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The Manager

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ELECTRONIC LODGEMENT

Dear Sir or Madam

Transcript from Full Year 2016 Financial Results – analyst briefing

In accordance with the listing rules, I attach a copy of the transcript from yesterday's Full Year 2016 Financial Results analyst briefing, for release to the market.

Yours faithfully

Damien Coleman
Company Secretary

MR KOPANIDIS: Good morning, everyone and welcome. My name is Peter Kopanidis, and I'm Telstra's Head of Investor Relations. On behalf of Telstra, I welcome you all, both here in Sydney and those joining us via webcast, to our 2016 full year results presentation.

As an important symbol of respect, it is our custom at significant Telstra events to acknowledge Australia's first people. Today, therefore, I would like to acknowledge that we meet on the traditional lands of the Gadigal people of the Eora Nation and pay my respects to elders both past and present. After presentations from our CEO, Andrew Penn, and our CFO, Warwick Bray, we will be taking questions from investors and analysts both here in Sydney and on the phone. With that, I will now hand over to our CEO, Andrew Penn. Good morning, Andy.

MR PENN: Well, thanks very much, Peter, and welcome to Telstra's results for the year ended 30 June 2016. This morning we have made a very important announcement regarding a significant investment for the future in our core business. I'm going to come to that soon, but firstly Warwick and I will take you through the results for the year. I will make some comments on the highlights before Warwick takes you through the results in detail.

2016 was a year of strong performance against the background of increasing competitive dynamics. Net profit after tax from continuing and discontinued operations was up 35.9 per cent to 5.8 billion and we delivered against guidance in our three key measures of income, EBITDA and free cash flow. Importantly, we continued to attract new customers, with 560,000 net new mobile customers and 235,000 fixed broadband services. We also saw 322,000 customers taking bundles. 2016 was also a very important year for the nbn. During the year, we added 289,000 net new nbn customers and the year also marked our 500,000th new customer since the beginning of the nbn. This event coincided nbn's announcement of its 1 millionth connected home. We also signed contracts with the nbn in relation to both build and maintenance to the value of over $1.6 billion over the next few years.

Our GES business performed very strongly, with income up 11.5 per cent, with a particularly strong performance from services including cloud in the first half of the year. We are very pleased with the performance internationally, with revenue up 55.5 per cent following the successful integration of Pacnet. We have seen some significant customer wins, domestically and internationally in GES, which will further underpin future growth. We have also achieved a targeted improvement in margins for services. The fixed broadband business has performed strongly, with customer wins that I have mentioned leading to solid revenue growth. We saw a particularly strong performance from Belong, which is now in its third year since launch. Our fixed broadband margin was strong, notwithstanding the acceleration in the migration to nbn.

There is no doubt that the mobiles market has been very competitive and this is reflected in ARPUs. We have performed well in that environment, and while underlying revenue growth was flat, EBITDA and margins both grew. Our mobiles performance in the business segment was very strong and reflects the increasing use of our mobile assets to drive new solutions for industries, mobile workers and connected devices.

Our productivity program has been dialled up, with an underlying decrease of 0.6 per cent in our fixed costs which Warwick will take you through later. It has also been a very important year for our media business and we have signed long term agreements for exclusive digital media rights for the AFL, the NRL and netball, Australia's biggest broadcast and grass roots sports. These leverage the growing trend of watching live sport on your mobile, which has never been more evident than the record-breaking mobile consumption of the Rio Olympics this week, enjoyed for free only with Telstra. We are using these media assets to enhance the value of our fixed and mobile services for our customers. For our fixed customers, we now have more than 300,000 Telstra TVs in our customers' homes following the launch only in October of last year. 2016 was also our biggest year ever for Foxtel from Telstra, with 20 per cent growth in customers. Already more than 750,000 mobile customers are enjoying premium sport and music content experiences through the Telstra mobile plan.

During the year, we took the next step in the evolution of our brand in line with our vision. We launched to the market in July and we are extremely pleased with the overwhelming positive response from our customers. The financial results for the year include a $1.8bn profit on the sale of the majority of our shareholding in Autohome. Autohome has been an incredibly successful investment for Telstra. Our decision to sell the majority of our shares reflects the opportunity to underpin the next phase of Autohome's growth through a very significant strategic partnership between Autohome and Ping An. Ping An is very well positioned to leverage their large customer base, with significant interests in motor vehicle insurance and financing. We retain a 6.5 per cent holding in Autohome and a board position.

The results for the year also included a $246 million impairment of Ooyala. The Ooyala impairment reflects the changing dynamics in the intelligent video market and the business performance but it remains a young and exciting company, with leading offerings in intelligent video which will continue to evolve and scale. Earnings per share for the year was up 37.4 per cent to 47.4 cents per share and 31.6 cents on a continuing basis. The board has declared a final dividend of 15.5 cents per share and this takes the total dividend for the year to 31 cents, up 1.6 per cent compared to last year. Further to our announcement on 2 May, we will also be undertaking a $1.5 billion capital management initiative which will be implemented through an on and off market buy-back over the next few months.

The one thing I am disappointed about for the year, though, is despite our strong performance, was that our customer advocacy result fell four points. We did not deliver to the extent we should for our customers. It is clear that we have more to do to improve our systems and processes to ensure that we consistently deliver a great customer service experience. We also know our customers, whether they be individuals or businesses, enterprises or governments, retail or wholesale, domestic or international have come to rely significantly on their smart devices and connectivity. And this is why the network experience is so important. Over the second half of the year we experienced a number of issues within the mobile, fixed broadband and IP networks and these caused disruptions for a number of our customers. We have taken extensive and end-to-end reviews of the networks involving international and independent experts.

As a consequence of these reviews, in June we announced a $250 million program of initiatives from within our current capital budgets. These include a $50 million investment in mobiles through improved recovery times and network monitoring, a $100 million investment in the core network to improve resilience and reliability and a further $100 million investment to increase ADSL capacity to meet consumer demand for rapidly growing streaming. We're well progressed in relation to this program of investment and we have already substantially improved our recovery times within the mobile network.

In parallel with the resilience program, we have continued to build out our network capabilities. During the year, we upgraded more than 2,000 network sites to 4GX and achieved 98 per cent population coverage with 4G. On average our customers experienced a 25 per cent increase in average download speed for their 4G devices on the Telstra network. We launched Australia's first voice over LTE service in September with more than 1 million customers now having access to high definition calling over 4G through VoLTE. In 5G we are actively engaged in setting new international standards and we are well progressed in relation to 5G readiness. We should not lose sight of the fact that we continue to have the best networks in Australia. With our mobile network providing the best coverage at the fastest speeds. We have always had a tendency and we have always been committed to be ahead of the technology curve and we're committed to continue to do so. I'm confident, with the $3 billion strategic investment in digitisation of networks of the future that we announced this morning, we will further enhance our leadership position.

We're also committed to continue to put the customer at the heart of everything that we do and it is improving the customer experience that has driven this decision to make a very significant further investment. Let me now hand over to Warwick to take you through the results in detail and I will then come back to you to talk to you more about the future.

MR BRAY: Thank you, Andy, and good morning everyone. The presentation this morning breaks down as, first, the overall results and comments on performance against guidance and prior period, second, the business unit and product performance, third, our expenses and productivity, finally, our capital management program and an update on our main balance sheet movements.

Firstly, let me take you through the overall performance of the business in FY16. Our FY16 results were consistent with our guidance across income, EBITDA, CAPEX and free cash flow. On a reported and continuing operations basis, sales revenue for the year was up 1.9 per cent to $25.8 billion. Total income was up 3.6 per cent to $27.1 billion and EBITDA was down 0.6 per cent to $10.5 billion. Reported EBITDA number is including the effects of the impairment of Ooyala intelligent video subsidiary, which decreased EBITDA by $246 million and regulatory pricing decisions, which decreased EBITDA by $62 million.

On a reported and continuing operations basis, net profit after tax was down 6.9 per cent to $3.8 billion and basic earnings per share was down 5.7 per cent to 31.6 cents. The guidance basis removes the effects of impairment, regulatory pricing decisions and in-year M&A. On a guidance basis, total income was up 6.3 per cent and EBITDA was up 2.6 per cent.

This is our first full year operating with Pacnet, which was acquired in April 2015. On a guidance basis and excluding Pacnet, income growth was 4.8 per cent and EBITDA growth was 2.1 per cent. From continuing and discontinued operations, net profit after tax was up 35.9 per cent to $5.8 billion and basic earnings per share was up 37.4 per cent to 47.4 cents. This included a $1.8 billion profit on the sale of 47.4 per cent of Autohome, the Chinese online car business, in June 2016. As a result of the sale, Autohome was classified as a discontinued operation and excluded from our reported result. We retain a 6.5 per cent stake in Autohome.

We have reported an increase in depreciation and amortisation of 4.6 per cent. This was mostly due to the acquisition of Spectrum in the prior period. Net finance costs were broadly flat and income tax was up 1.3 per cent to $1.8 billion. The effective tax rate on continuing operations was 31.6 per cent.

We now move to other main financial measures. This year capex was up 12.7 per cent to $4 billion, including increased investment in the mobile network. Our capex to sales ratio of 15.2 per cent was consistent with our full-year guidance of approximately 15 per cent. On a reported basis, free cash flow increased from $2.6 billion in FY15 to $5.9 billion. The FY16 free cash was influenced by the $1.3 billion associated with the sale of Autohome. Proceeds from the sale of PP&E increased by $376 million, mainly due to the transfer of assets to nbn co under the NBN Definitive Agreement (DA). And capex in FY16 was $456 million higher than in FY15. The increase in free cash flow compared to FY15 was also due to FY15 outflows, including $1.3 billion invested in spectrum and $508 million related to M&A and associated transactions.

As Andy mentioned, the board has declared a fully franked final dividend for FY16 of 15.5 cents per share, the same level as the FY15 final dividend. FY16 aggregate dividends of 31 cents per share are up 1.6 per cent on FY15. Our payout ratio increased to 98 per cent. Excluding the impairment, our payout ratio was 93 per cent and close to our FY15 payout ratio. Our dividend policy remains unchanged and future dividends will be subject to the Board's normal semi-annual approval process and in line with our capital management framework that sets out our goal to seek to increase the dividend over time based on growth in earnings per share on a sustainable basis.

In addition to the final dividend today, we are announcing details of our $1.5 billion capital management program. This will be covered later in my presentation.

Return on equity and return on invested capital remain sound. On a continuing operations basis, return on equity decreased by 3.8 points due to the impairment and increased equity from the profit on sale of Autohome. Return on invested capital decreased by 2.1 points mostly due to the investment in spectrum in 2015. Our future ratios will continue to be influenced by the changing mix in our major products, including the recurring and one-off NBN impacts.

Gearing fell 4.4 points to 43.9 per cent, including cash received from the sale of Autohome. Our credit metrics and balance sheet settings remain at the conservative end of our comfort zone. We retain our sound liquidity position.

Now, turning from our overall results to income performance across our business unit. Our retail income growth was influenced by the mobile terminating access service or MTAS regulatory decision. This reduced our retail revenue by $329 million with only a small impact on EBITDA. Total Retail income was down 1.5 per cent to $16.7 billion. Consumer was up 1 per cent, excluding the impact of the MTAS decision. This growth was achieved through fixed data and mobile subscriber additions, somewhat offset by declines in ARPU and voice revenues.

Business was down 1 per cent, excluding the impact of the MTAS decision. Growth in NAS was strong across managed network services and clouds. This growth was offset by lower revenue in fixed voice mobile excess data and international roaming. In Business we've now reached a milestone of having more revenue across NAS and data and IP than from fixed services.

Global Enterprise and Services income grew by 11.5 per cent, including the acquisition of Pacnet. GES domestic grew 1.1 per cent due to strong NAS and enterprise mobility, including postpaid and machine to machine. NAS growth included the achievement of significant delivery milestones on some major accounts in first half FY16. GES international grew 55.5 per cent to $1.7 billion. Including Pacnet, we've expanded our geographical presence and base of enterprise and wholesale customers.

Finally, Telstra Wholesale income was up 1.4 per cent, largely due to an increase in ISA ownership receipts. Telstra Wholesale income was reduced by the implementation of the ACCC Final Access Determination, or FAD for fixed line services from the 1st of November 2015. Turning now to our product framework.

At our Investor Day in May, we outlined the four factors that will influence our long term sustainable earnings. Firstly, the growth and change in mix of our existing products; secondly, the migration of fixed services to nbn where we identified a $2 to 3 billion per annum long term negative EBITDA impact; third, productivity; and fourth, our investment in long term new growth businesses.

Consequently, we're changing out financial disclosure to identify each of these factors. This new disclosure separately identifies performance from our recurring core, including separating the recurring influence of the nbn, and new business and NBN DA one-off impacts.

Now, let me take you through income performance within this product framework. Overall, we saw continued growth in reported income up 3.6 per cent to $27.1 billion. Our recurring core income growth was 1.5 per cent. Within our core income, the implementation of the MTAS and FAD decisions resulted in a $424 million income reduction. Excluding this impact, our core income grew by 3.1 per cent.

Mobile was up $143 million, or 1.3 per cent: a slower rate of growth than in previous years. Fixed was down $94 million, or 1.3 per cent: a slower rate of decline than previous years. We continue to be encouraged by our fixed line performance. Recurring NBN DA was up $13 million, or 3.5 per cent. Data and IP was down $50 million, or 1.7 per cent broadly in line with previous years. NAS continued its double digit rate of growth up $262 million, or 11.3 per cent. Global connectivity was up $566 million, or 64.4 per cent including Pacnet.

Outside our recurring core income, one-off NBN DA receipts was up $461 million, and new business was up $96 million, or 72.2 per cent. Turning now to product EBITDA performance.

Overall, we saw a decline in reported EBITDA down 0.6 a per cent to $10.5 billion. Our recurring core was down $103 million. This was the first year that we saw a major impact from the long term recurring influence of the NBN. This negative influence was $145 million in the year, and this is the number that we expect to grow to $2 to 3 billion per annum over the course of the rollout of the nbn network. The biggest component of the recurring impact of the NBN was increases in CVCs and AVCs.

Outside recurring NBN impacts, the remaining core was up $42 million and we'll go through this on the next slide. One-off NBN DA receipts, net of nbn costs to connect, were up $371 million in line with the nbn rollout. This included $90 million of increased nbn costs to connect.

New business EBITDA was down $90 million due to continued investment in Telstra Health and the Telstra Software Group. We also recognised that the $246 million impairment in the value of Ooyala intelligent video subsidiary. Turning now to recurring core product EBITDA performance in detail. This table now further expands the EBITDA performance of our core business. Working from the bottom, the difference between the reported EBITDA figure of $10.465 billion and the recurring core of $10.389 billion is the NBN one-off, new growth businesses and the impairment. Turning to our recurring core, the EBITDA was down $103 million, or as identified on the last slide, up $42 million excluding the recurring impact from the NBN.

Mobile was up $134 million, or 3.2 per cent. Data and IP was down $101 million, or 5.5 per cent. NAS was up $75 million, or over 100 per cent. Global connectivity was up $124 million including an additional $55 million EBITDA from Pacnet, and other core was down $190 million including reduced distributions from Foxtel.

Turning to the product performance in detail starting with the mobile portfolio. Mobile revenue was down 2 per cent, or up 1.3 per cent excluding MTAS. During the year we added a further 560,000 domestic retail mobile services, including 169,000 postpaid handheld customers, to bring our total subscriber base to 17.2 million.

In postpaid handheld, revenue was flat due to subscriber growth being offset by a reduction in ARPU. Postpaid handheld ARPU excluding MRO was down $1.11 to $68.40. Encouragingly, we continue to see customer migration to higher minimum monthly commitment plans and the quality of revenue improving. This ARPU growth was offset by lower excess data and voice charges, and tactical offers. More than 73 per cent of our consumer postpaid handheld base are now on extra data plans. Extra data gives customers the option to receive additional data in one gig blocks when they reach their monthly data limit for a flat rate of $10 per block.

Prepaid handheld revenues fell 3.5 per cent due to lower ARPU from increased allowances, leading to fewer recharges. We continue to see growth in prepaid unique users, up 3.3 per cent for the year. Mobile broadband revenue fell 4.7 per cent due to lower prepaid ARPU and a decline in unique users. We, however, continue to see opportunity in consumer shared plans and growth in our connected tablets to help our business customers further improve their productivity, in particular with field force and sales force solutions. Machine to machine revenue grew 16.8 per cent. We added 307,000 M2M SIOs in the year, exceeding recent trends. Over the year we have implemented multiple M2M solutions. These solutions have addressed productivity, driver safety, asset utilisation, long haul vehicle tracking and fleet management for our customers.

Mobile hardware revenue increased 10.1 per cent as a result of higher average retail prices on high-end smartphones. The mobile EBITDA margin increased two points to 42 per cent. Excluding the margin accretive impact from MTAS, mobile margins were closer to 40 per cent. Mobile margins also benefitted from the timing of lumpy costs and one-offs in the second half of FY16. Our postpaid handheld churn remains low but increased to 10.9 per cent. Postpaid handheld churn was higher in the second half FY16 due to increased competition and some effect from network outages.

Turning to our fixed performance. Overall, we had a strong year in fixed products in comparison to prior periods and also relative to the market. Fixed product revenue was down 2.2 per cent, or down 1.3 per cent excluding the fixed services FAD. Fixed data revenue grew 5.6 per cent. Retail fixed broadband subscribers grew by 235,000 – our best net subscriber additions in more than five years. This result was due to the continued focus on providing customers with simple, flexible and great value bundle plans together with unique inclusions like Telstra Air, Telstra TV and more capable home internet devices. Our challenger brand Belong also contributed to the subscriber and revenue growth again this year.

The fixed voice revenue decline was contained to 8.2 per cent. Retail fixed voice customer line loss was maintained at 271,000, or 4.5 per cent due to continued focus on retention in our save cells and proactive migration of home phone only customers to new bundled plans with broadband and wi-fi. The ARPU decline of 5.1 per cent was broadly in line with the prior corresponding period.

Our bundled products are performing well, including the “best bundle ever” launched in March 2016 with free Telstra Air and Telstra TV, and the Telstra BizEssentials bundles with double the data for our small business customers. These innovations have continued to deliver strong growth in retail bundles with bundled customers up 322,000 to 2.7 million. 83 per cent of our retail broadband customer base is now on a bundled plan, including our entertainment offers. Demand for our nbn services continues. During the year we added 289,000 nbn connections. As at 30 June 2016 we had 500,000 nbn connections made up of 407,000 voice and data bundles, 34,000 data only services and 59,000 voice only services.

Our nbn market share remains above our core broadband market share and increased in second half FY16. Like all of our broadband and bundled products, we differentiate our nbn services based on unique content experience that are only with Telstra like Telstra TV and Telstra Air. In June 2015, we launched Telstra Air: our residential and public wi-fi offering with over 1.1 million activated customers by the end of FY16 and growing to be the largest wi-fi network in Australia. The fixed voice margin fell by four points due to lower revenues while the fixed data margin was flat. Both fixed voice and data margins were negatively affected by the cost of connecting customers to the nbn and the ongoing nbn network costs. Excluding nbn, underlying fixed data margins increased on the prior period.

Turning now to data and IP. In data and IP we saw revenue growth due to higher global connectivity revenue, including from our Pacnet acquisition. GES international data and IP revenue growth was 79.8 per cent with international customers responding strongly to the combination of the Pacnet network with the Telstra brand, product and network expertise.

Domestic data and IP revenue declined at 1.9 per cent in line with recent trends. However, we performed well against the market with customers embracing our complementary NAS products and Next IP network flexibility, scalability and security. While we are achieving volume growth in IP access, we are seeing some price competition. IP access declined 3 per cent, reflecting these yield trends, offset by growth in customer connections.

IP MAN revenue, which represents 69 per cent of IP access, was up 2.4 per cent, with connections up 14.3 per cent, reflecting customer wins and demand for IP value added services. ISDN declined 8.9 per cent due to continued steady migration to IP access, unified communications, fixed data and nbn products. Our domestic EBITDA margin of 62 per cent was impacted by yield pressures in the IP market and the domestic revenue decline.

Now, turning to Network Applications and Services or NAS. We are pleased with our NAS performance. In FY16, we achieved strong revenue growth of 14.3 per cent to $2.8 billion and expanded margins. Growth was achieved across domestic and international segments, including an increased contribution from Pacnet.

As indicated at our half year results, growth in NAS revenue in second half FY16 was slower than first half FY16 due to the timing of contract milestones. We expect FY17 NAS revenue to grow above market rates. Managed network services revenue for the year grew by 6.4 per cent due to increased professional service and security activity, including from our Bridgepoint acquisition. We are pleased with the progress of this acquisition as it has brought greater capability in our managed network and security portfolio. Unified communications revenue was up 7.9 per cent as a result of increased IP telephony customer connections and cloud revenue grew by 35 per cent across public cloud solutions – or infrastructure as a service – and from Pacnet. Industry Solutions revenue growth of 19 per cent was principally due to increased nbn commercial works.

Integrated Services revenue was up 18.3 per cent due to the achievement of transition and transformation milestones on major accounts, and growth from annuity managed services. The NAS EBITDA margin improved 3 points through operational leverage and scalable standardised offerings.

Turning now to media and, firstly, Foxtel. As announced on the 8th August, Foxtel's revenue was up 4.6 per cent due to subscriber growth. Total subscribers were up to more than 2.9 million, with the vast majority of growth due to 4.7 per cent growth in broadcast subscribers. Broadcast residential ARPU for the full year was $89, a mid-single digit decline compared to the prior year. Churn for Foxtel increased due to increased use of no fixed-term contract offers in second half of FY16.

EBITDA decreased by 2.2 per cent to $880 million due to, firstly, increasing programming costs – particularly across sport and drama, and, secondly, planned higher offer costs associated with sales, and continued investment in Presto. EBIT improved 8.8 per cent to $558 million, including lower depreciation resulting from the increase in the useful lives of cable and satellite installations. In Telstra's books, the distribution received from Foxtel was down 70.4 per cent to $37 million due to Foxtel's investment in Ten Network and focus on debt management. We received no distribution from Foxtel in the second half of FY16. Cable access revenue was down 6.8 per cent to $110 million.

Now, moving to our other media assets. The role of Telstra Media is to add differentiated content experiences that complement our network advantage. In the home, we continued our strategy to bundle media with core fixed products. Foxtel from Telstra revenue grew by 8.6 per cent to $719 million, with net subscribers up 128,000 – our highest level of net subscriber adds in a year. We also launched Telstra TV in October. By the end of FY16, we had 300,000 Telstra TV devices in market.

IPTV revenue was up 4.2 per cent, including increased revenue from Telstra TV device sales and SVOD. This revenue growth was partially offset by the continued migration of our higher value Foxtel on TBox customers to Foxtel from Telstra. The IPTV subscriber decline of 11.3 per cent included 44,000 new SVOD subscribers across T-Box and Telstra TV. SVOD growth was offset by a decline in Foxtel on T-Box subscribers, down from 165,000 in FY15 to 96,000 in FY16. Media 'On the Go' revenue decreased 11.4 per cent due to declining legacy mobile download services. This reflects a shift in strategy from direct media revenue towards differentiation and data usage across Telstra's core products. In FY16, we added Apple Music and Netball to our portfolio of AFL and NRL products.

Turning now to income from the NBN Definitive Agreements or DA. During the year we recognised NBN DA related income of $1.35 billion, up 66.5 per cent. This included strong growth from the ISA ownership receipts and PSAA, which were up 80.3 per cent and 208.6 per cent, respectively, in line with the progress of the nbn roll out and migration.

Whilst the ownership receipts and PSAA will be influenced by the timing of the nbn rollout, the timing of related cash flows will vary between periods. Revenue from the Commonwealth Agreements increased 54.5 per cent due to the timing of income recognition from the Telstra Universal Service Obligation Performance Agreement within the Commonwealth Agreements. Retraining deed revenues of around $10 to 15 million per annum will continue to be recognised over the next two to three years. Recurring ISA revenue from ducts, racks and backhaul was up 3.5 per cent to $387 million. These receipts reflect nbn co ongoing use of our infrastructure. The NBN DA income represented on this slide was recognised across sales revenue and other income categories in our financial statements.

Sales revenue included NBN ISA revenue related to access to our infrastructure. Other income included the remainder of NBN DA income, including all income from the PSAA. NBN DA income does not represent all of the income we receive from nbn co. Outside the

NBN DA, we also received industry solutions revenue within NAS through the two commercial agreements – the Planning Design Services Agreement and the Joint Deployment Works Contract. nbn commercial works revenue was up 39.5 per cent to $233 million. Future nbn commercial works revenue will also include the HFC Delivery Agreement, Copper Sub-Loop Agreement and Operate and Maintain Master Agreement. In addition to commercial works revenue, we received additional data and IP sales revenue for wholesale ethernet transmission and facilities access.

Turning from our business and product performance, let me take you through our expenses and productivity. Our total operating expenses increased 6.7 per cent to $16.9 billion on a guidance and ex-Pacnet basis. On a reported basis, total operating expenses increased 6.4 per cent to $16.6 billion. We've updated our disclosed cost categories to match the product framework presented earlier. Compared to our first half disclosure, costs related to global connectivity and corporate costs are now recognised in core. Excluding the impairment and going through each of the four cost categories in turn.

Firstly, growth in our core sales costs or directly variable costs. Our core sales costs grew $343 million or 5.1 per cent. The five biggest contributors to the increase in sales costs were global connectivity, including Pacnet where we saw income growth of 64.4 per cent and margin expansion, NAS domestic, where we saw income growth of 11.3 per cent and margin expansion, mobile costs of goods sold associated with hardware revenue growth of 10.1 per cent. Our hardware margin on mobile increased as a result of lower unit subsidy in the year. nbn access payments increased to support nbn connection growth of 289,000 customers and Foxtel service fees, where we saw revenue growth of 8.6 per cent. Core sales costs growth was offset by a benefit from reduced interconnect costs due to MTAS. Excluding this impact, core sales costs grew at 10.4 per cent. So where we saw the largest dollar increase in reported costs, this increase directly supported our growth categories across the core. Overall, we saw an increase in the efficiency of our core sales costs.

Second, growth in costs in our new businesses. New business costs grew $186 million and supported Telstra Health, Telstra Software Group, as well as Telstra Ventures.

Third, growth in our nbn costs to connect. Our nbn costs to connect increased $90 million. Over the period however, we reduced the average cost per nbn connection by around 40 per cent. The nbn costs to connect include consumer connections and more complex business connections and exclude revenue we receive from customers for connecting nbn services.

Fourth, growth in our core fixed costs. Core fixed costs increased $137 million or 1.6 per cent. On an underlying basis, our core fixed costs declined by 0.6 per cent. This means that the results of our cost productivity programs more than offset inflation and reinvestment. This net measure is our primary measure of cost productivity. We remain committed to reducing core fixed costs on an underlying basis in FY17 and beyond.

The difference between the reported and underlying costs included increased nbn commercial works and DA costs, increased NAS labour on large contracts, increased global connectivity costs, including our Pacnet acquisition, offset by reduced corporate costs. Now let me turn to our productivity program in more detail.

We achieved the underlying fixed cost reduction through six productivity initiatives in FY16 – improving customer interactions through digitisation and simplification, product and sales optimisation, enabling the future IT network, organisation and process, building supplier partnerships for business outcomes and realising synergies from acquisitions.

In many cases, digitisation and simplification of our products and processes have led to better business outcomes for our customers as well as cost benefits. I will go through some of the examples. We have reduced the cost to connect by increasing the number of orders fully captured in upfront sales conversations, reducing the number of calls to customers during the connection process and increasing the number of customer interactions via digital channels. These changes have improved the experience for our customers and staff, and resulted in an around 40 per cent reduction in the cost per nbn connection.

For fixed line activation, we’ve changed how we activate ADSL and bundle services, eliminating a three day minimum activation lead time for customers where infrastructure is available. This has also resulted in a 65 per cent improvement in our ability to connect the service at the time nominated by our customers. When combined with improvements to our tools and processes for connecting customers to our cable network and how we dispatch technicians, we have reduced the number of truck rolls by 5 per cent or 185,000.

We’ve improved our customer self service capability by expanding the coverage and capability of our customer self-service assurance tools. This has improved the ability of our ADSL, PSTN and cable customers to resolve common problems related to modem connectivity, outages, hardware faults, email and Wi-Fi quality. This has resulted in 600,000 additional completed self-care interactions and the avoidance of over 500,000 customer calls and truck rolls.

To enable our Future IT Networks, investment in proactively identifying and remedying unstable ADSL services before a customer needs to contact us has resulted in more stable ADSL services for 2.2 million customers and the avoidance of over 280,000 customer calls and truck rolls. Additionally, targeted proactive maintenance of our copper access network has resulted in a 48 per cent reduction in the fault rate within target areas and a 2.5 per cent or 88,000 reduction in field technician tasks. Our adoption of new technologies has allowed us to take advantage of associated cost reductions, for example, using software defined networks has resulted in cost reductions from lower power consumption and reduced floor space requirements within our exchanges.

To improve first call resolution, we have simplified tools and processes to make it easier for our staff to serve our customers and resolve their enquiries. For example, we’ve implemented improvements to our guided step-by-step workflows for contact centre consultants to help our Digital Office Technology and Telstra Business Broadband customers resolve fault enquiries. This has resulted in improved first call resolution rates by 2 points across these customers, and avoided 26,000 customer repeat calls and truck rolls.

Finally, we continue to deliver synergies from our acquisitions. We have realised synergies from our Pacnet acquisition and optimised the performance of the combined business. In the last year, for the combined business, we have rationalised over 27 Pacnet products into around 16 single Telstra product offerings. We’ve migrated to a single set of delivery and support IT platforms for CRM, ordering, activation and ticketing and consolidated 17 network points of presence and 102 transmission circuits. We've renegotiated over 40 contracts and merged 13 offices. Turning now to capital management.

At our Investor Day in May we announced the intention to use the proceeds from the sale of Autohome shares to fund a Capital Management Program. Today, we are announcing a $1.5 billion capital management program, comprising of a $1.25 billion off-market buy-back and a $250 million on-market buy-back.

The buy-back program is expected to benefit all Telstra shareholders, whether or not they participate, through an increase in earnings per share. The off-market buy-back will be conducted through a tender process. Eligible shareholders can choose to tender shares at specified discount to the market price in a range of 6 per cent to 14 per cent. Eligible shareholders will receive further information on how they can participate in the off-market buy-back tender. For those eligible shareholders who successfully participate in the off-market tender, the ATO has indicated that for Australian tax purposes the capital component of the price paid for each share bought back will be $1.78 and the remainder of the price will be a fully franked dividend.

While participation in the off-market Buy-Back Tender will result in a shareholder selling shares at a price which is lower than the market price, depending on tax circumstances, they may be still be better off by selling shares through the off-market Buy-Back Tender.

The $250 million on-market buyback is expected to commence shortly after the completion of the off-market Buy-Back Tender. Neither the off-market buy-back nor the subsequent on-market buy-back will be made directly or indirectly into the United States. This $1.5 billion capital management program is another example of our balanced approach towards capital management, including active management of our investment portfolio and the creation of shareholder value in accordance with our capital management framework.

Turning now to some of the more detailed capital and balance sheet movements in 2016. Overall, our balance sheet remains strong. The increase in our gross debt in part reflects the issuance of $1.6 billion long term debt during the year ahead of maturities in FY17. Our closing net debt was reduced by additional liquidity reflecting the proceeds from the sale of Autohome. This additional liquidity will be used to fund our capital management program in FY17. Our average debt maturity has increased to 4.8 years from 4.6 years at the half. We continue to refinance at much lower average rates, as evidenced by our 10 year 750 million Euro bond in April 2016 with interest payable at 4.165 per cent per annum. We believe at time of issuance, this was the lowest ever 10 year rate for an Australian company.

Our finance costs on an accounting basis were broadly flat year on year. Positive influences on finance costs were a reduction on our average borrowing cost from 5.8 to 5.6 per cent and a small non-cash benefit from adoption of AASB 9. Offset by higher average net debt on issue and lower finance income due to lower average cash balances and a reduction in interest income received from Foxtel. Net cash finance costs were down 2.7 per cent to $729 million. Our gearing ratio has decreased to 43.9 per cent at 30 June 2016 reflecting the proceeds from the sale of Autohome.

Importantly, all of our financial parameters remain at the conservative end of our comfort zones to meet our criteria of a long term single A credit rating. We maintain strong investment grade long and short term credit ratings with S&P of A and A1, and Moody's of A2 and P1.

Thank you and I will now hand back to Andy before I return to talk about our capital management framework and guidance.

MR PENN: Well, thanks very much, Warwick. That concludes our presentation of the results for 2016 which, as I said earlier, was a strong year. So let me now turn to the significant strategic investment that we've announced this morning. Demand for services in our industry is just growing so strongly. Over the past five years data traffic on our networks has increased on average 60 per cent per annum. That is a sevenfold increase. If we break that down between fixed and mobile, mobile traffic in a similar period increased almost ninefold.

In 2013, mobile banking represented 24 per cent of all banking transactions in Australia. In less than two years that number nearly doubled to 38 per cent. Since 2011 mobile video consumption has increased eightfold with twice as many people watching four times as much media on mobile. Last week we launched the Seven Telstra Olympic app which is simultaneously streaming 36 channels of coverage. Since the launch there has been more than 10 million live streams and more than 1 million people have downloaded the app.

To put this in perspective, there were no mobile digital rights at the London Olympics. Now, if we have seen this much change in the last five years just imagine what 2020 is going to look like as the rate and pace of technology innovation accelerates. Because that's the world of the future, that's the world that we're building for and that's the world that we're investing in so that we can give our customers brilliant connected experiences.

We have a history of making investments ahead of the curve to create strategic differentiation. This has led to significant programs of investments every decade. As we did with 2G in the late 90s, as we did with 3G ten years ago, as we did with our Next IP network, as we did with LTE. We believe that the opportunity to do so again is here and now. Our customers and our networks are our biggest assets and it is critical that we invest in them.

So we will be lifting our level of investment to match our level of aspiration. Over the next three years we will be investing up to an additional $3 billion of capital expenditure and lifting our capex to sales ratio to approximately 18 per cent. We will be investing in three critical areas of importance to our customers. We will be investing in the network of the future which is the foundation of the program, we will be investing in accelerating the digitisation of our business and, ultimately, this will all lead to us investing in improving the customer experience that we provide.

These investments will deliver significant benefits for our customers while driving market differentiation and significant financial benefits for shareholders. They will be made in line with our criteria and our capital management framework with a target to exceed our current return on invested capital.

Let me turn to the benefits for customers, because once again we will define and deliver the next generation of customer experience, enabled by new network infrastructure and a supporting digital architecture. Consumers will experience rich communication services using capabilities such as Voice over LTE, integrated messaging and video and document sharing. Sporting events and other media will be greatly enhanced using broadcast services and video streaming based on LTE-Broadcast technology.

The world of augmented reality, autonomous driving and robotics will be enabled across our networks. For our business customers, new opportunities in productivity and business insight will be offered. Everything from agriculture to banking, healthcare to transportation services will be enhanced by millions of sensors and devices that are arriving with the internet of things. Similarly, applications in areas such drone technology and remote healthcare diagnostics will explode over the next four years.

The second key benefit to our customers is providing a seamless and customised experience across all of our networks: mobile, fixed, IP, nbn, wi-fi. Truly interconnected networks is a key deliverable of this program. With these investments we will offer the network of networks, an unparalleled range of contiguous assets giving customers the ability to move seamlessly between them. And as we have done repeatedly in the past, we intend to lead the market with the introduction of 5G. For all customers, this will mean faster speeds, lower latency and supporting the explosion in the number of connected devices.

For business and enterprise customers, both domestically and internationally, we will invest in our enterprise network stack of technologies and capabilities. In cloud, in collaboration and in managed security. We will offer our customers a deeper integration between their compute environment and our networks through the use of APIs. This will give them the ability to configure their network experience and scale capacity up or down dynamically based on their individual demands.

Finally, our investments will deliver greater reliability and greater resilience and greater security for all of our customers, consistent with our commitment to deliver the best network experience.

So how will we do this? We are going to drive a number of major initiatives across the business. To deliver the future network experiences, we will utilise software defined networking architecture to build a more programmable and flexible network that we can scale easier at lower unit cost. We will deliver the next generation of wireless services, 5G. In the very near term we will further improve service levels in our ADSL Fixed Broadband network to deliver faster speeds to more of our customers.

From a mobile perspective we will further enhance depth and breadth of our network. In metro areas this will mean greater in-building coverage, in your home and in your office. We will also extend 4G coverage in regional areas provided the regulatory setting which characterises the Australian mobile market remains conducive to supporting investment. We will invest in digital enablement of our sales, service, and product experiences. Our customers will increasingly be able to interact with Telstra on their terms, and will be able to do so more easily and more digitally. We will also accelerate the move of apps and services to the cloud and overhaul systems that we know disrupt our customers today such as billing.

We will digitise the assurance and order-to-activate processes. We expect these changes will deliver a customer experience, which is fundamentally better than when they interact with Telstra and as we create financial benefits for shareholders.

Underpinning all of these initiatives is the establishment of an adaptable digital IT core architecture that will deliver a single access point to our underlying systems rather than the myriad of systems which exist today. This morning I wanted to give you a sense of the scale and significance of the investments that we will be making and the changes that we will be making. Because we're building for a world where technology innovation is accelerating and offering wonderful opportunities and experiences for our customers and great business opportunities for our business customers. We will have the technology and the networks to match this.

Let me be clear about one thing though: this is about investing in our core. A core where for our customers, the services and applications that sit above the layer of the network are increasingly as important as the network itself. We need to continue to invest in building those capabilities, both domestically and internationally. We also remain committed to continuing to invest and grow Telstra Health for which we believe there are tremendous opportunities in the future and which has had a very successful year with a win of some very significant contracts.

We will provide an opportunity to discuss our plans later in the year at our investor market briefing and progressively thereafter. In this regard though, it will be critical that we maintain the right level of confidentiality to support our strategic advantage in an intensely competitive environment. Let me now hand back to Warwick to take you through what this means for our capital management framework and for guidance and then we can open up for questions on both results and our future plans. But let me also say before closing that I am immensely proud that once again Telstra – we will deliver the next generation of customer experience enabled by new network infrastructure and a supporting digital architecture.

MR BRAY: Thank you, Andy. Let me put our strategic finance investment announced today in the context of our capital management framework and investment criteria. This framework is underpinned by a clear focus on optimising for maximising returns for our shareholders, maintaining financial strength and retaining financial flexibility. These core objectives are supported by five principles that provide the structure and definition for what this means at a practical level. We remain committed to each of these principles which I will now go through.

We will maintain our balance sheet settings consistent with a single A credit rating. We will ensure our dividend remains fully franked and seek to increase it over time based on growth in earnings per share on a sustainable basis. That's exactly what today's announcement is about: investing in our core business to support future growth in earnings. Over the next three years, capex to sales will increase to approximately 18 per cent of sales. However, we remain of the view over the medium term that we will target 14 per cent.

The fourth principle forces important disciplines around making sure that we over the longer term we don't borrow from the future to pay our dividends or undertake capital management initiatives. Rather, we use the free cashflow that's either generated from the business today or our cumulative excess free cashflow that we've generated in recent years.

On the last principle, we will continue to maintain flexibility for portfolio management. Our strategic investment matches our organic investment criteria and is expected to deliver a return on investment above our existing return on invested capital.

Finally, turning to guidance, which takes into account our strategic finance investment. In FY17 we expect to deliver mid to high-single digit income growth and low to mid-single digit EBITDA growth. We expect to spend capex at approximately 18 per cent of sales. We expect FY17 free cashflow to be in the range of $3.5 billion to $4 billion.

As is usually the case, our 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 the purchase of spectrum. The guidance also assumes the nbn rollout is in accordance with the nbn Corporate Plan 2016 and 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 to $500 million. Our FY17 income and EBITDA growth on a reported and guidance basis will be impacted by the wholesale pricing decisions implemented in FY16. This will include a full 12-month impact from MTAS and FAD. Thank you. I will now ask Peter back on stage to moderate the Q&A.

MR KOPANIDIS: Good morning. So we will kick off with questions in the room here. If you could please introduce yourselves. Welcome to Sameer.

MR CHOPRA: Morning. Sameer Chopra from Bank of America Merrill Lynch. I had two questions. One is around the returns that you expect from the CAPEX investments that you're making. You mentioned that you expect these projects to be incrementally ROIC accretive so maybe perhaps if you can give us some colour around what are the returns that you expect, why is it not business as usual and who's going to lead the program, given the CTO position is currently vacant? That's my first question. And the second one was just around productivity. Reported fixed costs or the core fixed costs were still up 1.6 per cent. You've got a $2 billion drag coming from the nbn and I was wondering why we're not expecting or seeing bigger core fixed cost reductions.

And maybe – Warwick, you know, you also mentioned a $300 to 400 million redundancy charge or a restructuring charge. Perhaps you can give us some colour around what sort of cost benefits you can expect from that.

MR PENN: Thanks very much, Sameer. Well, why don't I comment first and then I will ask Warwick to talk maybe a little bit about the productivity program. So in terms of who's going to lead this, this is going to be led by the senior executive team and I'm going to be very intimately involved. There is nothing more important for the company than this investment. This is about really taking advantage of the opportunity to invest now and really extend our strategic competitive advantage because the one thing that is happening in our market, and I think we can all see, is just the dynamism with which technology innovation is changing and how that is being adopted and so that is what sits behind this program.

I think it's a tremendous opportunity for us to really invest during this period of the migration to the nbn to really put Telstra in a very strong position to grow in the future and that's fundamentally, as you know. Sameer - one of our key objectives is how do we make sure that we grow over the longer term so that we can support growing dividends in the longer term as well. Against the background of that \$2 to \$3 billion impact that you mentioned with the migration to the nbn. In terms of where do the benefits come from, well, they come from growing customer numbers. They come from reducing churn. They come from additional services that sit above the layer of the network as you've seen us achieve from a network application services basis in enterprise and government.

We expect to drive that further down into the small-medium business size sector. We expect to be able to deliver further improvements, onto your point, on productivity and cost to connect, cost to serve. We're solving for a very different world in the future and all of our investments will be measured up against our capital management criteria, which, as you heard from Warwick, is basically where we make organic investments. The objective is to get a positive NPV when we use our weighted average costs for capital plus an appropriate risk discount rate, which, as Warwick said to you there, is very much targeted to exceed our current return on invested capital. So that's how the benefit flows through.

To your point on restructuring, I mean, obviously this is about redesigning more aggressively the front end of our business. It's about redesigning how we go to market in many respects, how we redesign things in the back end as well and really moving to a digital environment more quickly. And that's going to incur a lot – a significant amount of capital investment, a substantial amount of which will go into the networks but also, incur some operating costs, as well, associated with it, which is hence what sits behind the restructuring charge that Warwick mentioned. Why don't I hand over Warwick to make any additional comments on the productivity program itself?

MR BRAY: Yes. Thanks and good morning, Sameer. And I will talk about the second question there. And, look, I will start by talking about the 0.6 per cent reduction in underlying fixed costs and then I will talk about the journey to 1.6 per cent. So just start with the 0.6 per cent. The way we think about productivity is, in our fixed cost base of about \$8 billion, without productivity we would have inflation and wages growth and there's actually still a bunch of reinvestment that's needed there as well. And what we've said is we've moved away from the gross productivity that we used to report. We've said that what's important to us is that our productivity has got to take into account all of those inflationary pressures, meet that and go further to get that net reduction.

We've talked about a net reduction in single digits and certainly that is our aspiration over the next few years – is to achieve what we've achieved this year and more. That's what we call upping the ante on our productivity program. And so that's what our aim is. In terms of the difference between reported fixed costs and underlying, in the way we account there are some costs in there that actually do vary and they vary with very large nbn commercial works and so the labour associated with that goes in there. Also very large NAS contracts –

the labour goes in there and there's also some of the global connectivity increases are in there as well.

And so what we say is those costs are very much associated with some specific revenue elsewhere in the business. So we put them to one side and then we say, of those remaining fixed costs, have we achieved that net decrease in productivity? And that's the way we think about it.

MR CHOPRA: And that restructuring charge – the 300 to 400 million – what does that buy you?

MR PENN: Well as I said effectively, that's the operating cost and the one-off operating costs which are not capitalised which are associated partly with the $3 billion of investment and partly with the productivity program that Warwick mentioned.

MR BRAY: And in terms of the financial returns from that, we – in all of our investments – we absolutely make sure that the return on invested capital is greater than our cost of capital and in this particular announcement it's higher than our existing return on invested capital. And just to give you an example of that, in all of those areas that Andy talks about this is just only one. It's that further improving what we call our order to activate process, which is the process when you ask for an ADSL line to be installed to the time that it's installed and you get the first bill, there is at the moment there's still some manual work in that process.

The digitisation program that Andy talked about is aimed at making that completely digital. In the road to doing that there's some capital required but there's also some one-off opex and that's what that restructuring charge represents.

MR KOPANIDIS: Next question, please, from Deutsche.

MR WONG-PAN: Craig Wong-Pan here from Deutsche Bank. First question just around the CAPEX program. I just wanted to understand what has really led to that because I guess there has been a bit of a step change from some of your comments before around where capex should be so I just want to try and get a better understanding of what has led to that. Second question, just around the NPS score, with that slight reduction, could you provide any details around either what customer segments that might be in or sort of products. That would be sort of quite helpful. And then, lastly, on the Belong brand, I guess with that having sort of been launched now for a couple of years, I just wanted to understand better around, you know, is there an intention to take that to other markets and products and, I guess, would you be launching a similar business-type more kind of corporate-type product?

MR PENN: Okay. Looks, thanks, Craig. Sorry, in relation – sorry. You first question again, the capex?

MR WONG-PAN: Just around the capex. Just in terms of what has really led to that.

MR PENN: Sorry. Yes, yes. Look, I mean, fundamentally – and so, firstly, I acknowledge this is a step change – this is a step up in terms of our level of investment and it's a reflection on the opportunity that's ahead of us and the breaking pace at which we're seeing technology innovation changing. And if you think forward four or five years, what does the customer want, what is the experience that the customers are looking for? They're going to – they want fast streaming, they want ubiquitous networks, they want to be able to move seamlessly across individual networks, they want to engage with us digitally. And I think – you know, our view is that the appetite for customers, the demand for customers to be able to do those things has accelerated, has increased as they have experienced just what technology innovation can do, and that's whether that be consumers watching media on mobile devices or whether that be businesses moving their businesses to the cloud.

We're just seeing so much demand for those services. And we must have both the capability to deliver those services, so that's a lot of software capabilities around software defined networking. We have to have the digital business architecture to enable customers to be able to deal with us digitally and to help themselves and serve themselves and then ultimately we've got to have the quality of the networks and the ubiquity of the networks that actually support that data that that will drive. And so, I think it's – what has changed, if you like, or what has caused this reflection is just the opportunity to really get ahead of that, invest now and make a step change in the strategic dynamics of the market and our strategic differentiation. And we believe that's absolutely the right thing to do for our customers and also for our shareholders.

MR WONG-PAN: So was there any linkage to the network review or a strategic review that you've undertaken?

MR PENN: No. Well, the network review which – we conducted a number of reviews across our mobile network, our IP network and fixed network and, as a consequence of those reviews, we announced a program of $250 million worth of investment and remediation, which I mentioned before. That is well progressed. It's not finished, but it's well progressed. No, this is about building for the future. This is building for the future.

On our NPS score –I should say that – I mean, I think our NPS score is a measure of a couple of things. I mean, firstly in terms of customer segments, we have very positive NPS with our large customers, business customers, with our government customers, with our wholesale customers. In the mass market, we know we need to do more and that's certainly – the investment in digitisation, we believe, is going to make a big difference on that.

And I think the reality is whilst we've come a long way in terms of how we respond to customers when they have issues, we've got to do more to take out the root cause of what creates issues in the first place. And I think customer expectations are changing and we've got to change and adapt to meet them. And, of course, the network interruptions – there's no doubt that will have had some impact on the perceptions of customers, but we believe that we should not lose sight of the fact that we still have the best networks in Australia, we have the fastest mobile network with the greatest coverage, we have the most ubiquitous network in Australia and that is going to be so important in the future.

I think as regards Belong, I would rather not say too much in relation to Belong, just for competitive sensitivity reasons, as you could imagine, other than to say, it has been very, very successful. You might recall we were looking at the possible acquisition a couple of years ago, which was, sat behind the same strategic thought and Belong is now performing well ahead of where that acquisition was when we were looking at it. So we're very pleased with what we've achieved with Belong, and we will continue to look at it very closely. It's a great complement to the key Telstra brand and it has been a good contributor, but not the only contributor to the strong fixed broadband performance.

MR WONG-PAN: Okay. Thanks.

MR BRAY: And just to add to that, we also have the Boost brand on mobile pre-paid that we're also pleased with.

MR PENN: Good morning, Andrew.

MR LEVY: Good morning, Andrew Levy. Macquarie. Just three questions. The first one – I suppose the concept of an incremental return on capital, requires an assumption on what the baseline outlook was for the business. I remember when Sol Trujillo announced his big program, he put charts up, talking about where the business would go if you didn't spend the money. I just want to get a sense, maybe, of what would have the status quo investment levels have produced for Telstra? Were you looking down the barrel of losing share and those types of things, you know, the opposite of what you talked about on the upside, just so we can understand how much will incrementally be delivered to earnings. The second one, I was wondering if you could just give some clarity between network and systems investment out of the $3 billion. And the third one was just looking at the ISA payment increase was only three and a half per cent for the recurring component. I was just wondering if you could give some clarity on how that scales up.

MR PENN: In the year?

MR LEVY: The ISA, yes. In the year.

MR PENN: Yes.

MR LEVY: I just would have thought that you would still be providing a lot more infrastructure and that might be

MR PENN: Yes.

MR LEVY: growing quite a bit faster.

MR PENN: Well, I will get Warwick to talk about that. Yes. So what are the incremental returns and also what is the base case? Well, if we go back to our capital management framework, it's one of the things that I've said very clearly our second principle is that we seek to pay a fully franked dividend and, obviously, over time, we look to increase that. So that's the fundamental premise of the strategy and that's what we're seeking to achieve for shareholders. The bottom line is the migration to nbn does lead to a $2-3 billion impact on our EBITDA. That's why the whole NBN economics – and the PSAA payments are there, for effectively to, in part compensate shareholders for that dynamic. We were building plans and continue to build plans and aspire to address that impact through productivity and through growing out of our core business, for investing in new areas as well, and so that was fundamentally part of our plans. Without making forecasts about the future, that's what we were seeking to do.

This investment is, if you like, not so much independent of that, but is incremental to that in that, you know, we believe there's an opportunity to really take ourselves forward strategically and really, continue to have that level of differentiation in the market. And we believe that will then provide incremental benefit. And the measure, as Warwick and I have both said, is ROIC. Now, how those two things intersect, I'm not making forecasts on that, other than to say our aspiration and our planning assumption and everything we're seeking to do is to look to how we grow dividends – or grow earnings over the longer term, so we can actually grow the dividend over the longer term in an environment where we have to transition between – and lose $2-3 billion worth of EBITDA over the next three to four years, as a consequence of the nbn.

In terms of the proportion that's, sort of, invested in networks and systems – I mean, I should say that clearly the network is the foundation of this investment. It's absolutely not all of the investment, but it's very much the foundation of the investment, so it will be a substantial and material part of the investment. But there's a lot that we need to do, in terms of servicing future customer needs around digitisation. And so there will be substantial investment there. And those two things in and of themselves will lead to significant improvements in customer experience, but then there's more that we can do on top, but I suspect that's going to be less capital intensive. So I think that it's probably fair to say that the majority of the investment – or, certainly, a very substantial part of the investment will be absolutely in the networks, followed by the digitisation and followed by some other incremental investment as well. And then Warwick can tell you why the ISA grew less than you had anticipated.

MR BRAY: The ISA divides into some revenues that are reasonably fixed. Some are semi-variable and some that are variable. And so, like, the variable costs that you would expect to increase with the rollout would be duct and they did increase with the rollout. But what happened is we actually had some major increases in the fixed side of that – the revenues that were more fixed in FY15, so associated with data fibre and racks. So, over the course, you should expect increases in ISA, and I wouldn't expect the three and a half per cent to be normal.

MR PENN: Yes. I think the bottom line is, Andrew, that there's the core fibre backbone and then there's the, sort of – as Warwick says, the racks in the exchanges and the ducts, etcetera. That core fibre – the revenue on that core fibre backbone was basically – sort of, if you like, achieved once all of that was built and so that's quite a big lump of it. And then the other piece will actually, as Warwick says, increase in line with the rollout and that's why you're seeing, perhaps, something that's slightly counter-intuitive in terms of the trend there.

MR LEVY: Thank you.

MR KOPANIDIS: If there's no more questions in the room, we will go to Conferlink. The first question comes from Raymond Tong from Goldman Sachs. Go ahead, Raymond.

MR R. TONG: Morning, Andy. Morning, Warwick. Just had a few questions just firstly on the $3 billion investment. Just firstly, can you talk about what the $3 billion investment sort of means for your debt profile going forward, I suppose the ability to grow the dividends in the short term and also what it means for additional capital management, I suppose, given you've already sort of announced the $1.5 billion buyback earlier this year.

MR PENN: Yes. I mean, if I sort of tackle a couple of pieces of that, Raymond. I will start with the dividends because I think that's the most logical place to start and then sort of capital management and debt and I will ask Warwick to contribute as well. But, I mean, the point about the dividend is what's motivating our decision to – in relation to dividends is our view of long-term growth and sustainable earnings. I mean, that's the bottom line. Now, we also have clearly said that what we won't do is borrow from the future to pay the dividend of today, and we have obviously strong free cashflow generation and we have cumulative free cashflow which we recorded at the year end as well. So we have strong resources there.

But the key driver really of the dividend is being confident and comfortable that we can grow earnings over the longer term from where they are today against the background of the $2 to #3 billion headwind, if you like, that's driven from the nbn. So that's the key. So it's not really a financial issue. It's more of an outlook issue, and clearly we've got a lot of work to do to make that transition, and these investments today will absolutely add to that program of work. In terms of capital management and debt, Warwick, do you want to comment there?

MR BRAY: Well, the first element of our capital management framework is maintaining our settings for that single A debt rating, and so when we look at the judgments we've made over the dividend, the capital return, the increase in capex, all of them were made in the light of that first element of our capital management framework.

MR TONG: And just secondly, can you talk about maybe just the execution risk of the investment? You know, historically, you know, seven or eight years ago when Telstra sort of embarked on the investment as well, there was some issues with, I suppose, the transformation of the IT core network back then. Can you maybe sort of talk about the risk that you see going forward?

MR PENN: Look, I think it's a fair question, Raymond. I think – well, first thing I would say, as I said to Andrew, there's no doubt that the network is the platform of this investment. It's a very significant part. And I think we have got a long and very excellent track record of execution in rolling out network and network infrastructure. Of course, increasingly, software is playing a very critical role not just in our front-end systems, but also in how you operationalise the network through software-defined networking, and we've been investing heavily in those capabilities. But I think the paradigm for today is very different to that which it was five, six, seven years ago in systems investment. It's today it's a lot less about major, you know, single system migrations and single system implementations and it's more operating in a digital world where one which is built in sort of apps and services which can be discretely built and migrated to the cloud.

So, you know, I think that there's a lot less risk from an execution point of view in a program like this. I think what's most important for us is making sure we have a very clear understanding and a clear perspective of what our customers want, and it's then building to what our customers want. And I think that's really where we've got to invest the time and that's what we're committed to do because, as I mentioned before, I mean, it's one thing to provide a great service experience to customers when they have issues or when things go wrong. We've got to build a world in the future where customers can actually service themselves and they don't need to go into shops or they don't need to call centres because actually we digitally enable that – well, we don't give rise to the issues in the first place and we digitally enable them to be able to service themselves.

MR TONG: Thanks, Andy. And just my final question just is on mobile postpaid ARPU. It declined a little bit more in the second half. Warwick, can you maybe just talk about, you know, the trends in the stayers, leavers and joiners that you sort of talked about before and sort of whether you're seeing sort of, you know, people turning off – high value customers turning off because of the network issues that you've experienced?

MR BRAY: Yes. Thanks. And good morning. So, look, on postpaid handheld ARPU, the consistent theme across all three of our segments is that the quality of the revenue continues to increase. And so the effect that we talked about at the half-year results where for those who recontract we are seeing them recontract at consistently higher plans, and so that trend continues and that's pleasing. Then sort of the other effects that somewhat mask that positive revenue quality vary between the segments. And so with consumer postpaid handheld, the combination of the excess data line which was acting as a negative on consumer postpaid handheld ARPU – that has pretty much stabilised. And so what's happening there is those who have come off the old excess data are moving onto Extra Data. A lot of those effects appear to have stabilised. What's going on now is – that led to the decline that you noted is more short-term tactical offers in channel.

In terms of small to medium business, we're still working our way through the excess data, and there we're a bit later on some of the great international roaming packs. That's still working its way through to small to medium business. And, like, I should note overall we had a fantastic year in enterprise mobility, and that was good from both subscribers, advanced services, you saw that high teens result in machine to machine, and so it's a very good result in enterprise mobility.

MR KOPANIDIS: Next question, Fraser McLeish from Credit Suisse.

MR McLEISH: Great. Thanks very much. Just three from me, please. Just, Warwick, on the NBN PSAA payments are obviously expected to ramp up pretty significantly next year and make up, you know, a reasonable addition to EBITDA. There does seem to be quite a big timing connect between what you're reporting as revenue and the sort of disconnections we're seeing from NBN. Are you able to give us any feel for what you think the PSAA payments are going to be next year? It would be helpful. The second one just on the restructuring charges around your investment. Given it's a three year program –should we expect those restructuring charges to be similar for, you know, '18 and '19? And my final one would just be on mobile margins. You made a comment, Warwick, about there being some lumpy costs that impacted mobile margins. Could you just give us a little bit more on that and what that kind of means for margins going into next year? Thanks.

MR BRAY: Thanks, Fraser. I will work from the third backwards. Starting with the mobile margins, they were up to 42 per cent. About 1.4 points of that was MTAS, which is a non-economic change, so it changed the revenue line, but it didn't materially change the EBITDA line. So that's 1.4 of it. Look, the other thing that was going on is that there were some lumpy costs – we benefitted from some lumpy cost movement in the second half and also year to year that we wouldn't expect to be recurring. In terms of the nature of those costs, the biggest was roaming rebates where – movements in costs between our roaming partners. But we absolutely wouldn't expect that margin increase to be recurring for next year on the non-MTAS aspects of the mobile margin. In terms of the restructuring, we wouldn't expect the bulk of those restructuring costs to be recurring in '18 and '19. In terms of the PSAA payments, can you just sort of repeat the question again it's sort of guidance on specifically the PSAA payments? Was that the question?

MR McLEISH: Yes. Basically. It's obviously a big number, and it's just a bit hard to forecast because there does seem to be some timing, you know, differentials between, you know, your revenue and nbn connections. So if you are able to give us any guidance or help on what you think PSAA payments are going to be next year that would be fantastic.

MR BRAY: Yes. So I think we've given guidance on the cash aspect of that, which is, I believe, quarterly in arrears. In terms of the revenue aspects of that, I would expect that would follow the nbn corporate plan which they've set out.

MR KOPANIDIS: Next question from Eric Choi from UBS.

MR E. CHOI: Hi, guys. I just had a few. First question was: can you comment on how the increased investment in domestic might impact your Asia strategy? And then the second question just on free cash flows. So even accounting for the extra capex it looks like you're guiding to a fall in underlying free cash flow in FY17 versus FY16 despite an increase in EBITDA, so just wondering what's happening there. And then third question, I thought I might try a follow up to Sameer and Andrew's questions on the investments. Your ROIC in FY16 was 13 per cent, so 13 per cent on the $3 billion, or $3.3 to $3.5 including the restructuring costs sort of implies an extra $400 million of NPAT, so just wondering how much of that is actually new revenues versus holding existing earnings versus how much is it essentially an opex to capex trade there.

MR PENN: Eric – sorry – It's Andy here. Could you just repeat the first question? I didn't quite catch the first one, sorry.

MR CHOI: The first one was just how the increase in investment impacts the Asia strategy.

MR PENN: Sorry. Got it. Yeah. Okay. Cool. Well, look, so what I should say is that we will need to continue to invest domestically and internationally. What we are going to do is make sure that we invest this close to the core of our business, but the core of our business is also including the services which sit above the layer of the network. So you should expect us to continue to invest in things like Pacnet and also the cloud based services and software based capabilities some of which are domiciled overseas and some of which we can buy in Australia such as with Kloud and Readify that we invested in this year. But absolutely we will continue to invest and we already are the largest submarine cable network provider across the Asia-Pacific region.

We're seeing a really strong performance. I think I said earlier our sales on the GES international side were up fifty-five and a half per cent. We're getting some big wins not just because of our scale but also because some of the capabilities we've acquired, the data centre in China, the software defined capabilities and we are absolutely going to continue to invest in and build upon that. I might ask Warwick to talk about the free cash flow comment in a second, but in relation to your third point which is the ROIC. I mean, I think your maths and logic is right, so that's the way we're thinking about it. As I say, it's – and then we know that over the longer term to increase the dividend, which ultimately is our long term aspiration, then, we've got to increase underlying earnings.

So you can assume that that is our aspiration. That's what we're planning to do. That's what we're aiming to do, but we're doing that against the background of $2 to $3 billion worth of EBITDA headwind. So beyond that I'm not going to comment further on the sort of – on the specifics. In terms of where the benefits come from, which was your question also, how much from revenue, how much from costs, how much from market share, etcetera. I mean, it's going to be a combination clearly of all of the above. If we can deliver what we aspire to deliver we will acquire more net new customers. We'll keep customers with us for longer so we'll reduce churn. We will continue to support the value in our services, which is reflected in the price that we charge for our service. We will reduced the costs to connect, we will reduce the cost to serve, so it should come through in multiple, and our modelling is that it comes through in all of the lines – effectively key lines of the P&L account. But, Warwick, can you comment on the free cash flow question for next year?

MR BRAY: Yes. So, like, in the journey from EBITDA to free cash flow next year, so capex will clearly be up. What is also going on is that based on the nbn corporate plan there should be more PSAA payments and so you do need to take into account the timing aspect of the delayed cash on that. And then also in the journey from EBITDA to cash important given the way that we sell our handsets – depending on your view of the handset market next year – then, you would expect that our MRO debt on our balance sheet would go up, which has a cash impact as well. So they would be the main differences between EBITDA and cash next year.

MR CHOI: That's helpful. Thanks.

MR KOPANIDIS: Next question. Roger Samuels from CLSA. Go ahead, Roger.

MR R. SAMUELS: Hi. Good morning, guys. Just a few questions from me. Firstly on the mobile churn rate. Obviously it's ticked up in the second half, and are you seeing churn rate continue to increase in the first half just – sorry – in the first quarter just in light of your competitor Optus' result today. It looks like they've got a pretty strong subscriber net adds in postpaid. And my second question is on the cost to connect for nbn. I think you mentioned that it's about $218 million in FY16. I'm just wondering if that's an all in cost. Yeah. So does that include your CVC, AVC and marketing support as well or something else? Thanks.

MR PENN: Warwick, I think, can answer.

MR BRAY: Yeah. So starting with the nbn cost to connect. What it does include is the – It does include CVCs AVCs, so this is the act of connecting a customer to the nbn. So it does include some direct marketing cost and cost to acquire and also cost to connect. What it does not include is revenue that we receive from some of our nbn customers for a connection, and then also it's important to note that our nbn cost to connect varies quite differently from a consumer customer to a complex business customer and the nbn cost to connect that we've released covers all customers. So that's what's in there. In terms of churn, what I would say is that our joiner – in terms of our joiner, leaver, stayer framework - our joiner churn remains higher than our leaver churn. You are right. Churn is up, and as I indicated in the speech that's a combination of increased competition in the market and the outages may have had some effect.

MR SAMUELS: All right. Thank you.

MR BRAY: Excuse me, Peter. Could I just go back on the working capital – the answer I gave previously about cash flow? One other thing I should have added to the journey between EBITDA and cash flow, we've announced some major new commercial works with the NBN and they will have a timing difference in between the accounting EBITDA and cash flow as well, so that would be another reason for the difference.

MR KOPANIDIS: The next question comes from Brian Hahn from Morningstar. Go ahead, Brian.

MR B. HAN: Good morning, gentlemen. Thanks. I just have two very quick questions. Your new 18 per cent capex to sales, how does that compare with what is being spent by your global peers. And also you also mentioned that you have 322,000 bundle retail customers. Do you have any reliable data on what the churn rate is among this group?

MR PENN: Thanks, Brian. Look, a couple of comments. I mean, firstly, in terms of global peer comparisons – and like with all of these things it's never straightforward, and that's got to do with geography, it's got to do with the number of competitors in the market, it's got to do with scale, it's got to do with regulatory environment and whether there's network sharing and all of that. But, look, notwithstanding all of that, what I would say is that there has definitely been a trend over the last few years particularly with the advancement of LTE of increasing capex to sales ratios, and we would not be out of line with global peer comparisons when you sort of make all of those adjustments.

But the other thing that you will see consistently as have done is from time-to-time at certain periods all telco companies tend to sort of invest in a new wave of technology. That is what we have done. You can see that in the US with some of the operators there, but, no I mean, the global peer analysis would support absolutely our strategy and what we're doing, and I think our past performance we've had a history of investing ahead of the curve and in new waves of technology innovation and that's what we'll continue to do. On the – to your question in relation to the bundled customers. So we now – to your point we have 322,000 customers shifting to a bundle. I think that number now in terms of the in force base is well over 80 per cent of our fixed broadband customers are now in a bundle. And without disclosing what's relatively sensitive, as you would expect the customers who are in a bundle are more inclined to stay with us for longer than customers who have a single product.

MR HAN: All right. Thank you.

MR KOPANIDIS: The next question comes from Ian Martin.

MR I. MARTIN: Good morning. Andy, last week Rod Sims, chairman of the ACCC, announced a telecoms market review. You know, the ACCC seems concerned about, you know, the nbn not perhaps working out in competition terms the way they might have expected. He was asked in an interview after that whether there might be a possibility of, you know, doing a declaration review on mobile, which he deflected. I just wonder with this capital spending you're looking at largely going into mobiles – what your expectations are there with, you know, is there a growing risk that the ACCC might look at declaring mobiles? And also, just in relation to the margin trend and your long-term expectations for, you know, costs in fixed line, the $3 billion, you know, in that – that would push fixed margin below 10 per cent compared to, you know, David Thodey originally talking 20, 25 per cent.

So I just wonder what your expectations are there around, you know, the long-term ARPU trend from nbn and, you know fixed line retail pricing.

MR PENN: Okay. Look, thanks Ian. So let me just sort of deal with the second one first, which is margins in fixed line. I mean, ultimately, the margins will be, you know, a function of the market dynamic and the pricing in the market, which is obviously – is dynamic and also the input costs from nbn and then, of course, you've got to activate your costs to serve and so you're right. I mean, if the market puts pressure on ARPU's – puts ample pressure on ARPU's then that squeezes the amount of return that is available for shareholders. I mean, as you said, David – and I think, you know, the company always sort of was setting itself a planning parameter, if you like, of a 25, 20 per cent return and absolutely that's what we would aspire to achieve.

But it will be constrained by the number of levers obviously you've got to pull between the input costs and the market pricing and, you know, in terms of how that plays out that's hard to tell. But it's why many of the increased services that we provide are important, whether it be around media. Bundling is obviously going to be an important strategy in that regard. And then also the in-home experience and the smart home – some of the smart home investments we're making will be all-important in relation to that mix. But I can't sort of predict on margins but I understand, you know, your maths and I'm not arguing with it as I say it's a function of how the market plays out.

On the first point on the ACCC conducting a review – and your question, would the sort of – around the mobile market. I mean, I couldn't conceive – I couldn't conceive how there would be regulatory change. It would create a disincentive to invest in regional Australia and providing coverage for customers in the region. I really couldn't conceive that were the case. But obviously, you know, we will provide some input into the review and we will provide what help and assistance that we can and, of course, our investments will be cognisant of anything that comes out of the review that creates a disincentive for us to invest. But I just can't conceive why that would happen because, you know, customers in rural, regional Australia – they need network. They need investment.

And we are the company that's been making those very, very substantial investments and so we think that that's the world that we will continue and we will absolutely continue to invest in improving and extending our coverage. But we will obviously keep an eye on how the review plays out.

MR MARTIN: Thanks, Andy.

MR PENN: Thank Ian.

MR KOPANIDIS: If there's – there's no more questions on Conferlink so if there's any – no more questions in the room, looking at – no. Okay. Well, thank you for your attendance. That's this – that now concludes the sort of investor analyst section of today and I will ask my colleague, Jason Laird, to come up and facilitate the media session so thank you for your attendance.

BRIEFING CONCLUDED [10.59 am]