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ELECTRONIC LODGEMENT

Dear Sir or Madam

Foxtel, FOX SPORTS Australia To Combine Into New Premium Sports and Entertainment Company - Media & Analyst Call Transcript

I attach a copy of the transcript, from the media & analyst conference call held on Friday 18 August 2017, in relation to Telstra's announcement that Foxtel and FOX SPORTS Australia is to combine into a new premium sports and entertainment company, for release to the market.

Yours faithfully

Damien Coleman
Company Secretary

Foxtel, FOX SPORTS Australia To Combine Into New Premium Sports and Entertainment Company - Media & Analyst Call Transcript

MR J. LAIRD: Good morning, everybody. Welcome to the Telstra Analyst and Media Call in relation to the announcement last night from News Corp and Telstra relating to Foxtel and Fox Sports. My name is Jason Laird. I'm the Head of Communications at Telstra. I have with me this morning CEO Andy Penn, who will make a few remarks in relation to the deal following on from the announcement. We will then take calls via the operator, queued up in the order in which they're received. So, Andy, I will pass to you.

MR A. PENN: Thanks very much, Jason, and good morning, everybody. Thanks for hooking in. As Jason mentioned, last night we announced that we have entered a binding process agreement with News Corp to look to combine Foxtel and Fox Sports into a new company, which would create, we believe, Australia's most dynamic and innovative provider of premium sports and entertainment.

You've heard me say many times before that demand for media continues to grow. More people are watching more content on more devices every day of the week. And that's clearly being enabled by the digital world in which we live today. And that's obviously also being delivered over Telstra's network. And in that sense, media is critically important to Telstra. And our investment in Foxtel is very important to Telstra. And we're committed to that investment, as I have said many times.

In fact, you can see in many of our offerings today, we have great media products, such as our AFL and our NRL apps, as I mentioned yesterday. We've got now more than 1.4 million users of those apps. Telstra TV – again another demonstration of how we're integrating media into our premium services for our customers, and so this is a really important and exciting announcement that we made last night in conjunction with News because whilst media continues to grow, the impact of digital – the digital world in which we're living in and the amount of media that's coming over IP means that Foxtel needs to adapt its business model to be able to deliver its content through an IP world as well as through a broadcast world as well.

We've been working with News over a considerable period of time, ultimately to simplify the arrangements between Foxtel and ourselves and all of the parties that are interested so that we actually can put Foxtel in a much stronger position to respond, and this announcement today is part of that process, and so the bringing together of Foxtel and Fox Sports is a critical element of that because ultimately today Fox Sports sits behind Foxtel as the production engine and the content engine of much of, obviously, the sports content, which is then distributed by Foxtel as the distributor of those pay TV products and services.

And so bringing them together simplifies the overall situation and puts the company in a much better position to respond and actually creates a very dynamic provider of entertainment, as I mentioned earlier. This is a further step, therefore, in that process, and ultimately we would look towards moving the new entity to ultimately a position where it could be floated and separately listed through an IPO. So that would come at some point in the future if the transaction obviously progressed, because it's subject to essentially finalisation of binding agreements and, of course, the normal regulatory approvals that you would expect on a transaction of this nature.

The key highlights are News will have 65 per cent of the combined entity; we will have 35 per cent of the combined entity. News will appoint the chairman and have the majority of the board's directors; we will also have directors on the board as well. Importantly, we will continue with our arrangements where we are the key distributor of Foxtel products and services and also where we continue to provide Foxtel with telecommunication services as well, and these are an important strategic element of the transaction for us.

So this is definitely a win-win for Telstra, where we increase our investments by virtue of our investment in Fox Sports as well as Foxtel, we reduce our overall economic interest to 35 per cent, we build on our existing partnership in terms of access to content and extending that into IP content as well. That enables us to deliver really unique and from only Telstra offerings to our customers and continue our partnership on the telco side, and we think it's going to put Foxtel, most importantly, in a really strong position to respond to dynamics in the market and to be, as I said, Australia's preeminent and most dynamic provider of premium sports and entertainment.

So Jason, they're the comments I wanted to make by way of introduction and happy to take any questions.

MR LAIRD: Thanks, Andy. And so operator, if we can commence the Q and A session. Operator, do we have questions in the queue?

OPERATOR: We did have one question from Eric Pan from JP Morgan. Go ahead, please.

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MR E. PAN: Good morning, guys. Good to talk to you again. So with regards to the transaction, should we expect any financial impact for you guys – or you or News Corp need to contribute any additional capital both now and for in the future, and was this transaction a factor in your capital management. Thank you.

MR PENN: Thanks very much, Eric. I might answer part of that, and then I'll ask Warwick, who's with me, to follow up as well. In terms of the bringing together – essentially what we're doing is we're exchanging a 15 per cent interest in Foxtel to receive a 35 per cent interest in Fox Sports. So that's the value equation, and so therefore there's no change of hands in relation to the money other than that bringing together. It's sort of a merger, obviously. But in terms of the financial sort of reporting, etcetera, Warwick, I might just turn to you in terms of how it gets treated.

MR W. BRAY: Yes. It's likely be equity accounted, and so our share of the new entity – our share in the new entity, that entity's impact, that will come through our profits.

MR PENN: And from a capital management point of view, I think the only thing probably to observe would be that Fox Sports essentially has no debt, and so Foxtel does, and so therefore bringing those two things together would lift the financial situation of the combined entities. That's not the reason for doing it, by the way. That's just a matter of fact. So from a capital management point of view, we don't envisage that it has any other bearing other than – other than what was said.

MR PAN: And what's the prospect of you having to contribute any capital either now or in the future?

MR PENN: That's no different to whatever the situation is today. I mean, both entities are EBITDA positive and have strong earnings. I mean, that will be a function of the strategy of the company over the longer term, essentially, but there's no sort of imminent plans or thoughts in that regard.

MR PAN: Right. Thank you.

MR PENN: Thanks, Eric.

OPERATOR: The next question we have is from Geoff Long from Communications Day. Go ahead.

MR G. LONG: We saw in New Zealand earlier this year that there was a merger or proposed merger between Sky and Vodafone that got axed by the regulator. I'm just wondering based on that decision if the ACCC is likely to take a closer look at this, given that the New Zealand one was also largely axed because of tying up sport. Do you think that the ACCC might put some extra hurdles in the way of this merger?

MR PENN: Well, I mean, obviously a transaction of this nature would be subject to the ACCCs review, and undoubtedly they will look at it. But the situation for us is different to that in New Zealand. In New Zealand essentially Vodafone were looking to basically acquire 100 per cent or merge potentially 100 per cent with Sky. We own today 50 per cent of Foxtel. Fox Sports basically is just the – provides all of the content behind Foxtel, and actually we're just bringing together Foxtel and Fox Sports, and actually we're reducing our economic interest overall to 35 per cent.

But ultimately, obviously the ACCC will need to look at it and formulate their own point of view on that, but I think in that sense it doesn't actually change the relationship between ourselves and Foxtel in any significant way to that which it is today. It's just the bringing together of Fox Sports and Foxtel that are essentially part of the same business chain at the moment anyway.

MR LONG: Right. It was just the – I think the ACCC said in the past that it does have a concern with sports and other content being tied up. I'm just thinking maybe this is a trigger for them to – to take a bit of a closer look at the issue.

MR PENN: Well, as I say, I'm sure they will look at the transaction as they do with all material transactions, but, I mean, ultimately that will be a matter for them.

MR LONG: Okay. Thank you.

MR PENN: Thank you.

OPERATOR: The next question that we have is from Max Mason from AFR. Go ahead.

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MR M. MASON: Good morning, Andy. I just had a couple of questions. What you would see as a rough value of the combined entity, and would you be able to give me a bit more colour around Telstra's access to content? Does it change in any way the relationship you already have with Foxtel? And you talked about long term potentially listing the combined entity. Is there any sort of timeline there? I mean, obviously Foxtel is going through a massive structural change, as the rest of the media industry is at the moment, sort of looking to sort of try and get through that – some of those headwinds first before you do that. The structure of how that deal might look long-term last year was sort of bandied around where Telstra might have – I think it was something like 19 per cent. Do you anticipate selling down in an IPO?

MR PENN: Let me take those in order, Max. I mean, the first point really around valuation is that – no. I mean, this was a share exchange, so therefore we're not announcing and/or we haven't placed an overall valuation of the combined entity on the transaction. In relation to the intercompany relationships between Telstra and Foxtel for the distribution of content, etcetera, they are basically the subject of separate agreements to this, and reseller arrangements, and those get updated from time to time, and they've been updated recently. They're not materially different. They take account of the fact that a lot of media is coming over IP today as well as broadcast, but that's essentially the only situation I can think of.

And then finally, your last question in terms of timing for an IPO, I think that what I will say is that we think that ultimately the combined business will be further strengthened and further well positioned if ultimately it was listed, and that's a view that we share with News. But to your point, I mean, obviously you want to go through the merger appropriately and make sure the business is in the best position to the IPO, then we wouldn't see that happening immediately, but we're going to work together to see when that might be possible. And so – and then was there one last question?

MR MASON: Yes. I guess on the structure of a future deal, I think you probably

MR PENN: Well, obviously we would need to dilute some equity to allow new investors to come in, and News have indicated that they would want to retain the ability to essentially consolidate the business into their accounts, and so we would envisage that we would dilute down some, and really it's a matter for News as to what they would do in that situation. I'm not – I won't quote a number of where our equity would end up. But we would be definitely prepared to dilute down to achieve that IPO position.

MR MASON: Okay. Thank you.

OPERATOR: The next question that we have is from Darren Davidson from The Australian.

MR D. DAVIDSON: Good morning, Andy. Do you see the likes of Amazon, Facebook and YouTube participating in the auction – or the next auctions for top-tier sports rights locally and is this move partly a response to any potential looming competitive threat from those tech giants? And then just lastly, what do you make of Tim Worner's comments earlier this week where he said he thinks that the market for sports rights has reached a tipping point and there's no more room for price hikes?

MR PENN: Thanks, Darren. Certainly, our immediate sector is very dynamic at the moment and basically with more media becoming available over the internet essentially, that's changing the dynamics of the industry and as you said, there are new players such as Amazon that are providing media offerings and Netflix. Foxtel and Fox Sports together – because Foxtel, really, is the key distributor for Fox Sports so in a sense it's the same content – we think has the pre-eminent and the best content in Australia so this move is to just bring those two businesses together and simplify the structure so they can be well positioned to respond to all of the changing market dynamics, including the need to actually make more of that content available over the internet, over an IP network as well as through broadcast as well.

I mean, as regards where does the price of content go, the Foxtel team and the Fox Sports team are probably better equipped to comment on that than I am. I mean, what I would observe is that there is more content being consumed today and more demand for content than there has ever been so you've got – on the demand side, you've got customers wanting to watch content. I think the price of subscription TV and pay TV is definitely reducing as well and you've got that dynamic sort of playing out as well.

But I mean I couldn't – I wouldn't be brave enough to sort of predict where content prices are going, to be honest. I think probably those in the media industry are closer to it than I am. What I would say though is that I think, in terms of having content as part of an offering for our customers is important because more and more people are watching more and more content over IP in the home so it's a valuable part of our claim.

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MR DAVIDSON: Thank you.

MR PENN: Thank you, Darren.

OPERATOR: The next question we have is from Brian Han from Morningstar. Go ahead.

MR B. HAN: Good morning, Andy. When this combined entity lists on the market, does it need to engage in M&A to make it a more sustainable company?

MR PENN: My answer to that would be no, it doesn't need to do M&A. It's already a very big provider of content and great media services in Australia. Whether it wishes to do M&A, whether there are opportunities to do M&A, I guess time will tell in that regard, but absolutely it doesn't need to.

MR HAN: Because going back to the sports rights question, you can probably sort of make a case that this combined entity could be interested in a free-to-air distribution platform so that it has leverage against sports rights holders.

MR PENN: Yes. As I say, I mean, I don't think it needs to do any M&A, but I can – ultimately, like any business, I mean, that's a further opportunity to develop the business strategically.

MR HAN: Have you done any preliminary work on how much synergies there are?

MR PENN: No. This isn't about synergies. This is actually about bringing together the businesses which are essentially already part of the same value chain, if I can put it that way, and just eliminating some of the intercompany complexity which exists as a consequence of that. So I'm sure there will be some opportunities to improve efficiency of the running of the whole business as a consequence of bringing them together, but I haven't done any work – or my team hasn't done any work in terms of the numbers because it's not motivated by that.

MR HAN: Okay. Thank you.

MR PENN: Thanks.

OPERATOR: The next question we have is from Craig Wong-Pan from Deutsche Bank.

MR C. WONG-PAN: Morning. Just one question from me. Given that you will now be equity-accounting the merged entity – does that mean there will be any Foxtel debt that is deconsolidated from the Telstra balance sheet? And if so, can you quantify what the impact is.

MR BRAY: So the Foxtel debt isn't on our balance sheet in the accounting sense. But it would to some degree help us in the way rating agencies look at our debt.

MR WONG-PAN: Okay. Thanks.

MR PENN: Thanks, Craig.

OPERATOR: And the next question we have is from Lucy Battersby from Fairfax Media.

MS L. BATTERSBY: Hi. Thanks. I just wanted to clarify Telstra's ownership. In the accounts that you filed yesterday it said that Telstra has an 80 per cent equity stake in Foxtel, but you've effectively worked this as a 50 per cent stake with News. So are you turning an 80 per cent stake in Foxtel into a 35 per cent stake in the combined entity?

MR PENN: No, Lucy, we have a 50 per cent interest in Foxtel. I'm not sure – I mean, Foxtel has a corporate structure with a number of different entities. It's actually a partnership. So I don't know what the 80 per cent is that you're referring to. But I will go back and have a look to clarify that. But to be clear, our economic interest in Foxtel, today and since the inception of Foxtel, has only ever been 50 per cent. It was when we started it up; it's 50 per cent today. So what we're – this transaction involves us giving up essentially 15 per cent of our investment in Foxtel for a 35 per cent investment in the overall entity and so therefore a 35 per cent investment in Fox Sports, which we don't have today.

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MS BATTERSBY: And just a couple of housekeeping things. How many directors will you have on the board, and what will be the name of the new entity?

MR PENN: We haven't yet decided on the name of the new entity. So that's something we will communicate in due course. I mean, the transaction is subject to regulatory approvals and the finalisation of the usual documentation. So that will be a matter coming down the path. And also we haven't yet necessarily agreed the precise number of directors.

MS BATTERSBY: Okay. Thanks.

MR PENN: Thanks, Lucy.

OPERATOR: The next question we have is Andrew Levy from Macquarie Securities.

MR A. LEVY: Thank you. Congratulations on the announcement. Just two questions. The first one – the agreements for Foxtel to buy telco services via Telstra going forward: is that in perpetuity, like it was in the old shareholder agreement? Or is it for a fixed period? And if so, how long? And the second one is can you just clarify what's going to happen with the shareholder loans to Foxtel? And also, is there any interest income in your accounts – like, in your FY17 accounts – attributed to those shareholder loans?.....

MR PENN: I might ask Warwick to comment on the debt and interest questions.

MR BRAY: Yes. There was some interest in the twenties of millions – I will – we will clarify the figure for you – in our FY17 accounts. And then in terms of the shareholder loans, look, we will clarify that as we get closer to announcing the details of the deal.

MR PENN: And regarding the telco services, the telco services do continue under the new arrangements. It's part of the – be part of the sort of binding terms, once they're agreed. They don't go into perpetuity, but they do go forward for quite a long period of time. I don't think we've actually disclosed that, but it's a good number of years.

MR LEAHY: Okay. And is that contractually embedded now? So if you sold/IPO or something like that, that wouldn't change those arrangements?

MR PENN: Correct.

MR LEAHY: Thank you.

MR PENN: Thanks, Andrew.

OPERATOR: The next question we have is Raymond Tong from Evans and Partners. Go ahead.

MR R. TONG: Good morning, Andy and Warwick. Just a couple of questions. Can you also maybe just clarify whether the Telstra/Foxtel HFC Cable agreement still remains in place going forward? And secondly, does the transaction change how Telstra approaches mobile sports rights going forward in any way?

MR PENN: Thanks, Raymond. As regards the HFC arrangements, the transaction doesn't have a bearing on those arrangements. Those arrangements roll forward until – trying to – looking at Warwick. I think it's 2021 or 2022.

MR BRAY: Yes. It's around

MR PENN: Yes. 2021/2022. And so this transaction has no bearing on those. That agreement – those arrangements stay in place. And as regards does it change our approach to AFL NRL sporting rights, no. We have significant media interest directly ourselves, from a mobile perspective and also through Telstra TV, and this arrangement gives us the flexibility to continue to pursue those opportunities as well as having this investment in the combined entity.

MR TONG: Great. Thanks, Andy.

MR PENN: Thanks, Raymond.

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OPERATOR: And the last question we have for now is John Stensholt from the Financial Review.

MR J. STENSHOLT: Good morning. Thanks, Andy. Just a quick one. I think it's probably just clarifying something - the management. I mean, maybe it goes to synergies as well. Does – any changes to, say – well, given Foxtel and Fox Sports both have separate CEOs at the moment, any changes in that regard?

MR PENN: The current arrangement is that News runs in the sense that they appoint the CEO and they appoint the senior executive team, and of course, Fox Sports is 100 per cent owned by News today, so the matters of management are really down to News.

MR STENSHOLT: Okay. No problem at all. Thank you.

MR LAIRD: Thank you. That nicely coincides with the amount of time we had available for the conference this morning. So thank you everybody for dialling in. Thank you, Andy. And enjoy the rest of the day.

SESSION CONCLUDED