would be categorized as private customers in the United Kingdom, as such term is defined in the rules of the Financial Services Authority, should read this material in conjunction with the last published reports on the companies mentioned herein and should refer to the risk warnings that have been sent to them by Goldman Sachs International. A copy of these risk warnings is available from the offices of Goldman Sachs International on request. Unless governing law permits otherwise, you must contact a Goldman Sachs entity in your home jurisdiction if you want to use Goldman Sachs & Partners Australia's or GS's services in effecting a transaction in the securities mentioned in this material.

European Union: Goldman Sachs International, authorised and regulated by the Financial Services Authority, has approved this research in connection with its distribution in the European Union and United Kingdom; Goldman, Sachs & Co. oHG, regulated by the Bundesanstalt fuer Finanzdienstleistungsaufsicht, may also be distributing research in Germany.

General Disclosures

This research is for clients only, as stated above. Other than disclosures relating to Goldman Sachs & Partners Australia this research is based on current public information that we consider reliable, but we do not represent it is accurate or complete, and it should not be relied on as such. We seek to update our research as appropriate, but various regulations may prevent us from doing so. Other than some industry reports published on a periodic basis, the large majority of reports are published at irregular intervals as appropriate in the analyst's judgment.

Goldman Sachs & Partners Australia and/or its affiliates conduct a global full-service, integrated corporate advisory and financing, investment management, and brokerage business. We have corporate advisory, corporate finance and other business relationships with a substantial percentage of the companies covered by our Investment Research Division.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients and our proprietary trading desks that reflect opinions that are contrary to the opinions expressed in this research. Our asset management area, our proprietary trading desks and investing businesses may make investment decisions that are inconsistent with the recommendations or views expressed in this research.

Goldman Sachs & Partners Australia and our affiliates, officers, directors, and employees, excluding equity analysts, will from time to time have long or short positions in, act as principal in, and buy or sell, the securities or derivatives (including options and warrants) thereof of covered companies referred to in this research.

This research is not an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Clients should consider whether any advice or recommendation in this research is suitable for their particular circumstances and, if appropriate, seek professional advice, including tax advice. The price and value of the investments referred to in this research and the income from them may fluctuate. Past performance is not a guide to future performance, future returns are not guaranteed, and a loss of original capital may occur. Certain transactions, including those involving futures, options, and other derivatives, give rise to substantial risk and are not suitable for all investors.

In producing research reports, members of Goldman Sachs & Partners Australia Investment Research may attend site visits and other meetings hosted by the issuers the subject of its research reports. In some instances the costs of such site visits or meetings may be met in part or in whole by the issuers concerned if Goldman Sachs & Partners Australia considers it is appropriate and reasonable in the specific circumstances relating to the site visit or meeting.

Our research is disseminated primarily electronically, and, in some cases, in printed form. Electronic research is simultaneously available to all clients. Disclosure information is also available at <http://www.gs.com.au/Disclosures> or from Research Compliance, Level 42, 1 Farrer Place Sydney NSW 2000.

Investment Adviser & Broker Disclosure Statement

The disclosure statement for Goldman Sachs & Partners New Zealand Limited and your adviser is available on request and free of charge. Please contact your adviser to obtain a copy.

Research Analyst Certification

Each equity and strategy research report excerpted herein was certified under Reg AC by the analyst primarily responsible for such report as follows: I, <Name of Analyst>, hereby certify that all of the views expressed in this report accurately reflect my personal views about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

Copyright 2010 Goldman Sachs & Partners Australia Pty Ltd ABN 21 006 797 897 AFSL 243346

No part of this material may be (i) copied, photocopied or duplicated in any form by any means or (ii) redistributed without the prior written consent of Goldman Sachs & Partners Australia.

Goldman Sachs is a registered trade mark of Goldman, Sachs & Co.

Australia - Research Recommendation Definitions

Sell (S)	Stock is expected to underperform the S&P/ASX 200 for 12 months
Hold (H)	Stock is expected to perform in line with the S&P/ASX 200 for 12 months
Buy (B)	Stock is expected to outperform the S&P/ASX 200 for 12 months

Other Definitions

NR	Not Rated. The investment rating has been suspended temporarily. Such suspension is in compliance with applicable regulations and/or Goldman Sachs & Partners Australia Pty Ltd ("GS&PA") policies in circumstances when GS&PA and/or, our New Zealand affiliate, Goldman Sachs & Partners New Zealand Limited ("GS&PNZ") is acting in an advisory capacity in a merger or strategic transaction involving the company and in certain other situations
CS	Coverage Suspended. GS&PA has suspended coverage of this company.
NC	Not Covered. GS&PA does not cover this company.

Target Price

Analysts set share price targets for individual companies based on a 12 month horizon. These share price targets are subject to a range of company specific and market risks. Target prices are based on a methodology chosen by the analyst as the best predictor of the share price over the 12 month horizon.

Research Criteria Definitions

The above recommendations are primarily determined with reference to the recommendation criteria outlined below. Analysts can introduce other factors when determining their recommendation, with any material factors stated in the written research where appropriate. Each criterion is clearly defined for the research team to ensure consistent consideration of the relevant criteria in an appropriate manner.

Industry Structure:	Based on GS&PA industry structure ranking. All industries relevant to the Australian equity market are ranked, based on a combination of Porter's Five Forces of industry structure as well as an industry's growth potential, relevant regulatory risk and probable technological risk. A company's specific ranking is based on the proportion of funds employed in particular industry segments, aggregated to determine an overall company rating, adjusted to reflect a view of the quality of a company's management team.
EVA™ Trend: ¹	EVA™ trend forecast for coming 2 years. Designed to reflect "turnaround stories" or to highlight companies GS&PA analysts believe will allocate capital poorly in the estimated timeframe.
Earnings Momentum:	The percentage change in the current consensus EPS estimate for the stock (year 1) over the consensus EPS estimate for the stock 3 months ago. Stocks are rated according to their relative rank, effectively making it a market relative measure.
Catalysts:	A qualitative and quantitative assessment of a company's long term catalysts that the analyst believes should be considered and possibly recognised by the market.
Price/Valuation:	The premium or discount to base case DCF valuation at which the stock is trading relative to the average premium or discount across the market.

For Insurers

ROE Trend:	ROE is used as a proxy for EVA™. Rating takes into account the expected level and trend of ROE over the next 2 years.
Balance Sheet:	Analyst's assessment of the quality and strength of the insurer's balance sheet, including conservatism of provisioning, sufficiency of capital, and quality of capital.

For REITs

Strategy:	Used instead of industry structure as many REIT investors are intra rather than inter sector focussed.
EPU Growth:	Ranking of Earnings Per Unit growth relative to other listed Real Estate Investment Trusts. Used instead of EVA™ Trend.
Yield:	Yield relative to the REIT sector average. Used instead of Earnings Momentum.

For NZ Companies

Relevant Index:	If a research report is published by our New Zealand affiliate, GS&PNZ, the recommendation of a company or trust is based on their performance relative to the NZSX 50 Index (Gross) and not the S&P/ASX 200 Index.
-----------------	---

¹ EVA™ is a registered trademark of the U.S. consultancy firm Stern Stewart

Distribution of Recommendations – as at 30 September 2010

Recommendation	Overall	Corporate relationship* in last 12 months
Sell	7%	0%
Hold	57%	58%
Buy	36%	42%

* No direct linkage with overall distribution as the latter relates to the full GS&PA/GS&PNZ coverage (>250 companies). The above table combines the corporate relationships and recommendations of both GS&PA and GS&PNZ.