

Letter to shareholders



Andrew Penn (CEO), John Mullen (Chairman)

Dear Shareholders,

Telstra today announced its results for the first half of financial year 2017. Our financial overview for the six months ended 31 December 2016 follows:

- On a reported basis, total income excluding finance income decreased 0.7 per cent to \$13.7 billion and EBITDA decreased 1.6 per cent to \$5.2 billion
- On a guidance basis and excluding the impact of regulatory decisions on MTAS and FAD, income increased 2.2 per cent to \$13.7 billion and EBITDA increased 2.4 per cent to \$5.4 billion
- Added 200,000 domestic retail mobile services, 90,000 retail fixed broadband customers, 124,000 bundles, 292,000 nbn connections and 322,000 Telstra TV devices
- Underlying core fixed costs reduced by 2.6 per cent or \$92 million
- \$1.5 billion share buy-backs completed
- After regulatory decisions and restructuring costs, earnings per share decreased 14.0 per cent to 14.8 cents
- Fully franked interim dividend of 15.5 cents per share, returning \$1.8 billion to shareholders

We have added retail mobile services and retail fixed broadband customers, reporting total income up 2.2 per cent and EBITDA up 2.4 per cent higher on a guidance basis¹ and excluding the impact of regulatory decisions.

The Board announced an FY17 interim dividend of 15.5 cents per share fully franked, returning \$1.8 billion to shareholders.

The results show Telstra has performed well in a highly competitive market, gaining customer numbers and increasing market share in nbn.

It is significant that we were able to increase subscriber numbers in mobiles and retail fixed plans despite the increased competition.

Data volumes have increased and intense competition on pricing across fixed, bundles, mobile, data and IP has had an impact. Those are in parallel with the acceleration of the rollout of nbn which, over the longer term, will have a negative impact on EBITDA of \$2-3 billion.

We have a clear strategy to differentiate our products through the speed, coverage and reliability of our networks, innovative product design and new customer experiences, including access to media content.

We are committed to improve the experience we provide our customers and as announced last year, we are investing up to \$3 billion incremental capital expenditure in networks for the future and digitisation of the business.

Work has commenced on these projects which will position us to deliver significant customer benefits, reinforce our market differentiation over the longer term, and deliver business benefits such as capital efficiency, reduced operating costs and increased revenue.

We are also continuing to review our capital allocation strategy as announced in November last year, taking into consideration the long term business and financial profile of Telstra. The review is looking at all aspects of our capital management framework and taking into account the specific nature of the payments associated with the nbn.

Regulatory decisions impacted reported first half 2017 income and EBITDA by \$400 million and \$38 million respectively for the Mobile Terminating Access Service (MTAS) and the Fixed Line Services and Domestic

Transmission Capacity Services Final Access Determinations (FAD). Excluding these impacts, higher total income was achieved through double-digit growth in Network Applications and Services (NAS) and increased receipts from nbn co.

Net profit after tax reduced to \$1.8 billion due to planned restructuring costs and increased amortisation associated with shorter asset life for business software.

Delivering brilliant customer experiences

While the incremental \$3 billion investment is in the early stages of being implemented, we have made a number of important improvements to customer service in the half.

These included improving customer delivery options by introducing flexibility and choice for customers receiving hardware from Telstra, replacing the scripted lengthy terms and conditions information with simple messages, simplifying the international roaming day pass pricing to two zones and improving protection for customers who have incurred additional charges through premium services by introducing a double opt in process.

Despite these improvements, our strategic NPS was eight points lower than the same period last year, largely due to the impact of the network disruptions on our customers. We expect our NPS to recover as our investments in networks and digitisation are implemented.

Driving value and growth from the core

We continued to add customers across our key products, including mobiles, fixed data and bundles. The decline of fixed voice customer numbers continued at rates lower than most other major global

1. On a guidance basis, total income decreased 0.7 per cent to \$13.7 billion and EBITDA increased 1.7 per cent to \$5.4 billion. The guidance basis excludes adjustments including restructuring costs of \$165 million in the half.

providers. Mobile revenue impacts included regulatory changes to voice and SMS terminating charges, lower hardware sales volumes and a higher mix of 'bring your own' plans.

We were able to retain mobile EBITDA margins, excluding margin benefit from MTAS, despite intense competitive pressures. Mobile revenue declined 8.7 per cent to \$5 billion compared with the first half of FY16 and increased 2.6 per cent compared with the second half of FY16. Postpaid handheld mobile churn decreased on 2H16 excluding the impact of the closure of the 2G network. We added 200,000 domestic retail mobile services, including 79,000 postpaid handheld customers to take our total mobile subscriber base to 17.4 million services. Postpaid handheld ARPU (excluding MRO), although down 2.6 per cent on the first half of FY16, has been stabilising.

We continue to see growth in machine to machine (M2M) with revenue growing by 13.3 per cent and 130,000 M2M services added during the half as the result of new Internet of Things solutions being implemented.

In the 12 months to December 2016, traffic over the mobile network increased 39 per cent, traffic on the fixed network including nbn grew 51 per cent and traffic on the Telstra Air Network increased almost tenfold.

Overall revenue from our fixed business declined 4.7 per cent to \$3.3 billion. Fixed data revenue grew 1.8 per cent to \$1.3 billion and the decline of fixed voice revenue was 9.4 per cent. nbn connections grew by 292,000 to 792,000 at the end of December with our market share (excluding satellite) now approximately 51 per cent.

NAS revenue increased 18 per cent to \$1.5 billion due to higher revenue from cloud services and industry solutions, which included revenue from nbn commercial works, with the NAS EBITDA margin increasing six percentage points to 8 per cent.

We continue to expand our 4G footprint bringing faster speeds and a better mobile browsing experience to more customers. There are now more than 6,400 4G sites across the network, with more than 900 mobile sites upgraded to 4GX in the past six months. Telstra Air provides Wi-Fi access through more than 750,000 hotspots nationally including more than 4,700 public hotspots. The number of activated customers on Telstra Air increased by more than 400,000 in the half, with more than 1.5 million customers now taking advantage of the service.

Our media entertainment services and content continued to provide a valuable competitive differentiation. Telstra TV is the fastest growing streaming device in Australia with more than 622,000 Telstra TV devices in market.

Building growth in businesses close to the core

We refined our strategy during the half with our growth pillar now concentrating on building new growth businesses close to the core.

Telstra Health is part of the growth pillar and is focussed on using technology to help solve the challenges faced by the healthcare sector. In recent months it has secured some important key customer contracts, such as delivering a Community Health Information System for the Western Australian Government and a partnership between its joint venture Fred IT and the Sigma pharmacy chain. The Health business is now focussed on integrating acquired capabilities and utilising them to deliver new services. For example, Telstra Health is drawing on its existing capabilities to deliver the National Cancer Screening Register for the Commonwealth Government.

Telstra Ventures continued to expand its portfolio in the half, including investments in leading cyber security firm AttackIQ based in Silicon Valley and NS1, a New York based company offering advanced network traffic management solutions.

Our Smart Home product, which allows Australian consumers to control smart devices in their homes such as light globes, motion sensors and cameras through a single integrated app, has been launched across sales channels this month.

EBITDA of new business increased by 3.4 per cent while revenue fell by 14.5 per cent.

Productivity

Reported operating expenses were reduced by 0.1 per cent. Underlying core fixed costs were reduced by 2.6 per cent or \$92 million in 1H17, ahead of the target to reduce by more than 2 per cent each year. Reported operating expenses included increased ongoing network payments to nbn co and one-off nbn migration and connection costs.

Key productivity initiatives included automating the scheduling and dispatch process for customer appointments, removing manual steps for business and enterprise sales which has improved the turnaround time by 60 per cent for customers, and removing 700 mobile plans from our IT systems which has improved average system response times for orders.

This means that the results of our cost productivity programs more than offset inflation and reinvestment. We remain committed to reducing core fixed costs on an underlying basis by more than \$1 billion over the next five years to offset up to one third to one half of the \$2-3 billion negative impact of the nbn.

Cash and capital management

Our operating capital expenditure for the half was 16 per cent of sales revenue or \$2.1 billion. We announced our strategic investment program in August 2016 and provided further details in November 2016 of the up to \$3 billion additional capital investment. This program is in its early stages with investment expected to increase in the second half. Our FY17 guidance for capex to sales ratio remains at 18 per cent.

We also completed a \$1.25 billion off market share buy-back in October 2016, which was heavily oversubscribed, and a \$250 million on market share buy-back in December 2016.

We have been engaging and obtaining feedback from stakeholders to better understand their views and priorities as part of the capital allocation strategy review.

The overarching objectives of the capital management framework will remain unchanged, namely to maximise returns for shareholders, maintain financial strength and retain financial flexibility.

However we are considering the best use of nbn payments, both one-off PSAA payments and recurring payments under the ISA and the most effective way of maximising long term shareholder value from these cashflows.

The review will also cover long term capex post the rollout of the nbn, and investment decisions including M&A criteria and take into consideration shareholder returns including dividends, buy-backs and other forms of return. Importantly we remain committed to maintaining balance sheet settings consistent with the single A credit rating band. We will provide a further update later in the year.

Regulatory environment

We expect a decision from the ACCC during the second half in relation to its inquiry into domestic roaming.

We have invested heavily in regional Australia and will continue to do so if the regulatory settings remain in place. We are obviously concerned regarding the impact that declaration would have on operators' incentives to invest and the negative impact that this would have on customers in Australia, particularly in regional Australia.

We made two submissions to the ACCC on the issue and we are encouraged by the huge response from across regional Australia showing that improving mobile coverage is the top priority. More than 100 community groups, councils, businesses and farming organisations had their say, and it was clear that most do not support regulated mobile roaming as the solution.

Outlook

Today we reconfirmed our FY17 guidance of mid to high-single digit income growth and low to mid-single digit EBITDA growth. Free cash flow is expected to be in the range of \$3.5-4 billion and capital expenditure is expected to be approximately 18 per cent of sales.

First half income growth was impacted by lower hardware revenue. Given this, we expect that full year FY17 income growth will be at the bottom end of our mid to high-single digit range. In the second half of FY17, the MTAS impacts in the first half will drop out of the comparison so the full year effect will be smaller, and the nbn rollout is expected to accelerate in accordance with the nbn Corporate Plan.

Guidance assumes wholesale product price stability from the beginning of the financial year 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 in accordance with the nbn Corporate Plan 2016. Capex to sales guidance excludes externally funded capex.

FY17 guidance also excludes the \$246 million Ooyala intelligent video subsidiary impairment in FY16; and excludes restructuring costs in FY17 of \$300-500 million.

We always welcome and consider the views of our shareholders and in November 2016 we said that we would seek feedback from all of our stakeholders specifically on our capital allocation strategy. We appreciate the feedback received to date and would now like to remind shareholders who are yet to do so, your views and priorities can be provided to investor.relations@team.telstra.com or at <https://www.telstra.com.au/aboutus/investors>. You can also contact us via phone on 1800 880 679, or in the mail to Investor Relations, Telstra, Level 25, 242 Exhibition Street, Melbourne, VIC 3000.

We thank you for your loyalty as a shareholder.



John P Mullen,
Chairman



Andrew R Penn,
CEO and Managing Director

2017 INDICATIVE FINANCIAL CALENDAR¹

Ex-dividend share trading commences	Wednesday 1 March 2017
Record date for interim dividend	Thursday 2 March 2017
DRP election date	Friday 3 March 2017
Interim dividend paid	Friday 31 March 2017
Annual Results announcement	Thursday 17 August 2017
Ex-dividend share trading commences	Wednesday 30 August 2017
Record date for final dividend	Thursday 31 August 2017
DRP Election Date	Friday 1 September 2017
Final dividend paid	Thursday 28 September 2017
Annual General Meeting	Tuesday 17 October 2017

1. Timing of events may be subject to change. Any change will be notified to the Australian Securities Exchange (ASX).

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To access your information, you will need your SRN/HIN and postcode. Follow the prompts to log in and select from the following menu options:

Holdings – transaction history, holding balance and value and latest closing share price.

Payment and Tax – dividend payment history, payment instructions and TFN details. You can update your bank details here.

Communication – become an e-Shareholder and update postal/email addresses and communication elections here.

Shareholder Enquiries

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