Chum Darvall
Chief Executive Officer
Australia & New Zealand

Deutsche Bank

9 July 2009

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Alison Kelly
Committee Secretary
Select Committee on the National Broadband Network
Parliament House
Canberra ACT 2600

Dear Alison

Financial analysis of NBN and structural options to reach win/win outcomes

This submission is made by Deutsche Bank to the Senate Select Committee on the National Broadband Network and reflects our analyst, Sameer Chopra's view on the financial aspects of the NBN.

Deutsche Bank is one of Australia's leading investment banks with over 800 staff in offices in Sydney and Melbourne. Today, the Deutsche Bank group in Australia is a recognised market leader, providing a fully integrated suite of investment banking, asset management and private wealth management services.

Globally, Deutsche Bank is a leading global investment bank with a strong and profitable private clients franchise. With more than 80,000 employees in 72 countries, the bank competes to be the leading global provider of financial solutions for demanding clients creating exceptional value for its shareholders and people.

As part of Deutsche Bank's Global Markets franchise in Australia, Sameer is one of 31 Deutsche Bank analysts dedicated to covering almost 170 stocks that equate to 88 per cent of the All Ordinaries in Australia.

We trust that the analysis provided will make a positive contribution to the debate. Should you have any questions, please do not hesitate to contact either of us.

Yours Sincerely

Chum Darvall
Chief Executive Officer
Deutsche Bank, Australia

Sameer Chopra
Research Analyst
Deutsche Bank, Australia

Attach.

26 May 2009

Telstra Corporation

Reuters: **TLS.AX** Bloomberg: **TLS AU** Exchange: **ASX** Ticker: **TLS**

Valn discount likely to persist - downgrade to Hold

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NBN creates too much uncertainty to allow near-term positive re-rating
Telstra offers investors a number of attractive attributes a) mid single digit EPS growth b) FY10 P/E at a 22% discount to market multiple and a slight discount to telco peers c) 9% div yield. However, there is significant earnings & free cashflow uncertainty associated with the outcome from NBN and final phase of transformation cost-out - FY15 EPS range 37c-41c/share. Until there is greater clarity around NBN and new CEO's strategic vision, we can't see stock outperformance - Downgrade to Hold

Vending Fixed copper network is good hedge if NBN is seen to be successful
In our view, if Telstra were to vend the copper access network (excl backhaul & electronics) in return for minority equity share in National Broadband Network and transfer $8.5bn existing debt to new asset owner, it could be attractive for both TLS investors - reduced uncertainty associated with "lost network profits", EPS neutral outcome & potential to share in upside if NBN is successful. Similarly, NBN coy could reduce total funding requirement by ~$9.5bn through improved take-up rates and capex oversight that TLS could offer. In our view, such a deal could see a positive re-rating in stock but an outcome is at least 9 mths away. We see low risk of forced hybrid fiber coaxial cable (HFC) divestment as we estimate this could require TLS to be compensated to the tune of ~$2.2bn.

Forecasts cut 2% due to billing concerns & operation separation
We have cut our EPS forecasts by 2% to allow for delays in consumer billing platform ($30m in FY09) & further operational separation ($50m pa from FY10). On our latest estimates, management's FY10 targets of FCF of $6bn-$7bn are achievable but margins are likely to be shy of 46-48%.

Target price at 15% discount to valn
Our TP of $3.70 is derived from the average of our SOTP and DCF valns after applying a 15% discount for NBN related uncertainty. Key risks relate to outcome of NBN negotiations. Also see pp 14-15.

Forecasts and ratios

Year End Jun 30	2007A	2008A	**2009E**	2010E	2011E
Sales (AUDm)	23,708	24,657	**25,468**	25,551	26,252
EBITDA (AUDm)	9,868	10,417	**11,004**	11,666	12,113
Net Profit (AUDm)	3,275	3,671	**3,844**	4,036	4,404
EPS (AUD)	0.26	0.30	**0.31**	0.32	0.35
% Change	0.0%	0.0%	**-0.5%**	-2.1%	-2.3%
EPS Growth (%)	2.9	12.1	**4.7**	5.0	9.1
PER (x)	15.7	15.4	**10.0**	9.5	8.7
EV/EBITDA (x)	6.4	6.6	**4.8**	4.6	4.4
Yield (net) (%)	6.8	6.1	**9.1**	9.7	10.0

Source: Deutsche Bank estimates, company data

[1] Pre-exceptionals/extraordinaries
[2] Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Company Update

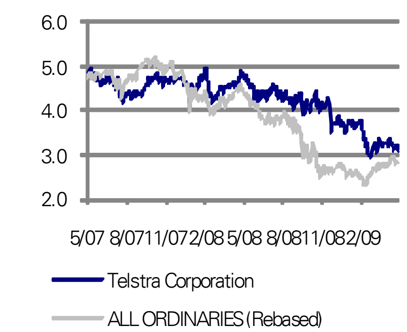
Hold

Price at 25 May 2009	**3.09**
Price target - 12mth	**3.70**
52 week range (AUD)	**4.80 - 2.96**
ALL ORDINARIES	**3,735**

Key changes

Rating	Buy to Hold ↓	
Price target	3.90 to 3.70 ↓	**-5.1%**
EBIT margin (FYE)	25.7 to 25.5 ↓	**-0.5%**
Net profit (FYE)	3,864.8 to 3,843.8 ↓	**-0.5%**

Price/price relative



Performance (%)	1m	3m	12m
Absolute	*-5.2*	*-18.3*	*-35.8*
ALL ORDINARIES	*1.8*	*13.8*	*-36.3*

Stock data

Market cap (AUDm)	**38,449**
Market cap (USDm)	**30,037**
Shares outstanding (m)	**12,443.1**
Daily volume (USDm)	**91.54**
Free float	**48.00**

Key indicators (FY1)

ROE (%)	**31.9**
ROA (%)	**16.8**
Net debt/equity (%)	**144.4**
Book value/share (AUD)	**0.97**
Price/book (x)	**3.2**
Net interest cover (x)	**6.4**
EBIT margin (%)	**25.5**

Model updated: 25 May 2009

Equity Research

Asia Pacific

Australia

Telecommunications

Telstra Corporation Ltd

Reuters: TLS.AX Bloomberg: TLS AU Sedol: 6087289

Hold

Price as at 25-May	A$3.08
Target price	A$3.70

Company website

http://www.telstra.com

Company description

Telstra Corporation Limited is Australia's dominant full service wireline and mobile carrier. The company provides fixed line services to homes and businesses nationally, supplying local, long distance, dial-up and broadband Internet services. Telstra is Australia's leading mobile operator with national CDMA and GSM networks. The company also owns 50% of the leading Pay TV operator, Foxtel, and 100% of the national directories business, Sensis.

Research Team

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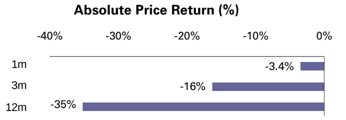
Absolute Price Return (%)

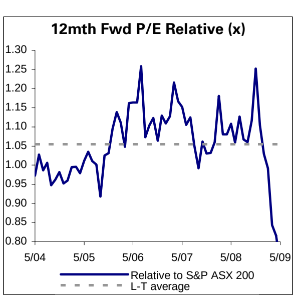


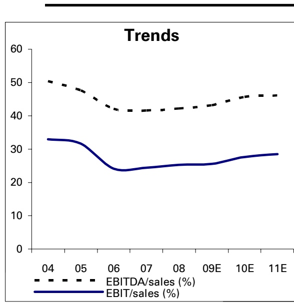
52-week High/Low:	A$4.86 - 2.96
Market Cap (m)	A$ 78,214
	US$ 61,210

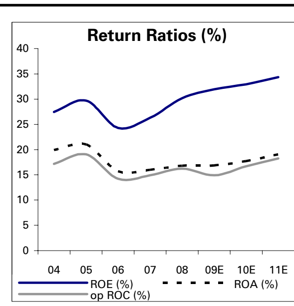
DCF VALUATION (A$)	
Beta (MRP - 6.00)	0.75
Debt/mkt value ratio (%)	20.0
WACC (6.25% bond yield)	9.6
Net value per share ($)	**4.99**
Price/NPV (x)	0.62

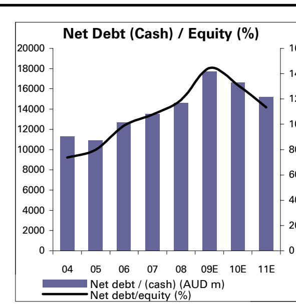
Y/E 30 June	02/03	03/04	04/05	05/06	06/07	07/08	08/09E	09/10E	10/11E
SUMMARY									
Normalised EPS (A$)	0.328	0.342	0.344	0.256	0.263	0.295	0.309	0.324	0.354
P/E ratio normalised (x)	13.8	14.0	14.4	16.1	15.7	15.4	10.0	9.5	8.7
Normalised EPS growth (%)	12.6	4.3	0.7	-25.7	2.9	12.1	4.7	5.0	9.1
Operating CFPS (A$)	0.548	0.584	0.652	0.618	0.604	0.619	0.661	0.692	0.725
P/CFPS (x)	8.3	8.2	7.6	6.7	6.9	7.4	4.7	4.5	4.2
DPS (A$)	0.270	0.260	0.400	0.340	0.280	0.280	0.280	0.300	0.310
Dividend yield (%)	6.0	5.4	8.1	8.3	6.8	6.1	9.1	9.7	10.1
Price/BV (x)	3.78	3.93	4.51	4.07	4.18	4.72	3.18	3.07	2.92
Enterprise Value (A$m)	41,345	38,688	40,518	40,280	65,890	67,592	52,885	53,910	52,636
EV/EBITDA	4.1	3.7	3.8	4.2	6.7	6.5	4.8	4.6	4.3
EV/EBIT	6.2	5.7	5.8	7.3	11.4	10.9	8.1	7.6	7.0
DIVISIONAL REVENUE (A$m)									
Total PSTN products	8,265	8,320	7,740	7,201	6,887	6,666	6,230	5,910	5,720
Total Mobile	3,613	4,336	4,688	4,984	5,656	6,376	6,950	7,390	7,990
Total Data & Internet	2,818	2,974	3,641	4,011	4,328	4,644	4,941	5,028	5,052
Advertising & directories	1,217	1,342	1,696	1,814	1,952	2,116	2,310	2,350	2,430
Solutions Management	487	508	1,029	1,055	1,051	1,049	1,010	710	730
CSL & TelstraClear	1,456	1,300	1,359	1,450	1,573	1,479	1,600	1,650	1,710
Other	2,988	1,981	2,028	2,220	2,261	2,327	2,427	2,512	2,620
PROFIT & LOSS (A$m)									
Sales revenue	20,844	20,761	22,181	22,735	23,708	24,657	25,468	25,551	26,252
Total revenue	22,049	21,222	22,525	23,137	24,017	25,074	25,757	25,840	26,542
EBITDA	10,195	10,253	10,558	9,571	9,868	10,417	11,004	11,666	12,113
Depreciation/amortisation	3,447	3,615	3,529	4,078	4,082	4,190	4,500	4,600	4,630
EBIT	6,748	6,638	7,029	5,493	5,786	6,227	6,504	7,066	7,483
Net interest income (expense)	-795	-712	-880	-933	-1,087	-1,086	-1,018	-1,304	-1,196
Income tax expense	1,534	1,731	1,746	1,381	1,417	1,429	1,647	1,730	1,888
Associates/affiliates	-1,025	-78	-94	5	-7	-1	5	5	5
Minorities/preference dividends	35	1	0	0	0	0	0	0	0
Net profit	3,429	4,118	4,309	3,184	3,275	3,711	3,844	4,036	4,404
Significant items	-674	-110	0	0	0	40	0	0	0
Net profit excluding significant iter	4,103	4,228	4,309	3,184	3,275	3,671	3,844	4,036	4,404
Net abnormals and extraordinaries	0	0	0	0	0	0	0	0	0
CASH FLOW (A$m)									
Cash flow from operations	7,057	7,433	8,161	7,688	7,520	7,703	8,224	8,608	9,021
Capex	-3,261	-3,015	-3,539	-4,255	-5,652	-5,327	-4,500	-3,900	-3,780
Free cash flow	3,796	4,418	4,622	3,433	1,868	2,376	3,724	4,708	5,241
Other investing activities	769	-481	-270	177	-25	266	-30	-30	-30
Equity raised/(bought back)	0	-1,009	-756	0	0	0	0	0	0
Dividends paid	-3,345	-3,186	-4,124	-4,970	-3,479	-3,498	-3,484	-3,608	-3,733
Net inc/(dec) in borrowings	-1,005	-379	1,393	493	1,761	930	-210	-1,070	-1,478
Other financing cash flows	33	24	-18	18	17	15	0	0	0
Total cash flows from financing	-4,317	-4,550	-3,505	-4,459	-1,701	-2,553	-3,694	-4,678	-5,211
Net cash flow	248	-613	847	-849	142	89	0	0	0
Movement in net debt/(cash)	-1,253	234	546	1,342	1,619	841	-210	-1,070	-1,478
BALANCE SHEET (A$m)									
Cash and other liquid assets	1,300	687	1,548	689	823	899	899	899	899
Tangible fixed assets	23,012	22,863	22,891	23,622	24,607	24,311	24,961	24,911	24,711
Goodwill	2,018	2,104	2,037	2,073	2,126	2,017	3,017	3,017	3,017
Other intangible assets	3,534	3,768	4,292	4,050	4,499	5,228	4,528	3,828	3,128
Associates/investments	338	120	48	23	19	15	100	185	270
Other assets	5,124	5,214	4,395	5,718	5,801	5,451	7,613	7,639	7,781
Total assets	35,326	34,756	35,211	36,175	37,875	37,921	41,118	40,479	39,806
Interest bearing debt	12,282	12,023	12,448	13,378	14,362	15,499	18,619	17,549	16,071
Other liabilities	7,622	7,372	9,105	9,965	10,933	10,177	10,224	10,227	10,360
Total liabilities	19,904	19,395	21,553	23,343	25,295	25,676	28,843	27,776	26,432
Shareholders' equity	15,420	15,359	13,656	12,587	12,330	12,018	12,047	12,475	13,146
Minorities/other	2	2	2	246	251	228	228	228	228
Total shareholders' equity	15,422	15,361	13,658	12,833	12,581	12,246	12,275	12,703	13,374
Net working capital	3,275	3,334	3,684	3,838	4,033	4,063	4,214	4,239	4,372
Net debt/(cash)	10,982	11,336	10,900	12,689	13,539	14,600	17,720	16,650	15,172
RATIO ANALYSIS									
Sales growth - pcp (%)	1.7	-0.4	6.8	2.5	4.3	4.0	3.3	0.3	2.7
EBITDA/sales (%)	48.3	50.4	47.6	42.1	41.6	42.2	43.2	45.7	46.1
EBIT/sales (%)	31.7	33.0	31.7	24.2	24.4	25.3	25.5	27.7	28.5
Payout ratio (%)	81.5	75.4	95.7	156.1	106.2	94.7	90.6	89.4	84.8
ROA (%)	18.8	19.9	21.0	15.7	16.0	16.8	16.8	17.7	19.1
ROE (%)	27.8	27.5	29.7	24.3	26.3	30.2	31.9	32.9	34.4
Operating Return on Capital (%)	17.5	17.2	19.1	14.2	14.9	16.2	14.9	16.7	18.3
Tax rate (%)	25.8	29.2	28.4	30.3	30.2	27.8	30.0	30.0	30.0
Capex/sales (%)	15.6	14.5	16.0	18.7	23.8	21.6	17.7	15.3	14.4
Capex/depreciation (x)	1.2	1.0	1.2	1.3	1.7	1.5	1.2	1.0	1.0
Net debt/equity (%)	71.2	73.8	79.8	98.9	107.6	119.2	144.4	131.1	113.4
Net interest cover (x)	7.4	8.7	8.0	5.9	5.3	5.7	6.4	5.4	6.3

Source: Company data, DB estimates









Summary of view

NBN Economics

- Our base case assumption is the NBN will require ~$28bn of funding. The business case is highly sensitive to bond yield, take-up rate & capex over-runs. Under adverse scenarios, the total project funding might increase by 50% to $42bn. In our view, a collaborative engagement with Telstra & contractors will help mitigate these risks. NBN wholesale company could be EBITDA positive by 2015 and the first substantial tranche of debt will need to be raised in 2012.
- In addition to spend by NBN Coy, telcos will need to spend $1200-$2400/home connected to activate customers. This will strain future earnings performance.
- The NBN implementation study group should conclude negotiations in late FY10, with first subscribers in key national markets in late FY11.

Impact on TLS from alternative scenarios

- Our analysis shows a 10% range of earnings outcome for TLS depending upon the NBN's success in rolling out network & competitors ability to win regional subscribers.
- DB est that TLS' copper pairs & exchanges are worth ~$8.5bn. We see substantial value in the backhaul network (DB est $4.7bn) which should be retained as a source of future differentiation.
- Vending copper network & exchanges in return for 30% equity share in NBN Coy & transfer of $8.5bn of debt to new owner would be EPS neutral for TLS. Post vending assets, TLS' EBITDA margins would be closer to global peers (at 40%), have 2% lower capex to sales ratio (~12%) & significantly lower gearing. Further, the company could benefit from lower "regulatory noise"
- Buying a legacy network would allow the NBN Coy to be EBITDA positive from the start, better manage take-up rates and benefit from TLS' capex management capabilities. A fully engaged TLS could also assist in mitigating of potential risk to the NBN from low take-up rates & high capex spend. We est this could be worth ~$9.5bn in additional funding required by the NBN . (from $38bn to $28bn)
- We think a forced divestment of cable network is highly unlikely– we estimate the network's inherent value to TLS is ~$3.6bn vs mkt value of ~$1.25bn, which could see a compensation claim of $2.2bn.

Figure 1: DB estimate of financial impacts from various strategic alternatives

		Basecase	Scenario 1	Scenario 2	Scenario 3
		"Slow NBN roll-out, no market share losses"	**"Fast NBN roll-out, market share losses"**	**"Fixed copper network vended for $8.5bn +30% equity share"**	**"forced to divest cable"**
Industry structure		PSTN op sep	PSTN op sep	**PSTN vended**	PSTN op sep
		HFC retained	HFC retained	HFC retained	**HFC divested**
NBN	TLS role	Minor	Minor	**Equity stake: 30%**	Minor
	Roll-out	**20% by 2015**	**90% by 2018**	90% by 2018	90% by 2018
Probability		50%	5%	40%	5%
EPS $/share	FY11	$0.35	$0.35	$0.35	$0.36
	FY15	$0.41	$0.37	$0.40	$0.37
FCF $/share	FY11	$0.52	$0.52	$0.42	$0.62
	FY15	$0.47	$0.45	$0.40	$0.46
Gearing: Net Debt/EBIT	FY11	2.0x	2.1x	1.1x	2.0x
	FY15	1.3x	1.5x	0.3x	1.3x
Dividends	FY11	30c	30c	30c	30c
	FY15	30c	30c	30c	30c
Valuation/share	DCF	$5.00	$4.70		$4.80
	SOTP	$3.80	$3.60	$4.00	$3.70

Source: Deutsche Bank

Revisiting NBN economics

We are of the view that there are 3-4 factors worth considering in NBN roll-out which might prove decisive in its eventual success. The main variables are deployment costs (scope – aerial vs buried), take-up rate (the traffic forecast), access cost (the toll) and cost of debt (the funding model):

NBN coy's capex is likely to be $22bn-$30bn, with an additional $1200-$2400/home connected spent by telco providers to activate customers.

- The cost of rolling out a passive FTTH network in Australia is ~$15bn-$20bn ie $1700-$2400/home passed. There is an additional cost of ~$7bn-$10bn to connect homes to the passive infrastructure ie $800-$1200 per home connected eg trenching premises & providing an external optical line terminal (box outside home). We assume this is borne by NBN coy. Finally, there is a cost of ~$10bn-$20bn in providing set-top boxes & cabling premises ie $1200-$2400/home connected. This final cost could be borne by consumer or telco providers. We have sourced our analysis from a recent study conducted for the NZ Ministry of Economic Development (FTTP cost Study Feb 09).
    - We suggest that the Govt might introduce a $500 subsidy to households to enable them to "fibre within the premises". This would encourage more rapid adoption.
- Current evidence from offshore deployments suggests that take-up is likely to be 25-30% in initial yrs despite FTTH's superior technology. Over time, the network's take-up should rise to 60-70% levels.
- We are of the view that wholesale access (excl backhaul & electronics) is likely to be in the range of $25-$30/home, a slight premium to current ULL prices. The Govt might be inclined to subsidise the network to ensure that pricing supports demand.
- The Govt has previously indicated that it might fund the NBN debt through infrastructure bonds and/or Govt guarantees. We have assumed a yield of 5%. As the cost of debt is significantly below telco sector WACC (est 9.6%), the fully funded cost of the NBN could be ~$28bn.

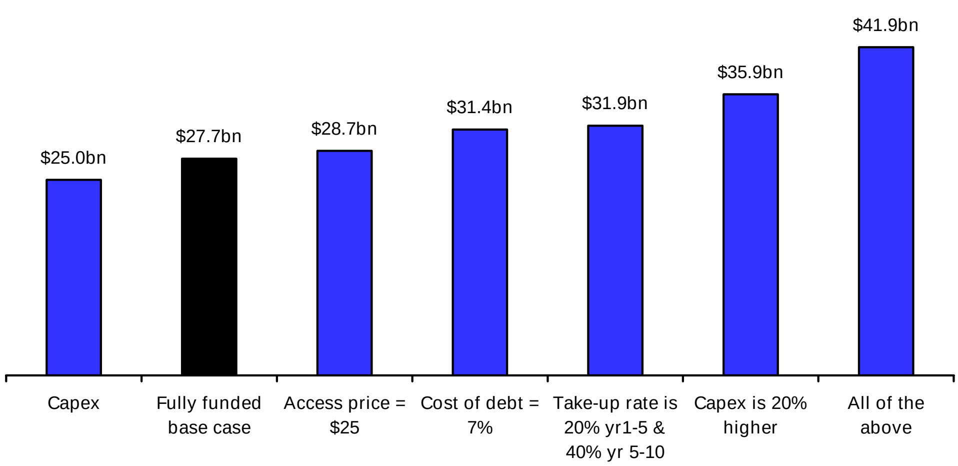
Our base case assumption is the NBN will require ~$28bn of funding (assuming access price = $30/mth, 65% take-up in Yr 8, bond yield 5%, capex $25bn).

Our base case assumption is the NBN will require ~$28bn of funding.

The business case is highly sensitive to bond yield, take-up rate & capex over-runs. Under adverse scenarios, the total project funding might increase by 50% to $42bn.

In our view, a collaborative engagement with Telstra & contractors will help mitigate these risks.

Figure 2: Sensitivities around a fully funded NBN



Source: Deutsche Bank

The NBN wholesale company could be EBITDA positive by 2015 but NPAT losses are likely to continue until 2018 due to high D&A and interest costs. The first tranche of substantial debt raising is not required until 2012 (est $4bn) and will then progressively rise to $14bn by 2016. We estimate that the company's capex bill is likely to be $3.2bn pa during construction phase, 65% of this relate to civil works.

NBN wholesale company could be EBITDA positive by 2015 but profits are unlikely before 2018.

We est the first substantial tranche of debt will need to be raised in 2012.

Figure 3: Projected financials for NBN wholesale company

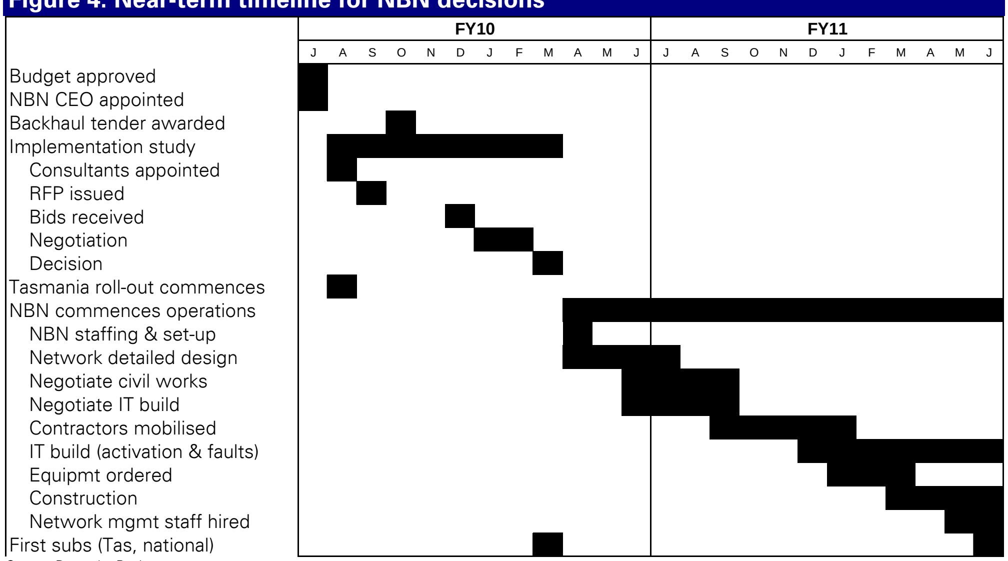
	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18
Earnings									
Rev $bn	0.00	0.01	0.04	0.12	0.27	0.50	0.80	1.22	1.77
EBITDA $bn	-0.02	-0.03	-0.07	-0.02	0.04	0.23	0.49	0.87	1.39
Net Profit/(Loss) $bn	-0.01	-0.12	-0.29	-0.33	-0.69	-0.55	-0.77	-0.40	-0.18
Cashflows									
CFO $bn	0.0	0.0	-0.1	0.0	0.0	0.2	0.5	0.9	1.4
CFI (maint +new capex) $bn	-0.8	-2.5	-3.1	-3.2	-3.2	-3.2	-3.2	-3.2	-3.2
CFF $bn	2.3	5.0	3.9	0.9	5.0	0.4	5.2	-0.2	1.6
Balance Sheet									
Total Assets $bn	0.5	6.2	9.9	10.6	15.2	15.3	20.4	20.4	22.6
Gross Debt $bn	0.0	1.2	4.2	4.2	8.7	8.7	14.2	14.2	16.2
Share Capital $bn	2.3	6.2	7.2	8.2	9.2	10.0	10.5	11.0	11.5
Gearing: Debt/Total Assets	0	0.2	0.4	0.4	0.6	0.6	0.7	0.7	0.7
Assumptions									
Homes passed (m)	0.1	0.2	1.0	2.0	3.4	4.4	5.4	6.8	8.8
Homes connected (m)	0.0	0.0	0.2	0.5	1.0	1.8	2.7	4.1	5.7

Source: Deutsche Bank

The NBN implementation study group is likely to invite fresh tenders in Oct 09 with negotiations concluding in late FY10.

Early wins are likely in regional backhaul deployment & Tasmania. However first subscribers in key national markets are unlikely before late FY11.

Figure 4: Near-term timeline for NBN decisions



Source: Deutsche Bank

Scenario 1: Play current network advantage, abstain from NBN ownership

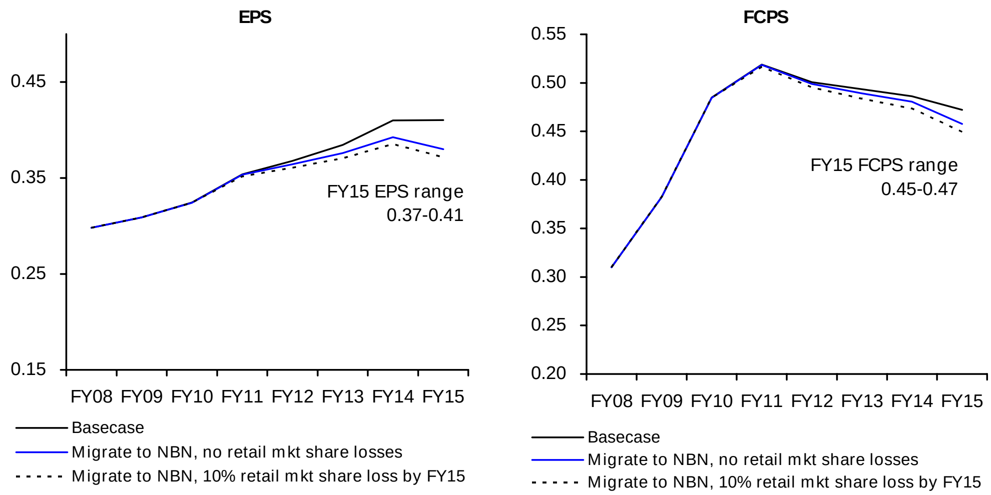
If TLS abstain from taking an active interest in a successful NBN (90% coverage in 8 yrs with access pricing of $30/mth), investors could see one of two outcomes:

- Loss of earnings from fixed network ownership of ~$540m by FY15.
- Additional lost earnings from retail mkt share losses. We estimate 10% mkt share loss = $150m EBITDA decline.

If NBN roll-out is successful without TLS engagement, earnings could start to decline from FY14.

However, FCF/share is unlikely to change materially implying dividends can be comfortably covered.

Figure 5: Abstaining from NBN – potential EPS and FCPS outcomes



Source: Deutsche Bank

If an NBN is successful and TLS lose 10% of retail customers while migrating their customers to the new network, we would value the existing Fixed network at $10.6bn using DCF. This equates to an EV/EBITDA multiple of 3.6x.

Figure 6: Sum-of-the-parts valuation if migrate to NBN & 10% retail mkt share loss

	EBITDA	Multiple	EV
Fixed retail & wholesale	3,440	6.5	22,360
Fixed infrastructure (CAN, b'haul)	2,930	3.6	10,550
Mobile	3,180	5.5	17,490
Sensis	1,050	6.5	6,830
CSL New World, TelstraClear	410	4.0	1,640
Other	660	3.0	1,980
Foxtel (50%) less $1070m debt		8.8	1,310
Total	11,670	5.3	62,160
Less Net Debt			16,400
Equity Value			45,760
Number of shares			12,443
Value: $/share			**3.70**

Source: Deutsche Bank

Ownership of the consumer fixed line network (ie exchanges, copper & backhaul) directly contributes ~25% of Telstra's EBITDA.

There is a similar amount of EBITDA generated by retailing these services to consumers, SMEs & competitors.

Key assumptions underlying Scenario 1

Figure 7: Operationally separated P&L (DB est for FY10)

	Rev		EBITDA		Margins
Fixed (telephony & internet)					
Retail: Corporates	2,940	11%	740	6%	25%
Retail: Cons & SME	7,500	29%	1,950	17%	26%
Ext wholesale	1,500	6%	750	6%	50%
Network: CAN+Backhaul	4,512		2,930	25%	65%
Mobile	7,390	29%	3,180	27%	43%
Sensis	2,350	9%	1,050	9%	45%
Foxtel contrib + PayTV bundling	590	2%	500	4%	85%
Solutions & Services	710	3%	90	1%	13%
Other products	940	4%	90	1%	10%
CSL New World	1,100	4%	320	3%	29%
TelstraClear	550	2%	90	1%	16%
Telstra Group	25,570	100%	11,670	100%	46%

Source: Deutsche Bank

Our base case assumptions for TLS' retail fixed line business are detailed below. For the purposes of this analysis, we have reduced retail market share from 80% to 70% by FY15.

Figure 8: The contestable fixed line market – retail & wholesale

	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15
Rev (cons retail, wholesale)	9,340	9,190	8,950	8,780	8,590	8,360	8,130	7,930
Total lines (m)	9.90	9.70	9.55	9.40	9.25	9.10	8.95	8.80
Retail mkt share	80%	80%	81%	81%	81%	81%	80%	80%
Retail telephony ARPU	64	60	58	57	56	56	55	54
Retail lines	7.87	7.80	7.75	7.65	7.50	7.35	7.20	7.05

Source: Deutsche Bank

Scenario 2: Vend exchanges & copper network into JV

Our analysis of whether TLS and the NBN coy might consider a deal involving the transfer of copper assets proposes that

- Vending asset in return for 30% equity share in NBN Coy & transfer of $8.5bn of debt to new owner would be EPS neutral
- Post vending assets, TLS' EBITDA margins would be closer to global peers, have 2% lower capex to sales ratio & significantly lower gearing. Additionally, the company could benefit from lower "regulatory noise"
- Buying a legacy network would allow the NBN Coy to be EBITDA positive from the start, better manage take-up rates and benefit from TLS' capex management capabilities.
- TLS should retain backhaul as a source of future competitive advantage

Retain backhaul & core network. Vend copper pairs, ducts & exchanges

While a potential deal might include vending "monopoly assets", we see value in retaining backhaul & electronics as these are sources for future competitive advantage.

Figure 9: What fixed assets should be retained vs divested under the deal

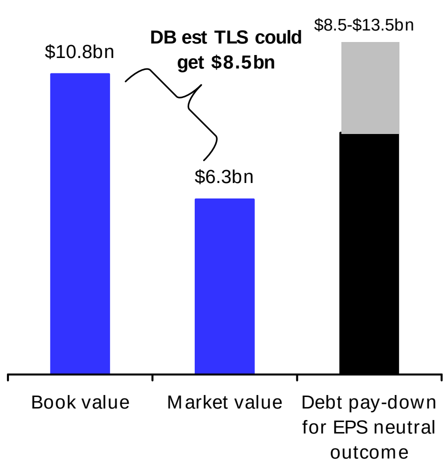
Retained	Divested to NBN
Switches, DSLAMs	Copper pairs
Core network	Ducts, Pillars
All backhaul	Exchanges/ Buildings
Corporate fibre	
HFC cable	Payphones ??

Source: Deutsche Bank

DB est that TLS' copper pairs & exchanges are worth ~$8.5bn - a mid-point of book & mkt value.

In our view, there is substantial value in the backhaul network (DB est $4.7bn) which should be retained as a source of future differentiation.

Figure 10: Ascribing a value to copper + exchanges



	Bk Value	Mkt Value
Total Fixed Network	$16.3bn	$12.1bn
Less HFC	$3.6bn	$1.3bn
Less Backhaul	$1.9bn	$4.6bn
Fixed CAN	$10.8bn	$6.3bn

Methodology

1. Method: Determine value of the entire fixed network. Subtract values for HFC & backhaul to derive value for Fixed CAN
2. Mkt value of entire fixed network is calculated using DCF with $2.93bn EBITDA at Yr 1, $1.2bn capex, -5% TV growth rate, 9.6% WACC. The implied EV/EBITDA for Fixed Network is 4.1x
3. Backhaul mkt value assumes $850m EBITDA, capex of $400m pa, 0% TV growth rate, 9.6% WACC. The implied EV/EBITDA is 5.4x

Source: Deutsche Bank

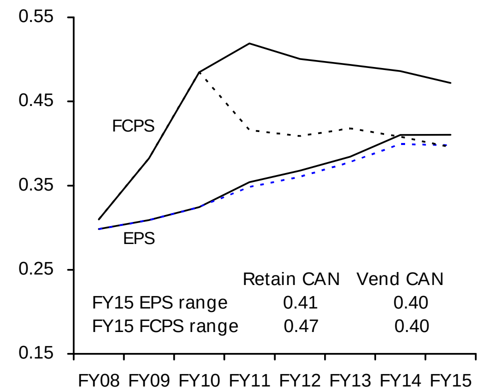
The case for TLS to divest exchanges & copper network

We estimated vending copper network & exchanges in return for 30% equity share in NBN Coy & transfer of $8.5bn of debt to new owner would be EPS neutral for TLS. Post vending assets, TLS' EBITDA margins would be closer to global peers, have 2% lower capex to sales ratio & significantly lower gearing. Additionally, the company could benefit from lower "regulatory noise".

Vending Fixed copper assets for $8.5bn would have minimal impact on EPS, more closely align TLS' EBITDA margins to global peers, reduce capital intensity (capex to sales lower by 2%) and improve gearing.

Figure 11: Impact of vending Fixed CAN for 30% share in NBN & $8.5bn debt

	As Is	Vend Fixed CAN
Growth rates: FY11-FY15		
Sales growth	1.8%	2.1%
EBITDA growth	0.5%	1.8%
EPS growth	3.8%	3.5%
FY11 metrics		
EBITDA margin	46%	40%
Net Profit margin	17%	17%
Capex to sales	14.4%	12.6%
Gearing (Net Debt/EBIT)	2.1x	1.1x



Source: Deutsche Bank

Our sum-of-the-parts valuation of TLS if copper network is vended for $8.5bn is $4.00/share.

Figure 12: Sum of the parts valuation if copper & exchanges vended for $8.5bn

	EBITDA	Multiple	EV
Fixed retail & wholesale	3,440	6.5	22,360
Fixed infrastructure (b'haul)	850	6.9	5,850
Mobile	3,180	5.5	17,490
Sensis	1,050	6.5	6,830
CSL New World, TelstraClear	410	4.0	1,640
Other	860	3.0	2,580
Foxtel (50%) less $1070m debt		8.8	1,310
Total	9,790	5.8	58,060
Less Net Debt			7,900
Equity Value			50,160
Number of shares			12,443
Value: $/share			**4.00**

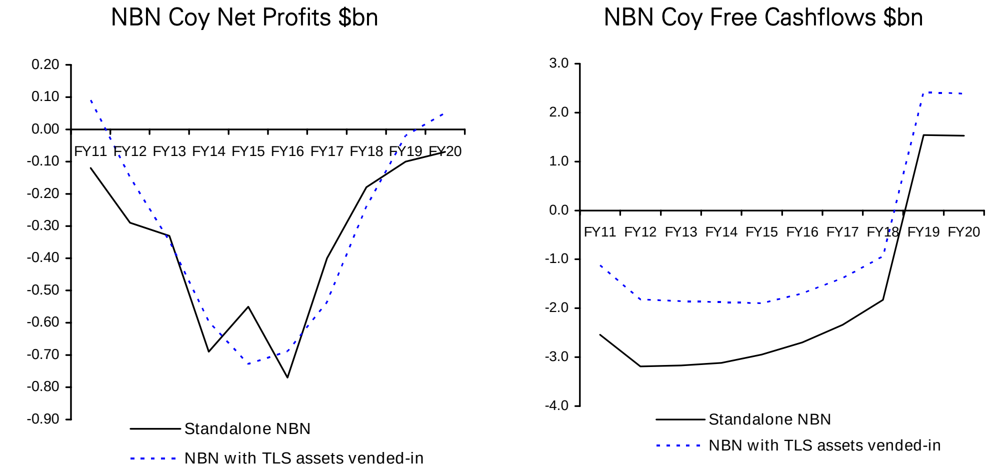
Source: Deutsche Bank

The case for the NBN Coy to acquire exchanges & copper network

Buying a legacy network could allow the NBN Coy to be EBITDA positive from the start, better manage take-up rates and benefit from TLS' capex management capabilities. A fully engaged TLS could also assist in mitigating of potential risk to the NBN from low take-up rates & high capex spend. We est this could be worth ~$9.5bn in additional funding required by the NBN.

Owning legacy copper network would allow NBN coy to report EBITDA of $2.0bn at commencement (vs nil otherwise) & offer bondholders better FCF.

Figure 13: NBN Coy economics under the "standalone" vs "vended assets" scenarios



Source: Deutsche Bank

We estimate that EBITDA from legacy copper network reduces the need for the NBN Coy to access public debt markets by ~$5bn over the life of project.

NBN Coy could lower risks by engaging with TLS upfront. We est this might save $9.5bn in later yrs.

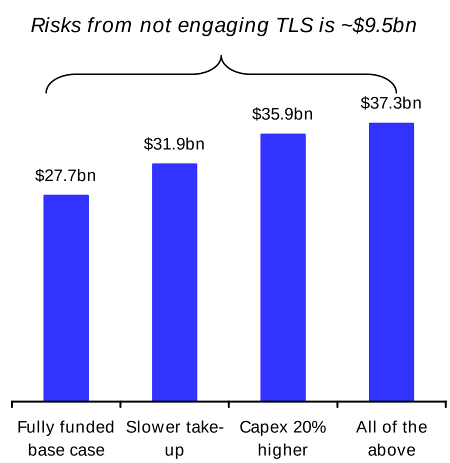
Figure 14: NBN Coy risks under the "standalone" vs "vended assets" scenarios

Sources of funding

(note $8.5bn of bank debt sits above funds from bondholders)

	Funds from Govt $bn	Funds from Bondholders $bn
Standalone NBN	11.5	16.2
NBN with TLS assets vended-in	11.5	11.0

Funding required under scenarios



Source: Deutsche Bank

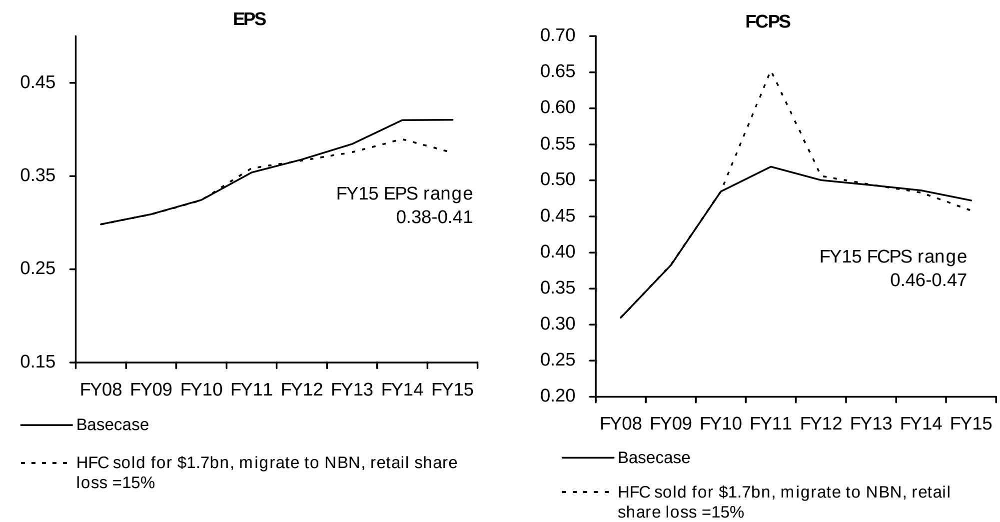
Scenario 3: "forced to divest cable"

We view forced divestment of the cable network as a highly unlikely scenario – the network's inherent value to TLS as ~$3.6bn, a price which others might not pay given the potential of NBN based competition.

The Government's regulatory review has highlighted that it might consider the forced divestment of Telstra's HFC cable network. In our view there are significant hurdles to this being achieved as a forced sale might require TLS to be compensated up to $2.0bn as mkt values is below original investment and strategic value to company.

The key direct impact of divestment would be a loss of revenues received from Foxtel for use of HFC (est $80mpa), but this a low margin offering. There is an offset from lower capex spent on the network (est $160m pa). There is the potential for greater competition if the buyer uses the network to retail triple play offerings. In our view, the threat from a third party using HFC to offer triple play is less than the competitive threat posed by the NBN.

Figure 15: Divest HFC & migrate to NBN – potential EPS and FCPS outcomes



Source: Deutsche Bank

Our sum-of-the-parts valuation of TLS if the HFC is divested for $1.25bn and a successful NBN is built is $3.70/share.

Figure 16: Sum of the parts valuation if HFC divested & NBN built successfully

	EBITDA	Multiple	EV
Fixed retail & wholesale	3,440	6.2	21,330
Fixed infrastructure (CAN, b'haul)	2,930	3.3	9,670
Mobile	3,180	5.5	17,490
Sensis	1,050	6.5	6,830
CSL New World, TelstraClear	410	4.0	1,640
Other	660	3.0	1,980
Foxtel (50%) less $1070m debt		8.8	1,310
Total	11,670	5.2	60,250
Less Net Debt			14,700
Equity Value			45,550
Number of shares			12,443
Value: $/share			**3.70**

Source: Deutsche Bank

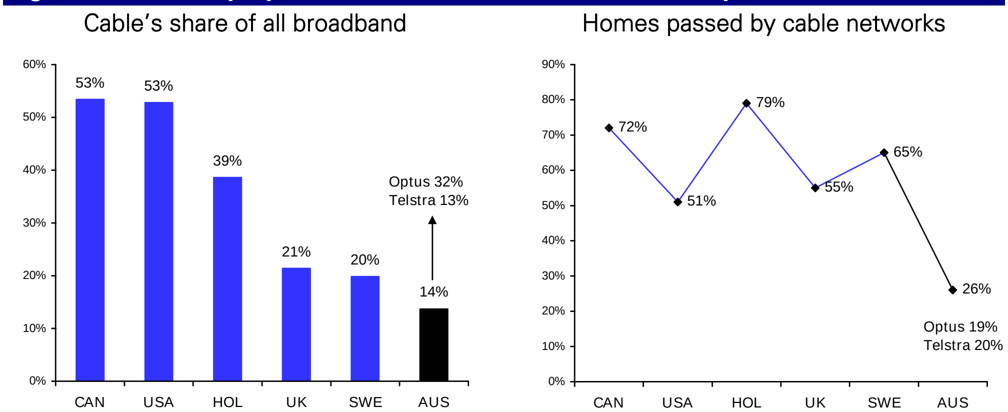
The regulator's rationale for proposing divestment

Cable's penetration of broadband is low in Australia. This is largely because the cable network only passes 26% of homes vs 50-80% in other markets. In our opinion, forced sale of HFC is unlikely to result in a large extension of existing network.

Cable's penetration of broadband is low in Australia because the network only passes 26% of homes vs 50-80% in other markets.

A forced sale of HFC is unlikely to see these metrics improve.

Figure 17: Cable deployments: broadband mkt share & homes passed



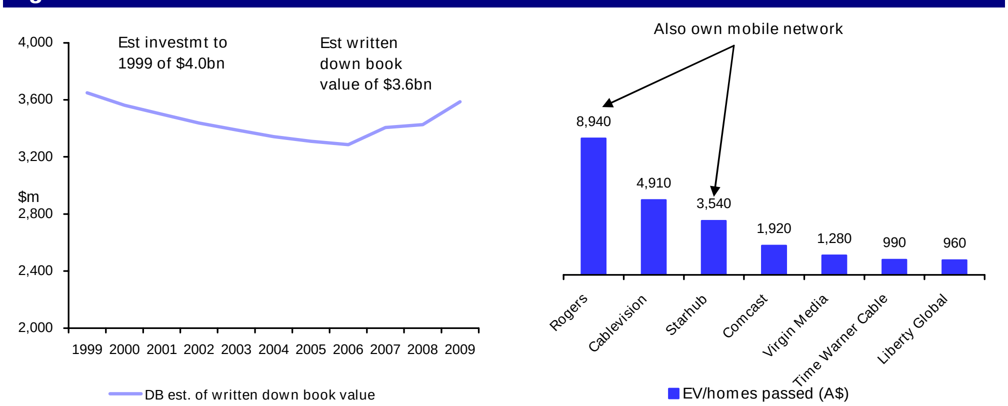
Source: OECD, CRTC, NCTA, ABS, Company reports, Deutsche Bank

Value of cable network

DB est that book value of HFC cable network is ~$3.6bn ie $1450/home passed. While cable assets with triple play bundling are currently trading at A$960-$1920/home passed, the value of a "naked cable network" is likely to be ~$500/home passed, implying a market value of $1.25bn for Telstra's HFC network. This large spread of valuation could pose a challenge to the potential divestment of the network with the potential for compensation claims if potential buyers are unable to meet price expectations of an unwilling seller.

DB est that book value of HFC cable network is ~$3.6bn, while market value is ~$1.25bn. These equate to book value of $1450/home passed & mkt value of $500/home passed.

Figure 18: Book & market value of HFC cable network



Source: Deutsche Bank

Lessons from the United States

The US market has had the benefit of FTTH deployment by Verizon (not covered). Initial evidence from the US suggests that FTTH has assisted in abating fixed line revenue decline to low single digits through a substantial rise in consumer ARPUs (from $54 in 2006 to $68 in 2008). However, this has come at a cost – capex to sales ratio in fixed line is 20-22% and PSTN line losses have accelerated to 8% pa. Currently, take-up rates for fibre are ~30%.

Recent financial & operational data from Verizon suggests that fibre has assisted in abating decline in fixed revenues to low single digits through growth in ARPUs but it has come at a cost – high capex spend & accelerated PSTN line decline.

Figure 19: Verizon case study (fixed line business)

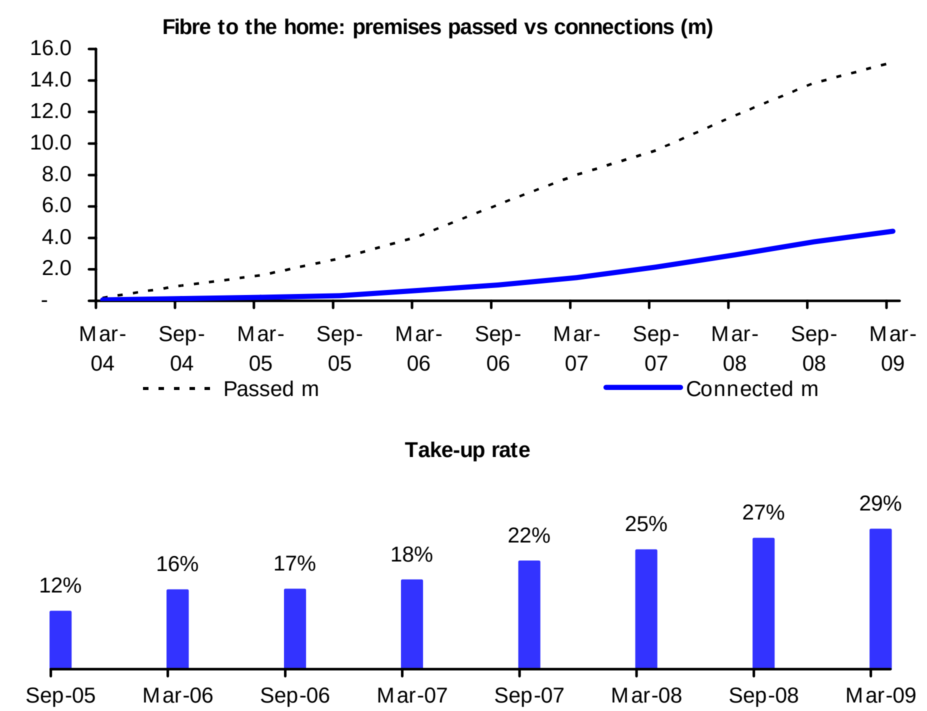
Financials & Operating stats				FiOS Business Case	
	2006	2007	2008		
Rev $bn	49.5	49.13	48.21	Capex	
EBIT $bn	4.39	4.49	3.86	FiOS capex to 2010	$18bn
Rev growth	-3.5%	-0.7%	-1.9%	Per home passed	850
EBITDA margin	27.9%	27.5%	25.4%	Opex	
Capex to sales	21%	22%	20%	Annual opex saved	$1bn
				Savings % of network cost	17%
PSTN lines (m)	43.1	39.9	36.2	Network report rate	80% lower
FiOS homes passed (m)	6.0	9.3	12.7	Revenue	
FiOS b'band subs (m)	0.7	1.5	2.5	Churn	<1.5%
Consumer ARPU $/mth	53.59	59.48	68.46	TV penetration	21%

Source: Company reports

Evidence from North America highlights that despite being a superior technology, FTTH can suffer from initial low take-up rates.

We have witnessed similar low initial take-up rates in Australian 3G, where on average take-up rates are ~40% after 4 yrs of deployment.

Figure 20: Pace of FTTH deployment in the US



Source: FTTH Council: North American FTTH Deployment Update

Valuation & Risks

Valuation: DCF and SOTP

Our valuation of Telstra is $3.70/share (prev $3.90), being the average of our DCF and P/E SOTP multiple valuation after applying a 15% discount to reflect NBN related uncertainty.

Discounted Cash Flows

We use a three-stage discounted cash flow (DCF) model to discount post tax free cash flows, including the benefit of imputation credits. We forecast explicit cash flows to FY2015, followed by a 20-year horizon period where cash flow growth rate fades from 2% to our long term assumption of 1.5%. Our DCF-based valuation of Telstra is $5.00/share, using a WACC of 9.6% (Beta 0.75; risk free rate of 6.25%).

Figure 21: DCF valuation

DCF Input Parameters	**(%)**
Beta Estimate	0.75
WACC	9.58
Horizon (2015 - 2029F) & Terminal Growth	2%/1.5%
DCF Valuation	**($m)**
NPV forecast cashflow	31,898
NPV horizon cashflow	38,613
NPV terminal value	9,051
Other assets	1,360
NPV of cashflow	79,562
Less net debt	-17,720
Equity value	61,841
Diluted DCF/share ($)	5.00

Source: Deutsche Bank

Sum-of-the-parts valuation

Our sum-of-the-parts valuation check of Telstra is $3.80/share.

Figure 22: Sum-of-the-parts valuation

	EBITDA	**Multiple**	**EV**	
Fixed retail & wholesale	3,440	6.5	22,360	35%
Fixed infrastructure (CAN, b'haul)	2,930	4.1	12,010	19%
Mobile	3,180	5.5	17,490	27%
Sensis	1,050	6.5	6,830	11%
CSL New World, TelstraClear	410	4.0	1,640	3%
Other	660	3.0	1,980	3%
Foxtel (50%) less $1070m debt		8.8	1,310	2%
Total	11,670	5.5	63,620	100%
Less Net Debt			16,400	
Equity Value			47,220	
Number of shares			12,443	
Value: $/share			3.80	

Source: Deutsche Bank

Figure 23: Relative value vs telco peers

	EBITDA Margin	Avg EBITDA growth	Avg Capex to sales	Capex growth	Gearing	Yield		EV/EBITDA		P/E	
	FY09-FY10	FY08-FY10	FY09-FY10	FY08-FY10	Interest cover	Div	FCF	FY09	FY10	FY09	FY10
Telstra Corporation	44%	6%	16%	-18%	6.4	9.1%	9.9%	4.8	4.6	9.9	9.3
AT&T	34%	-1%	NA	NA	8.7	7%	NA	4.7	4.8	9.9	10.9
Deutsche Telekom	32%	8%	14%	3%	2.7	9%	18%	4.7	4.1	12.7	10.3
France Telecom	35%	-2%	12%	-2%	4.4	8%	17%	4.9	4.6	11.2	9.1
KPN	37%	3%	14%	0%	4.1	8%	13%	5.5	4.9	12.3	9.4
Rogers Communications	36%	4%	NA	NA	4.0	4%	NA	6.9	6.7	15.0	14.7
Swisscom	39%	-1%	16%	-3%	8.3	7%	11%	5.7	5.3	9.8	8.8
Telecom Italia	40%	-1%	16%	-8%	2.4	5%	11%	4.7	4.3	10.0	9.2
Telecom Corp of NZ	31%	-3%	22%	22%	4.5	10%	-4%	3.5	3.8	8.9	11.6
Verizon	33%	11%	NA	NA	3.3	7%	NA	4.6	4.4	11.3	11.0
Peer Median	35%	-1%	15%	-1%	4.1	7%	12%	4.7	4.6	11.2	10.3

Source: Deutsche Bank, Bloomberg consensus for stocks not covered by DB

Risks

Key upside risks are:

- Reaching an agreement with the Govt about TLS' role in building NBN. If TLS were able to receive over $8.5bn for copper assets, we would view this positively.
- Achieving FY10 EBITDA margin target of 46-48% through aggressive cost-out through 2HFY09 and FY10. This would see an upgrade to DB and consensus estimates of ~3-5%.

Key downside risks are:

- Outcome of regulatory review which could result in a more severe form of operational separation.
- Delays in cost-out as a result of issues with migrating to the new billing and OSS systems
- Proliferation of VOIP: Australia is still a nascent market in relation to the broad adoption VOIP technologies. A large scale marketing of VOIP alternatives by select competitors would place additional pressure on Telstra's declining PSTN revenues.

Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist			
Company	**Ticker**	**Recent price***	**Disclosure**
Telstra Corporation	TLS.AX	3.08 (AUD) 25 May 09	1,2,7,8,14,17

*Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies.

Important Disclosures Required by U.S. Regulators

Disclosures marked with an asterisk may also be required by at least one jurisdiction in addition to the United States. See "Important Disclosures Required by Non-US Regulators" and Explanatory Notes.

1. Within the past year, Deutsche Bank and/or its affiliate(s) has managed or co-managed a public or private offering for this company, for which it received fees.
2. Deutsche Bank and/or its affiliate(s) makes a market in securities issued by this company.
7. Deutsche Bank and/or its affiliate(s) has received compensation from this company for the provision of investment banking or financial advisory services within the past year.
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1. Within the past year, Deutsche Bank and/or its affiliate(s) has managed or co-managed a public or private offering for this company, for which it received fees.
2. Deutsche Bank and/or its affiliate(s) makes a market in securities issued by this company.
7. Deutsche Bank and/or its affiliate(s) has received compensation from this company for the provision of investment banking or financial advisory services within the past year.
17. Deutsche Bank and or/its affiliate(s) has a significant Non-Equity financial interest (this can include Bonds, Convertible Bonds, Credit Derivatives and Traded Loans) where the aggregate net exposure to the following issuer(s), or issuer(s) group, is more than 25m Euros.

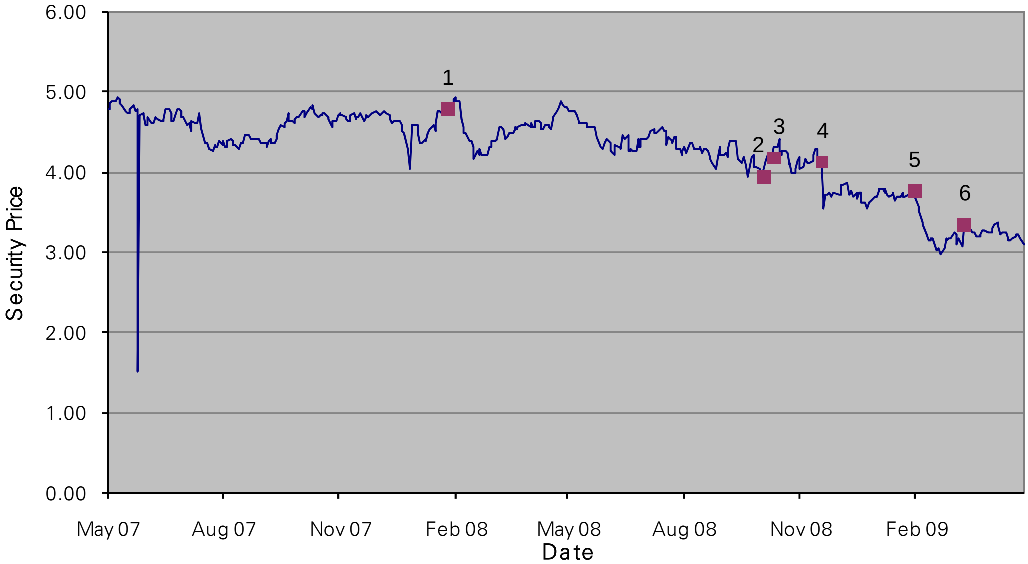
For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at http://gm.db.com/ger/disclosure/Disclosure.eqsr?ricCode=TLS.AX**.**

Analyst Certification

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s) about the subject issuer and the securities of the issuer. In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. Sameer Chopra

Historical recommendations and target price: Telstra Corporation (TLS.AX)

(as of 5/25/2009)



Previous Recommendations

Strong Buy
Buy
Market Perform
Underperform
Not Rated
Suspended Rating

Current Recommendations

Buy
Hold
Sell
Not Rated
Suspended Rating

*New Recommendation Structure as of September 9, 2002

1.	21/2/2008:	Buy, Target Price Change AUD5.40	4.	15/12/2008:	Buy, Target Price Change AUD5.00
2.	29/10/2008:	Buy, Target Price Change AUD5.30	5.	26/2/2009:	Buy, Target Price Change AUD4.20
3.	6/11/2008:	Buy, Target Price Change AUD5.40	6.	7/4/2009:	Buy, Target Price Change AUD3.90

Equity rating key

Buy: Based on a current 12- month view of total shareholder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield) , we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total shareholder return, we recommend that investors sell the stock

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Notes:

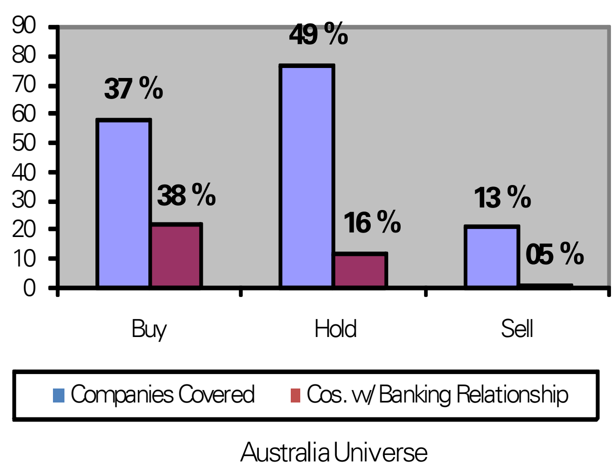
1. Newly issued research recommendations and target prices always supersede previously published research.
2. Ratings definitions prior to 27 January, 2007 were:

    Buy: Expected total return (including dividends) of 10% or more over a 12-month period

    Hold: Expected total return (including dividends) between -10% and 10% over a 12-month period

    Sell: Expected total return (including dividends) of -10% or worse over a 12-month period

Equity rating dispersion and banking relationships



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