Telstra Corporation Limited
Shareholder Statement pursuant to
Section 249P of the Corporations Act 2001

TELSTRA BOARD’S RESPONSE TO SECTION 249P STATEMENT

Telstra

Dear Shareholder

The accompanying statement, titled “Shareholder risks associated with the National Broadband Network” has been received from a group of shareholders. Pursuant to section 249P of the Corporations Act, we are required to provide this statement to all our shareholders with the notice of meeting for our Annual General Meeting.

With regard to the issues raised in the statement, the Directors can assure shareholders that they are working towards a result from the National Broadband Network (NBN) Request for Proposals (RFP) that provides maximum benefits for shareholders.

The Board is working closely with senior management in developing Telstra’s final response to the RFP. The NBN is a very large infrastructure project which is vital to Australia’s future economic prosperity and social advancement. Telstra is well-placed to build the NBN given the company’s proven record, its financial capacity, its skilled workforce and the fact the NBN is likely to be an upgrade of Telstra’s fixed network.

The statement raises three specific shareholder risks associated with the NBN.

The first risk is the potential for another bidder to be selected to build the NBN, including the possibility that Telstra may decide not to bid. The Board has not made a final decision on whether the company will lodge a bid for the NBN by the due date of 26 November 2008. This decision will be based on a thorough examination of the business case and an assessment of whether the company is in a position to lodge a proposal that is in its shareholders’ interests and will not devalue shareholders’ investments in the company. In the current financial climate and given the RFP criteria and associated regulatory risks, the Directors do not discount the possibility that it may not be in the interests of shareholders to bid for the NBN. For example, if structural or functional separation of Telstra is a pre-condition, I have publicly made clear that Telstra is not in a position to bid for the NBN.

The second risk referred to in the statement is that of further separation of Telstra. The Directors agree that further separation would result in a significant loss of value for Telstra’s shareholders who have bought into the company on the basis that it would remain vertically integrated. Telstra’s transformation is predicated on the fact that Telstra is a vertically integrated company. Further separation would significantly increase costs, reduce efficiencies and make it more difficult for Telstra to offer world-leading services to its customers. Any forms of further separation would be value destructive. Telstra is working hard to educate key decision makers and their advisers that both functional and structural separation are unnecessary, discourage innovation, discourage investment in broadband infrastructure and have not worked anywhere in the world.

The third risk in the statement relates to concerns that adverse pricing and regulatory decisions around the NBN will put shareholder value at risk. The Directors agree that this is a significant risk. It would be irresponsible of the Board to contemplate an investment of the size and magnitude of the NBN, without a guaranteed commitment of regulatory certainty for the life of the investment. The Board recognises the need for wholesale and retail prices to encourage take-up but equally the prices must enable shareholders to achieve a competitive, non-dilutive return on their invested capital.

In closing, the Directors fully recognise the long-term risks associated with the NBN and are committed to an approach that minimises these risks and protects shareholders’ investments in the company. Telstra has a productive working relationship with government and will continue to firmly advocate its position on behalf of shareholders, including where it faces the prospect of adverse regulatory or political decisions. In all cases, this advocacy will seek to protect and promote the interests of its shareholders in the most effective manner.

Yours sincerely

Donald G McGauchie AO
Chairman

Telstra Corporation Limited
ABN 33 051 775 556

Telstra is required to give this statement at the request of 100 shareholders in accordance with section 249P of the Corporations Act

Shareholder risks associated with the National Broadband Network

The Federal Government's proposed National Broadband Network (NBN) is being billed as the largest infrastructure project in Australia's history. Its importance to the future of Australia's economy and to society as a whole cannot be underestimated. It will be the central infrastructure over which will run telephony services, high speed internet and data services, IP television services, e-health, education, business and scientific applications.

Telstra is bidding for the tender to build the NBN and, as Australia's largest telecommunications company, should be the front runner for the contract. However, we are concerned that the approach the senior management team is taking in relation to the tender may be decreasing the likelihood of an outcome which is in shareholders interests. There are at least three serious risks for Telstra regarding this project.

Non Participation

Firstly, there is the risk that Telstra isn't involved in the build. Senior management have stated that Telstra will not participate in the tender under certain conditions. Yet Analysts at Merrill Lynch and Citigroup recently identified non participation as *the biggest risk* to the company in the future[1]. Citigroup actually modelled a value erosion of $13.4 billion from the company; that's more than $1 lost from the share price. If a competitor wins the tender and is granted exclusive licence to build a fibre network, Telstra might find itself with no place left in Australia to expand its network.

Can the Board explain how "walking away" from the NBN tender fits with maximising shareholder value, or how threatening to do so increases the likelihood of winning the tender?

Separation

Secondly, even if Telstra wins the contract, the Government has indicated that it is determined to see the implementation of a stricter separation regime on the company. Senator Conroy said that "Labor [opposes] the current operational separation regime that applies to Telstra... The regulatory arrangements and structures around the National Broadband Network are a central consideration"[2].

We are concerned about the potential loss of value this may entail for shareholders. Merrill Lynch analysts estimated a potential 30 cents per share decline in valuation "on the imposition of an aggressive separation regime"[3]. While they believe that this situation is unlikely to occur, there is no evidence that the senior management team's approach toward government will help create the most favourable outcome for the company in this regard. Indeed Citigroup say the only instance where separation is not value destructive is if Telstra co-operates with the government. Alarmingly, analysts suggest the likelihood for this scenario is only 1%[4].

Several recent press articles suggest that the senior management team's relationship with government is far from constructive[5].

Regulation

Thirdly, a poor outcome in the pricing and regulatory regime will put shareholder value at risk. JP Morgan and Citigroup analysts list the amount of regulatory risk for Telstra as "high" and "extremely high"[6]. We are concerned that senior management's approach to these issues is increasing the likelihood of negative outcomes for shareholders. Over the last 3 years this approach has resulted in few regulatory victories. In particular, as Michael Sainsbury pointed out in *The Australian*

> *Telstra has ... failed twice to negotiate a deal with the ACCC and the federal government that would see Telstra build a national fibre-to-the-node network. That project is now out to tender.*

We have no confidence that the same approach this time around will result in a better outcome. The reality seems to be that the government will build the NBN regardless of whether or not all of Telstra senior management's regulatory recommendations are met.

Telstra appears to have acknowledged some of these risks[7]. The company notes in the end of year financial results that "both S&P and Moody's continue to hold Telstra on a "negative outlook" with major factors being the uncertain regulatory environment and NBN process". We wonder whether senior management's performance hurdles for remuneration relate to mitigating the risks outlined here.

There is a tremendous opportunity for the company to move forward in a collaborative way. There can be nothing more important to shareholders than a positive outcome on the NBN. However, we believe that the *long term* risks to the company relating to the NBN tender have not been sufficiently appreciated. We ask that the Board explain how the long term interests of shareholders are being effectively protected and promoted with regard to this project.

1 Tim Smeallie and Phil Campbell, "Telstra Corp Ltd: Beware the Elephant in the Room", *Citigroup Global Markets Equity Research*, 7 August 2008, p. 4. Stephen Myers and David Kaynes, "Telstra Corporation Limited Company Update: Separation Anxieties", *Merrill Lynch*, 15 July 2008, p. 8.

2 Senator Conroy address to the Sydney Institute, Tuesday May 6 2008

3 Stephen Myers and David Kaynes op. cit. p. 1

4 Tim Smeallie and Phil Campbell op. cit. p. 4

5 Josh Gordon, "Crossed lines as Gillard warns Telstra of 'breach'", *Sunday Age*, 7 Sep 2008, p. 9

6 Matt O'Sullivan, "Telstra flags risk of split under plans for broadband network", *Sydney Morning Herald*, Friday 5 Sep 2008, p. 23

7 See Telstra Annual Debt Issuance Program Prospectus, 4 September 2008, pp. 14-15

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