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The Manager

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ELECTRONIC LODGEMENT

Dear Sir or Madam

Transcript – Analyst Briefing – Telstra's revised FY18 guidance for nbn

I attach a copy of the transcript, from the conference call held this morning, in relation to Telstra's revised FY18 guidance for nbn, for release to the market.

Yours faithfully

Damien Coleman
Company Secretary

MR BURLEY: Good morning, everyone. Thanks for joining us to discuss this market update announcement. This is Nathan Burley of Telstra Investor Relations. On the call today we have Telstra's CEO, Andrew Penn, and CFO, Warwick Bray. Andy will make a brief opening statement, and then we will open up for Q&A. With that, I'll hand over to Andy. Andy.

MR PENN: Thanks very much, Nathan. And firstly, thank you, everybody, for hooking in, and for those of you that are in Melbourne, hopefully you're taking precautions against the somewhat challenging weather we're about to see. Look, as Nathan said, I'll make a couple of comments before we open for Q&A. And as you will have seen earlier this morning, we announced that we have revised our financial year 2018 guidance as a result of the impact of nbn co's announcement that it would cease sale on HFC technology for a period of six to nine months from the 11th of December. By the way, just on that point, we're working with nbn right now to see if we can cease sale earlier than that, because we think that that's in the best interests of customers. And so we expect to be able to implement that over the next day or two.

We also updated guidance in relation to nbn's Corporate Plan for 2018. I want to be clear in our update this morning that our revised guidance is only in relation to these two delays. Our operating outlook guidance remains unchanged to that which we provided to the market in conjunction with our full-year results of 2017 back in August. Also, importantly, we are reaffirming our 2018 dividend. That is expected to be at 22 cents per share, fully franked, including the ordinary and special components, which is in accordance with our dividend policy that we did announce in conjunction with our results in August.

As you know, when we announced our guidance on the 17th of August, it was based on the nbn Corporate Plan for 2017. nbn subsequently updated their Corporate Plan for the 2018 Corporate Plan on the 31st of August. That change did reduce the number of brownfields that would be ready for service, and also brownfield activations in 2018 relative to their previous plan. And of course, it did impact Telstra's financials. However, that impact did not result in our outlook falling outside of our guidance range at that time, and hence we did not need to update guidance at that time.

However, with the addition of the delays that were announced earlier this week from the cease-sale by nbn of HFC, which is much more significant – Telstra's outlook financially is now outside of our guidance range by virtue of these delays from nbn. And therefore – that is why we have updated our guidance, and which is the announcement that we're making this morning. The most significant impact from a timing perspective, I think as most people understand, is a proportion of the one-off receipts, including the PSAA and ongoing ownership receipts that arise to Telstra from nbn, are being delayed into future periods. And I want to make that point clear, as well. These receipts will ultimately be received by Telstra. They will just be received in a future period.

Also, there is an impact in the revenue recognition for Telstra commercial work contracts with the nbn, and the revenue recognition is being delayed. On this point, nbn has asked us to continue with the work that we're doing for them, but because the revenue recognition is associated withhow the individual areas are declared ready for service – that is what the revenue recognition is attached to, rather than necessarily the work. That results in an accounting delay in some of the revenues, but not a delay in relation to the work or a delay in relation to the cash received. And that's one of the reasons why you can see in our updated guidance the cash flow impact is lower than the earnings impact.

And there are other reasons for that as well which we can pick up in Q&A but I just really wanted to make that point clear as well. There are, of course, benefits that are offsetting this, including lower nbn costs to connect, lower network payments to nbn and retained wholesale EBITDA which will partially mitigate the reduction of the one-off receipts, but bearing in mind that this is happening in the second half of the year and the ramp-up obviously increases during the second half of the year. The impact of those is lesser in the year than one might otherwise expect and we can touch on that in Q&A as well.

So while the nbn rollout delays the impact on Telstra's outlook for 2018, it is actually anticipated to have a modestly positive financial effect on Telstra over the full rollout of the nbn and that's due to the effects of the natural hedge which continues to exist. And it's noted that nbn, in their announcement on Monday, indicated that they remained committed to completing the rollout for FY – by 2020, rather.

So, in summary, we've announced our revised 2018 guidance as a result of the impact of nbn co's announcements, including their updates of their plan in August of this year, but otherwise in relation to our outlook for the business, our guidance is unchanged. It's really just in relation to these two matters. And, importantly, notwithstanding this, and against this background, we are reaffirming that we expect, subject to the usual – obviously, conditions of the board etcetera, that the dividend for 2018 will be the 22 cents that has been previously indicated.

So they're my introductory comments and I'm happy to hand back to Nathan to facilitate the Q&A session, which we're happy to do now.

MR BURLEY: Great. Thank you, Andy. We will now open for questions, so, operator, if you could open up the line for questions. And our first question is from Raymond Tong of Evans and Partners.

MR TONG: Good morning, Andy. Just a couple of questions. I just wanted to see whether you could help us understand the quantum of the impact of – I suppose the change in the 2018 Corporate Plan and also just the – I suppose the delays announced earlier this week is my first question.

MR PENN: Yes. I mean, we haven't actually provided a breakdown between the two. And the delays are driven by slightly different things. And Warwick can perhaps if there's a follow-up question, talk in a bit more detail about how the relative impacts were – but essentially, the bigger impacts – by far the much bigger impact is actually in the delay in relation to the HFC cease sale that was announced earlier this week.

MR TONG: And just following up from that, in terms of the impact and the EBITDA outside of the $0.6 billion for the lower one-off nbn receipts is it fair to assume that it's the, I suppose, higher wholesale EBITDA and lower payments to nbn is just completely offset by the lower recurring income in commercial works? Is that a fair assumption?

MR PENN: Yes. Look, I think so. I mean, by far the biggest impact overall is on the one-off receipts. The things that you're alluding to obviously are the positive effect of the natural hedge happening the other way, and that would be smaller than if the delay sort of effectively happened from day 1 in the year, and that's – or, rather, the rollout was expected to be all fully completed within the year, and it's because the rollout is increasing and this decision has been announced in relation to the second half of the year, the positive impact of the natural hedge doesn't represent, if you like, one full year of that. It's actually a relatively small proportion of the overall amount you would expect to receive in year. And of course, that will – therefore, the benefit of that will obviously flow into next year.

MR TONG: Yes, I understand. And just curious, just in terms of the delays, whether that, I suppose, has an impact on the broader business and the profile and the progress of your cost-out program over the next few years?

MR PENN: Look, I don't think so in any material way, Raymond. Our cost-out program is still targeted where it is and – no. I mean, obviously we've only been provided this information on Monday and we're focused on obviously making sure we implement the cease sale in the way in which is most supportive and the least disruptive for customers. But no, we're committed to our long-term productivity program and obviously our other strategies.

MR TONG: Great. Thanks, Andy.

MR BURLEY: All right. Thanks, Raymond. The next question is from Kane Hannan from Goldman Sachs.

MR HANNAN: Good morning, Andy. Good morning, Warwick. So firstly, could you just talk through, I suppose, the decision process and considerations that the board went through when reiterating the 22-cent dividend following the announcement, and then I suppose whether there's any impact on the future dividend expectations. And then, just the second one, just confirming whether the – in terms of saying you've got lower recurring nbn receipts, is that from the HFC delay, or is that more a change in the 2018 Corporate Plan? I'm just wondering how the HFC impacts the recurring side of things.

MR PENN: Yes, sure. Okay. Well, I think – look, in relation to the dividend consideration, I mean, the factors that we've taken into account are firstly that – and this goes a little bit to your point on the longer-term dividends, as well. Firstly is that this is an in-year delay and these payments will move forward into next year, and overall we believe this will be – our expectation is this will be modestly positive to the long-term economics of Telstra because of the impact of the natural hedge. And so therefore, for future dividends, this has no bearing on outlook or perspective in relation to future dividends. If anything, it sort of supports our long-term future dividend trajectory because of the more positive impact on Telstra, albeit in the great scheme of Telstra, I mean, in – aside from the economics, it's relatively modest.

But nonetheless, it's net positive. In relation to the dividend considerations this year, as you would imagine, the board would have considered all of the factors – the impact on EBITDA, how that flows through to NPAT, solvency, liquidity, and taking into account the dividend policy that we announced in August. And on the back – against that background, they're comfortable to reconfirm that it's their expectation to pay a 22-cent dividend. In relation to the recurring payments, I mean, essentially, as you know, the nbn is paying us for access to our infrastructure – pits, ducts, exchanges, dark fibre – and ultimately we expect those payments – which are called the infrastructure access payments, which are recurring – ultimately we expect those payments to reach just under a billion dollars, and then to increase with inflation thereafter at the point the nbn is fully rolled out.

But in the meantime, those payments – the recurring payments – increase in quantum roughly in line with how the nbn is rolled out, because they're attached to access to the infrastructure and, of course, nbn do not require access to certain infrastructure until such time as they arrive in all the various different service areas. And so, therefore, that's why not only does it have an impact on the one-off receipts, but it also has an impact on the rate and pace at which those infrastructure access payments increase over the period, as well. But similarly, they will – nothing changes in those in the long term. We still expect those – project those to keep to the same number that we've expected it to previously, in conjunction with the full rollout of the plan.

MR HANNAN: And sorry, just a technical one. In terms of the guidance and that cease sale, are you guys assuming the full nine months in terms of the delay, or

MR PENN: Well, if – actually, it's sort of, in a sense – whether it's nine months or six months is sort of slightly academic for 2018, because, given that the cease sale essentially is going to be from sort of now, which is December, there's only really six months that are relevant for 2018, in any event. To the extent that it's longer than six months and how much longer than six months it is will be a – well, will impact 2019 rather than 2018, if that makes sense.

MR HANNAN: Yes, thanks.

MR PENN: Okay, thanks.

MR BURLEY: Thanks, Kane. Our next question is from Eric Choi from UBS.

MR CHOI: Hey, guys. Thanks for the questions. I just had three. The first one's just a follow up on Raymond's question on the split of the $600 million EBITDA impact. I guess, just based on the information available to us, it still looks like it could be – call it $200 million of change between the 2017 and '18 Corporate Plans, and maybe $400 million for the HFC cease sale. So just wondering if you can ballpark confirm whether that's correct or if we're missing something because we're perhaps lacking access to information.

MR PENN: And your – can you give the other questions, and I'll – we'll deal with them all at once.

MR CHOI: Sure. The second question is just around the delay in the commercial works revenue recognition.

MR PENN: Yes.

MR CHOI: Given NAS is low margin, should we be thinking that that cost recognition is delayed, as well? So the EBITDA impact is actually quite minimal? And then just third question's on the duct and pit remediation credits that you're going to pay the nbn co. Just wondering if there's any delay in these, as well, and also wondering if you can comment on how material these will be, so we can work out what we need to offset that recurring $1 billion of infrastructure payments by, please.

MR PENN: Yes. Well, I might just comment on the first one, and then I might get Warwick to comment on the other two. I mean, look, we've not disclosed the breakdown between the two. But, as I said, it's – the bigger majority is in relation to the cease sale that occurred this week, and so that's probably as much as we're – as much information as we're giving at this stage. But do you sort of want to comment on the other – the delay in the commercial works and the remediation credits, Warwick?

MR BRAY: Yes. In terms of the commercial works, we're still going to do the same commercial works this year, and the cash for those commercial works will be broadly the same. But the way that we recognise revenue and costs for the commercial works, one of the most important figures for that revenue recognition is Brownfields RFS, and so that's what's changed, the accounting commercial works, so it does affect both revenue and costs in an accounting sense, but it doesn't affect us in a cash sense, and that's one of the reasons that there's a difference between the revenue recognition and the accounting and the cash.

MR BURLEY: And, Eric, could you just please repeat your third question?

MR CHOI: Just wondering – obviously you're going to start paying duct and pit remediation credits back to nbn co for them assuming sort of remediation responsibilities for HFC. So I was just wondering if the profile of that gets delayed. That's kind of question 1, and the sub-question to that is we still don't have much of a feel for how big these remediation credits are, so if you can give us a feel for that.

MR BRAY: Yes. So look, we've definitely taken that into account in the recurring impact. So what we've done in the recurring impact, apart from commercial works, in making these adjustments, is assuming more wholesale revenue, lower CVCs, AVCs, and more recurring nbn DA, sorry less recurring nbn DA. We have taken the remediation credits into account, as well. I don't think that we've quantified them at the moment. Let me consider whether we should give you a quantification at the half-year.

MR PENN: But I think for the purposes of this morning's sort of communication – I mean, obviously the big impact is the one-off, and then there are some other effects and differences as it flows through to income and flows through to free cash-flow. And then as you see, in the release we've actually provided quite a lot of bullet-points as to how it impacts each individual line. So I'm not sure that we are disclosing each of those individual calculations. But I think probably just suffice to say the big one is the one-off payments. Nathan.

MR BURLEY: Thanks, Eric.

MR CHOI: Thanks, guys.

MR BURLEY: Our next question is from Eric Pan of JP Morgan.

MR PAN: Good morning, guys. Thanks for taking my questions. A few from me. First off, why adjust the guidance for both the Corporate Plan changes and the HFC delay, if the impact from the Corporate Plan changes remain within the guidance? And then secondly, on the issues with the HFC rollout – to your knowledge, is there significant additional cost and effort required to remedy the situation, or is this more of a precautionary change in nature? Or asked differently, could this delay be more than six to nine months? And has the nbn come to you for help with the issue? And lastly, what would happen if the nbn decides down the line that the HFC network is not fit for service? Would you still receive the contractor payments?

MR PENN: Yes. Look, thanks very much, Eric. Sorry, just making a note of your questions. So firstly, in relation to your question why did we adjust for both points in relation to guidance – well, the first thing I would say is just to make it clear that our guidance outlook from an operating point of view has not changed. So we're not changing that at all. That is basically the same as we provided back on the 17th of August when we announced our results.

When that first update occurred from nbn at the end of August, in relation to their plan – at that point, that adjustment or that impact meant that actually it didn't take us outside of our guidance range. So we assessed it and said, well, on balance, it doesn't change our overall guidance range, albeit affects our outlook within the guidance range. So therefore we didn't adjust it. When this change was announced, which is a much bigger impact, the aggregate of the two absolutely do impact where we're at in our guidance ranges. And so therefore we are updating our guidance range for both of the impacts. And in doing that, we're saying that our guidance outlook for the purpose of our operating performance is unchanged. And so that's the process that we've been through. And that's why we made both of the adjustments.

In relation to your second question about the – what's the extent of the remedy, how much could it cost, how long might it take – I mean, I think that's really a question for nbn. I think the only point I would say is that the HFC is continuing to perform as it always has, and very well, for our Foxtel customers and for Telstra's existing broadband customers. So this isn't an issue with the HFC per se. It's continuing to perform well for all of our customers. It's obviously – at the point the HFC asset is handed over to nbn, they obviously make some technology changes to it, to enable it to be utilised for an nbn service and it's in those changes where there has become an issue for a number of customers. And I don't want to speak for nbn – it wouldn't be appropriate for me – in terms of the extent of that issue and what they're doing to remedy it and – but what they've indicated is that they will propose to cease sale for six to nine months so they can go back and address that for existing customers and make sure they change whatever processes they need to to ensure that doesn't occur for future customers.

And so as to whether that takes longer, what's involved, how much that is going to cost, I think really I would direct you to the nbn team in relation to that question. And then, your final question which is if the HFC – ultimately, somebody decided they didn't want to use the HFC, again, it's not something for me to comment on whether that's likely to happen or not, other than to say it's working just fine for Foxtel and for Telstra broadband customers. And the contracts basically provide for nbn to take the assets on an "as is, where is" basis. So, to the extent that they decide not to use those assets, they still have an obligation to take them from us on the terms that are currently in the agreements with the nbn.

MR PAN: So if they do decide not to use the network, you would still get the subscriber payments?

MR PENN: Correct.

MR PAN: Got it. Thank you.

MR PENN: Thanks.

MR BURLEY: Thanks, Eric. Our next question is from Ian Martin from New Street Research.

MR MARTIN: Good morning all. Hi. I've got three questions if you don't mind. First, there's two major impacts here. One is the 300,000-odd HFC customers that are delayed and the other is the 200,000 brownfield activations you mentioned. So if we look at the total revenue impact of 700,000 and divide by that 500,000-odd, it gets us about $1,3000 or so per customer. But there's a timing difference. So the HFC customers might come in next year and you will pick up that extra money next year, but the brownfields activations – nbn has actually still got the same number of activations in this year's Corporate Plan as they had – I mean, at the end of June next year – 4.4 million – as they had in last year's Corporate Plan. And the reason we're getting fewer activations this year is because they actually beat last year's number in which case, we should have got the revenue last year, but that didn't seem to show up in last year's nbn income. So that's my first question is how that cash flow might work. Secondly – and that, kind of, brings me to the second question in that what nbn reports as subscriber payments seem to be 20 or 30 per cent different to what Telstra reports as a revenue impact, 2.9 billion is in the Corporate Plan this year – 3.4 billion next year. Your previous guidance was 20 or 30 per cent below that and it's just – if it is just differences in revenue recognition, then surely we're going to see – that has got to equalise over the long term, so that whatever the shortfall is now, we will see that go up in future years and particularly with the extra money coming from the HFC delays, we might be looking at a 4 billion number next year. Is that in the ballpark of possibilities is my question.

MR PENN: And you had a – I'm – we're just making a note of these questions, Ian, so we can, sort of, come back to them. And you had a third one?

MR MARTIN: Yes. My third one is is there a risk of further delays, not just in the HFC footprint but elsewhere and also, related to that, I guess you would have seen Verizon's announcement that they're looking at five – a commercial 5G rollout and really targeting the similar kind of dense urban metro footprint as what nbn's delayed rollout and – yes. I will be interested in your comments on that.

MR PENN: Yes. Look, I think I will hand over to Warwick to do 1 and 2. I mean, I think just on the last one, including Verizon's – your point about Verizon – I mean, I think on – sorry. On the further delays, look, I mean, I can't comment – I don't think it would be – well, sorry. I can't comment. So I think I would really point you to the nbn team in terms of whether that's possible or not possible as the case may be. I did give a speech earlier this week talking about this issue on will 5G and mobile replace the nbn and fixed broadband services and my conclusion on that point is that there's no doubt that customers increasingly like to access mobile broadband and will increasingly do so and so therefore there is undoubtedly a proportion of customers that will give up the fixed line services, in fact – I mean, that is the current trend and that we will move to a fixed broadband service – sorry, move to a mobile service.

I mean, ultimately, however, the average number – sorry – the average data download of a customer on a mobile plan today is about 3 gigabytes per month and the average on a fixed plan is about 150 gigabytes a month, so 50 times as much. So there's a big difference. And so my comment in my speech this week is that, yes, a proportion of current fixed broadband customers will migrate to mobile, but, no, 5G and mobile won't ultimately completely replace the nbn. So both technologies continue to be important and that's why we're passionate about making sure that the rollout – in the rollout, the customers get a great experience and an affordable nbn plan. And so that's my comments on those two points, but I might hand over to Warwick on the – and I should say, on the mobile broadband point – I mean, we already have very attractive offers in the market today for our customers that choose to want a mobile service. Our Nighthawk mobile broadband hotspot – so it was the first gigabyte per second download mobile device in the world and remains still one of only a very few, and that's a great solution for customers that might want to be mobile only. Warwick.

MR BRAY: Thanks, Andy, and I'll talk – speak to the second question. Look, the difference between what the nbn recognise as payments in their accounts and what we receive, we understand that the revenue recognition is the same in both companies, but the difference is mostly they also make payments to Optus. In terms of the first question, you're right that the brownfields progress at the end of FY18 in the Corporate Plan 18 and 17 was the same. But in 18, we get paid on in-year activations, and so – and you're also correct that in 17, the nbn did better than their plan. So by having the same end point but a higher starting point, the in-year activations came down at the August nbn plan update, and that's what's changed our in-year activation number, which affects our PSAA payments. And we did recognise the extra performance last year in last year's results.

MR PENN: Thanks, Ian. Nathan, I think we're running up to end of time. I think we've got a couple more questions.

MR BURLEY: Yes, we have two questions left. The next question is from John Durie from The Australian.

MR PENN: Hi, John.

MR J. DURIE: Hi, Andy. Just a quick one. It's really following on Ian's question. I was sort of confused. When I first saw the announcement, I saw – you guys always complain that you're going to be losing revenue through the nbn and margin contraction and so forth, so I would've thought that's a net positive. Could you give us sort of feel for the – how the positive and negative played out in this one.

MR PENN: Sure. No, absolutely, John. And I should say, we never complain. We just point out – try and make sure that it's clear to the market. But, I mean, it's a simple point which is that in the context of the migration to the nbn, Telstra is being paid certain compensatory payments for giving up long-term recurring profits which arise as a consequence of, effectively, the government renationalising the fixed access network for retail customers in Australia, and so it's a question of comparing a one-off with a long-term recurring profit. And so – and that's why the numbers play out the way they do, is, in the current year, we receive less of the one-off payments, but our recurring impact is proportionately less. But ultimately, the one-off payments are to compensate us from not having those one-off payments over a much longer period of time, and that's why, in the short term, the nbn, we receive higher payments, but in the long term, the shareholders are ultimately worse off as a consequence of the migration to the nbn because of that dynamic, and that's all you're really seeing.

And because this announcement is made – we're halfway through the year already, and this relates to the rollout for the rest of the year – the positive impact is relatively – in the short term – is relatively small. The negative impact is the one-off payment. So it's really just a dynamic between one-off and recurring.

MR BURLEY: Thanks, John.

MR DURIE: Thank you.

MR PENN: Thanks, John.

MR BURLEY: And our last question today is from Peter Ryan from the ABC.

MR RYAN: Hi there. Thanks for taking the question, Andy. Look, just in a general sense with the nbn rollout, which is meant to be a nation-building project, how do you actually feel from where you're sitting about how this is progressing, given that there have been a number of issues and bumps in the road in terms of the technology actually working for Australians who have high expectations out of it?

MR PENN: Look, what – I think what I would say is that with technology innovation increasing, the importance of connectivity has elevated for all of us both in terms of businesses and for individuals and consumers. That ability to be connected is more important today than it's ever been, and, for the reasons that I mentioned before, all sorts of technologies are going to be important in supporting that. Mobile technology and, critically, the nbn is part of that overall equation. So for all of us, all of our interests are completely aligned to the successful rollout of the nbn for all Australians. It's obviously a very big project, and, understandably, there's always challenges with very big projects. We're not doing the rollout, obviously. It's an nbn government initiative and program, and it wouldn't be fair for me to sort of comment qualitatively on it.

We're just here to support the nbn in any way we can in making sure the rollout is effective and they hit their plans if they can. And I – as I said earlier in the week, I think the right decision has been made here, because there clearly were some negative impacts on customers, and it's important that the rate and the pace of the rollout is not pursued at the expense of getting the best possible experience for customers. And we'll continue to advocate for that point.

MR RYAN: Okay. Thank you.

MR PENN: Thanks, Peter.

MR BURLEY: Thank you, Peter. Given that is the last question, I will now close the call.

MR PENN: Thank you everybody for dialling in.

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