Australian Shareholders' Association

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Changing of the guard

Company/ASX Code	Telstra / TLS
AGM and EGM date	Tuesday 11 October 2022
Time and location	9:30am AEDT Hilton Hotel George Street Sydney, with EGM following
Registry	Link Market Services
Type of meeting	Hybrid
Poll or show of hands	Poll on all items
Monitor	Mike Robey assisted by Lewis Gomes
Pre-AGM Meeting?	Yes, with Chair John Mullen and IR manager Nathan Burley

Monitor Shareholding: An individual involved in the preparation of this voting intention has a shareholding in this company.

Summary of issues for the meetings

The only concern about Telstra is that it is just about to change its long-serving CEO, Mr Andy Penn (for Vicky Brady, an internal appointment) and will be changing the even longer serving Chairman Mr John Mullen in the course of FY23. We hope the momentum required to complete their change program, dubbed T25, will not stall since many of the benefits are future-dated. We note that there are two meetings, the regular AGM and a special EGM immediately following. See below for details.

Proposed Voting Summary

No.	Resolution description	
1	Chairman and CEO presentations	
2	Discussion of financial statements and reports	
3a	Re-election of Eelco Blok as a Director	For
3b	Re-election of Craig Dunn as a Director	For
4	Allocation of equity to Vicky Brady	For
5	Adoption of the remuneration report	For
6*	Adoption of the scheme for separation of Telstra	For

*The subject of an EGM meeting, following the AGM

Summary of ASA Position

Discussion of financial statements and reports - No vote required

Telstra completed the fourth year of an ambitious transformation strategy during this year. This was called T22 and was a response to the introduction of the NBN as a monopoly fixed network for Australia. All of the high margin on-net traffic of the former copper network has migrated to the low margin NBN with consequent negative financial impacts. In the consumer and small business groups, the NBN migration is nearly complete and so the financial consequences are nearly all booked. The Consumer business alone suffered a 40% reduction in this revenue. To prepare for this Telstra embarked on T22 which called for a radical change in the service model using digitised sales and service and yielding significant cost reductions. They also dramatically simplified their product offerings over the lifetime of T22 from 1800 to 20 and removed many of the lock-in and excess charges which infuriate customers. Sales and service calls were increasingly completed without the need for an (expensive) call centre staff holding the customer's hand and thereby enabled $2.7b in cost savings and fewer staff overall.

The move to a fully digitised business with interests in adjacencies such as digital health also mandated reskilling Telstra with AI, software engineering and other digital technical skills. The company states that the major transformation is now virtually complete and that from 2023 onwards they are free of the NBN financial headwinds and can grow the transformed business from its new digital base. In addition to simplification Telstra has prepared its business to realise the value in its core assets by enabling a split into four independent businesses under a holding company. They have already devolved a mobile towers business, called Ampitel and for $2.8b sold 49% to a consortium of 2 superannuation fund managers, namely Commonwealth Super and Sun Super and the Australian Sovereign wealth fund, the Future Fund. $1.9b of the proceeds were used in a share buyback, benefitting shareholders.

- **EGM scheme meeting for the creation of the Telstra Group**

Telstra proposes to restructure into a holding company, Telstra Group, with four independent subsidiary companies; ServeCo, the service delivery company we are mostly familiar with, InfraCo fixed, which contains all the assets associated with the fixed networks, Amplitel and Telstra International. This enables more freedom to invest in or divest portions of these businesses, for instance if they wished to monetise portions of their cable infrastructure, cable ducts, or to invest in any future float of the NBN. The EGM which immediately follows the AGM this year will put this to a vote for the shareholders. In part this has already started with the Amplitel split and partial sale, but the size and complexity of the other Telstra assets requires a more formal separated structure. The ASA agrees with the expert's opinion on this separation, which finds that there are no real differences to shareholders and some potential for benefits in the future, so will vote for the resolution.

Most financial metrics retreated during the year, with the completion of the transformation, but were within guidance. Total income dropped from $23.1b to $22.0b from 2021 to 2022, and underlying earnings before profit, depreciation and amortisation (EBITDA) also dropped from $7.64b to $7.26b and free cash flow from $4.88b to $4.0b. The share price however improved marginally as the market grew confident that they had done as they planned in the T22 strategy. Telstra continued to pay dividends throughout the transformation period and provided a fully franked 16.5c dividend in 2022.

Most legacy telcos the world over are struggling with similar challenges to Telstra, barring the additional curveball of the NBN nationalisation of the core fixed network. The hijacking of their former revenue streams from the over-the-top (OTT) social media companies (which do not pay for the use of the broadband networks on which they build their offerings), the near complete loss of their main sources of revenue, such as on-net timed fixed and mobile calls, texts, international roaming, international calls have left them seeking other sources of revenue, apart from access revenue to their broadband networks (which the NBN has also removed from Telstra). They also remain saddled with high capital costs to build and improve the performance of their mobile and fixed networks, so their return on capital (ROIC) is carefully tracked by analysts and discounted by the cost of this capital (WACC) to assess the viability of the company. For many, the course which Telstra has taken is necessary to survive and Telstra has shown them how. Some have invested in content providers to control some of the content, but they are up against some of the most competitive monopolies in the current world economy and have struggled to make these content businesses work.

Telstra has chosen digital health as an adjacency with potential for scale and acquired software companies (Medical Director) specialising in general practice management (which are gatekeepers to the Australian health system) and a specialist billing and clinical coding software company (PowerHealth). Telstra Health earned $243m in the year and was recently awarded a $200m Government contract to provide 1800RESPECT. We will watch the development of this non-core business over the coming years. They have also invested heavily in both the latest generation of mobile networks 5G, with rollout to 80% of the Australian population and the internet of things (IOT), which offers machine-to-machine communications over the Telstra networks. They have also set up a joint venture with Quantium, an AI company specialising in analytics and data science. The objective here is to offer charged services mainly to its Telstra Enterprise (TE) customers, in order to assist them analyse and build value in their supply chains.

Additionally, after the nudging of the Federal Government, Telstra this year finalised the acquisition of a South Pacific telco, called Digicel Pacific. Telstra paid US$270m and the Federal Government tipped in US$1.33b, reportedly to build Australian geo-political influence in the region. Telstra gets all the equity and priority dividends in a profitable established business. Digicel will fold in under the proposed Telstra International subsidiary. We have been assured that Telstra cybersecurity experts have been all over the operations of Digicel to evaluate its vulnerabilities and it is on a good footing.

Governance and culture

According to the employee survey results Telstra has grown its employee engagement over the period during which it also was transforming into a digital business. Complaints to the telecommunications ombudsman were down, presumably an outcome of implementing their strategic plan T22, which called for dramatic simplification of their phone plans and increased digitisation of sales and service. The episode net promoter score (eNPS), which is a measure customer satisfaction after an interaction with the service staff, also achieved a substantial uplift. While this is an industry standard measure, it does focus only on those customers who have had a recent service contact with Telstra and who are prepared to give a rating, so is somewhat non-representative of the entire customer base.

It is however valid to track progress from year to year. We challenged the use of this measure and the relatively high rating in the executive bonus scheme, and they pointed to the inclusion next year of the addition Reptrack measure which is also a global standard and is not linked to having had a recent service experience. T22 required a reduction in the number of management layers by 2 to 4, combined with a way of working in flexible teams, dubbed agile, which is a sort of bureaucracy buster and speed-to-market accelerator. It stemmed from the IT world where it demonstrably improved quality and productivity and speed of development and has since spread to many functions of digital businesses. Telstra has apparently one of the largest agile workforces in Australia, with more than 17,000 staff (of a total of 29,000) working this way. It appears to be central to achieving the results required in the T22 strategic plan.

ASA focus issues

The Telstra Board skills matrix is very basic and gives little confidence that selection of Board members is conducted according to rigorous criteria. Our discussion with the Chair on this revealed that they do not subscribe to the idea that formal qualifications of Board members are necessary in all cases to indicate ability in a particular area. We gave an example that finance skills normally requires a formal stint as a Finance executive and were presented with the example of Ms Scheinkestel, the outgoing chair of the Audit and risk committee who has no formal financial qualifications however has served as a senior banking executive responsible for project financing. We think the requirement for financial skills in this example would be well satisfied by this background and that it was no reason to avoid a detailed matrix.

Telstra has committed to net zero emissions and has a comprehensive ESG report, as rated by the Australian Council of Superannuation Investors (ACSI). Executives have 5% of their Executive Variable remuneration Plan (EVP) weighting for a reduction in scope 1 and 2 emissions, measured from 2019 with a baseline of 14% already achieved. They have also been certified 100% carbon neutral since July 2020 (excluding impact of the recently acquired Digicel) and they are aiming to use 100% renewable energy equivalent to their usage by 2025. Telstra has committed to 50% reduction (from 2019 base) in absolute greenhouse gas (GHG) emissions by 2030.

Summary

(As at FYE)	**2022**	**2021**	**2020**	**2019**	**2018**
NPAT ($m)	1.800	1.857	1.819	2.149	3.529
UPAT ($m)	1.800	1.857	1.819	2.149	3.529
EPS	14.4	15.6	15.3	18.1	30.0
Dividend (cents)	16	16	16	19	26.5
Share price ($)	3.85	3.76	3.13	3.85	2.62
Simple TSR (%)	6.6	25.2	(14.5)	53.0	(34.0)
CEO total remuneration, actual ($m)	4.272	5.305	3.656	4.998	

Election or re-election of directors

- **retirements** during the financial year:

Mr Hearl, 70 yo, appointed in 2014 and with a background in fast moving consumer goods.

Ms Seale, 60 yo, appointed in 2012 with a diverse background, including some healthcare exposure.

- **imminent retirements** after the AGM/EGM on 11 October.

Mr Penn, 59 yo, CEO, appointed in 2015 with a background in insurance.

Ms Scheinkestel, 62 yo, appointed in 2010, a PhD in law and diverse business background.

Prior to the planned departure of the CEO Andy Penn and Ms Nora Scheinkestel after the scheme meeting on 11 October, the board comprised 9 members and met our gender diversity guidelines. It had shrunk from a similarly diverse 11 directors in the prior year, so in the absence of a detailed skills matrix we might conclude that the new board is short of experience in healthcare, which is a stated key growth area, in IT/cyber of complex companies and in women, since there will be now only two in a board of 7. We will watch keenly the background of new appointees to see if they fill these gaps. The board has a majority of independent directors, none of whom are overloaded and is strong in telco experience, since it has three international former legacy telco senior executives. However, Telstra's T25 strategy is pursuing a new digital forwards reinvention, so experience in successful challenger telcos would be useful on the board. Hence it would be prudent to recruit a someone from a significant digital media company background.

- **standing for re-election:**

Eelco Blok, 65 yo, appointed 2019 from Dutch legacy telco KPN. Finance background and a 35-year history in the whole telco ecosystem. Mr Blok is a member of 5 supervisory boards in Europe, which we do not consider to be excessive.

Craig Dunn, 58 yo, appointed 2016. Background in finance, notably MD of AMP from 2008-2013, during which it suffered a significant decline, and a director of Westpac from 2015 to 2021, a period during which Westpac share price declined significantly and which recently received a fine of $113m from ASIC for compliance failures uncovered during the Financial Services Royal Commission. He was re-elected to Telstra in 2019 after receiving only 70% approval. The ASA was at the time conflicted about the re-election of Mr Dunn, since we had voted against his re-election in 2018 at Westpac, but in the end voted for. The issue of substantial ASIC fines awarded last year against Westpac rekindles the case of accountability against Mr Dunn, but on balance we will vote for. Our reasons are that a) he has apparently served Telstra well for 6 years and b) Telstra will be shortly further depleted in Directors and doesn't need further board disruption at this time. Mr Dunn is not a Director of any ASX listed companies but holds Directorships of a blockchain ISO standards committee and two Lion brewing companies. He is Chair of the Australian Ballet, so is not overboarded.

- **directors' skin in the game.**

The company has a minimum shareholding requirement for both board and senior Executives, but the quantum held is based on the purchase price at the time and not the current market price. All Directors apart from the CEO comply with ASA guidelines for "skin in the game". The Chair however holds 126,159 shares, worth $484K at current market price which is considerably less than our guidelines (100% of base fee, or $751K). Telstra policy requires 200% of base fee (after 5 years) at purchase price without any indexation for share price rise. We were advised that he still meets his own company guidelines, possibly because he has not yet served 5 years as Chair. This a moot point as Mr Mullen has signalled that he will be stepping down from the Chair position this year, but didn't want to unsettle the shareholders by doing so at the same time as the CEO Mr Penn.

Adoption of Remuneration Report and approval of equity grants to Managing Director/CEO

The ASA supports the remuneration outcomes for this year and the award for the incoming CEO for 2023, which is unchanged.

The meeting will be asked to vote on the issue of 196,803 restricted shares and 224,918 performance rights to Ms Brady, the incoming CEO. These are subject to the performance metrics outlined below. The total package is fair relative to peer companies and the measures and hurdles comprehensive and challenging.

Appendix 1

Remuneration framework detail

Telstra has a single remuneration structure called an Executive Variable remuneration Plan (EVP) rather than the conventional STI and LTI. It is unchanged since last year.

It comprises 25% in cash, paid in the period immediately following the results release, 35% in restricted shares and 40% in performance rights. Restricted shares vest progressively over 4 years, commencing a year after the performance period. Performance rights vest after 5 years against a relative total shareholder return (rTSR) condition but do not require that the absolute TSR be positive. This last point was justified in that Telstra has been subject to the nationalization of the fixed network by the Government owned NBN, which had a negative impact on all service providers. The comparator group for rTSR is the ASX100. Telstra had a multi-year headwind in its fixed network offerings since each customer migration off the legacy fixed network onto the NBN involves a margin loss for Telstra. This process of migration is nearly over, so the headwinds have abated.

Target EVP for the CEO is set at 200% of his fixed pay and the maximum at 300%.

The EVP is subject to achieving primary performance measures, which comprise 60% financial (Total external income 15%, underlying earnings before interest, depreciation and tax (EBITDA) 15%, Free cash flow (FCF) 15%, net operating expense reduction(opex) 15% and 40% for other strategic measures (episode net promoter score, eNPS 15%, Consumer and small business (C&SB) product simplification 5%, C&SB digital engagement 5%, Telstra Enterprise digital engagement 5%, employee engagement 10%).

The Performance rights, start to vest after 5 years if the rTSR exceeds 50%, at which 50% are awarded which increases linearly to 100% vesting at 75% of the comparator group rTSR.

CEO rem. Framework for FY22	Target* $m	% of Total	Max. Opportunity $m	% of Total
Fixed Remuneration	2.390	33.3	2.390	25.0
EVP - Cash	1.195	16.7	1.793	18.8
EVP – restricted Equity	1.673	23.3	2.510	26.2
EVP performance rights	1.912	26.7	2.868	30.0
Total	7.170	100.0%	9.561	100%

The CEO take home pay is disclosed for the past two years, as reported in the prior table, and is well below the target since for 3 of the past 4 prior years the performance was below target. In 2022 the CEO reached 93.1% of target and 62.1% of maximum EVP. Equity is valued using face value and purchased on market.

The CEO has substantial equity in Telstra, amounting to ca. $10m at the current share price.

The remuneration report is very clearly laid out and, as remuneration reports go, relatively easy to follow. All the performance metrics are stipulated and comprehensive in number and scope. Although it is an unusual model it is both fair and reasonable. In only one year of the past 5 has the CEO reached target remuneration, so the target is also no gimee.

The incoming CEO, Vicky Brady will receive the same fixed remuneration and EVP as the outgoing Mr Penn, so no gender pay gap here.

The overall structure of the 2023 EVP remains the same with 200% target and 300% maximum awards, but the details of the performance metrics changes a little. The performance rights still have a 60% financial to 40% strategic metric split, but the finance measure of Opex is swapped for underlying Return on invested capital (ROIC), which is logical for a capital-intensive business such as a telco.

The strategic and customer measures in 2023 change to: eNPS 15%, RepTrack (a global index of reputation tracking across a number of attributes, as evaluated by customers) 10%, Scope 1 and 2 GHG emission reductions 5%, digital leadership 5% and employee engagement 5%. This is the first time Telstra has explicitly included an ESG measure in its bonus scheme which supports net zero emissions target.