

Challenge

An international, Australian-listed telecommunications carrier needed to explain a major change in corporate direction at the height of the global telecoms craze.

Solution

The annual report became a major communications tool for explaining the new strategy to the investment community and to business partners. It formed the basis for future corporate announcements.

Chairman's letter

Dear Shareholders,

Welcome to the second annual report of Davnet Limited and its associated companies (Davnet Group).

The consolidated operating profit after abnormal items and tax for the financial year 1999-2000 amounted to A\$41.9 million (1999: A\$(5.2 million)). Earnings per share were A\$.06 (1999: A\$(.02)).

Consolidated revenue grew to A\$40.1 million (1999: A\$1.8 million).

The results were positive and reflected the rapid investment in new markets and new products and services, particularly in the second part of the year.

Davnet's share price had a volatile year, going from A\$0.31 on 1st July 1999 to a peak of A\$5.99 on 29th March 2000. The stock price suffered during the correction that affected global technology stocks in April to May 2000. It is to be expected that in future the share price will more realistically reflect the full value of the Davnet business worldwide.

A significant feature of the Davnet Group as it begins the new financial year is the strength and experience of its senior management team. In July, Robert 'Hal' Turner, an experienced leader of international telecommunications companies, was appointed as Group Chief Operating Officer overseeing our global operations. He is working alongside Managing Director and Chief Executive Officer Stephen Moignard, who has taken direct responsibility for mergers and acquisitions, and new business development. Together they have formed a new 'Office of the CEO' to provide integrated guidance and leadership, supported by a strong international team. I am also pleased

to report that the Group has been fortunate to attract a range of other talented staff for individual markets and in corporate positions.

The rapid expansion of the Group has produced some changes to the board of directors. Bill Liao, one of the original directors, retired from the board at the end of the financial year. I would like to thank Bill for his immense contribution to the development of Davnet over the past two years. He was actively involved from the early days when Davnet was a small private concern to its present position as a publicly listed international organisation.

During the year, we welcomed new board members Jürg Walker, a significant investor in the Davnet Group and Brendan Brown, an investment banker by profession and a long-time advisor to the Group. In addition, Hal Turner joined the board.

On behalf of the board of directors, I would like to express my thanks to all our shareholders, customers, partners, and staff for their support in the past year. As you read this annual report, I'm sure you'll join with me in welcoming another exciting year for the Davnet Group which is now well placed to benefit from the expansion of global communications in the years to come.

The rapid expansion of the Group has produced dramatic changes... that make Davnet well placed to benefit from the expansion of global communications in the years to come.

Business review

Australia

Davnet Telecommunications

The flagship of the Davnet Group, Davnet Telecommunications Pty Limited (Davtel), has grown substantially in size and scope in the past 12 months. The most significant development was the strong partnership cemented in November 1999 with NTT Communications.

This vote of confidence propelled Davtel onto a new level and allowed for substantially faster growth. The scale of growth was dramatically illustrated by the increase in staff numbers from 91 in November 1999 to 165 at the end of the 2000 financial year.

One practical result of the Japanese investment was to give Davtel access to the NTT Communications Arcstar international network that covers more than 50 countries, with consequent capacity, speed and cost benefits that can be passed on to its Australian customers.

Towards the end of the year, the Australian business was restructured and consolidated. Subsidiaries Magna Data Australia Pty Limited, which provided aggregated Internet and data broadband services and Magna Systems Pty Limited, which specialized in systems integration, were brought under the Davtel umbrella. The positive outcome is that all aspects of the business, from building licensing, network roll-out, core engineering, network management, data collection, wholesaling and retailing are all now delivered under the 'Davnet' brand.

On an operational level, Davtel ended the financial year on target, having increased its Australian network with over 80 cabled and fully operational commercial buildings in Sydney, Melbourne, Brisbane and Perth.

Shortly after the end of the financial year, independent software consultant Open Telecommunications successfully completed interconnection tests to link Davnet's planned next-generation IP network with Telstra's conventional PSTN network. This paves the way for Davtel to launch its nation-wide carrier grade voice network scheduled before the end of 2000. This will provide Davnet customers with a low-cost, high-quality alternative to traditional telephone services provided by the incumbent carriers.

The 2001 financial year will be a year of further consolidation and continued strong organic growth with Davtel management firmly focused on revenue and earnings growth, industry-leading service standards and the implementation of improved business systems and procedures.

QAI

QAI Australia Limited (QAI), a majority-owned Davtel subsidiary, buys local, long-distance and international minutes from other carriers and resells them to customers along with support services. QAI's principal customers are small and medium-sized enterprises located outside Australia's main cities, a niche market.

Hobart-headquartered QAI manages nearly 25,000 customer voice circuits. Some 90 per cent of its customers are on the Australian mainland.

In its first full year as a member of the Davnet Group, QAI increased operating revenues from A\$17 million to A\$20 million, a 17.5% improvement. The customer base increased from about 6,500 to about 7,500.

Highlights

- NTT investment
- Consolidation under 'Davnet' name
- Expansion of Australian network and operations
- Completion of voice-over IP interconnection tests
- QAI increased revenue by 17.5 per cent
- QAI established mobile business and outsourced call center operations

Business review continued

Highlights

- Davnet acquires e-DataGroup, one of Australia's largest independent data business
- e-DataGroup wins major Australian federal government on-line contract
- Video applications added to Davnet's suite of services
- Successful international IP video link tested

In March, QAI expanded from fixed line to mobile business, via a CDMA mobile network.

QAI also moved into the outsourced call center business — a market estimated to be worth A\$1 billion per year in Australia. The business targets customers in major cities that have a short-or medium-term need for call center services. It provides outbound sales calls as well as handling inbound customer services.

e-DataGroup

Davnet acquired e-DataGroup Pty Limited in April 2000. The e-DataGroup specializes in information and data access, storage, and protection and management solutions. Before the acquisition, e-DataGroup was one of the largest independent data business in Australia serving top 500 corporations and federal and state government departments. The acquisition enables Davnet to offer value-added information and storage-related services to customers in Australia and across the global network.

Data storage is one of the fastest growing sectors in the information technology and telecommunications industries, with a 70% compound annual growth rate.

In August 2000, the e-DataGroup signed a contract with the Office of Government on-line as part of an Australian federal government initiative for all federal, state and local government departments to procure storage management software.

Smartvision

To further enhance Davnet's product offering, the Group acquired Smartvision (International) Pty Limited, a video applications service provider.

Established in 1998, Smartvision is a leader in video technologies through designing applications that deliver video conferencing, streaming, broadcasting and video monitoring over the Internet to customers' meeting rooms and desktops.

Demand for video solutions is growing rapidly, driven by global demand for broadband connectivity and the expectations of commercial customers for applications that enhance productivity, learning and new business efficiencies. The acquisition of Smartvision gives Davnet a unique advantage by being the first telecommunications company to integrate video terminals and applications as part of its core IP network.

During the year, Smartvision and Davnet engineers successfully tested delivering IP video conferencing between Davnet cabled buildings in Australia and Hong Kong. The results mean that Davnet is able to offer value-added video applications to its customers, including other telecommunications providers.

ASIA

Hong Kong

In its first full year of operations, Davnet Digitel Hong Kong Limited (Davnet Digitel) quickly established an active presence in Hong Kong. In September 1999, the company was appointed manager of Davnet Digitel Hong Kong partnership. Davnet has a 66% interest in the partnership.

By the end of June a broadband digital network was operating, supported by a Hong Kong data center.

A fiber backbone leasing arrangement with Hutchison Communications Limited was established early in January 2000.

By the end of the financial year, Davnet Digitel had cabled and operated in-building fiber-optic networks inside 14 office buildings, had licenses for an additional eleven, and was in final negotiations for a further nine building licenses. The total gross floor area of these buildings is more than 9 million square feet.

Investment will be made in building awareness of the Davnet products and services and the Group's expertise in delivering broadband solutions. In the first phase, Davnet Digitel will continue to expand core broadband service offerings, such as bandwidth-on-demand and data center operations. At the same time, on-line website creation and hosting, and turnkey application services will be developed and rolled out. Also, third-generation mobile services such as WAP-site facilitation and enablement will be marketed.

As elsewhere in the Davnet Group, customers will be encouraged to use new value-added products that require incremental bandwidth. These will include such services as IP-based virtual private networks, voice-over and fax-over IP products, video telephony and conferencing, unified messaging, video-on-demand and multicasting.

Singapore

Davnet Singapore Pty Limited (Davnet Singapore) was incorporated earlier this year as a wholly-owned subsidiary of the Davnet Group.

In March 2000, Davnet Singapore received one of five provisional facilities based operator licenses awarded by the Info-Comm Development Authority of Singapore, the country's telecommunications authority. In June, this was upgraded into a full license, valid for 15 years. The license allows the company to provide IP-based services in Singapore.

A few days before the end of the financial year, Davnet Singapore won approval to cable the five office towers in Suntec City, one of Singapore's largest commercial complexes with a total gross floor area of 2.3 million square feet. Cabling has been completed.

The growth strategy for Davnet Singapore will be similar to that in Hong Kong.

To provide better co-ordination and development between Hong Kong and Singapore, the Group's Asian operations were placed under the umbrella of 'Davnet Asia' in May 2000. The success of operations in Hong Kong and Singapore is important to paving the way for expansion elsewhere across Asia.

Highlights

- Hong Kong network and data center established
- Fiber leasing arrangement with Hutchinson Communications Limited in Hong Kong negotiated
- Davnet Singapore received one of five facilities based operator licenses

Business review continued

Highlights

- Ten-year access agreement with FiberNet
- New York's Chrysler building licensed and cabled; 39 others licensed
- Start-up in Canada
 - First licenses in Toronto obtained

NORTH AMERICA

USA

Davnet Inc, established in December 1999, is 88 per cent owned by Davnet Limited. By the end of the financial year, Davnet Inc had opened offices in Chicago and New York and employed 36 people.

In May 2000, Davnet Inc entered into a ten-year building and network access agreement with FiberNet, a carrier's carrier that designs, builds and operates metropolitan optical networks in major US cities.

The agreement gives Davnet Inc access to these networks and the ability to sell its services in FiberNet's licensed buildings. Davnet's Chicago operations center has the capability to remotely manage buildings and customers in other cities.

By working with FiberNet, Davnet Inc will be able to enter several markets very quickly and with minimal capital investment. As FiberNet moves into other US cities, Davnet Inc can follow, utilising its infrastructure.

Davnet Inc has signed, or is in the process of finalising, building access and access related agreements with over eight significant property owners, giving it potential access to over 400 buildings in up to 12 major cities in the US.

The principal strategy of Davnet Inc mirrors that of the rest of Group.

An additional factor that will drive Davnet's operations in US will be the rise and fall of the 'dot com' phenomenon. In the coming year, Davnet Inc has opportunities for acquisitions, agreements and other relationships from the shake out among

US-based 'dot coms'. Many of these firms offer innovative or sound business ideas, but are under-financed or poorly managed.

Davnet Canada Inc

In March 2000, Davnet Canada Inc was established to offer Davnet products and services to clients in major cities across Canada. Davnet Canada is a 100% owned subsidiary.

Davnet Canada aims to provide leading-edge broadband services on an IP platform and network architecture. It eventually expects to serve to more than 300 commercial buildings in five major cities. The first are being rolled out in Toronto. Vancouver and Calgary are expected to be served by January 2001, and Montreal and Ottawa later in 2001.

One of the attractive characteristics of the Canadian market is that eight companies own and manage a substantial majority of the country's commercial real estate. To date, Davnet Canada has commenced negotiations with five of the eight in order to secure access to their properties.

The focus will be on offering products that drive bandwidth in order to make Davnet the broadband provider of choice in Canada.