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The Manager

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Dear Sir or Madam

Telstra Corporation Limited - Transcript of Investor, Analyst and Media briefing - Negotiations ended on Philippines wireless joint venture

In accordance with the Listing Rules, I attach a transcript of a conference call for investors, analysts and media held at 10.30 AM AEDST on 14 March 2016 in relation to the above topic, for release to the market.

Yours faithfully

Damien Coleman
Company Secretary

Telstra – Negotiations ended on Philippines wireless joint venture Investor and media transcript

MR P. KOPANIDIS: Good morning everyone and welcome to this morning's teleconference. And thank you for joining us at short notice. My name is Peter Kopanidis. After some brief comments from our CEO, Andrew Penn this morning, we will be taking questions from investors and analysts and then, at the conclusion of that, I will hand over to my colleague, Jason Laird, who will moderate the media Q and A. With that, I will now hand over to our CEO, Andrew Penn. Good morning, Andy.

MR PENN: Hi Peter, and good morning everybody and, as Peter said, thanks very much for dialling in at relatively short notice. I think everyone will have had a chance to appraise themselves of the media market release that we put out this morning in relation to the Philippines but I did want to give everybody the opportunity just to ask us any questions directly if, indeed, you had any. So, obviously, this morning's announcement is to advise that Telstra and San Miguel have been unable to reach commercial arrangements on a possible equity investment for the joint venture in the Philippines and negotiations have, therefore, ceased.

You know, there was an enormous amount of effort put in on all sides to make this transaction, to make this deal work and, unfortunately, we just simply were not able to come to the commercial arrangements that would have enabled us to proceed. And whilst the opportunity is, and remains, strategically attractive and we have great respect for San Miguel Corporation and, in particular, Ramon Ang, the President of San Miguel, it was obviously crucial that the commercial arrangements did achieve the right risk-reward balance for everybody that was involved. As we said in the market communications, we have offered to continue to provide technical network design and construction consultancy to support San Miguel should they require those services.

And, of course, we continue to pursue great opportunities in Asia consistent with our strategy. As I said at results, we've completed the full integration of Pacnet. That's going really well. We're very pleased how that's providing us with a really strong platform off which to grow our enterprise services business into the region and, of course, we continue to invest and grow our partnership in Indonesia. But, unfortunately, we were not able to come to commercial arrangements on this one and that's why negotiations have ceased. And, of course, you know, all of our investment decisions will continue to be guided by our capital management framework. So with those introductory comments, Peter, I might hand back to you to facilitate questions and answers.

MR KOPANIDIS: Okay. Thanks, Andy. And so also on the call this morning, we've got our CFO, Warwick Bray and our Group Executive International New Businesses, Cynthia Whelan, also on the call. But, as I say, Andy will be happy to take your questions. So, Lorraine, if we could have our first question from investor or analyst, please?

OPERATOR: Certainly. Thanks, Peter. Our first question is from Eric Choi, UBS. Thank you, Eric, please go ahead.

MR E. CHOI: Hey guys, thanks very much. I just had three questions if I could please. The first question was just on, obviously, in terms of the uses of excess capital. So with the franking balances at 197 million, which looks like it's only enough to frank sort of three to four DPS so it looks like it's special is probably unlikely, so then the question is a buyback. And then in 2014 when you were sort of tossing up M&A versus a buyback, the market price was 5.34 and you chose a buyback. So I guess would we be correct in assuming a buyback is also a relatively attractive option now as well. That's the first question. Should I continue with the next two or give you - - -

MR PENN: Yes, please, Eric.

MR CHOI: Sure. The second question, you mentioned not being able to achieve the right risk-reward balance as part of the reason why negotiations failed. So I presume you're talking about – you know, those NPV and WACC hurdles in the second leg of your investment criteria. I'm just wondering if you could provide us more colour on what sort of risk premium you're applying because, obviously, while this JV failed, that $500 million of incremental mobile Capex you're spending over FY16[1] and FY17[2] that didn't fail and that did meet that investment criteria. So I would be interested in, you know, sort of gauging what sort of risk premium you're applying. And then the last question, just a bit of housekeeping. In that conference call release, it says you were tossing up a wireline investment. So just confirming that that's obviously typo and you weren't considering any sort of fixed investment.

MR PENN: Okay. Thanks very much, Eric. On the last point, well, it was definitely a wireless investment. I'm not sure if there was a typo or something in all of that but I can confirm it was a mobile opportunity that we were looking at. Just on the first one, in terms of the usage of capital, as you know, I mean – you know, we continue to have a very clear capital management framework which is what we will use for making the right capital allocation decisions. You will appreciate I can't really sort of speculate openly about what we may or may not do at any point in time other than to say, you know, we do see that a mix of investing and capital management initiatives is the right approach and we will use that framework for making those decisions and, as you say, I'm also cognisant of the franking balance at the half year which was a couple of hundred million dollars.

But, look, I mean, we continue to look at all options in that regard. But, really, this morning was mainly about just communicating where we've arrived at in relation to the Philippines. On the last point which is the risk-reward balance, you know, in the end, as I say, this was a strategically attractive opportunity. We tried really hard to get there on all sides. It's just unfortunate we weren't able to bring together a set of commercial arrangements that worked. Obviously, our investment criteria is one element of all of that which reward considerations but, you know, it's not the only one. In terms of the risk premium, I mean, basically our investment criteria is a weighted average cost of capital, NPV greater than the weighted average cost of capital with an appropriate risk premium and that risk premium takes into account, you know, the market risk as well as the investment risk.

So it wouldn't be the same risk premium that we would apply for this investment as compared to the mobile network domestically. They would obviously have different risk dynamics but we have an appropriate risk premium for each but we haven't disclosed exactly what that number is. But, anyway, it's specific to both the market and also the investment opportunity.

Thanks, Eric.

MR CHOI: That's all. Thanks.

MR KOPANIDIS: Next question, please.

OPERATOR: Thank you. Our next question is from Sameer Chopra from Merrill Lynch. Thank you, Sameer. Please go ahead.

MR S. CHOPRA: Good morning. I have two questions. One, Andy, could you talk about the pipeline of other investments that you may be looking at? Are they of a similar size to the ones you were considering in the Philippines or much, much smaller? Is there a vast pipeline there? I'm just trying to get a sense of that. And then the second one is there's been a couple of issues with the mobile network in Australia and I wonder, you know, whether management needs to sort of refocus back on the Australia business? Perhaps if you could make a few comments around that, thanks.

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[1] Verbatim: 16
[2] Verbatim: 17

MR PENN: Thanks, Sameer. I mean, look, this is always a difficult question to answer, as you will appreciate in a sense this is talking about pipelines of other initiatives because, on the one hand, I want to obviously continue to give the market some colour and the parameters of that are the sort of things that we're considering in our strategy. And on the other hand, it's not obviously appropriate for me to talk openly about files that we may or may not be looking at. But let me try and give you sort of some broad parameters. I mean, if you look back over the last, you know, period of time we've made investments such as Pacnet which was, you know, close to a billion dollar investment all up. We've obviously made acquisitions in software, in health. Some have been in the tens of millions and a few have been in the hundreds of millions.

I think, you know, looking forward into the future, that continues to be the nature of the types of investments that we have in our pipeline and the attributes that we look at, they're either capability additions that enable us to sort of accelerate the growth of our network application services businesses or software investments or expand our health business as well as more sort of infrastructure type of investments such as Pacnet. And, you know, I think the sort of – the spectrum of money that we've invested remains the sort of the nature and the scale of the size of deals that we receive. So, I think the summary answer of all of that is you should expect transactions of a similar scale and magnitude. So I think that's probably all I can say.

Look, on the mobile network, I mean, I can assure you we're very focused on our core business. We continue to invest significantly in relation to the mobile network. We've had one issue a couple of weeks ago which was a – sort of a process thing which resulted as a consequence of a – a human error but was largely sort of a process issue. And those things do happen in – I can assure you in lots of people's networks from time to time. It's because of the complexity and the scale and the volume of traffic on the network.

So look, we are very, very focused. We're very pleased with the performance of the network. I think the data free day completely validated the robustness and the resilience of the network where we had twice our average data and the biggest single volume of data in any one day. And I think – I put that in the context of data volumes increasing more than 40 per cent over the last 12 months on mobile and more than 70 per cent on fixed. So we're very focused on that. We're investing and we believe we continue to have and maintain the best networks in Australia.

MR CHOPRA: Thanks, Andy.

MR PENN: Thank, Sameer.

MR KOPANIDIS: Next question is from Roger from CLSA.

MR R. SAMUEL: Yes. I just have a few questions. Firstly, I was just wondering, outside of the Philippines which other countries are you looking at for a potential deal and also whether it's likely to be B2C, or is it likely to be B2B just like Pacnet? And second question is just around the structure of the potential deal. Do you prefer something like a JV, or do you prefer to acquire the company outright? Thanks.

MR PENN: Thanks, Roger. Look, in terms of countries, I mean, one of the things that we've previously said is that one of the strategic dynamics that's interesting is that we're seeing the potential demand and growth of data in the region growing very strongly. And one of the things that's driving that is the cost of smartphones is coming down quite dramatically at the same time as many markets outside of the major cities don't really have access to fixed broadband or much mobile broadband internet access. And so as smartphones come down in that environment basically what it means is a much bigger proportion of the population become able to access the internet much more quickly, which is then requiring and putting demand on for growth in networks and growth in mobility.

The Philippines was particularly attractive – is particularly attractive because of that dynamic that exists there. Plus also it's only a two-player market, whereas many of the other markets around the region have multiple players so I don't see the same dynamics in specifically any other market at the moment, but there are different dynamics. So given that I think our bias is probably towards B2B opportunities, but we continue to monitor how that disruptive dynamic will play out in the B2C sector as well, and we'll keep that in focus as well. In terms of the structure of the deals if we have a preference to JV or acquire, I mean, I think the reality is in most, if not in many, markets telecommunications is a regulated industry and foreign investment restrictions are such that as a foreigner you can't necessarily own all of the equity and so that tends to be the sort of – the gateway to what determines whether it's a JV or it's a wholly owned business.

At the same time, there are some significant benefits from having a local partner particularly a local partner with the strength and reputation and credentials as Ramon Ang and San Miguel, which is why we were disappointed not to be able to come to the right commercial arrangements with all the parties. So we would be open in summary to both JV or acquiring and one of the big drivers of that is the regulatory environment.

MR SAMUEL: Thanks for that.

MR KOPANIDIS: I think the next question comes from Sachin Gupta.

MR S. GUPTA: Can you hear me?

MR PENN: Hey, Sachin. Yeah. I can hear you.

MR GUPTA: Yeah. All right. Thanks. Just two questions. Firstly, Andy, you sounded relatively confident a few weeks ago that you should be able to close this one. Anything that's changed in the past few weeks or it's just a combination of various things? That's one. And secondly, do you think San Miguel still goes ahead?

MR PENN: Look, I think on the first point, Sachin, I think what I said and I said most recently through the results is that it remains strategically attractive. We are excited by the opportunity. It's taking longer to conclude the discussions than we would have liked and had hoped, but that wasn't unusual and I've been around long enough to know that you never declare victory in completing a deal until it's actually all completed. So in summary, nothing's changed from that and it's unfortunate that we just have not been able to get to an agreement on all of the commercial arrangements to suit everybody notwithstanding an enormous amount of effort, but there's nothing more in it than that.

As regards San Miguel and whether they will progress on their own, I think that's really, with respect to Ramon, a matter for Ramon. I know that there was a quote I think from Ramon indicating that that would be the case, and as I said earlier, we've offered to continue to provide technical construction consultancy if that was something that they would like.

MR GUPTA: Yeah. Thank you.

MR KOPANIDIS: At this point I don't believe there's any other analyst questions, so, Jason, I might hand over to you to moderate the media Q&A.

MR J. LAIRD: Sure. Thanks, Peter. I think our first question is from David Ramli.

MR D. RAMLI: Can I just ask, did you – have you already raised any debt for this project? We've had word that you might have, and if so what happens to that money? The second point was just can we get a little colour on what the sticking point was? I mean, did you want more management control, or was it another issue? Was it a profit sharing issue or something like that? Maybe one for Cynthia there.

MR PENN: Look, thanks very much, David. Firstly in relation to debt. So the project was comprised essentially San Miguel and Telstra jointly investing equity capital plus San Miguel investing their existing telecommunication assets. And then in conjunction with that we were working with a number of banks to source financing to support the venture. But that debt has not been injected or advanced, and so depending on what San Miguel's plans are from here that will be a matter for them, but the point is that the debt hasn't so far been invested or raised. In terms of the colour on the sticking points, David, look, I mean, I don't think I can really say anything more than I've said this morning and in the release, which is that despite an enormous amount of effort on all sides unfortunately we just weren't able to come to commercial arrangements which enabled us to proceed and get the right risk/reward balance for everybody.

And in that you can assume that it wasn't one single thing. It's a complex transaction involving a number of parties with financing with San Miguel and ourselves, and also the build of a new mobile network and it wasn't one particular item but we just unfortunately weren't able to get there.

MR LAIRD: All right. And we have a question from Brian Han.

MR HAN: Thank you for taking my question. Just a – just one question. You made it very clear that Telstra will continue to canvass opportunities in Asia but what about locally? Are there any business areas or industries that may attract Telstra's interest?

MR PENN: You mean domestically, Brian, in Australia?

MR HAN: Yes.

MR PENN: Yes, absolutely. We continue to invest in Australia as well. We have bought a number of businesses – invested in a number of businesses in supporting our initiatives in health – in electronic health. And also we just completed an acquisition a couple of weeks ago called Kloud, which is basically a cloud integrator, to support our network application services in addition to businesses in security recently as well as other services businesses as well. So no, no, we're as focused on investing domestically as anywhere else.

MR HAN: What about – what does media reform mean to Telstra? What does content and distribution mean to Telstra in the traditional sense?

MR PENN: Well, look – I mean, we're here to talk about the Philippines. I will take this one but, look, the point is that media is important in that people are very much relying on the quality of our networks to increasingly watch more and more media online, whether that be at home, through a subscription service or whether that be on mobile as well. And so we're interested in media from the point of view of providing a great media experience with unique assets that we have, such as the mobile rights to the AFL and the NRL, as well as not only providing unique sporting media on unique content, but also providing it on the best network in Australia so it – it's the best experience.

MR HAN: Okay. Great. Thanks Andy.

MR LAIRD: And we have one more question from Elizabeth Knight.

MS E. KNIGHT: Hi guys.

MR LAIRD: Hi Elizabeth.

MS KNIGHT: I'm sorry if you have already answered this – I have had a few troubles on the call actually hearing some stuff – but it's probably similar to David Ramli's question. Just on that risk reward. You were talking about weighted average cost to capital and a few other things that you had to – hurdles that you had to actually cross. Can you just give us a little bit more detail on what they were and how this deal just didn't match up?

MR PENN: Yes. Look, I think, Elizabeth, they're two sort of slightly different things. There's a very specific point, which is in our capital management framework we have some criteria for acquisitions – financial criteria for acquisitions and also for organic investments. And in relation to organic investments, which is what this would have been because it was a start-up new business as opposed to acquiring an existing business, in relation to those we have a stated objective in our capital management framework that we will seek to achieve a return with a net present value – a positive net present value using a weighted average cost of capital plus an appropriate risk premium and so that was specifically one element of it. The broader element, if you like, is really that's not the only consideration we have on any transaction. It's more than just the pure financial consideration. There's a range of, you know, risk factors that we have to take into account. And so I was just addressing both of them.

MS KNIGHT: So are you saying it didn't meet the first of those?

MR PENN: I'm not saying that

MS KNIGHT: Your organic investments' objective on the NPV using a certain – your weighted average cost capital. So are you saying it didn't – it didn't get over that hurdle in the first instance?

MR PENN: I didn't say that and I'm not – I'm not commenting on that. What I'm just saying is when you look at the deal in total, we were not able to reach commercial agreements which enabled us to proceed.

MS KNIGHT: So – so you're saying this was sort of more your decision than San Miguel's decision; is that what we can take from that?

MR PENN: No. No, I didn't – I didn't say that. I said that we weren't able to – when I say we, I mean us collectively – we're not able to agree.

MS KNIGHT: Okay. So both companies. Yes. Okay. Good. Thank you.

MR PENN: Thanks, Elizabeth.

MR LAIRD: Next question is from John Durie.

MR J. DURIE: Hi Andy.

MR PENN: John.

MR DURIE: A couple of questions if I could. Firstly, what percentage of your income now is derived from Asia? And allied to that is this deal I think you spent over – you know, pretty well a year on it. What does it tell you about dealing in Asia and the difficulties you face?

MR PENN: Well, look, in terms of what percentage of the income comes from Asia, with the Pacnet acquisition, you know, it's going to be around about 10 per cent. In terms of what does it tell me about Asia; well, I have been doing business in Asia a very long time and I don't know that it's just Asia necessarily. I think, you know, any large complex transaction which requires, you know, a new start up takes a lot of time to work through. So, you know, as I said at results time, the negotiations and the discussions were taking longer than we had anticipated or hoped. That wasn't surprising, based on my experience and unfortunately, we were just not able to come to, you know, a set of commercial arrangements which worked for everybody. I suppose the only other message I learnt from it but I think already knew, is one has to be patient and be prepared to invest the time and, you know, work through these things.

MR DURIE: Okay. Just a quick follow up. Given that they obviously weren't prepared to pay for your consultancy services, what chance of them taking up your offer now?

MR PENN: I never said that they weren't prepared to pay for the consultancy services.

MR DURIE: Well, they weren't prepared to pay what you wanted clearly.

MR PENN: I didn't say that.

MR DURIE: Well, why didn't the deal go ahead?

MR PENN: Well, as I said, we weren't able to come to an agreement in relation to the commercial arrangements which basically worked for everybody with the right risk-reward.

MR DURIE: Right.

MR PENN: I never said anything specifically about the consultancy aspect. I don't think that was an issue at all.

MR DURIE: Okay. Well, are you – are you confident that you will do a deal there?

MR PENN: Well, as I say, we have ceased negotiations.

MR DURIE: No. But you said you have offered a consultancy agreement.

MR PENN: Sorry. Sorry. The point of our consultancy is we just can offer to continue to provide them with consulting support and technical support. That's just what we had been providing them to the venture for the last period of time. We just offered to continue to provide it to them if they wished for the – you know, for the next period of time.

MR DURIE: And will they wish?

MR PENN: I don't know yet.

MR DURIE: Okay. Right. Thank you.

MR PENN: Thanks, John.

MR LAIRD: Okay. We have time for one more question and I believe it's from Michael Smith from The Financial Review. MR M. SMITH: Good day Andy. Look, just wondering how long have you guys been talking – I mean, I know this sort of first became public knowledge around August last year but how long have the talks been going on for? And just, secondarily, there has obviously been some concern in the market from some fund managers around the deal. Did those concerns at all influence the way – the outcome here – the way the negotiations have gone?

MR PENN: Look, if I just take the second point first. I mean, no – I mean no, obviously, we have an ongoing dialogue with our shareholders but, as I said recently, you know, ultimately, our job is to make sure that our strategy is clear and we're transparent about how we're implementing against that strategy and this decision was a function of the fact that we weren't able to come to commercial arrangements. It wasn't to do with any particular feedback or dialogue with shareholders. In relation to how long have the discussions been ongoing, as you just heard from John, more than 12 months, as you would expect on a deal of this nature.

MR SMITH: Yes. Okay. Thanks.

MR LAIRD: All right. We will need to conclude the conference at this point so thank you everybody for dialling in, particularly if you have been in one of the public holiday states or territories. So thank you everyone and have a good day.

MR PENN: Thanks guys.

BRIEFING CONCLUDED **[10.59 am]**