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The Manager

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ELECTRONIC LODGEMENT

Dear Sir or Madam

Telstra announces outcomes of capital allocation strategy review

In accordance with the Listing Rules, I attach a copy of a market release, for immediate release to the market.

This announcement has been released simultaneously to the New Zealand Stock Exchange.

Yours faithfully

Damien Coleman
Company Secretary

MARKET RELEASE

Telstra announces outcomes of capital allocation strategy review

Thursday, 17 August 2017 – Telstra has announced the outcomes of the capital allocation strategy review it commenced in November 2016, including a potential plan to monetise a portion of locked-in recurring nbn receipts, a new dividend policy and a revised capital management framework.

Speaking at the company's full year results announcement, Telstra CEO Andrew Penn said Telstra had reviewed its balance sheet structure and settings, longer term capex requirements, investment decisions including M&A, returns to shareholders including dividends, buy-backs and other forms of returns, and the best way to manage receipts from the nbn.

"We have consulted extensively with shareholders and other stakeholders during this review and the overwhelming and consistent feedback from this consultation process has been to ensure we are planning for the longer term, and retaining financial flexibility," Mr Penn said.

"This includes the importance of retaining a strong balance sheet through the nbn transition period and in light of the increased competitive dynamics and digital disruption."

The outcomes of the capital allocation review are:

1) a **potential monetisation of a portion of locked-in recurring nbn receipts**, subject to legal documentation and satisfaction of certain conditions;
2) a **revised capital management framework** focused on maintaining tight fiscal discipline, maximising returns for shareholders, maintaining financial strength and retaining financial flexibility for investment in the future; and
3) a **new dividend policy** to more closely align ordinary dividends to underlying earnings[1] and to return in the order of 75 percent of net one-off nbn receipts[2] to shareholders over time via fully-franked special dividends.[3]

Potential monetisation of recurring nbn receipts

At its Investor Day in November 2016 Telstra said it would look at ways to crystallise value from recurring nbn receipts for key infrastructure and today announced a potential plan to monetise a proportion of these receipts.

Mr Penn said recurring receipts for access to Telstra's extensive infrastructure were expected to grow to just under $1 billion annually by the end of the nbn migration period.

"If we were to proceed with these plans, it would involve approximately 40 percent of the total receipts that are expected, representing the already locked in receipts for fibre and exchanges," Mr Penn said.

"The scale of the proposed transaction is approximately $5 – 5.5 billion[4] with Telstra to retain some equity interest. Our intention would be to use the proceeds to reduce debt by around $1 billion, with the balance to support a capital management program to enhance shareholder returns, most likely through a series of on and off market buy-backs.

"The proposed transaction is subject to agreement and a number of steps including approvals and consents from investors, the Government and nbn co.

"We are currently in discussions regarding these matters. We cannot confirm whether they will be achieved but we will update the market in due course," Mr Penn said.

Dividend Reinvestment Plan

Given the ongoing discussions with nbn co and Government on the potential monetisation of a proportion of the recurring nbn receipts, in order for Telstra to manage its ongoing continuous disclosure obligations it has suspended the Dividend Reinvestment Plan with an intent to reinstate it when circumstances allow.

Capital Management Framework

The objectives of the revised capital management framework remain the same as those communicated to the market in 2012, including maintaining Telstra's tight fiscal discipline, maximising returns for shareholders, maintaining financial strength and retaining financial flexibility.

As a result of the capital allocation strategy review some of the principles supporting these objectives have changed. The new principles are to:

- Maintain balance sheet settings consistent with an A band credit rating;
- Pay a fully-franked ordinary dividend of 70-90 percent of underlying earnings;[1]
- Target capex/sales ratio of ~14 percent excluding spectrum from FY20; and,
- Maintain flexibility for portfolio management and to make strategic investments.

The revised Capital Management Framework is attached.

Dividend Policy

The new dividend policy supports the objectives of the capital management framework and is consistent with shareholder feedback to maintain a strong balance sheet and flexibility to manage the business and invest, especially during the nbn transition.

Mr Penn said the new dividend policy, which will commence after the payment of the final dividend for the 2017 financial year, would move Telstra away from a historical practice of paying out almost 100 percent of profits.

"From FY18 we will adopt an ordinary dividend payout ratio of 70-90 percent of underlying earnings[1], which is more in line with global peers and local large companies," he said.

"In addition to the ordinary dividend, we intend to return in the order of 75 percent of net one-off nbn receipts[2] to shareholders over time via fully-franked special dividends.

"We believe this is appropriate given one-off income is akin to compensation for an asset sale over a number of years and aligns with market feedback and expectations that these receipts are returned to shareholders.

"With the implementation of this new dividend policy, we expect total dividends in respect of FY18 to be 22 cents per share fully-franked, including both ordinary and special dividends."[3]

Mr Penn said in adjusting the capital management framework and resetting the dividend policy Telstra had balanced the importance of providing consistent returns to shareholders with the long term sustainability of returns and strategic direction of the company.

"We realise this is a material reduction from the historic level of our dividend and we do not underestimate the impact on our shareholders. It is for this reason we are providing advance notice of this change and why the Board has maintained a 31 cents dividend this year," Mr Penn said.

"These are important changes to Telstra's approach to capital management and appropriate in the context of our strategic transformation. This is about setting the business up for success in the future."

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1 "underlying earnings" is defined as NPAT from continuing operations excluding net one-off nbn receipts (as defined in footnote 2 below).
2 "net one-off nbn receipts" is defined as net nbn one off Definitive Agreement receipts (consisting of PSAA, Infrastructure Ownership and Retraining) less nbn net cost to connect less tax.
3 Return subject to no unexpected material events, assumes the nbn™ rollout is broadly in accordance with the nbn Corporate Plan 2017 and receipt of associated one-offs, and is subject to Board discretion having regard to financial and market conditions, business needs and maintenance of financial strength and flexibility consistent with Telstra's capital management framework.
4 It is anticipated Telstra would retain approximately 25% of the equity component of the transaction.

Updated Capital Management Framework

FISCAL DISCIPLINE

OBJECTIVES

1 MAXIMISING RETURNS FOR SHAREHOLDERS

2 MAINTAINING FINANCIAL STRENGTH

3 RETAIN FINANCIAL FLEXIBILITY

PRINCIPLES

1. We remain committed to retain balance sheet settings consistent with an A band credit rating
2. Pay fully-franked ordinary dividend of 70-90% of underlying earnings[1,2]
3. Target capex/sales ratio of ~14% excluding spectrum from FY20[4,5]
4. Maintain flexibility for portfolio management and to make strategic investments

Return in the order of 75% of net one-off nbn™ receipts to shareholders over time via fully-franked special dividends[2,3]

Capex/sales ratio[4,5] of ~18% in FY18 and FY19

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2. “net one-off nbn receipts” is defined as net nbn one off Definitive Agreement receipts (consisting of PSAA, Infrastructure Ownership and Retraining) less nbn net cost to connect less tax.
3. Return subject to no unexpected material events, assumes nbn™ rollout is broadly in accordance with the nbn Corporate Plan 2017 and receipt of associated one-offs, and is subject to Board discretion having regard to financial and market conditions, business needs and maintenance of financial strength and flexibility consistent with Telstra’s capital management framework.
4. Capex excludes expenditure on spectrum, measured on an accrued basis. Capex excludes externally funded capex.
5. This guidance assumes wholesale product price stability and no impairments to investments, and excludes any proceeds on the sale of businesses, mergers and acquisitions and purchase of spectrum. The guidance also assumes the nbn™ rollout is broadly in accordance with the nbn Corporate Plan 2017.