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The Manager

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**ELECTRONIC LODGEMENT**

Dear Sir or Madam

**Telstra Trading Update - transcript**

In accordance with the Listing Rules, I attach a copy of the transcript from Telstra's trading update yesterday, for release to the market.

Yours faithfully

**Sue Laver**  
Company Secretary

MR B. LUETJENS: Good morning, everybody. Brent Luetjens here from Telstra Investor Relations. Thanks for hooking in to our trading update call this morning. I have Warwick Bray here with me this morning, CFO. Warwick will make some opening comments on the two documents lodged with the ASX this morning, being the market update and a copy of Andy's address that he is giving tomorrow morning in Boston. We will then open up the call to questions from institutional investors, sell-side analysts and then media. Warwick.

MR W. BRAY: Thanks Brent. So today we're providing an update on trading based on our year-to-date results to April. So we are reaffirming our FY18 guidance, however EBITDA is expected to be at the bottom end of the range and free cashflow is expected to be at the top end to moderately above. Our chief executive, Andy Penn, will be presenting to an equity conference in Boston tomorrow on progress against the company's strategy and we have simultaneously lodged his speaking notes on that.

Look, the summary of the trading update is that there's quite strong progress against implementing our strategy, pleasing growth in subscriber numbers in both fixed and mobile and we are continuing to see increased demand for telecommunications services. Despite that the industry is facing challenges and that is leading to increased pressure on both fixed and mobile ARPU and margins. We would expect those challenging conditions in FY18 to continue into FY19. So we will provide a further update to the market in the second half of June regarding additional initiatives that we're taking. We would note that most of those initiatives very much depend on the investments we've already made as part of our strategic investment plan.

The next few paragraphs talk about the – some of our March quarter results. In summary, sound additions to customer numbers but pressure on ARPU. We continue to focus on reducing our costs and we expect our FY18 underlying core fixed costs to decline by about seven per cent. In terms of restructuring costs we said that we would incur to \$200-300 million dollars and it's likely to be at the upper end. We are reaffirming our FY18 total dividend to be 22 cents per share fully franked. The basis upon which we talk about guidance and also the dividend is included in the footnotes in the release. With that, I will open up the questions.

OPERATOR: And our first question is from Eric Choi from UBS. Go ahead, please.

MR E. CHOI: So the questions – I guess, the first question is just around this trading update versus the Macquarie conference. I guess the incremental information we have since then is probably April trading so I'm just wondering if you can comment on how that \$65.35 has potentially moved into April. The second question is just on the free cashflows. I guess if I look at FY18 guidance now, more of that EBITDA is weighted towards those one off NBN payments which should create a working capital drag. So given that, just wondering what other offsets there are, such that free cash flow conversion has actually gone up. And then just a last question is I guess looking ahead into FY19, you guys previously launched Belong, and I think when you launched it you didn't charge for voice – sorry – you charged \$5 for voice but you since scrapped that. I was just wondering if you can comment on the take-up of those non-voice plans, obviously relevant for your competitor and how successful they might be going forward, please, thanks.

MR BRAY: Yeah. So on the first question, which is the April result, the challenging conditions have continued through into April. On the second of those questions, look, that factor in and of itself is negative on working capital, as you pointed out. What has been positive on the free cash flow is two things. First is that we have had a big emphasis this year – particularly this year on working capital management, including tight management of accounts payables, accounts receivables and inventory. Some examples of initiatives in there would be the electronic bills which sort of helps out days receivable.

But the second factor on free cash flow is that we have multi-billion dollar contracts both in terms of receiving cash and also paying out cash. Now that we're six weeks away from the end of the year, we have a much better view on the exact timing of some of those, and so many of those come in in the last couple of weeks of June, and so a few days either way can shift hundreds of millions of dollars of cash from one year to the other, and so having better visibility of that would be the second impact on the free cash flow.

The third question is on Belong, and Belong is an important part of our strategy, which is to make sure that we have a fighter brand at the appropriate part of the market. We continue to be pleased with the progress of Belong Mobile. I don't have a specific answer onto – on the voice – charging for the voice. I'll get my investor relations team to get back to you on that.

MR CHOI: Thanks, guys.

MR LUETJENS: Thanks, Eric. I believe the next question is from Kane Hannan, Goldman Sachs.

MR HANNAN: You've provided a reasonable bit of colour on the mobile and fixed businesses, but can you just update us on performance of some of the other key EBITDA lines, the data and IP and NAS businesses in terms of this update? And then just on the dividend, obviously confirmed that at 22 cents in FY18. Based on your expectations for the more challenging conditions in '19, comment on how you're thinking about the 22 cent divi into '19, whether we think that is a reasonable number to be basing it on.

MR BRAY: Yes. So – thanks, Kane. Look, we – NAS – the NAS business – the second half and indeed the last quarter is always a critical time for our NAS business. We have strong expectations for NAS and will update the market in August on that. We have recently recommitted to getting to an EBITDA margin for NAS in the mid-teens. Data and IP are broadly in line, and, of course, there's some pressure on ISDN with Data and IP, and we have some improvement in our International business. In terms of the FY19 – in terms of the dividend, so we're recommitting to the 22 cent dividend in FY18. For years after that, we will – the board will determine the dividend along the lines of our capital management framework and our dividend policy. The capital management framework includes the A band credit rating and the dividend policy requires us to pay 70 to 90 per cent of underlying earnings as

dividends, and 75 per cent of the nbn<sup>1</sup> one-offs – around 75 per cent of nbn<sup>2</sup> one-offs over time, and so the dividend for FY19 and beyond will be determined by the board in accordance with those policies, and of course, earnings will be an important part of that determination.

MR LUETJENS: Thanks, Kane. Next question is from Sameer Chopra, Bank of America Merrill Lynch.

MR S. CHOPRA: Morning. Two questions. Firstly, look, congratulations. Really strong net adds both on mobiles and fixed data. My question was on pre-paid and mobile broadband. The revenue issue there, is that coming from subs or ARPU? If I can get some colour on that. And then the second one was – there was some press around the relationship with ZTE, and I was just wondering if you could talk about does that change in any ways your 5G launch plans, or do you think you have enough other suppliers in the mix. Thank you.

MR BRAY: Look, over the years we say prepaid to postpaid, postpaid to prepaid migrations. For quite an extended period, we're seeing a prepaid to postpaid migration. So for the market overall and for us there's pressure on both ARPU and there's pressure on subscribers. With mobile broadband, what we're seeing there is continued strong momentum in subscribers. So we're seeing people loving getting their tablets connected and their cellular Wi-Fi devices, but there is pressure on ARPU for postpaid mobile broadband and pre-paid mobile broadband is a sector that continues to decline, but we've previously talked about that. In terms of ZTE, look, the first point is that we have very, very strong supplier governance policies and so we expect the high standards from our suppliers. We note the press this morning and, of course, investigation of that will be an important part for all of our suppliers. Also note that we announced a stop sell of selling ZTE devices last Friday on the basis of the US determination. So that speaks to the devices.

MR LUETJENS: Thanks for your question, Sameer. Next up, we have Raymond Tong from Evans and Partners. Go ahead, Raymond.

MR R. TONG: Good morning, Warwick and Brent. Just a couple of questions from me. Warwick, just a question on the postpaid ARPU decline of 3.6 per cent for the third quarter which was sort of worse than that 2.9 per cent in the first half. And I think, Warwick, you mentioned that the half-year result, as well, that there was a one-off impact of around about that \$15 million that impacted the first half. So just trying to understand the reasons or the drivers behind the worsening decline, which seems to have accelerated quite a bit into the quarter and whether that's just a lot of people spinning down, SIM-only – just like to understand that a bit more.

MR BRAY: Yes. Thanks, Raymond. So there's two pressure points on ARPU. So we have four segments. We have consumer, small to medium business, premier business and enterprise. And what – and the two areas that I will talk about on ARPU – and there's different factors going on – is premier business and consumer. So in premier business, we are seeing intense competition, that means that whilst we

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<sup>1</sup> Verbatim one-offs

<sup>2</sup> Verbatim one-offs

always aim to sell more for more, we are seeing recontracting – as we do a recontract after, for instance, two years, we're recontracting at a lower ARPU than two years before, which is not our aim, but that is what's going on in premier due to the challenging conditions. In consumer, it's a quite different story.

We're not seeing spin down at all. In fact, minimum monthly commitments in consumer remains amongst the healthiest that I've seen. So stayers, leavers and joiners are all adding to the minimum monthly commitment. What we are seeing in consumer is the out of bundle revenue is in decline partly as a result of the more generous plans that are in the market. So they are the two areas that are influencing ARPU the most, Raymond.

MR LUETJENS: Thanks, Raymond.

MR TONG: Yes. And just – Warwick, just on your comment on sort of providing an update to the market in June in regards to additional strategies, can you maybe give a bit of colour in terms of what that means and does that mean Telstra will be sort of stepping up competition a little bit in the coming quarter and also sort of, I suppose, like, what that means for the \$3 billion dollar investment is – does that change or is that going to be any more there. Thanks.

MR BRAY: Look, let me start with the strategic investments that we're making. We're really starting to see strong progress and output from what we're absolutely seeing in the market. And so, for instance, in the network, we're seeing – we've updated the four backbone networks so it's capable for five times more traffic by 2020. We've got in next generation OSS so we can see real-time what's going on with the customer. That's on the network side. And on the digitisation side, we're similarly seeing some great progress, including implementing the enterprise stack, which means that we can get great products like Liberate and the Telstra Programmable Network out there much more quickly. And Andy's providing a lot more colour on that, and I encourage you to look at the speech that we've lodged simultaneously with this trading update. Those investments that we have made are enabling us to do more initiatives, and we'll be talking to those and other initiatives in June, but that's all I'm going to say on those at the moment.

MR LUETJENS: Thanks, Raymond. Next question we have is Andrew Levy from Macquarie.

MR A. LEVY: Yeah, thank you. A couple of my questions got asked. I've just got a question on the use of subsidies, sort of particularly through November, December of last year and then in pockets of this year. What level of subsidy is Telstra providing relative to previous periods? And, Warwick, can you just talk through, from an accounting perspective how that – how that flows through these days and what might still be to come in, the remainder of this year and FY19 in terms of the impacts fully washing through in the numbers. Thanks.

MR BRAY: Yes. So a couple of things there. On the subsidies, I mentioned at the half-year they were at an elevated level, and nothing much has changed over that. In terms of the accounting, it's – because – and what's underlying your question is the move from MRO to lease. We're mostly through that in terms of influence.

MR LEVY: Okay. And just more generally, like, it's all – like, do you see this as all competitor-led, so Telstra's strategy is just to be, on them to make sure you keep getting the subscriber growth and you're sort of matching them in market as long as need be?

MR BRAY: Look, we start with the network. We aim to – we aim and we do have the best network in Australia, and we're investing in the network in the way that we've talked about in the speech, and we're making sure that we're being clear about the benefits of the network. We're improving our customer service even more. We're digitising our business to enable us to put out better products, and more digital products. And so that's sort of at the heart of our strategy. And then in terms of how we show up in the market, we aim to get – provide that for customers and achieve a price premium, and the price premiums that we aim to achieve are along the lines that we've talked about before.

MR LUETJENS: Thanks, Andrew. Next up we have Brian Han from Morningstar. Brian?

MR B. HAN: Thanks. Warwick, just one question. Do you think Telstra is competing as aggressively as it can in the mobile space, or are there things that are still hindering the way you're going after subs?

MR BRAY: Well, really pleased about the investments in the network, which are providing us with continued network advantage. Really pleased with seeing what's coming out about digitisation programs, and some of the great products that we've put into the market. Look, in recent times, we have seen initiatives like launching Belong Mobile, and we've seen some innovative price packages, and we've seen the introduction of our fighter brand Belong Mobile, and also, of course, our continued MVNO strategy. So we are taking rapid measures in the market and continuing to provide a differentiation.

MR HAN: Also, Warwick, if you don't mind, just for my benefit, can you just briefly explain the difference between the consumer segment and the premier segment?

MR BRAY: So the consumer segment goes up to the – it goes – it's families, individuals – goes up to all customers who don't have an ABN, and the ABN – and then we have small to medium business, which starts from the smallest business, and then there are three segments in business: small to medium business, premier and then enterprise, and premier is the set of businesses in the middle.

MR HAN: Thank you.

MR LUETJENS: Thanks, Brian. Next question, Roger Samuel from CLSA.

MR R. SAMUEL: Morning, guys. Two questions from me. First one is – so Telstra launched the unlimited mobile plans a few weeks ago, and I'm just wondering what you expect internally in terms of mobile ARPU going forward. Is it going up or down? And secondly, I'm just wondering if this trading update has any impact from the adoption of IFRS 15. Thank you.

MR BRAY: Yeah. So I note that unlimited is one part of an – one part of the overall consumer ARPU, which is one part of the overall post-paid handheld ARPU, and the unlimited is available on our BYO plans. Now, in terms of its impact on ARPU there are two factors at play. The first it has been launched high in the BYO set of plans and so we would expect some upgrading. On the other hand there is the opportunity for some other customers to move to unlimited. And this question about how to manage recontractors is at the heart of skills of being a mobile operator. We always aim to provide value and provide more for more, and then we've sort of carefully assessed this plan and that's how we've thought about it.

MR LUETJENS: Thanks Roger. Next up, we have Ian Martin from New Street.

MR I. MARTIN: Yeah, actually I was going to ask about the unlimited plans as well and the ARPU impact. So my sense of your answer was that you don't think it would have much impact on overall ARPU?

MR BRAY: I think I answered that one Ian.

MR MARTIN: All right. I've got a couple of other questions then. Has the impact of the HFC pause been much as you expected in December and, secondly, given the rates of change and your caution about next year's outlook and so on, I wonder if you've given any thought to perhaps having quarterly reports as more of a routine rather than necessarily a trading update here and there.

MR BRAY: Yes. We haven't announced anything on that here.

MR LUETJENS: Thanks Ian. Next up we have Sondal Bensen from Pandal Group.

MR S. BENSON: Yeah, hi Warwick, I just want to go through some of the numbers you've given in terms of the earnings impacts and obviously we know all the numbers in the first half and you've updated a fair bit of them for the full year now in terms of restructuring costs. I mean, the bit I don't really understand is if you look at the first half results, I mean, admittedly there are a few one offs that you called out that impacted core business growth and the timing of NAS and the one off impacts in mobile ARPU that Raymond mentioned before, I mean, when you adjusted for those few factors and it looked like the sort of the core business excluding NBN one off contributions which you've now updated for the full year, the core business excluding that sort of declined by about 380-odd million dollars.

That's with – that's including those one off timing effects on NAS and also that one off mobile ARPU impact. So obviously it was less than the 380 mill. But if I look at what's implied by your second half on that exact same basis – this is all pre-restructuring costs just so you're looking at the right numbers – it looks like the implied reduction in your core business excluding the NBN net one off contributions is closer to \$1 billion. I'm just trying to understand how you can move from the core business going from roughly a 300-ish mill decline in the first half to nearly a billion in the second half and how the dynamic can shift so rapidly in a six month period based on one quarter's trading.

MR BRAY: Yes. Thanks Sondal. So, look, in terms of the underlying – well, in terms of our overall business, the factors at play are the NBN one offs, as you point

out. And then what's going on in the underlying business is, firstly, there is pressure on mobile ARPU and that's leading to pressure on gross margins as well and then of course there's the subsidy factor as well. The second factor that's going on is that the NBN is impacting the fixed line and not only is the NBN impacting the fixed line, we're also seeing pressure on the margins, the ARPU that we provide on the NBN.

The combination of mostly those two factors is larger than the benefits that we're getting from the fixed cost and so therefore, as you point out, the underlying business is negative for this half and it's negative at a greater rate. I would have to go through the way you put those figures together to confirm your exact figures.

MR BENSAN: Right. I'm still not sure how the number could be so large, though. I mean, you already had a pretty rapid decline in mobile ARPU in the first half so you have that again in the second half plus a little bit more based on your quarterly update. I mean, it still doesn't reconcile how the gap from the second half '17 to second half '18 could be so large. I mean, there has to be something else going on within P&L for the gap to be so large. I mean, either you're not getting the costs out that you're saying you're getting, or there's some other hole in the P&L somewhere.

MR BRAY: I have to go through your numbers on that one, Sondal, but the factors that I've described are the factors. It's ARPU on mobile, ARPU on fixed lines, and it's the impact of the NBN, are the main factors, and the costs are coming out as we've described.

MR LUETJENS: Thanks, Sondal.

MR BENSAN: Just one other – just one other question, sorry. Just on the ARPU, I mean, I know you answered Raymond's question. I missed some of it because I was speaking to the operator, but the – I don't know if you went through the ARPU – I know you said the minimum monthly spend is still going up, which has been happening for a while. The other component – did you mention at all how much of the total ARPU is actually these excess or out of bundle components, that is, the negative drag?

MR BRAY: Yes. So we've mentioned that the MMC is going up in consumer, but we've got pressure on that in premier, so it's different in the different segments, and we haven't as yet quantified our out of bundle revenue, but that's good feedback. Thank you.

MR LUETJENS: Thanks, Sondal. Next up we have Sameer, Sameer Chopra returned from Bank of America Merrill Lynch.

MR CHOPRA: Thanks. Thanks, guys for the follow up question. Just a quick one. Warwick, you were – you mentioned that it's the out of bundle revenues that are causing the issue. Could you give us a sense around how much more there's still to go in the out of bundle and when we can start moving to a – just a monthly minimum commitment?

MR BRAY: Yeah. We haven't quantified that yet, Sameer, and it's good feedback, and we'll contemplate that quantification for later on.



MR CHOPRA: Thanks.

MR BRAY: Hey, I should also mention I skipped over a question about IFRS early on, and I have given a couple of indications of IFRS from early on in – from results, and nothing has changed in our view on IFRS, so IFRS has nothing to do with today.

MR LUETJENS: Okay. So moving on to the media component of today's call, Jason, I'll hand over to yourself.

MR J. LAIRD: Sure. Thanks. And, Operator, can you proceed with the media questions now, please.

OPERATOR: Thank you. The first media question we have is from Peter Ryan from ABC. Go ahead.

MR P. RYAN: Yes, good morning. Thank you for taking my question. Look, some of this has already been covered, but just looking at the ongoing impact of the – of the NBN, is that the main factor in you, being cautious there in your earnings guidance?

MR BRAY: So, look, there's two main factors, and so one of them is the impacts of the NBN, and we're still of the view that if the – that by the conclusion of the NBN, it will influence negatively about \$3 billion worth of EBITDA. And the second reason for caution today is on our average revenue per users, both in the mobile business and in the fixed line business.

MR RYAN: Okay. So you've got the NBN on one hand, but also fewer people signing up to your plans?

MR BRAY: So it has been a really pleasing set of subscriber numbers, so it's actually about how much each of them spend, which we call the average revenue per user. Our subscriber numbers are strong and our customers are pleased with the services that we provide and the network, but it's – the pressure is on the ARPU reflecting the challenging market conditions.

MR RYAN: Okay. Thank you very much.

OPERATOR: The next question we have is Max Mason from The Australian.

MR M. MASON: That's the Australian Financial Review, not The Australian. But good morning, guys. Good morning, Warwick. I'm wondering, can you tell me why you can't outline some of these additional strategies? I mean, the reasons why you're going to be at the lower end of your EBITDA guidance – they're not new pressures. They're things that we've been speaking about for 24 months, 36 months. Can – as if you can't communicate that to investors now. Why do you need an extra one month?

MR BRAY: Look, today – sorry - over the next couple of days, we're providing a lot more colour on the benefits of some of the initiatives that we have been taking. And so we're going to be talking about continued investment in our network and

features such as Network Function Virtualisation, Software-Defined Networks, upgrading our backbone so it can handle five times the traffic, completely new operational support systems which provide in real time analysis of customers. And we're starting to see some fantastic outcomes from the digitisation of our business. And these capabilities, we're starting to really see coming into the market. And we will be talking more about that over the next couple of days. What these capabilities mean is that we can do even more, and that's what we're going to be talking about in June.

MR MASON: I guess, again, that, the pressures are nothing new. Why wasn't this outlined in a strategy 12 months ago?

MR BRAY: Well, we have outlined the set of strategies that I've just talked about, including reinvesting in our mobile and fixed networks. We've invested in our enterprise IT system – so whole new sets of products are available for our customers. And we've continued the strong progress on our cost out.

MR MASON: Okay. Thank you.

OPERATOR: And the next question we have is from Jennifer Duke from Fairfax.

MS J. DUKE: Hi, Warwick. Look, just referring again to ZTE, did you say that you're internally looking into the claims made in the media? Could you clarify sort of what that involves, and is it difficult to find companies outside of China to build the 5G network?

MR BRAY: Look, we have the strongest supplier governance and policies and we will always review new material, and so we will review new material about all of our suppliers. And governance will be – governance and probity and abiding by regulations is a critical part of our supplier decisions for all suppliers.

MS DUKE: And just in terms of that, that question regarding looking at companies outside of China, are there few options for you?

MR BRAY: Look, today is a trading update, and I've probably said all I want to say on that.

MS DUKE: Thanks.

OPERATOR: The next question we have is from Corinne Reichert from ZDNet.

MS C. REICHERT: Hi, Warwick. Can you provide any more detail about the technology stacks and mass market consumer and small business that's referred to briefly in Andy's speech?

MR BRAY: Yes. Look, Andy will be talking about that more today in – more over the next couple of days, and we will provide more details, but today is really a trading update.

MS REICHERT: Great. And just on another question, how do you think the entrance of TPG will impact FY19, and what are you doing to mitigate this risk?

MR BRAY: We're reinvesting in our networks. We're very pleased with that. We're making sure that we're being clear about the benefits of the network. We're continuing to improve our customer service, and we're – and we've also launched the fighter brand Belong and we're also continuing to take costs out of our business. And we're focusing on providing the best possible services for our customers.

MS REICHERT: Thank you.

OPERATOR: And the last question we have is Petroc Wilton from Communications Day.

MR P. WILTON: Hi, Warwick. Some of this has come up already, but you've got TPG coming into the market, you've got the unlimited plan starting. That's across all operators. What's the plan to reverse the trend in mobile ARPU across the board? I mean, you talk about network reinvestment, but will that translate into, what, a larger premium that you guys can charge or - - -

MR BRAY: Look, we've got no plans to increase our premium. On the other hand, it's absolutely critical for us to continue to provide our customers with the best possible network, to continue to improve our customer service, digitise our business and get our costs out so that we can provide approximately the same premium that we always have.

MR WILTON: So how do you start getting ARPUs – mobile ARPUs heading back up again?

MR BRAY: Oh look, that's – ARPUs come down from time to time in markets. In terms of ARPUs going up, it is about us providing the best possible services, and we're confident that over the time the underlying demand that continues unabated will translate into us being rewarded for providing the best possible service.

MR WILTON: Thank you very much.

MR LUETJENS: Thank you. I don't believe we have any more calls, so we will end the call there. Thank you, Warwick. Thank you, everybody, for dialling in today. Have a good day.

**TELECONFERENCE CONCLUDED**

**[10.35 am]**