Letter to Shareholders

Dear Shareholder

Telstra yesterday released its half year results for financial year 2018, showing increased subscriber numbers on mobile and fixed, a reduction in underlying core fixed costs and progress being made under its strategic investment program.

On a reported basis, including the Ooyala impairment, total income was up 5.9 per cent, Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA) was down 2.5 per cent, net profit after tax (NPAT) was down 5.8 per cent and basic earnings per share (EPS) was down 3.4 per cent.

On a guidance basis total income was up 5.4 per cent and EBITDA was up 2.4 per cent.

As announced on 2 February 2018, we made a non-cash impairment of $273 million and written down the carrying value of Ooyala, our US-based intelligent video business, to zero.

Excluding this impairment NPAT was up 9.5 per cent and basic EPS was up 12.2 per cent.

The Board has resolved to pay a total fully franked interim dividend of 11 cents per share, comprising an interim ordinary dividend of 7.5 cents per share and an interim special dividend of 3.5 cents per share, consistent with our revised dividend policy and FY18 guidance.

The interim ordinary dividend represents a 71 per cent payout ratio on underlying earnings excluding impairment, and the interim special dividend a 58 per cent payout ratio on the net one-off nbn receipts in the half. The interim dividend, to be paid on 29 March 2018 will distribute $1.3 billion to shareholders.

We are operating within a significant period of change, including migration to the nbn, competitive challenges, accelerating pace of technological change and preparation for the transition to 5G. Within that environment, we are pleased to have delivered a solid result in line with guidance for this half.

We are in one of the most dynamic periods the company has faced and need to increase our level of intensity. We are stepping up how we aggressively compete in the market, particularly leveraging our multi-brand strategy including Telstra, Belong, Boost and Telstra Wholesale.

Our productivity program has delivered a 7.2 per cent reduction in core fixed costs for the half, more than offsetting inflation, higher power costs and reinvestment. While we announced increased targets in August, we will look to do even more, again increasing our focus on reducing costs.

This is critical against the background of the acceleration in the rollout of the nbn, which is having a material economic impact on us. Of the estimated $3 billion annual impact, to date we have cumulatively absorbed approximately $870 million of the negative impact to EBITDA from the nbn, including $370 million in the period.

The impact of the nbn, along with increased competition, highlights the importance of the up to $3 billion strategic investment program, and we are on track to deliver economic benefits from this of more than $500 million of EBITDA by FY21.

We will accelerate these investments to lay the foundation for future success, scrutinising every aspect of our capital spending to ensure our investments are driving the greatest results.

Progress on strategic investment program

Until the end of December, we had invested approximately $1.4 billion of additional capex, or approximately half of the up to $3 billion in its strategic investment program. This included $1.3 billion on networks and $100 million on digitisation.

We have upgraded our core backbone infrastructure in Australia to enable support of a five times increase in capacity to meet future customer demand and improved resilience. Our next generation optical transport network has already been deployed on routes between five capital cities.

During the half we switched on our Cat M1 Internet of Things (IoT) capability, which has the largest IoT coverage in the country at around three million square kilometres. We followed this in January with the launch of our Narrowband IoT capability, which is now available over our mobile network in major Australian cities and many regional towns.

We are now breaking through achieving 1Gbps theoretical speeds on 4G and gearing up for new speed milestones as we prepare for the rollout of 5G.

We are well advanced in our planning for 5G and last week announced a suite of activities over the next six months on the Gold Coast, as we opened our 5G Innovation Centre.

These investments continue to support industry leading mobile differentiation, coverage, speed and resiliency.

Our digitisation program is in its early stages, but we have already delivered some quick wins, with new capabilities implemented across the business, including improvements to its digital self-service channels, reducing call volumes.

Continuing to improve the customer experience

Our number one strategic objective remains to deliver brilliant customer experiences.

As a result of a number of improvements made in the half, including the benefits to date of our digitisation program, we have seen a reduction in the need for customers to call us, with calls down 13 per cent compared to last year. The number of active users of our 24x7 app also grew by 24 per cent in the half.

While these improvements are having a positive impact, as recognised by the movement in our Episode Net Promoter Score (NPS), we have much more to do to meet the standard of service our customers expect.

At the same time, we are in the middle of the biggest migration in our industry's history as customers switch to the nbn – it is an industry issue and we are doing our bit to work collaboratively with nbn co.

On speeds, we have recently increased our capacity further to deliver 80 per cent of the maximum speed during peak times, ahead of ACCC guidelines. On affordability, we are pleased nbn has recently introduced discounts on its 50/20 plans, which is a step in the right direction as it flows through to retail offers. We have responded by upgrading the nbn speeds offered on our most popular bundles and I am pleased to announce that we are in the process of bestowing 50/20 speeds to the majority of our nbn customers.

Strategic NPS was flat compared to the prior period. Episode NPS was up four points achieving the 3 – 6 point target improvement. Excluding nbn, Episode NPS was up six points. On a sequential basis Episode NPS improved one point while strategic NPS, which includes enterprise customers who are measured on a seasonal basis, was down six points.

Driving value and growth from the core

During the half we added 235,000 retail mobile services, including 130,000 postpaid handheld services of which 21,000 were Belong mobile. 118,000 wholesale mobile services were also added in the half. We have now increased our customer base in mobiles for 20 consecutive halves despite intense competitive pressures.

Mobile revenue was up 0.8 per cent on the prior corresponding period including net SIO add momentum and hardware growth. Mobile EBITDA margin declined by one percentage point on the prior corresponding period to 40 per cent due to postpaid handheld average revenue per user (ARPU) reduction and some one-offs.

We added 454,000 nbn connections, maintaining a 51 per cent market share, excluding satellite. About 57,000 retail bundled customers were added during the half, with one third of these bundles including an entertainment component.

Fixed voice and fixed data EBITDA margins declined to 38 and 17 per cent respectively, negatively affected by upfront costs of connecting customers to the nbn network, and rising network payments to nbn co.

We have taken steps to win fixed-line customers, including the launch of unlimited data on higher-end plans and doubling data on other plans.

We are Australia's leading aggregator of digital entertainment products across fixed and mobile and continue to differentiate our core products through content and entertainment with Foxtel and Telstra TV.

We added a 12 month subscription to Foxtel Now on our $99 and above Go Mobile Plus plans and a three month subscription on our $99 broadband bundle.

More than 1.5 million customers enjoyed watching Netball, NRL and AFL games through the Telstra Live Sports app last year. We are also adding to our digital assets and successfully secured the rights to live stream all AFL Women's matches on mobile and Telstra TV.

Customer take up of our Telstra TV has been pleasing with more than one million Telstra TV1 and TV2 devices in the market. We continue to innovate with voice activation among many other new features coming later this year.

Building new growth businesses closer to the core

Revenue in our Networks Applications and Services (NAS) business again saw strong growth, up 14.1 per cent.

While NAS revenue growth was strong, we did experience declines in EBITDA margin largely due to the timing of major contract milestones but we continue to expect mid-teens margins for this business at maturity.

Given the importance of IoT to future growth, we acquired MTData, an Australian-based company specialising in fleet management solutions for enterprise customers globally. This has helped bolster our IoT ecosystem and is a key pillar of our Connected Vehicle solution.

During the half we enhanced our cyber security services with the opening of two new Security Operations Centres in Melbourne and Sydney. We have plans to open a further Security Operations Centre this year in London.

Dividend Reinvestment Plan (DRP) to be recommenced

The Board suspended the DRP on 17 August 2017 with an intention to recommence when circumstances allowed. The Board has now resolved to recommence the DRP from the FY18 interim dividend with Friday 2 March 2018 being the election date for participation in the DRP by eligible shareholders. We expect shares allocated to participants under the DRP to be sourced through an on-market purchase and transfer of shares to participating shareholders.

All prior shareholder DRP elections are reinstated and will continue to apply until a shareholder changes their participation instructions. If an eligible shareholder wishes to update their participation instructions for the DRP, they should either login to their shareholder account at www.linkmarketservices.com.au/telstra or contact the Telstra Share Registry on 1300 88 66 77. The deadline for providing updated DRP instructions is 5pm, Friday 2 March 2018.

More information, including the applicable DRP Rules, is available to eligible shareholders at www.telstra.com/drp

Outlook

Telstra today reconfirmed FY18 guidance[1] consistent with its 1 December 2017 announcement. In FY18 Telstra expects income of $27.6 − $29.5 billion and EBITDA of $10.1 − $10.6 billion. Guidance for EBITDA is after absorbing incremental restructuring costs of $200 – $300 million to support its increased productivity.

$1.4 − $1.9 billion of EBITDA is expected to come from net one-off nbn Definitive Agreement receipts less nbn net cost to connect. Capital expenditure is expected to be between $4.4 − $4.8 billion or approximately 18 per cent capex to sales and free cashflow is expected to be in the range of $4.2 − $4.7 billion.

Telstra also reaffirmed it expects its FY18 total dividend[2] to be 22 cents per share fully franked including ordinary and special, in accordance with its dividend policy announced in August 2017.

We thank you for your continued support as a shareholder and welcome your feedback. This can be made at investor.relations@team.telstra.com, via phone on 1800 880 679 or in the mail to the Telstra Investor Relations Department, Level 28, 242 Exhibition Street, Melbourne VIC 3000.

John P Mullen
Chairman

Andrew R Penn
CEO and Managing Director
16 February 2018

[1] This guidance assumes wholesale product price stability and no impairments to investments, and excludes any proceeds on the sale of businesses, mergers and acquisitions and purchase of spectrum. The guidance also assumes the nbn™ rollout is broadly in accordance with the nbn Corporate Plan 2018 adjusted for a cease sale on hybrid fibre co-axial (HFC) technology for six to nine months from 11 December 2017. Capex excludes externally funded capex.

[2] Return subject to no unexpected material events, assumes the nbn rollout is broadly in accordance with the nbn Corporate Plan 2018 adjusted for a cease sale on hybrid fibre co-axial (HFC) technology for six to nine months from 11 December 2017 and receipt of associated one-offs, and is subject to Board discretion having regard to financial and market conditions, business needs and maintenance of financial strength and flexibility consistent with Telstra's capital management framework.