

Ben Spincer: Good morning, everyone. My name is Ben Spincer, Director of Investor Relations at Telstra. I'd like to welcome you to this investor update, those of you here in the room, in Sydney; also those on the phone and watching on the webcast.

I'll hand over to David in a moment - maybe after I've just run through the obligatory disclaimer slide that you can all read. Just a very, very quick overview for you this morning on where we're going, what we're going to try and do with the break outs...

[Break in audio – technical difficulty]

I'll come back after Q&A and remind you where to get to the rooms. You've all got a number on your badges, so we can try and manage the numbers in each of those breakout sessions. For those with number 1 on the badge, we'd like you to start with Tony Warren.

Those with a number 2, we'd like you to start with Stuart [Lee] over in the far corner. Those with a number 3, with Gordon [Ballantyne] in the lab, which is just down here. I'll come back and remind you of that towards the end of Q&A.

That's probably enough from me this morning, so I'll hand over to David Thodey. Thank you.

David Thodey: Thanks, Ben. Let me just add my welcome to you all; great to see you here. A special welcome to my new colleague, Andy Penn, who's now part of the team, and great to have him on board.

Look, there's two things as Ben said we're going to talk to. Firstly, is capital management strategy and I know you've been waiting a while for that, but we're very pleased to take you through our thinking on this because it has been something that's been preoccupying us for a good few months, and we're going to give you some colour on that. Andy's going to take you through that.

Then, secondly - just on the NBN, the various aspects of the NBN; what it's going to mean to the business, wholesale, retail. Also Tony's going to take you through some of the contractual slides as well, so it's great.

Look, before I go any further - just to make sure there's no doubt - I'm pleased to say there's no change to guidance for the year. I just wanted to get that one out of the way so I don't need to talk about forecasts for the rest of the year.

Just in terms of the two things - capital management strategy is an area that does take a lot of work because there's so many different variables with it; but what we'll take you through of our strategy are the core principles that are going to drive our decision making and a framework.

The reason that it's so important is the alignment between the Board and management - and remember, you've got all our organic growth that we do every year - \$3.5 billion we're just investing, and there's other things we're going to do over the next three years. So I want to give you a good sense of that. Andy's going to take you through that in quite a bit of detail.

Then, of course, it's what you're dealing with. We are going to conserve - you would have probably seen in the ASX release - that we expect to have \$2 billion to \$3 billion of excess free cash over the next three years. So it does give us optionality, going forward. You've got to be clear that this is dependent on the NBN rollout and, of course, market conditions; but it is very pleasing, after three years of - it is nearly three years - of, pretty much, intense negotiations to get these agreements behind us, and we can get on with life and really run the business.

So that's all behind us, and now it's about how we really take this business to a whole new level.

So, as Ben took you through, Tony is going to go through the contracts. So I know you've probably seen this before, but it is important to understand the various contracts we have. Now it was in the EM but we think it's important to take you through, just step by step, what's in them.

Stuart will give you an insight into our Wholesale Business. Now, remember, the Wholesale Business has been primarily about regulated products; but in an NBN world it goes through a lot of change, and it really becomes a channel to market for us. So Stuart is going to try and give you some colour of the thinking we have in that area.

Then, of course, we've got how we're going to really go to market in an NBN world, what's going to happen, how we're going to do it. Gratefully, Gordon Ballantyne is here - the Chief Customer Officer - and also we've got Jenny and Brian, who have been critical parts of this.

Jenny's been driving the NBN transition market - that's Jenny Young - and Brian Harcourt, who's our Executive Director of all our Wireline products. He's going to give you a bit of insight of how we see the products portfolio changing, how we're going to really take the Business forward as we look into the NBN world.

So we want to give you a bit of a sense of it but, obviously, it's going to be a very competitive market. So one of the things that we've - Telstra have always tried - people want a lot of information from us. We're very conscious it's going to be a competitive market, so we'll give you what we can; maybe not everything.

I did want to say that we are working well with the NBN Co, and that's a very important relationship as we go forward. NBN will become our largest customer, and we'll be their largest customer as well. So working very well with the team; lots of things to work through because,

remember, we're being a constructor; we're also being a customer, and now a customer, so it's an evolving area; but it is an important relationship for us.

I did want to say right at the outset, the transit build - remember, this is the interconnection with the POIs - is going very well. Remember, that's the bit we've got a - that Infrastructure Services Agreement, and we've got to get all the backhaul connected to the POIs. So that's going well.

So I hope that after you've seen all this you'll get a sense that we are well prepared to compete and to serve our customers, which is going to be so critical as we go forward.

It is going to be street by street, house by house, person by person. So it's going to be a big 10 year program, and we are confident and looking forward to it. It's a very important move for Telstra about how we see that. Is it a threat or an opportunity? Let me say, we see it now as an opportunity because that's what we've got to really drive forward.

So I did want to stress a few things by way of introduction. The first thing is that this does fit within our core strategic priority focus areas. Remember, that is still this unyielding focus on customer service. I can't stress how important that is - not for our present - because it's good business. We've still got lots to do there, but we're on the way.

Continuing to retain and grow our customers, critically important, and, of course, the simplification of the Business is critically important because that's how we take costs out, that's how we're going to drive the better customer experience. In a company like Telstra there's lots of moving parts that we've got to keep focusing on and driving change in; then, of course, finding new growth opportunities.

So let me just give you a little bit of a picture of how NBN fits into that. So in terms of engaging with our customers, what we're very focused on is the transition experience as you move from copper to fibre. This is not easy, and it's something that we've really got to get right. So we're going to hear a little bit more about that in the breakout sessions.

Also how, in the new world of NBN and mobility, does this work together? We've done a lot of work in how we can actually enhance those products and provide a compelling customer experience between fixed broadband and mobility and use that as a differentiator; because if we can get that right, I think it will give us some real competitive advantage as we go forward; and, of course, this is about increasing value to our customers.

In terms of the NBN how can we use the NBN transition to simplify the Business. You see, the copper business is a very complicated business. It's been around for a long time. So if we can start to redesign the Business around the fibre world - with us being an access seeker - it actually gives us a great opportunity to simplify and take costs out; so it's a big part of reducing complexity in the Business.

Then, of course, how will the NBN allow us to go into new business opportunities? Of course, what people forget about that is that NBN creates new opportunities, some of which we've talked about before - applications and services, for example - or how cloud computing will provide a greater opportunity in the NBN world. So you've got to look at the opportunities as well as all the structural change. Of course, our media assets are very important with that. We've got a strong differentiation platform within that.

We're also pleased that the FOXTEL undertakings were accepted by the ACCC, and the AUSTAR FOXTEL merger was approved by the courts just last week, so it will be good to get that behind us; be able to give us some opportunities as we forward. So that's why the focus is - hopefully, if we execute well, we'll really fit in well as we move into the NBN world.

Another very important thing - it's a little bit technical, but I do want to just stress - because when you're running a telecommunications company network technology is very important. If you get a mis-step on technology it can really impact your business.

I want to make the point that everything in the NBN is about an acceleration of a trend or a direction we already knew about, not a significant change. You see, we've known about these changes for years. When you talk about voice-to-data, you talk about dumb pipes to intelligent networks. All that the NBN does is to accelerate a trend that we've always known was going to happen. Let me just briefly touch on a few things. It's a little bit technical, but I think it will give you some colour.

When you talk about an all data world, what that means is everything goes digital. Your voice used to be analogue; it goes digital. That's not new. I was going through some old papers the other day of Frank Blount's, who some of you would remember Frank. It was a strategy paper from 1995. Now, this may show how we don't always get our forecasts right, but we expected PSTN to have gone away by 2010.

So this is a trend we've always seen, but the acceleration of the trend was something like an inflection point with NBN growth is just all that's happening, not a new thing that we had necessarily not anticipated. We'd be very pleased that PSTN had stayed around for a long time, and we think it will be around for a lot longer as well.

Also, the rise in demand for high-speed broadband is nothing new. Every year we're just seeing this grow and grow and grow. It also has an impact on our capital expenditure, both the cost of copper and wireless, so we don't see this demand abating in any way at all.

Also, we've seen the growth in video traffic, be it on-demand video or even just people using YouTube and the incredible way that users deliver on the Internet via video. That has a significant impact on how you design your networks, which we've been working on now for - in my time, even the last eight to nine years.

The move towards bundling has been something we have very consciously moved to, and this is about moving from access and usage to a bundled product. That's a trend that we are very conscious about moving faster, because that's what happens in an NBN world by default. It's nothing new.

Also, the growth of these new applications like cloud services. Remember, last year we announced a significant investment in cloud services, which is all about preparing us for this new world, because you do need very rich and broad pipes to be able to provide cloud services. And, of course, this move which we call from being a network service provider to application service provider.

I won't go through it too much, but this is very important. Not concentrating on layer one, layer two networks, but about what you do with it and how you use it to create value. You refer to it as over-the-top players, we refer to it as applications and putting new things down the pipe to create value for shareholders.

These are all trends we've known about, but the NBN allows us to take advantage of the acceleration, and so in some ways you could say NBN is about realising our dreams, but we're actually getting paid to exit the copper and go to fibre. So in one way, it's quite good.

So that's just in terms of the directions, and in terms of just being ready for NBN, we've had enough time to really think about how do we compete effectively and efficiently in an NBN world? This is really important, and that will be our differentiator in an NBN world. We're going to give a little bit of an insight into that today, but let me just sort of take you through just the highlights.

Firstly, this customer transition is very important. How do you give a good experience to the customer as they transit from the copper to the fibre. Really important. I'll mention some experiences we've had in a moment on that. The product portfolio does change, and how do we build a product that will give some unique features and differentiation as we go forward.

Obviously our sales and marketing - you've heard me talk about us becoming a sales and marketing-oriented company. Still great engineering experts, but really moving to be really a consumer marketing company is going to be very important, and also leveraging that great engineering expertise we have right across Australia, touching every city in Australia. So we see it as an opportunity as we go forward.

Now, we were just up in Brisbane this week with the Board. We went out to the South Brisbane exchange. Now, some of you know this. This is where the Children's Hospital is being built, and because it's being built over an exchange we built in 1920, we had the opportunity to move it from copper to fibre.

Every street, every house is being moved from copper to fibre, and it's a fascinating area, because you've got a wide socio-economic group, you've got a lot of multi-dwelling units, you've got a lot of small businesses, some large businesses, you've got the big conference centre there as well, on the river, and it's just been a fascinating experience to actually go through with the customer the physical experience of moving from copper to fibre, and all the different products we have out there today as we think about ISDN or if someone's already got a different - what type of CPE they've got in a small business. There are a lot of complications you've got to work through.

As I said, it's been a great experience. We've now got 5,000 customers across, and also a large number of wholesale customers across as well. So that's given us some great learnings and insights that I think positions us well as we go forward, but Gordon Ballantyne will take you through that as well. So bearing forward, we're very focused on where we need to be next year and the year after, because that's where the game will go.

The other key thing is around shareholder protection. Now, I know that you'll probably have some questions on this as we go forward, but one of the things, as John and I went to the negotiation process, we were - everything we looked at, it was either about protecting or enhancing shareholder value, and that was all that we were concerned with.

Now, I know you've heard me say that before, but I can tell you even more so, it was everything we did. We've always assumed, in a project like this, a 10-year project, incredibly complicated, enormous scope, every project we touch in Telstra, it changes. The changes will be either technology, legislation, competition policy, or there'll be a change of political persuasion.

So everything we looked at, we assumed it would change, because that's the only way you can negotiate these long-term contracts, especially in an industry like ours, and many of you would understand that. So we knew that we had to negotiate a contract that would give us enough flexibility and protection for shareholders as we go forward.

Tony's going to take you through that in more detail so you can get a real sense of it, but there were four key things. The long-term contractual commitments to the infrastructure are really important. We didn't want to build something that they could say thank you very much, we don't need it anymore. So that contract was very, very important. If the roll-out ceased, we wanted to make sure we were going to get the returns for shareholders.

Now, the other thing is they roll out the fibre past homes to 20 per cent, and the \$500 million - that's 20 per cent of homes, then we get a \$500 million penalty payment, which rolls down as they roll out across the rest of the country. Thirdly, there was this protection against automatic termination of the government packages. That was very important, because remember, there's

a lot of legislature change in here, and we wanted to be very careful that we could manage through that.

Then the other key thing, which is this term we use, the natural hedge, is that if it did stop, that we could retain the copper. Remember, retaining the copper's not a bad option either. If we got the copper, that's pretty good. So we'd either get copper [unclear] or we'd get the long-run return on the copper network. So we believe we're in a good position, a strong position, in respect of any technology, legislative, or governmental changes going forth.

So let me just summarise before I pass to Andy, who's going to take you through the capital management strategy and framework. First of all, he's going to take you through the capital management strategy, and then he's going to give you some good foresight in terms of how we're going to approach capital going forward. We do expect to generate excess free-cash around \$2 billion to \$3 billion, subject to the NBN roll-out.

The NBN roll-out does fit within our existing strategy, and in fact accelerates trends that we've always known about, so it's nothing new. The NBN is going to create new opportunities for us that we're already working on and we think are quite exciting. We're working well with NBN Co. It's not always possible to do, but we're working well with them, we're going to support them, and we're ready to go out there and really compete.

So with that, let me throw over to Andy. Andy, it's great to have you here, and come on up and then we'll come back to Q&A. So thanks very much.

Andy Penn: Thanks very much David. It is a real pleasure to be here in my first official capacity, I guess, as the Chief Financial Officer of Telstra. Now, I know that a good number of you in the room will already know me from my previous role at AXA, but for those of you that don't, I'm very much looking forward to getting to meet you over the next few weeks and months as I settle in.

I commenced at Telstra on 1 March, and I obviously come from a very different background, but I guess I wanted to share with you really three reasons why it was important for me to join Telstra. Firstly, this is a fascinating and exciting industry, which really sits at the very heart of the technological revolution that's basically impacting every one of us in this room today. It really is quite remarkable, and inevitably, of course, that rate of change throws up challenges for us as an organisation.

I believe that Telstra really is uniquely positioned through both its financial resources, its absolute commitment on the customer, and its capabilities, to really take advantage of the opportunities that that presents. So for me, this is a really exciting change. It's a new industry, and not with - the second reason is notwithstanding the fact that I don't come from a telecommunications background, I guess I humbly hope that I am in a position to make a contribution.

I come from a background of a lot of international experience, regional experience, and Australian experience, and whilst I come from a different industry, I come from a very complex industry in a highly regulated environment, and I think there's a lot of parallels there. Of course, also an industry where there's a very strong financial content, both in my previous roles as a Chief Executive and Chief Financial Officer of AXA. So I hope that I can make a contribution to David and the senior team in what is a very exciting journey.

I think thirdly and finally, for me, David and the team's compelling commitment to put the customer at the heart of everything Telstra does. I know that you hear this from a lot of companies, I know it can be said quite glibly, but it's been one of the most compelling reasons that I joined Telstra.

In my six weeks at Telstra, I can assure you that it does live and breathe in every meeting, in every engagement that we have, and to me, it really is one of the most important aspects of Telstra's strategy, because in the end it's one of the hardest things to copy if you can get it right. I know that Catherine and David are committed to getting it right.

So I'm very pleased to be here, and as I say, I'm pleased to get to know everybody in the room that I don't already know over the coming weeks and months. With that said, I'm going to now take us through the capital management strategy, as David indicated.

As you heard from David, we expect to generate up to an additional \$2 billion to \$3 billion in excess free cash flow over the next three years. This is subject to the NBN roll-out and other significant market changes, of course, and it is also before considering material acquisition and other portfolio opportunities, should they arrive.

In my presentation this morning, I'm going to cover two things. Firstly, I will take you through our capital management strategy and the framework of principles that underlie it, and secondly, I'm going to cover our current capital position. In relation to the latter, I will confirm that we estimate our excess capital positions will be in the order of \$500 million to \$1 billion by the end of the current financial year.

Looking forward, the payments and benefits received under the NBN transaction, which are implicit in the \$11 billion of post-tax net present value, are expected to help offset the reduction in free cash flow from the fixed line business. Notwithstanding this, there is, in the next couple of years, an increase in free cash flow to Telstra as a consequence of the timing of the NBN financials. Subject to the rate and the pace of the NBN roll-out, we estimate this could add a further \$1 billion in excess cash in 2013 and 2014.

Now, our preference for returning capital to shareholders is via growth in franked dividends, however we do not expect to have the franking capacity to increase the dividends before 2014. Whilst in the meantime an alternative available to us is an on-market share buyback, at the



current level of our excess today, we do not believe an on-market buyback would be efficient, or to put it another way, we do not believe it would be of a magnitude to be meaningful.

Naturally, of course, we will review our capital position in conjunction with our full-year results, and we'll talk about that again in August. But let me now move to the presentation.

The key focus of our capital management strategy is to maintain a tight fiscal discipline. Our framework for managing capital is set against this. This framework has three objectives and five key principles that I will cover in the next few slides. These objectives and principles represent the model for how we manage capital and from which we can determine the excess that we have.

Firstly the objectives - our capital management strategy is underpinned by a clear focus on optimising for the following (1) maximising returns to shareholders through both dividends and capital growth (2) maintaining financial strength and (3) retaining financial flexibility.

These core objectives are supported by five key principles that provide the structure and definition for what this means at a practical level. They are

(1) maintaining balance sheet settings consistent with a single A credit rating and this will ensure that we maintain Telstra's financial strength.

(2) Over the longer term our objective is to grow dividends and to ensure those dividends are fully franked. We have communicated our intention for the market subject to the Board's normal approval process to determining dividends and of course there being no material events, the 2012 and 2013 dividend will be \$0.28 per share. This remains a key priority to us.

(3) Excluding spectrum payments which we will fund by debt and subject to the NBN rollout, our target CapEx to sales ratio is 14%. (4) Over the course of a year we will not borrow to either pay the dividend or to fund capital returns. Finally (5) we will retain the financial flexibility for portfolio management and to make strategic investments where our target hurdle rates can be achieved.

Before moving on to what this means for our capital position, I'm just going to talk a little bit further about these principles in the next few slides.

Firstly our balance sheet settings. Now you will have seen this slide before. What it does is it emphasises the importance that we place on maintaining strong balance sheet settings which we believe are consistent with a single A credit rating. That is to say a debt servicing ratio between 1.5 and 1.9, gearing between 50% and 70% and an interest cover of greater than seven times.

As you can see from our reported position at 31 December 2012<sup>1</sup> with the half year results we were operating at the lower end of these parameters. We expect this to increase modestly over the next 12 months as a consequence of our supporting the funding of our share of the AUSTAR acquisition by FOXTEL and spectrum payments which are due later in 2013.

Secondly turning to dividends - we have spoken to many of our shareholders and whilst we acknowledge there are different points of view, the majority of our shareholders would like us to continue to focus on supporting and increasing franked dividends. Over the last five years Telstra has returned more than \$17 billion in fully franked dividends to our shareholders.

Going forward as the Board has previously announced it is our intention to maintain that dividend at \$0.28 for 2012 and 2013 and it acknowledges that over the longer term shareholders would like to see this level of dividend increase as the company's performance grows.

Turning to the third and fifth principles, our CapEx to sales ratios and other investment opportunities. Our ongoing capital program is extremely important to support the underlying organic growth in the business and maintain the superior competitive performance of our networks.

It is also influenced by the investments that we need to make to support the rollout of NBN. Subject to this rollout we are targeting to operate in a CapEx to sales ratio of 14%. If the rollout changes and it does compromise our ability to make the appropriate capital investment we will obviously adjust the ratio at that time. The 14% excludes spectrum payments which I mentioned before will be funded by debt and it also excludes acquisitions and other portfolio management initiatives.

Regarding acquisitions we will continue to retain the flexibility to make strategic investments where our target hurdle rates can be achieved. Naturally each specific opportunity will be considered on its merit and in this regard we will obviously need to maintain some flexibility.

But with this proviso and as we have previously advised our guideline investment criteria in this regard are to be EPS accretive in year two and a return on investment to be above our weighted average cost of capital by year three. Or to put it another way any acquisition needs to be more value accretive than a share buyback of a similar magnitude.

Let me now turn to our current capital position. In the previous slides I have set out clearly the objectives of our capital management strategy and the framework of underlying principles that support this. I'd now like to cover the model for how we then take that for determining what our excess is. We will view this in conjunction with our full and half year results starting with reported free cash flow from operations.

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<sup>1</sup> This is a reference to 31 December 2011

We've already provided guidance to the market but our expected free cash flow this year will be in the range of \$4.5 billion to \$5 billion. This is subject to some allowance for acquisitions. Reported free cash flow is then adjusted to add back spectrum payments and in 2012 the AUSTAR transaction given that these are both funded from debt.

In addition we need to add cash items that have been excluded from our guidance. For example the \$320 million that we recently received from the government as part of the NBN payments. Against this we deduct provisions for dividend and interest. We also need to make provisions for known future commitments outside of our normal operating cash flows and make some provisions to retain financial flexibility.

Whilst I do not propose to disclose the detail of those adjustments as you can understand, I can advise that against this framework we estimate that our excess capital position will be in the range of \$0.5 billion to \$1 billion by the end of this current financial year.

I also want to make some comments regarding the outlook for our capital over the next couple of years. In this regard if I can talk for a moment specifically about NBN. Over the duration of the NBN arrangements they will obviously run for many years. The \$11 billion of after tax net present value of the transaction to Telstra is offset by a number of costs and lost revenue.

That is to say that whilst Telstra will receive a number of payments and benefits under the Definitive Agreements for NBN which are implicit in the \$11 billion of net present value, these are expected to help offset the decline in the reduction in free cash flow from the fixed line business.

Now you may recall in the Explanatory Memorandum we presented the chart on the right of this slide which breaks the \$11 billion down into its key component parts. These include firstly the \$4 billion relating to the PSAA payments on the left-hand side of the bar chart. These are the payments that Telstra will receive each time a customer is disconnected from the copper network. They will be offset by the higher copper margins that we currently receive.

Secondly, the \$5 billion relating to infrastructure access payments from NBN Co. These cash flows will be partly offset over time by the ongoing maintenance costs and capital investments in that infrastructure.

Thirdly, the last three components adding up to \$2 billion covering a number of other items including payments under the TUSMA Agreements, payments for training and development and other arrangements and avoided expenses by Telstra.

In the appendix to my presentation today I have also included some information on how these payments will be treated from an accounting point of view. Whilst over the longer term of the contract the \$11 billion is offset, the chart on the left-hand side which was also in the

Explanatory Memorandum demonstrates that the timing is such that Telstra's free cash flow is estimated to increase in the near term.

What I can advise is that the quantum of this over the next couple of years subject of course to the way in which it rolls out is estimated to be approximately \$1 billion and this will add to Telstra's growing capital position.

So let me summarise. Telstra's capital management strategy is supported by a clearly defined framework of objectives and principles focused on maintaining our tight fiscal discipline, delivering growth and value for our shareholders, maintaining our financial strength and retaining the financial flexibility for investment in the future.

Our balance sheet settings are targeted to be consistent with a conservative single A credit rating. Against this background our excess capital position will be in the order of \$0.5 billion to \$1 billion by the end of the 2012 financial year. In addition, NBN is estimated to add a further \$1 billion to this free cash flow in 2013 and 2014.

Given this and looking out over the medium term we expect to generate an additional \$2 billion to \$3 billion in free cash flows over the next three years. This of course is all subject to the NBN rollout and any other significant market changes and it is also before considering material acquisition and other portfolio opportunities should they arise.

It is clear that over the longer term delivering shareholder value via growth in fully franked dividends is the key priority for the company. In the short to medium term an on-market buyback is an option available to us however at our current level of excess we do not believe an on-market buyback today is warranted.

We will update the market of our capital position at the full year results in August and I look forward to seeing you then. In the meantime, I invite David back to the stage and we'd be happy to take some questions.

Ben Spincer: Thanks Andy. Thanks David. We've got about half an hour now for questions before we go to the break-out session. So I would be grateful - there's probably quite a lot of you want to ask questions if you could keep to probably two questions at most and then come back if there's time at the end.

Question: (Sameer Chopra, Merrill Lynch) I had two questions. Firstly David can you provide a perspective on what happens to the free cash flow position if the NBN rollout is running, say at a third of its pace so if there's a delay in the NBN over the next couple of years how does that \$2 billion to \$3 billion position change looking out towards 2015?

Andy if I can just ask you one question - you said may consider an on-market buyback over the short to medium term and the Board's position is to focus on a fully franked or growth in a

fully franked dividend over the medium to longer term. You also said that you could be in a position to grow the franked dividend in 2014. Does that mean your short term view is '12 and '13 and longer term is '14 and '15? I just what to understand what you mean by medium term and longer term.

David Thodey: Okay so I'll take that Sameer on the first one. If there is a delay in the NBN rollout you've got to look at the different revenues we're receiving. There's a fair chunk on the infrastructure build which will get built. We're under a contract to get that done. Then the thing that will move out will be the PSAA payments because that's the more variable one.

So it would have an impact but it's only a part of an impact. I won't give you the exact numbers but roughly say 50% is infrastructure, the rest is sort of other things and that would probably move out. So that's about as much but you could do the modelling on it.

Question: (Sameer Chopra, Merrill Lynch) So there could be a change in the guidance of \$2 billion to \$3 billion...

David Thodey: Yes.

Question: (Sameer Chopra, Merrill Lynch) ...if the NBN is running...

David Thodey: Yes the \$2 billion to \$3 billion is dependent on the NBN rollout as we know it today over the next two to three years correct. Therefore that's part of the consideration with that to have as we work through this.

Andy Penn: Sameer the point about the short to long term. So we do not expect to be in a position to increase our franking in 2013 - sorry 2012 and 2013. As we look forward and of course it's also influenced by NBN in the comments that David just made. We expect that franking position to increase in 2014 which will give us the capacity to increase dividends at that point in time but again subject to how this rolls out. But that's my distinction between short to medium term if you like and medium to longer term. It's clear that the Board's longer term priority is to grow franked dividends and that's the feedback that we have from our shareholders.

Question: (Sameer Chopra, Merrill Lynch) Great thank you.

Question: (Ian Martin, Royal Bank of Scotland) David you're coming up to three years in the job and congratulations. I don't think three years ago you imagined you'd be here in the position you're in that would be quite a good outcome and certainly better than I think most people might have thought at that stage.

David Thodey: Yes thank you.

Question: (Ian Martin, Royal Bank of Scotland) Bearing in mind what you said about protecting and enhancing shareholder value it does seem to me there is still one overhanging risk in the whole NBN arrangement.

I'll just read this out from the ACCC's Structural Separation Undertaking Assessment which is to say that if the arrangements don't fall out the way it's expected in the Government's statement of expectations of the NBN corporate plan, the adjustments to existing regulatory settings will be required in order to ensure that it all goes the way they want. That still - an option the Government's written itself to change regulation to make the NBN work out, isn't that still a risk, substantial risk to Telstra Shareholders?

David Thodey: Yeah, I can't - I agree. I mean any regulator always reserves rights to do something should it not completely work out, however you've got to put the list - when we looked at that, we put it against the context of everything that has been done from the regulation in terms of the SSU, the commitment of the Government, it would be very hard to unwind. However, the ACCC I think can - anything within the legislation option policy, they reserve the right to do anything at any time.

However I think the likelihood of that, I probably only a little bit I probably wouldn't agree is it high risk? Well it's a big risk, but I'm not sure that unpicking all this is going to be that easy. So that's our judgment, so as you go through these sort of things, you always try to balance that, but that's where we landed.

Might allow Tony, if you want to put any context to it, but that's where we go to, but yes, I'm sorry, any regulator always reserves their rights at the end of the day to pretty much do anything. So I think it'd be hard.

Question: (Ian Martin, Royal Bank of Scotland) Can I just ask a second question of Andy?

David Thodey: Yeah.

Question: (Ian Martin, Royal Bank of Scotland) Just regarding the CapEx to sales guidance of 14%, with that slide you had showing the future cash flow coming out of fixed line, it's clear if I apply 15 more, more of that's coming of NBN payments, shouldn't that lead to a reduction in the CapEx to sales, you're not actually required to finance that with capital expenditure in a sense.

Andy Penn: Well that's partly true. Obviously we will - our CapEx in that part of the business will reduce on the one hand. On the other hand, we're investing heavily in other parts of the business such as mobile, such as network application services.

Question: (Ian Martin, Royal Bank of Scotland) At a greater rate per revenue in mobile than these other areas?

- Andy Penn: True. To continue, obviously to grow the business, so that's the CapEx to sales ratio framework that we're allowing for ourselves. That's what we think is the right framework for longer term investment.
- David Thodey: Can I just - the CapEx we've put into fixed in the copper isn't significant. I mean it bears a few hundred million dollars and we've got to maintain it. There's a lot of OpEx. I mean it's more around all the guys in the field fixing it when we've got those network problems where you get the guys out there, fix it up. So it's more in the OpEx than the CapEx. However I do want to be clear. CapEx management internally is really, really important and while we think we're going to be running about 14% with no commitment to reducing it, we've got to find ways to really make the CapEx work harder for us as we go forward, so big focus for us.
- Question: (Ian Martin, Royal Bank of Scotland) Great, thanks.
- Question: (Christian Guerra, Goldman Sachs) Morning guys, it's Christian Guerra here from Goldman Sachs. Two questions for you: firstly, on the free cash flow chart that you put up earlier, that's I think pretty much the same chart you guys put up in the EM last year. I'm just wondering why you haven't changed that chart given the pretty material downgrade from NBN a couple of weeks ago in terms of their corporate plan, in terms of target, rollout targets, et cetera.
- Andy Penn: The two charts that were actually replicated from the Explanatory Memorandum are the ones you're referring to Christian?
- Question: (Christian Guerra, Goldman Sachs) Yeah.
- Andy Penn: No, you're exactly right. They have not been adjusted. They are the charts that we used in the Explanatory Memorandum and our focus is to make sure that we respond to the rollout of NBN and as David said, capitalise on the opportunity presents us not second guess what the rollout might be. So what I'm saying is that if the rollout is consistent with essentially what NBN are currently saying, we estimate that roughly there will be that billion dollars of excess capital. So that's our current view based on what the rollout plan is.
- Question: (Christian Guerra, Goldman Sachs) So are your numbers based on what they said two weeks ago or what they said in December 2010, because that chart is based on the 2010 rollout.
- Andy Penn: It is, but I don't know that there's a material difference from that financials point of view, in terms of the PSAA as David said, because we're already into rolling out the infrastructure build which will lead to those infrastructure payments coming to us and then ultimately it's a function of the number of houses connected that will trigger the PSAA payment. So that's the point that will affect it.

- David Thodey: Christian, while the charts is the old one in the EM, the numbers we're talking about is what we actually see. So we're very conscious of any number we put out there we'll be held accountable.
- Question: (Christian Guerra, Goldman Sachs) Okay, good. Just my second question, you talked, when you released the DAs you talked about \$2 billion of CapEx and OpEx that you'll need to spend for things like remediation of the ducts for emergencies...
- David Thodey: Correct, yeah, infrastructure building.
- Question: (Christian Guerra, Goldman Sachs) So what's the timeline there? Are we going to see - obviously the CapEx is part of your 14% but on the OpEx side, are we looking at some sort of increase over the next FY13 to 15 or is it in the existing envelope or what's the...
- David Thodey: We're doing it the hard way Christian, we're keeping it within the envelope. So the 14% on the current rollout, we've got all the build costs and the CapEx. And the OpEx, as we talked to you about next year at the end of this year, where it's all being sucked up in the current operating envelope is stuff because we do need to. But we are managing as we're taking costs out, it's already tough. It's getting tight, but we're there and we're going to manage this thing through.
- Question: (Christian Guerra, Goldman Sachs) So we shouldn't expect any sort of spike in OpEx?
- David Thodey: I'm not giving forecasts today, but I'm telling you that we are trying to manage it within the current envelopes.
- Question: (Christian Guerra, Goldman Sachs) Great, thank you.
- Question: (Bradley Clibborn, Credit Suisse) Just a quick one for Andy first, just in terms of your excess capital position, when you're saying a billion dollars or half-a-billion dollars, is that against the midpoint of your gearing targets that we should be thinking about that?
- Andy Penn: No, that is against essentially where we're currently placed at the lower end of our balance sheet settings.
- Question: (Bradley Clibborn, Credit Suisse) Okay and secondly one for David, just the conservatism I guess around the capital management, you've put a slide in there about acquisitions, is the next couple of years a time where you think there could be opportunity for acquisitions and could you update us on your views in terms of where you think the most attractive opportunities might be?
- David Thodey: Yeah, well it's a good question because we're managing very tightly the business as it is today and over the next three years. We've got a lot of work to do in NBN and the company's very focused on that. But yeah, I've got to look at the business out five and 10 years and we are looking at a large number of alternatives as we look at how to structure the business.



What you've got to have comfort on is the fiscal discipline. We have done acquisitions before, FOXTEL's the best thing we've ever done and there's a lot of other stories along the way. So we've got to be very disciplined but we have to look at taking advantage of other things as we go forward and there's a very active program looking forward over the next where we need to be in 10 years' time. So I think that the thing that as an investor should be very clear on is the fiscal discipline and also looking for new opportunities as we go forward.

Question: (Bradley Clibborn, Credit Suisse) Are there segments that you think are strategically important in that 10 years?

David Thodey: Yeah, there are. There are. It's actually a group of about 13 key areas that we're looking at. So I know you'd like me to talk about media, but - which is one of them - but it's not the only one. You've seen other telcos around the world move into some application areas. You've seen other people moving to adjacencies. But you've got to really know what you're doing and we will be very disciplined through that process.

Question: (Richard Eary, UBS) Hi, it's Richard Eary from UBS. Good morning guys. Just two questions, just the first one on a housekeeping point of view, if you look at the cash position at the end of June '11 at 2.6 and I think it was \$3 billion at December, so if you add in the excess cash that you talked about for '12 plus the excess cash flow through to '15, presuming that the acquisitions are funded by debt, you're looking at a cash balance of between \$5 billion and \$6 billion. I just want to make sure I'm correct on that and if that is correct, it doesn't seem a particularly effective use of cash to be holding that on balance sheet in that size. That's the first question.

The second question is: can you talk about labour, because obviously you've now put out some plans for example, the next three years or out to '15, can you discuss about the labour under NBN, what that means in terms of are we looking at cost out from labour, or are we looking at reinvesting those labour to facilitate other opportunities such as NBN infrastructure opportunities?

David Thodey: Andy can do the first one, I'll do the second one.

Andy Penn: So Richard, I'm not sure necessarily that I followed all of your maths there and I'm happy to sit down with you and Mark and go through, but fundamentally we're rolling forward from our current balance sheet position and as Brad's just asked, is our outlook for this year at the mid-end range of our balance sheet parameters and the answer is no, it's at essentially the lower end of our balance sheet parameters. So that is our starting position. So any free cash flow that has been rolled forwards is then factored into that and then our position is basically rolled forward from there. But I mean I'm happy to sit down with Mark and go through those details with you if there's some discrepancy there.

Question: (Richard Eary, UBS) No, I'm just asking, you've got \$3 billion of cash on balance sheet today at December, you've got \$2 billion to \$3 billion on the slide there and that takes you to five to six.

Andy Penn: We just pay the rather large dividend and then we've got an ongoing billion dollar a year interest commitment.

Question: (Richard Eary, UBS) But that excess over dividend? That slide there says after dividend.

Andy Penn: That's right.

Question: (Richard Eary, UBS) So clearly there's a large cash pile that is built up over the next three years.

Andy Penn: Well the cash that was built, the excess that we predict is built up over and above us maintaining that position with the criteria here which brings us back to a set of balance sheet settings that are single A credit rating, we believe which is excess, is \$2 billion to \$3 billion.

David Thodey: But the balance sheet remains very strong which is a good thing.

Question: (Richard Eary, UBS) Yeah, I was just questioning why then fund spectrum through debt or why fund FOXTEL acquisitions through debt. Why not run down cash balances if you're not going to return it?

David Thodey: But we look at all options and at the moment we are where we are, but we can - we'll continue to look at options as we go forward. I think that that is an option and we'll look at it. I'm not - it's the principles here that we applied everything, but I think your point - the balance sheet's sitting very nice at the moment.

But remember, we look at total market conditions. Mark and the team, we did the debt raising in Europe which was, I think, very good because they had such a strong balance sheet. That's given some advantages. So as you would understand, there's many things we look at as we look at the different alternatives. So we can pick it up with you, but your point's well made.

Question: (Richard Eary, UBS) On the labour side David?

David Thodey: Yeah, on the labour side. Well this is actually - there's lots of different types of labour we have, but I think you're probably referring to the field force primarily, but when you're talking about - as the NBN rolls out, our workforce changes through that process. So yes there's no question that we will need less labour as the fibre's rolled out, but remember there's quite a big transition how we manage our customers through that transition.

The other thing is we've got retraining, because we also would like to have them gainfully employed, that's always what we try to do. We like to drive productivity every year, but we like keeping our people around. So at the moment we're looking at some other alternatives so the

retraining fund gives us some opportunities around fibre and what we do there. But also there's other opportunities that Brendon's been looking at in terms of how we maybe can provide some revenue generating opportunities from our field force. That's been factored in too.

But overall, you will see a labour reduction, or labour moved to revenue generating, or retraining and they are the three things we're looking at and it actually is quite an exciting time in that part of the business as we go through.

Question: (Richard Eary, UBS) Thanks.

Question: (Laurent Horrut, JP Morgan) Good morning Laurent Horrut, JP Morgan. Two questions, first of all, so you first talked about the possibility of capital management or you considered capital management options in November 2010 at the AGM...

David Thodey: Yes.

Question: (Laurent Horrut, JP Morgan) ... so you kind of have created a bit of an expectation in that time. I'm just wondering, what really has changed in your thinking since that time? Is it purely a function of the share price is close to a dollar higher and therefore any buyback would be less accretive. But that's - are you flagging potentially that the M&A - you could pursue a more aggressive M&A agenda? For example just interested in your thoughts, for what's driven the slight change in thinking back from those days.

David Thodey: Well actually Laurent, it's interesting. Yes we did signal capital management back in February, and at the AGM. But our actual thinking has not changed. I know there's been a lot written about share buybacks and - but we never used those words. We said we would look at all options. I think John said once in response to a direct question about fully franked dividends and our franking credits, therefore that would mean that a large share buyback would be an option to look at.

But no, what we are saying is a very active capital management strategy against a framework that hopefully gives you the clarity about what we would do. That's been actually a lot of discussion at the board going back over nearly 18 months about what our balance sheet setting should be in terms of global markets. Then looking at what free cash we're going to spin off the NBN, underlying business, looking at our franking credits on market. Then when we actually get the cash, then we'll make the decision what to do.

I think that that should give you the clarity that there's a really tight management. But I actually don't in all of the discussions there's been any significant change. We've looked at different options through that, we've modelled different options, but this is where we feel very comfortable to be and think there's very good clarity on our thinking and keeping board and management tightly together has been the other part of this.

Question: (Laurent Horrut, JP Morgan) Okay, second question just picking up on future years of excess cash. How are you likely to think about sort of excess cash? Is it determining the level or the appropriate level of distribution? Are you going to apply this formula? So say by FY14 you generate \$0.5 billion of excess cash. Are you happy to send all that back through an increase of that quantum in dividends? Is that what you're saying or--

David Thodey: No.

Question: (Laurent Horrut, JP Morgan) No.

David Thodey: No, we're saying that any time we've got excess free cash, and Andy can help too, we will apply these principles to it and then make the best decision on behalf of shareholders we believe. Obviously that will be the lens through which we'll look at it. Also to make sure that it's something that's significant. One thing that we've always noted on share buybacks is you can do them and they come and go and they don't necessarily create value to shareholders. So we've got to be able to do something that's substantive enough to create value and also to give clarity going forward. So that's why we're reticent to do small things that isn't going to be consistent on whether you drive value. So that's our thinking there.

Question: (Laurent Horrut, JP Morgan) Okay.

Andy Penn: The only extra colour on it is the franking position and as I say, the fundamental philosophy is we think that broadly shareholders' best values are focusing on the franked dividend and over time increasing the franked dividends. We don't think we can do that in 2012 and 2013 for franking reasons. There is excess in the meantime, but as David says it's subject to a number of variables and if we were to do something other than that, i.e. an on market buyback, frankly it needs to be meaningful to be value adding to shareholders is our view.

David Thodey: To your other point, it must be subject to market conditions, which is sort of the outlook.

Question: (Laurent Horrut, JP Morgan) And it's fair to say it's not certain you'll have enough franking credit by '14 to fully franked increase - any increase in dividends. Fair comment?

David Thodey: Twelve, '13, '14 - '14 we're starting to get into the realm, yep. But it is at the end point of the three year period. I think we've discussed that one before. If we can get more we will tell you, we will.

Question: (Laurent Horrut, JP Morgan) Thank you.

Question: (Mark McDonnell, BBY) Yes good morning Mark McDonnell from BBY. My questions are about the cash and non cash impacts on your CapEx profile and how that changes. If we start initially at non cash, obviously as you disconnect copper, there is some write off of that if there's anything left on the books. Also the deep packet and other equipment that's copper specific back at exchange level.

I'm just wondering if we should be looking for some level of accelerated depreciation and against that, whether there's some opportunity, melting down the copper et cetera for you to recover some of the cost? That's the first part of my question.

David Thodey: Okay, well. I'm pretty sure I'm going to look at Mark. Is that right? Yeah I think we're pretty clear.

David Thodey: (Mark McDonnell, BBY) And we'll come back and talk about the copper resale opportunity.

Mark Hall: Yes the current service life for copper and the electronics are all in line with the NBN roll out. So existing service lives cater for the depreciation.

Andy Penn: So nothing new, so we're good there. Look on the copper side, there will be opportunity. The thing is it's different by different area Mark. It's really about how easy it is to pull it out. But you can be assured that we are looking at that opportunity. Not a mining company, but it has quite a big copper arm.

Question: (Mark McDonnell, BBY) There's a lot of value in scraps, especially with copper. Look the bigger side of this question of course is the way that your network changes with the NBN. Without wanting to pressure you for too much technical detail. Obviously the NBN is purely a layer two wholesale network and I imagine that a substantial part of the 14% CapEx to sales ratio is accounted for by the new investment that you need to make for layers three, four, five, six and seven in the new network and also the way that the architecture of that network needs to change.

I'm thinking about things like local caching and deep packet inspection, not at the core, but closer to the periphery. Particularly when you start overlaying policy and enforcement objectives associated with the Telecoms Interception Act and related copyright issues that are now becoming a matter of courts deliberations. All of these things are going to impact your CapEx very materially.

The thing that surprises me is not the magnitude of the 14%, but the proposition that that would be a flat level. I would assume that your CapEx will be very heavily geared to the rate of NBN roll out as you seek to make those matching investments and also seek to gain some sort of competitive advantage around the way that you invest in that changed architecture. Any comment?

David Thodey: Well, firstly it's a very good question and you are absolutely right in your supposition about the importance of Layer 3 and above in differentiating ourselves going forward. This has started actually with the OSS network that Sol did going back 3 or 4 years ago. The only thing that is important to note, yes, there is investment there. In fact we have a very specific project on that today about our end state architecture.

It's not significant capital - when I say not significant it is there but it doesn't change the 14% guideline and we are trying to do everything within that and we would do it as required. In terms of getting to the outer entrance point on the network if there's some requirements - deep packet inspection's very important in terms of quality of service and how we differentiate our offerings going forward.

However, in terms of the intercept that's work in progress at the moment, there's different ways to approach that. But do remember a lot of this is done on software now. There's a lot of hardware. This is a software-driven world and I think we've got a very good feel of it at the moment.

At the moment I would not say at the moment that it's going to require incremental CapEx beyond what we're already seeing. Yes, there's quite a bit of expenditure there but we're putting it within the envelope.

Question: (Mark McDonnell, BBY) Okay. Finally from me, then, given that investment do you see Telstra seeking to preserve unto itself those higher level functionalities or will you be active in the wholesale market around that capability?

David Thodey: We'll be active in the wholesale market to a degree but no, we are investing for retail differentiation. We'll definitely provide services to wholesale clients on a resale basis but we will be looking to differentiate at the application layer, at the service management layer as much as we can. Because this is going to be a differentiated service to the client and how we can do remote management, how we can service them and that is very clearly in our competitive interest going forward. So a good question, really good question.

Question: (Vikas Gour, Deutsche Bank) Vikas Gour, Deutsche Bank. Just a couple of questions as well. In relation to, firstly, the fact that you're borrowing for the AUSTAR merger transaction as well as spectrum, I think your debt servicing ratio is at 1.48 times. Does that risk, with that servicing ratio going above 1.5 times which means that the ratings agency might be looking at it for a potential downgrade by a notch.

Secondly you spoke about cash flow calculations and there was an item in there about retaining financial flexibility. So other than potential M&A transactions does it include anything else and can we get a bit more colour around that?

Andy Penn: I'll just comment on the first part of the question. Firstly what I should say, FOXTEL has its own financial resources so the extent to which we're supporting FOXTEL in that acquisition and other shareholders are supporting them is not for the full purchase price of AUSTAR. The balance sheet settings that we've obviously discussed with the rating agencies, they're not looking at a single A credit rating be equivalent with 1.5. Our range is 1.5 to 1.9 and they are comfortable with that range.

As regards whether we go slightly above 1.5 I can't quite remember. Mark may have a view but it won't be material. As regards the second one I guess it's really up to you guys whether you want to add any more colour into what's in our bucket of financial flexibility but obviously acquisitions is a part of that. Other significant investments or portfolio reconstruction, we're just ensuring that we retain the financial flexibility to be able to execute opportunities that present themselves to us.

Question: (Vikas Gour, Deutsche Bank) So just to confirm if it does go over 1.5 it's not going to be a major issue from a ratings agency perspective.

David Thodey: I wouldn't have expected it to be, no. I mean, we're being clear and communicated with the rating agencies that our target range is 1.5 to 1.9, not that we'll be below 1.5. In terms of going forward, look, I think you've got to look at our recent history. I think we've been pretty disciplined in what we have done. We do need to look at organic growth and inorganic.

We'll continue -we look at lots of different options but against this lens. Also I think Andy showed there continued portfolio management. That's very important. There's still a lot of value right across this business that we may be able to realise different ways of creating value for shareholders. There's many different options there, as well. So it's a very active program and more active than I've ever seen at Telstra in my 10 years, yep.

Question: (Digby Gilmour, CLSA) Thanks, guys. Digby Gilmour from CLSA. Just one question on the franking account and the extent to which the NBN build impacts the franking. If we look at the infrastructure and then the decommissioning payments at the majority of cash flow on which you'd pay tax, delay to the build therefore reduces franking and the ability to grow the dividend. Is that fair? So if slippages in the build occur that FY14 could become '15 and '16.

Andy Penn: Yeah, I mean, that's - that is fair, Digby. I mean, the cash flows which come from NBN, that additional \$1 billion that I referred to is a combination of the infrastructure payments and also the PSAA payments. They are taxable payments in the hands of Telstra and therefore generate franking credit. So to that extent that is correct but of course in addition the \$2 billion to \$3 billion is also supported by the underlying growth in the performance in the business. Management's aspirations are obviously to continue to drive that and that will drive franking credits as well.

I think that probably reinforces a comment I made. Our working relationship with NBN Co is really important. Yes, lots to be done, it's a big project, so how well we work with NBN Co getting this thing done and customers' transition is in our mutual interest at the moment.

Question: (Digby Gilmour, CLSA) Thanks and I'll just ask one last question. There's a distinct lack of mention of Sensis so far in the presentation. I wanted to be sure that the revenue declines weren't getting worse.

David Thodey: Look, as I said, I'm confirming our guidance but this wasn't a market update in terms of Sensis. We'll take you through in August how we're doing. But no change to guidance so...

Question: (Digby Gilmour, CLSA) Thanks, David,

David Thodey: Look, just in summary, really important, everything that is driving us is about maximising value to shareholders. We've done a lot of work to try to look at how all the variables work together to give something that can give you predictability about how we will behave going forward, that's really important. You should be clear that we're not here driven by acquisition growth just to make us feel good. It's about a very disciplined, very structured, very precise management of the balance sheet. Look, doing what we can with the excess free cash, looking at how the business is running and managing all the variables that we have. So that's what we want to give you a picture of today. I think it's a good place to be in and I think gives us optionality going forward as well and we're looking forward to the next few years. So it's great to have Andy on board. So thanks very much.

**End of Transcript**