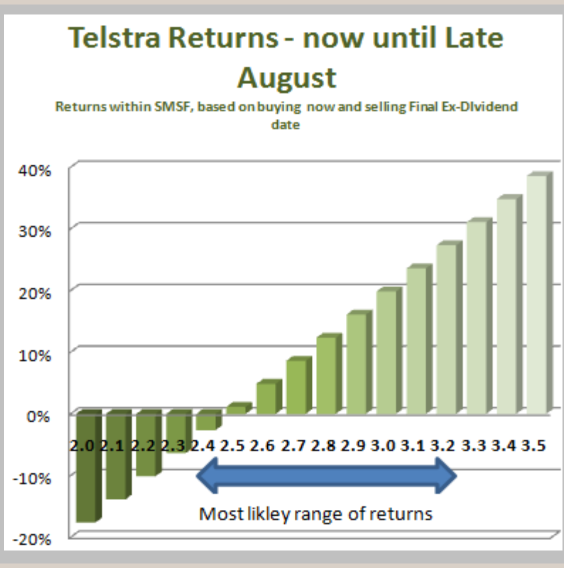
TELSTRA

CORPORATION LIMITED (ASX:TLS)

JANUARY / 2011

Fusion Investing: A different perspective



EXCELLENT RISK/RETURN PROFILE

EXCELLENT SHORT LONG PLAY

Multiple payoff windows make Telstra an excellent short/long timeframe investment. 28 cents dividend by late August, 42 cents by Feb 2012 and 84c or $1.20 pre-tax over three years, with possible capital gains along the way.

Telstra has an excellent risk/return profile over the next seven months, as shown by chart to the left.

The downside comes from a falling share price. Telstra is one of the best large cap Australian equities to own during tough times, but with earnings likely to continue to fall this year (analysts' consensus of drop of 14%)Telstra's P/E could compress further sending the share price to the low $2's. A couple half remembered quotes come to mind, "how can I break this stock" and "focus on the downside as the upside will take care of itself".

With 2011 being transformational for Telstra we are forced to tread the murky waters of forecasting. Less assets and therefore depreciation combined with lower interest will make the fall in earnings smaller than the fall in revenue. In the longer term lost PSTN revenue will be replaced by other communication and media opportunities.

For $2.80 you get $1.20 pre-tax income in next 36 months

That's a 40% pre-tax return and you should be left with an asset still returning the same profit.

Dividend Yield	9.96%
P/E	8.98
Market Cap ($m)	34,965.04
Enterprise Value ($m)	47,939.04

Key Ratios and Multiples

Period	2009A	2010A	2011E
ROE(%)	32.8	30.6	30
Div. payout (%)			
Div. Yield			
EV/EBITDA			
CF/Share			

WHAT WE KNOW AND CONSERVATIVELY GUESS

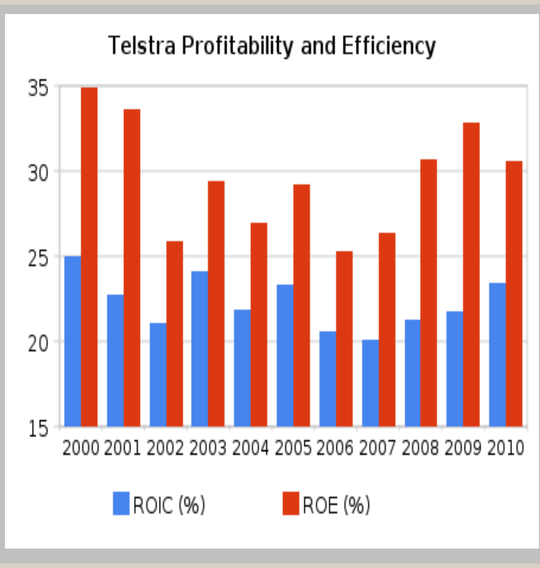
- $9B + $2B from NBN
- Capex down
- Depreciation down as selling the asset
- Interest expense fall substantially
- Revenue fall (how much is the key question)
- Margins fall.

TLS ($B)	2010 Actual	2012 Guess
Market	30	30
Revenue	25	20
EBITDA	10.8	7
Depreciation	(3.5)	(1.5)
EBIT	6.5	5.5
Interest	(1.2)	(0.2)
Pre-Tax	5.3	5.3
NPAT	3.8	3.8

Using bad news at every step(1) yet Telstra returns same profit(2) on less investment. Free of shackles, best brands and a 65% market share.

(1) Addressable market remains same despite growing population and telecommunications use.
Market share falls.
EBITDA margin falls from 43% to 35%.

(2) Depreciation down as major assets sold to NBN
Interest down as debt repaid from sale to NBN.
Pre-tax profit same in 2012 as 2010.



Strong ROE and ROIC

Downside

- Sensis' value and future revenue likely to decline, exacerbated by the Federal Court's copyright decision.
- NBN agreement risk.
- Unable to deliver improved customer service.
- Dividend cut. Well known and priced in.

Valuation

My valuation range for Telstra is $2.10 to $3.20.