Letter to Shareholders

11 October 2018

Dear Shareholder

I am writing in advance of Telstra's Annual General Meeting (AGM) because as we have listened to shareholders over the last few weeks, we know that a number of you are disappointed with this year's remuneration outcome. It has been a challenging year for Telstra as we address significant market pressures, the impact of the nbn and increased competition. We set what we believed was a demanding plan for our management team in the face of these challenges and even though many of these were met, we recognise that this has not translated into positive outcomes for our shareholders. In recognition of this, the Board applied discretion and reduced the Executive Variable Remuneration Plan (EVP) outcomes by 30% to balance recognising the achievements of the management team and your experience as shareholders.

We recognise that despite this action by the board, some shareholders still feel that our remuneration outcomes were either not sufficiently transparent or resulted in higher payouts than shareholders felt were reasonable. With hindsight, we recognise we perhaps did not provide enough transparency around some of the metrics that we adopted to measure management performance and the reasons as to why these were chosen. For this we apologise.

While I will address the outcome for FY18 further at the AGM, I am therefore writing to provide additional information on our FY19 EVP to give greater transparency as to why we believe that shareholder interests are reflected in the plan we set for management and the targets which underpin their variable pay opportunity. For FY19, we have put particular focus on setting goals which clearly align our management team with the delivery of our ambitious and bold Telstra2022 strategy, which we outlined to the market on 20 June 2018.

Telstra2022 (T22)
Telstra is operating in an increasingly competitive environment, with the accelerating impact of the transition to the nbn and increased competition in Australia's mobile market driving a challenging period for the Australian telecommunications industry. In response we recently announced the T22 strategy, which details how we will lead the Australian market through simplified operations and products, and improved customer experiences.

As announced, our T22 Strategy is underpinned by four key pillars:

- Pillar 1: Radically simplify our product offerings, eliminate customer pain points and create all digital experiences
- Pillar 2: Establish a standalone infrastructure business to drive performance and set up optionality post the nbn rollout
- Pillar 3: Greatly simplify our structure and ways of working to empower our people and better serve our customers
- Pillar 4: Deliver an industry leading cost reduction programme

In implementing this new strategy we face numerous significant challenges, including putting at risk more than $500M in legacy revenues over the next three years as we simplify our product offering, reduce our workforce and transition to a smaller, more agile and knowledge-based organisation.

FY19 Executive Variable Remuneration Plan (EVP)
Our total remuneration structure is designed to link financial rewards directly to Senior Executive contributions, company performance and long term shareholder value creation. The EVP is fundamental in delivering against these objectives by combining both short and long term performance assessments to ensure Senior Executives remain aligned to, and accountable for, decisions and actions through business cycles. The plan delivers a majority of reward opportunity over the longer term through the use of equity, with a portion vesting over two years and another subject to Relative Total Shareholder Return (RTSR) performance hurdles vesting over five years, ensuring pay outcomes align with shareholder interests.

This combined scheme replaced our previous more traditional STI and LTI plans in 2017, as we believed that in particular, our LTI plan was losing its effectiveness in today's world of disruption and rapid change. Simplistically, this was because by the time each plan came to vest so much disruption and change had taken place that many of

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the originally chosen metrics were no longer relevant or needed adjustment. This in turn led to confusion with investors and meant executives felt the award was disconnected from their performance and was not clearly linked to driving management behaviour.

In moving to a combined plan, we considered reducing the overall quantum of the award to executives but instead, we introduced a second performance hurdle being a RTSR threshold before the final tranche of equity vests after 5 years. This means that to obtain the equivalent of the previous LTI grant which used to be made automatically, executives have to first deliver on short term targets to receive the grant and then after 5 years, 39% of their grant (in the form of Performance Rights) only vests if the 50% RTSR hurdle has been achieved. Having the double hurdle makes it considerably harder for executives to obtain their variable compensation than was the case previously.

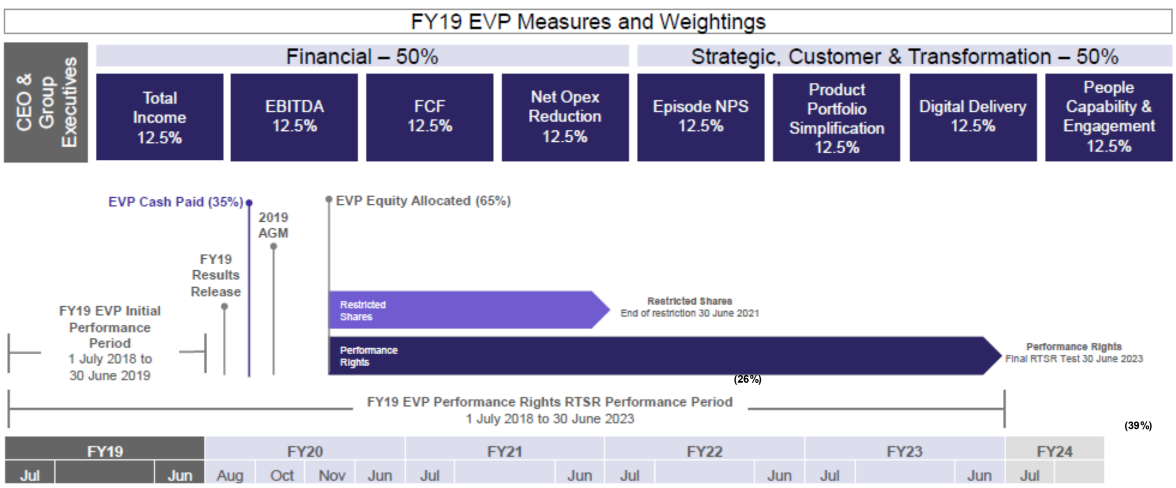
Using our CEO as an example, the following tables outline the application of our total remuneration structure:

CEO Total Remuneration Structure	Fixed Remuneration (Salary, Superannuation)	Variable Remuneration awarded under EVP Target = 200% of Fixed Remuneration comprised of:		
	100% Fixed Remuneration	35% Cash	26% Restricted Shares	39% Performance Rights
	Minimum Share Ownership obligation of 100%		Total Equity = 130% of Fixed Remuneration	

The structure is designed to ensure that the majority of the reward is subject to performance assessment in the short and long term with:

- EVP awards subject to the primary performance assessment at the end of the initial performance period (financial year)
- Restricted shares deferred for two further years
- Performance rights subject to a RTSR performance test at the end of an additional four year period, resulting in a 5 year performance period in total

As disclosed in our 2018 Annual Report, having considered the introduction of our T22 strategy, the Board has enhanced the performance measures for the FY19 EVP to focus performance against delivery of the new plan. The FY19 measures and weightings disclosed in the report, as well as the performance and vesting horizon, are shown below:



To provide greater transparency, the table below outlines the actual metrics and performance levels that will be used in assessing incentive outcomes across FY19. It is important to note that there will be no component of the plan based on an assessment of individual performance, with all executives taking shared accountability for results.

EVP financial targets are set based on our Business Plan with consideration given to market guidance at the time of target setting. Subsequent adjustments to guidance throughout the year (for example relating to the nbn rollout or unplanned one-off events) and their impact on EVP pay-outs are considered at the end of the year in accordance with established principles to ensure that outcomes appropriately reflect the performance of Senior Executives. Any adjustments so made will be fully disclosed to shareholders.

All of the measures have been selected on the basis that they are directly linked to our strategy as described below.

	Measures	Metric	FY18 Base	Gate	Target	Max	Rationale	Alignment
Financial	Total Income	Total Income $M	**29,042**	Above Bottom of Market Guidance	Approx At Midpoint of Market Guidance	Above Top End of Market Guidance	Key indicator of financial performance, ensuring continued focus on customer retention and growth. The decline in Total Income, FY19 market guidance compared to FY18 base is largely attributable to expected legacy fixed declines as a result of nbn and ongoing fixed voice declines, with the overall market for fixed and mobile expected to reduce two to three per cent.	Pillar 1
Financial	EBITDA	EBITDA excluding restructuring costs $M	**10,407**	Above Bottom of Market Guidance	Approx At Midpoint of Market Guidance	Above Top End of Market Guidance	Key indicator of financial performance, ensuring appropriate focus on cost to deliver. The decline in EBITDA, FY19 market guidance compared to FY18 base is attributable to FY19 being forecast as a material year in the migration to the nbn and its negative impact on Telstra	Pillar 4
Financial	FCF	FCF excluding spectrum $M	**4,808**	Above Bottom of Market Guidance	Approx At Midpoint of Market Guidance	Above Top End of Market Guidance	Key indicator of financial performance, appropriate for capital intensive business. The decline in FCF, FY19 market guidance compared to FY18 base is attributable to a reduction in working capital and lower EBITDA offset by reduced tax and capital expenditure.	Pillar 4
Financial	Net OPEX reduction	Underlying core fixed cost reduction $M	**-**	388	438	513	Delivering significant absolute cost reduction aligns with intent to drive productivity and reduce cost to serve. Over FY19, the target provides for cumulative operating cost reduction since FY16 of $1.1B relative to our FY20 commitment of $1.5B and ensures we are on track for our $2.5B cost reduction target under T22 strategy.	Pillar 4
Strategic, Customer & Transformation	Episode NPS	Improvement in Episode NPS	**+19**	+21	+24	+27	Internationally recognised measure of customer advocacy and leading indicator of overall customer experience. Provides greater insights / opportunities for improvement as it is based on customer interactions. The improvement from baseline for target payout set at +5 ensures significant stretch (greater than equivalent required improvement in prior year (+3) and builds off maximum achievement in FY18). The results will be independently audited.	Pillar 1
Strategic, Customer & Transformation	Product Portfolio Simplification	Number of active plans – C&SB	**400**	40	30	20	Reduction of our product offering will increase the simplicity, transparency and satisfaction that our customers experience, as well as allowing the delivery of material cost reductions. Reduction of Products across Consumer & Small Business (C&SB) from 1,800 plans comprising 1,400 legacy and 400 active – exiting legacy to begin FY20 onwards. Maximum outcome requires the completion of the entire plan reduction target in just one year.	Pillar 1
Strategic, Customer & Transformation	Product Portfolio Simplification	Number of active plans – TE	**651**	570	549	527	The Telstra Enterprise target provides progress toward our T22 reduction of 50% by FY21.	Pillar 1
Strategic, Customer & Transformation	Digital Delivery	C&SB Digital Sales Transactions / Total Transactions ratio..	**6.2%**	11.3%	14.0%	16.5%	Delivering cost reductions relies heavily on our ability to offer a seamless digital customer experience, and reference to C&SB in near term ensures focus is on high volume area. Improvement to reach target payout (+7.8%) will require more than doubling existing ratio of digital transactions. The target provides progress toward our T22 target of 45% by FY22.	Pillar 1
Strategic, Customer & Transformation	People Capability & Engagement	Maintenance of Employee Engagement from FY18 baseline	**74**	n/a	74	76	Focusing on our people and employee engagement throughout a period of significant disruption and in the face of having announced a reduction of 8,500 roles is critically important to attract and retain the talent needed to deliver on our strategy.	Pillar 3

Notes:

- The measures and metrics appearing in this table are for the purpose of the EVP and do not constitute market guidance.
- Total income excludes finance income.
- FY19 market guidance means guidance as set out in Telstra's ASX announcement dated 16 August 2018
- Targets set in accordance with FY19 Business Plan, taking into account competitive operating environment and profile to achievement of T22 targets
- FY18 Base is shown under FY18 accounting standards. The FY18 base for Financial measures as shown above represent the FY18 reported financials with EBITDA ($10,121M reported) adjusted for $286M restructuring costs and FCF ($4,695M reported) adjusted for $113M Spectrum payments.

As a Board we are deeply disappointed that some shareholders are critical of our FY18 EVP outcomes. However we acknowledge the criticism and hope that this communication goes some way to explaining the reasons why we still believe that our EVP is the right structure to align management incentives with shareholder interests. We also hope that by providing shareholders with much greater detail now regarding our current FY19 EVP, shareholders will have a much better understanding of the metrics we are judging our management by this year, the reason that we chose these particular metrics, and why we believe that these are aligned with shareholders' interests.

In common with many larger telecommunications companies, Telstra's earnings and share price have been under pressure due to market disruption, competitive intensity and the challenge of monetising the exponential demand for data carriage. This has been exacerbated in Australia by effect of the roll-out of the nbn which when fully implemented negatively impacts Telstra's EBITDA by approximately $3B per annum and reduces Net Profit After Tax by up to 50%. To date Telstra has absorbed roughly 50% of this impact. The reality is that these factors are significant drivers of the movement in share price and the perceived performance of the company.

Increased competitive intensity, market disruption and the challenge of monetising exponential demand for data present an exceptionally difficult market context for Telstra management. We believe that in challenging market conditions, motivating and incentivising management becomes even more critical to the future success of the business and maximising shareholder value. For the board this means that we will set targets for management that we think are ambitious and deliver lasting value to shareholders despite the market environment. The achievement of these targets will inevitably mean that variable compensation may be paid even at a time of a poorly performing share price.

Equally, it is important that the Board ensures that we continue to have competitive remuneration practices in place to attract and retain the talent required to deliver on our ambitious and market leading strategy, especially if such talent is sourced from overseas as is often necessarily the case.

Following the AGM, we will continue to engage with stakeholders, listen to their feedback and consider opportunities to further enhance the effectiveness of our reward structure with a commitment to ensure we are focused on the alignment of the interests of our executives with the generation of long term shareholder value.

I look forward to sharing more with you at the upcoming AGM and welcome the opportunity to answer any further questions that shareholders may have at any time.

As always we welcome your feedback. You can contact us at investor.relations@team.telstra.com, via phone on 1800 880 679 or in the mail to the Telstra investor Relations Department, Level 28 242 Exhibition Street, Melbourne, VIC 3000.

John P Mullen
Chairman

Attachment 1 – EVP Metric Additional Detail

Measures	Metric		Rationale
Total Income	Total Income $M		Our financial measures have been selected as the key drivers of company health and to ensure we balance both short and long term success. Delivering on our key financial measures is essential to deliver benefit to our shareholders. Total Income has been included as a key indicator of financial performance, ensuring continued focus on customer retention and growth. At a time where telco's globally are struggling to deliver strong growth, it is critical that Telstra focuses on monetizing the increasing demand for data and demonstrates that post the nbn revenue will grow again. The decline in total income, FY19 market guidance compared to FY18 base is largely attributable to expected declines in legacy fixed products as a result of nbn and ongoing fixed voice declines, with the overall market for fixed and mobile expected to reduce two to three per cent.
EBITDA	EBITDA excluding restructuring costs $M		EBITDA has been included as a key indicator of financial performance, ensuring appropriate focus on cost to deliver. It is the most commonly externally used metric for financial performance and one that the board monitors closely as it is a strong indicator of underlying company profitability. The decline in EBITDA, **FY19 market guidance** compared to FY18 base is attributable to FY19 being forecast as a material year in the migration to the nbn and its negative impact on Telstra
FCF	Free cash flow $M		FCF has been included as a key indicator of financial performance, appropriate for capital intensive business. FCF is also critical in managing the company's ability to pay a dividend and maintain balance sheet strength. The decline in FCF, **FY19 market guidance** compared to FY18 base is attributable to a reduction in working capital and lower EBITDA offset by reduced tax and capital expenditure.
Net OPEX reduction	Underlying core fixed cost reduction $M		Net OPEX reduction has been included as the ongoing management and active reduction of our costs will be key to competing and delivering strong financial performance in an increasingly competitive market. Delivering significant absolute cost reduction aligns with intent to drive productivity and reduce cost to serve. Our target is to take out $2.5B of cost by 2022 which will place Telstra in the top quartile of global cost performance. Over FY19, the target provides for cumulative operating cost reduction since FY16 of $1.1B relative to our FY20 commitment of $1.5B and ensures we are on track for our $2.5B cost reduction target under our T22 strategy.
Episode NPS	Improvement in Episode NPS		We have included Episode NPS in our EVP measures as ensuring we continue to focus on and improve customer experience will be a key driver of business success and our ability to differentiate in an increasingly competitive market. Increasing customer satisfaction is a key to generating increased share of wallet from existing customers, maintaining a price premium, and attracting new customers. It is in our shareholder interests to have the management team specifically focused on improving the key interactions that are most important to this customer experience and are most likely to drive both customer attraction and retention. Episode NPS is also the customer metric which is most directly aligned to the other key initiatives we are implementing to improve customer experience and ease of doing business with Telstra, including the simplification of our product portfolio and improving our digital delivery. It is a real time measure of progress made, as opposed to Strategic NPS which can lag by many months or years. In addition, Episode NPS also provides more direct and specific insights and opportunities for improvement as it is based on specific customer interactions. The improvement from baseline for target payout set at +5 ensures significant stretch (greater than equivalent required improvement in prior year (+3) and builds off maximum achievement in FY18). The results will be independently audited.
Product Portfolio Simplification	Number of active plans		Reduction of our product offering will increase the simplicity, transparency and satisfaction that our customers experience, as well as allowing the delivery of material cost reductions. Product simplification is designed to deliver a far superior customer experience and ease of dealing with Telstra which will lead to a greater share of wallet from existing customers, the maintenance of Telstra's price premium, and the gaining of additional customers. In parallel, product simplification is critical to Telstra delivering the scale of cost reductions targeted under T22. It will simply not be possible to reduce headcount by a net 8,500 people and deliver $2.5B of cost reductions unless we fundamentally re-engineer our processes and reduce complexity.
Digital Delivery	C&SB Digital Sales Transactions / Total Transactions ratio..		Delivering cost reductions also relies heavily on our ability to offer a seamless digital customer experience. Similarly to other metrics included in the EVP, this measure has been selected as it improves customer experience, supports our cost reduction focus and will enable delivery of strong financial results. Telstra receives in excess of 700,000 customer service calls per week and the scale of cost reduction planned cannot be achieved unless the majority of these interactions become digital with no human involvement.
People Capability & Engagement	Maintenance of Employee Engagement from FY18 baseline		Focusing on our people and employee engagement throughout a period of significant disruption and in the face of having announced a net reduction of 8,500 roles is critically important to attract and retain the talent needed to deliver on our strategy. We believe that is in our shareholder interests to have management strongly focused on maintaining and growing our employee engagement as it will support our ability to have both the key leadership and technical talent required to deliver on our ambitious strategy. We believe that maintaining employee engagement at a time where up to 10,000 people are exiting the business is highly ambitious, but critically important.