

# Letter to Shareholders

Dear Shareholders,

In 2017 technology and innovation continued to transform industries, businesses and the way in which we live our daily lives. This transformation is particularly significant for Telstra as the traditional worlds of telecommunications and computing are converging, as are many other technologies.

During a time of change, we continue to put the customer at the heart of everything we do and we have seen continued strong customer growth across all key segments of our business.



Andrew Penn (CEO), John Mullen (Chairman)

## Our financial performance

Our strong performance in the context of a highly competitive and dynamic market enabled us to increase Total Income, EBITDA and NPAT. On a reported basis from continuing operations, Total Income<sup>1</sup> increased by 4.3 per cent to \$28.2 billion and EBITDA increased 2.0 per cent to \$10.7 billion. On a guidance<sup>2</sup> basis we increased Total Income<sup>1</sup> by 4.3 per cent and EBITDA by 4.5 per cent. Excluding the proceeds from the FY16 sale of Autohome, NPAT increased 1.1 per cent on a reported basis from continuing operations.

The Board announced a fully franked final dividend of 15.5 cents per share, bringing the total dividend for the financial year to 31.0 cents per share.<sup>3</sup> Combined with the \$1.5 billion on and off market share buy-backs completed during the year, we returned \$5.2 billion to shareholders in FY17.

We also announced the outcome of the capital allocation review that commenced in November 2016. This included a change to our dividend policy<sup>4</sup> to reduce the payout ratio to 70-90 per cent of our underlying earnings<sup>5</sup>, to return in the order of 75 per cent of net one off nbn<sup>TM</sup> receipts<sup>6</sup> to shareholders over time via fully-franked special dividends, a new capital management framework and plans to monetise a portion of locked-in recurring nbn receipts (see breakout box for further details).

## An evolving market

We believe we have the right vision and strategy for the dynamic environment in which we operate. Our vision is to become a world class technology company that empowers people to connect.

During the year we refined our strategy with our three pillars now being:

- to deliver brilliant customer experiences,
- drive value and growth from our core, and
- build new growth businesses close to the core.

The changes to our strategy were not major, however they send an important signal that we will be very focused on delivering customer experience improvements and disciplined in how we invest in our networks, services and growth businesses.

Our highest priority remains improving customer experience and we are pleased that our key customer measure, our Net Promoter Score, recovered strongly in the second half of the year. While we have made progress on improving customer experience, we recognise there is more to be achieved.

We saw continued customer growth across key segments, with retail mobile net adds of 218,000, including 169,000 postpaid handheld net adds, and 132,000 domestic retail fixed broadband customers. nbn connections grew by 676,000 to 1,176,000 bringing total market share to 52 per cent (ex-satellite).

Almost 90 per cent of our retail fixed broadband customers are now on a bundle, with 224,000 adds on the back of the popular 'Best Bundle Ever' and 'Hottest Entertainment Bundle'.

Access to the best content is critically important to us as demand for media continues to grow. At the same time the media market is changing with new participants and increased competition. We remain committed to Foxtel and we continue discussions with our partner News Corp regarding the best arrangements and structure to support Foxtel's success into the future.

In an evolving market, we are seeing new entrants into the both mobile and fixed markets as well as pricing pressure in all sectors through price reductions, value enhancements and increased data allowances. Digital disruption is continuing to accelerate, not just for us but also for our customers, and we are entering a significant point in the transformation of the telecommunications market with the nbn rollout reaching scale.

These changes confirm why we must increase the speed of our transformation. It is for this reason that last year we announced during FY17 our intention to invest up to \$3 billion in additional capital expenditure over the next three years to achieve a further step change in our strategic positioning. This is in addition to our usual capital spend and takes our expected total capital investment including spectrum over the three years to FY19 to more than \$15 billion. To date we have focused the program predominantly on the network and have invested around \$750 million since November 2016.

In FY17 we reduced our underlying fixed costs by \$244 million, consistent with our announcement in November 2016 that we would achieve at least \$1 billion in productivity by FY21. We intend to accelerate our efforts to reduce costs even further over the next five years, bringing forward our \$1 billion net productivity target by one year to FY20. We have increased our target by a further \$500 million in cost savings and we plan to deliver more than \$1.5 billion in net productivity by FY22. As previously advised, we expect the benefits to accrue roughly equally over the life of the program.

For more detailed discussion of the progress we are making to deliver on our purpose, vision and strategy please refer to the Strategy and Performance section of our *Financial Results and Directors' Report for the year ended 30 June 2017* available on the financial results page of [telstra.com/investor](http://telstra.com/investor).

### Building world-class culture and capability

The culture and capability of our workforce is an essential part of delivering our vision to be a world class technology company that empowers people to connect. More than 32,000 talented employees working in over 20 countries contribute to our success.

Our efforts to further build a world class workforce in FY17 included a number of changes to our Senior Management team and the roles they play. We also announced a number of structural changes to bring some of our most important growth activities closer to the rest of the business to maintain our support and align them with their most relevant channel to market as they mature. These changes are designed to help us fully realise the long-term value these opportunities represent.

The Board has reviewed the current CEO and Group Executive remuneration structures, in particular the current long-term incentive plan structure. A new Executive Variable Remuneration Plan will be implemented for FY18 which combines our existing short-term and long-term incentive arrangements into a simplified variable incentive that drives performance against customer experience and financial metrics, creating long-term shareholder value. Further information can be found in our Remuneration Report available in our *Financial Results and Directors' Report for the year ended 30 June 2017* on the financial results page of [telstra.com/investor](http://telstra.com/investor).

We also saw changes at the Board level, farewelling Chin Hu Lim who retired at the conclusion of our AGM in October 2016, and welcomed Jane Hemstritch.

### Our commitment to gender equality

We remain committed to gender equality across our company. In 2017 we introduced a Global Recruitment Equality Procedure which requires recruitment and interview shortlists for all roles to include at least 50 per cent female representation. This applies to all current open roles and all new jobs, except in some specified roles where a 25 per cent requirement applies due to a known significant gender imbalance in the job market. For the third year running, Telstra also received the Employer of Choice for Gender Equality citation from the Workplace Gender Equality Agency (WGEA).

For FY18, the Board's diversity objective is that there will be at least four women on the Board, representing a female gender representation among non-executive Directors of at least 40 per cent, recognising that the level of gender diversity of the Board may be temporarily affected during periods of Board renewal.

### Delivering on our purpose, sustainably

In our increasingly connected world, digital technology is disrupting traditional operating models and helping society respond to major issues in a more agile and scalable way, from managing the impacts of climate change to making healthcare and education more universally accessible. That is why we have a multi-year vision for a more holistic approach to sustainability that informs and integrates all of our business activities.

Our sustainability efforts are focused on the issues that are most material for our business, the areas in which we have the expertise to make a meaningful impact, and where we see opportunities to use innovative, tech-based solutions to help address major societal challenges and opportunities. Our Bigger Picture 2017 Sustainability Report will detail the progress we are making. Highlights for FY17 include reaching more than 63,000 people through our digital literacy programs and our employees undertaking more than 8,900 volunteering days in the community.

### Regional, rural and remote communities

We remain deeply committed to customers living in every part of Australia. Over the past 10 years, approximately 15 per cent of our investment in our mobile network has gone to provide services to the most remote 2 per cent of the population. In FY17 we announced plans that could result in up to \$1 billion of investment and co-investment over the next five years, as we work to provide improved and expanded mobile coverage and high-speed mobile internet to regional communities. This kind of investment is delivering real benefits to customers. For example our 4G mobile network now reaches 99 per cent of the Australian population.

More work is needed to deliver the future that regional communities deserve. However, our investments are already building a bridge that regional communities can use to access knowledge, markets and services that may have previously been out of reach. Greater connectivity also enables greater innovation which is critical for the people and communities of regional Australia.

We welcomed the Australian Competition and Consumer Commission's draft decision not to declare wholesale domestic mobile roaming. This was the right decision for the people, businesses and communities of regional Australia because it ensures the industry still has the incentives to invest.

## The year ahead

Our business continues to experience changes driven by market developments, technological innovation and the continued evolution of our customers' needs and expectations. A revision of our Capital Management Framework including our Dividend Policy positions us to succeed in this changing environment.

In FY18 Telstra expects Income in the range of \$28.3 to \$30.2 billion and EBITDA of \$10.7 to \$11.2 billion. Guidance for EBITDA is after absorbing incremental restructuring costs of \$200 – \$300 million to support our increased productivity. \$2 – \$2.5 billion of this 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 \$4.4 – \$4.9 billion.

Telstra expects total dividends in respect of FY18 to be 22 cents per share fully-franked, including both ordinary and special dividends.<sup>4</sup>

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.

## Retail shareholder information meetings

In September, we are pleased to host a series of retail shareholder information meetings around the country with our senior executives. This year, meetings will be held in Sydney, Brisbane, Adelaide and Perth. The Sydney meeting will also be webcast live for shareholders to view online and further details can be found in the attached flyer. Our Annual General Meeting will be held on Tuesday 17 October 2017 in Melbourne and we look forward to sending you our Notice of Meeting in the coming weeks.

We thank you for your loyalty as a shareholder and if you have any enquiries or feedback, please email [investor.relations@team.telstra.com](mailto:investor.relations@team.telstra.com). Alternatively you can call 1800 880 679 (within Australia), or write to Telstra Investor Relations Department, Level 28, 242 Exhibition Street, Melbourne, VIC 3000.

The guidance also assumes the nbn rollout is broadly in accordance with the nbn Corporate Plan 2017. Capex excludes externally funded capex.

Our success is reliant upon the hard work and dedication of our employees. We thank the Telstra team for continued efforts to deliver brilliant experiences to our customers and their ongoing support for our strategy.

We believe our vision remains the right vision and our strategy the right way to achieve this. We have progressed significantly over the last two years and we look forward to continuing to deliver on our strategy.



John P Mullen,  
Chairman



Andrew R Penn,  
CEO and Managing Director

17 August 2017

1. Excluding finance income.
2. This guidance assumed wholesale product price stability and no impairments to investments, and excluded any proceeds on the sale of businesses, mergers and acquisitions and purchase of spectrum. The guidance also assumed the nbn rollout was in accordance with the nbn Corporate Plan 2016. Capex to sales guidance excluded externally funded capex. Guidance excluded the Ooyala impairment in FY16 and restructuring costs in FY17.
3. For the reasons explained below – see Capital Allocation Strategy Review, Telstra has suspended the Dividend Reinvestment Plan. Our intention is to reinstate it when circumstances allow.
4. Return subject to no unexpected material events, assumes the nbn rollout is broadly in accordance with the nbn Corporate Plan 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.
5. "underlying earnings" is defined as NPAT from continuing operations excluding net one-off nbn receipts (as defined in footnote 6 below).
6. "net one-off nbn receipts" is defined as net nbn one off Definitive Agreement receipts (consisting of PSAA, Infrastructure Ownership and Retraining) less nbn net cost to connect less tax.

## Capital Allocation Strategy review

### On 17 August 2017, we announced the outcomes of the Capital Allocation Strategy review that commenced in November 2016.

The review examined Telstra's balance sheet structure and settings, longer term capex requirements, investment decisions including M&A, returns to shareholders including dividends, buy-backs and other forms of returns, and the best way to manage receipts from the nbn.

We have consulted extensively with shareholders and other stakeholders during this review and the overwhelming and consistent feedback has been that planning for the longer term and retaining financial flexibility is a priority. This includes the importance of retaining a strong balance sheet through the nbn transition period and in light of the increased competitive dynamics and digital disruption.

The outcomes of the capital allocation strategy review are:

- a potential monetisation of a portion of locked-in recurring nbn receipts, subject to legal documentation and satisfaction of certain conditions;
- a revised capital management framework focused on maintaining tight fiscal discipline, maximising returns for shareholders, maintaining financial strength and retaining financial flexibility for investment in the future; and
- a new dividend policy to more closely align ordinary dividends to underlying earnings, and to return in the order of 75 per cent of net one-off nbn receipts<sup>6</sup> to shareholders over time through special dividends.

#### Potential monetisation of recurring nbn receipts

At our Investor Day in November 2016 we said we would look at ways to crystallise value from recurring nbn™ receipts for key infrastructure and today announced a potential plan to monetise a proportion of these receipts.

Recurring receipts for access to our extensive infrastructure are expected to grow to just under \$1 billion annually by the end of the nbn migration period.

If we were to proceed with these plans, it would involve approximately 40 per cent of the total long-term recurring nbn receipts that are ultimately expected, representing locked in receipts for dark fibre and exchanges.

The scale of the proposed transaction is approximately \$5 – \$5.5 billion, with Telstra to retain some equity interest.<sup>7</sup> Our intention would be to use the proceeds to reduce debt by around \$1 billion, with the balance to support a capital management program to enhance shareholder returns, most likely through a series of on and off market buy-backs.

The proposed transaction is subject to agreement and a number of steps including approvals and consents from investors, the Government and nbn co.

We are currently in discussions regarding these matters. We cannot confirm whether they will be achieved but we will update the market in due course.

#### Dividend Reinvestment Plan

Given the ongoing discussions with nbn co and Government on the potential monetisation of a proportion of the recurring nbn receipts, in order for Telstra to manage its ongoing continuous disclosure obligations, Telstra has suspended the Dividend Reinvestment Plan with an intent to reinstate it when circumstances allow.

#### Capital Management Framework

The objectives of the revised capital management framework remain the same as those communicated to the market in 2012, including maintaining Telstra's tight fiscal discipline, maximising returns for shareholders, maintaining financial strength and retaining financial flexibility.

As a result of the capital allocation strategy review some of the principles supporting these objectives have changed. The new principles are to:

- maintain balance sheet settings consistent with an A band credit rating;
- pay a fully-franked ordinary dividend of 70-90 per cent of underlying earnings;<sup>4,5</sup>
- target capex/sales ratio of ~14 per cent excluding spectrum from FY20; and,
- maintain flexibility for portfolio management and to make strategic investments.

#### Dividend Policy

The new dividend policy supports the objectives of the capital management framework and is consistent with shareholder feedback to maintain a strong balance sheet and flexibility to manage the business and invest, especially during the nbn transition.

The new dividend policy, which will commence after the payment of the final dividend for 2017 financial year, moves us away from a historical practice of paying out almost 100 per cent of profits. From FY18 we will adopt an ordinary dividend payout ratio of 70 – 90 per cent of underlying earnings<sup>5</sup>, which is more in line with global peers and local large companies.

In addition to the ordinary dividend, we intend to return in the order of 75 per cent of net one-off nbn receipts<sup>6</sup> to shareholders over time via fully franked special dividends. We believe this is appropriate given one-off income is akin to compensation for an asset sale over a number of years and aligns with market feedback and expectations that these receipts are returned to shareholders.

With the implementation of this new dividend policy, we expect total dividends in respect of FY18 to be 22 cents per share fully franked, including both ordinary and special dividends<sup>4</sup>, excluding any returns to shareholders from potential nbn monetisation.

In adjusting the capital management framework and resetting the dividend policy we have balanced the importance of providing consistent returns to shareholders with the long term sustainability of returns and strategic direction of the company.

We realise this is a material reduction from the historic level of our dividend reflecting the lower payout ratio. We do not underestimate the impact of this on our shareholders. It is for this reason we are providing advance notice of this change and why the Board has maintained a 31 cents per share dividend this year.

These are important changes to Telstra's approach to capital management and appropriate in the context of our strategic transformation. This is about setting the business up for success in the future.

7. It is anticipated Telstra would retain approximately 25 per cent of the equity component of the transaction.



# 2017 Telstra Retail Shareholder Information Meetings



Telstra invites you to participate in one of our retail shareholder information meetings.

Live Presentations			
Date	Local time	Location	Presenters
Mon 18 Sep	2.00pm	Wesley Conference Centre 220 Pitt St, <b>Sydney</b>	Andrew Penn, Chief Executive Officer Warwick Bray, Chief Financial Officer
Tues 19 Sep	10.30am	Hilton Hotel 190 Elizabeth St, <b>Brisbane</b>	Warwick Bray, Chief Financial Officer Tony Warren, Group Executive – Corporate Affairs
Wed 20 Sep	10.30am	Crowne Plaza 16 Hindmarsh Sq, <b>Adelaide</b>	Will Irving, Group Executive – Telstra Wholesale Ewen Stafford, Deputy Chief Financial Officer
Fri 22 Sep	10.30am	Parmelia Hilton Hotel 14 Mill St, <b>Perth</b>	Brendon Riley, Group Executive – Telstra Enterprise Janet Barnes, Director – Telstra Country Wide

For those shareholders unable to attend a meeting, the Sydney event will be webcast live online. There is no need to register for the webcast. Please visit our website prior to 2pm on Monday 18 September at [www.telstra.com.au/shareholdermeetings](http://www.telstra.com.au/shareholdermeetings)

#### Please register at your location

Dial: 1800 131 011 and follow the prompts or email: [shareholder.meetings@team.telstra.com](mailto:shareholder.meetings@team.telstra.com)

Visit our website for more information at [www.telstra.com.au/shareholdermeetings](http://www.telstra.com.au/shareholdermeetings)